

# ANGLIAN WATER SERVICES FINANCING PLC

*(incorporated with limited liability in England and Wales with registered number 4330322)*

€10,000,000,000

Global Secured Medium Term Note Programme  
unconditionally and irrevocably guaranteed by, inter alia,  
ANGLIAN WATER SERVICES LIMITED


*(incorporated with limited liability in England and Wales with registered number 2366656)*



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Anglian Water Services Financing  
Plc and Anglian Water Services  
Ltd are part of the awg Group.

**ANGLIAN WATER SERVICES FINANCING PLC***(incorporated with limited liability in England and Wales with registered number 4330322)***€10,000,000,000****Global Secured Medium Term Note Programme****unconditionally and irrevocably guaranteed by, inter alia,****ANGLIAN WATER SERVICES LIMITED***(incorporated with limited liability in England and Wales with registered number 2366656)***for the issuance of****Guaranteed Wrapped Bonds****of which up to £1,000,000,000 will be unconditionally and irrevocably guaranteed as to scheduled payments of principal and interest pursuant to financial guarantee insurance policies issued by****MBIA Assurance S.A.***(originally registered on 3 May 1990 with the Nanterre Register of Trade and Companies, currently registered with the Paris Register of Trade and Companies under No. B377883293 (98B05130))***and****Guaranteed Unwrapped Bonds**

Under this €10,000,000,000 Global Secured Medium Term Note Programme (the “**Programme**”), Anglian Water Services Financing Plc (the “**Issuer**”) may from time to time issue bonds (the “**Bonds**”) in bearer or registered form (respectively “**Bearer Bonds**” and “**Registered Bonds**”).

The payment of all amounts owing in respect of the Bonds will be unconditionally and irrevocably guaranteed by Anglian Water Services Limited (“**AWS**”), Anglian Water Services Holdings Limited (“**AWS Holdings**”) and Anglian Water Services Overseas Holdings Limited (“**AWS Overseas Holdings**”) as described herein. AWS, the Issuer, AWS Holdings and AWS Overseas Holdings are together referred to herein as the “**Obligors**”. AWS Holdings was incorporated in England and Wales under the Companies Act 1985 (as amended) as a limited company on 28 November 2001, whilst AWS Overseas Holdings was incorporated in the Cayman Islands on 16 January 2002 as an exempted company with limited liability. Neither AWS Holdings nor AWS Overseas Holdings is expected to have any significant assets other than the shares in their respective subsidiaries.

In addition to the guarantees given by each of the Obligors in respect of the Bonds, certain of the Bonds (the “**Wrapped Bonds**”) will initially be unconditionally and irrevocably guaranteed as to scheduled payments of interest and principal (as adjusted for indexation but excluding certain amounts including additional amounts relating to prepayment or any accelerated amounts or amounts by which the interest coupons on such Bonds exceeds the initial coupon on such Bonds as at the date on which such Bonds were issued (together, the “**FG Excepted Amounts**”) pursuant to the financial guarantee insurance policies (and the endorsements thereto) to be issued by MBIA Assurance S.A. (“**MBIA**”) as set out in Chapter 13, “*Financial Guarantor*”. Subject to the approval of the Dealers (and confirmation of no downgrade of the Wrapped Bonds in issue from at least two of the Rating Agencies (as defined below)), the Issuer may arrange for such other financial institutions to issue Bond Policies in respect of further Series of Class A Wrapped Bonds and/or Class B Wrapped Bonds (MBIA and each such other financial institution, a “**Financial Guarantor**”). The other Bonds (the “**Unwrapped Bonds**”) will not benefit from a financial guarantee insurance policy of MBIA or any other financial institution.

The maximum aggregate nominal amount of all Bonds from time to time outstanding under the Programme will not exceed €10,000,000,000 (or its equivalent in other currencies calculated as described herein), subject to increase as described herein.

Bonds issued under the Programme will be issued in series (each a “**Series**”), with each Series belonging to one of four classes (each a “**Class**”). The Wrapped Bonds will be designated as either “**Class A Wrapped Bonds**” or “**Class B Wrapped Bonds**”. The Unwrapped Bonds will be designated as either “**Class A Unwrapped Bonds**” or “**Class B Unwrapped Bonds**”. Each Series will comprise one or more Tranches (each a “**Tranche**”) of Bonds which are identical in all respects save for the issue dates, interest commencement dates and/or issue prices, and which are expressed to be consolidated and form a single Series.

The Bonds may be issued on a continuing basis to one or more of the Dealers specified under Chapter 2, “*Summary of the Programme*” and any additional Dealer appointed under the Programme from time to time by the Issuer (each a “**Dealer**” and together the “**Dealers**”), which appointment may be for a specific issue or on an ongoing basis. References in this Offering Circular to the “**relevant Dealer**” shall, in the case of an issue of Bonds being (or intended to be) subscribed by more than one Dealer, be to all Dealers agreeing to subscribe such Bonds.

Application has been made to the Financial Services Authority in its capacity as competent authority under the Financial Services and Markets Act 2000, as amended (the “**UK Listing Authority**”) for Bonds issued under the Programme during the period of 12 months from the date of this Offering Circular to be admitted to the official list of the UK Listing Authority (the “**Official List**”) and to The London Stock Exchange plc (the “**London Stock Exchange**”) for such Bonds to be admitted to trading on the London Stock Exchange’s market for listed securities. Admission to the Official List together with admission to the London Stock Exchange’s market for listed securities constitute official listing on the London Stock Exchange.

Notice of the aggregate nominal amount of Bonds, interest (if any) payable in respect of Bonds, the issue price of Bonds and any other terms and conditions not contained herein which are applicable to each Tranche of Bonds will be set out in a pricing supplement (the “**Pricing Supplement**”) which, with respect to Bonds to be admitted to the Official List and admitted to trading by the London Stock Exchange, will be delivered to the UK Listing Authority and the London Stock Exchange on or before the date of issue of the Bonds of such Tranche.

The Programme provides that Bonds may be listed on such other or further stock exchange(s) as may be agreed between the Obligors and the relevant Dealer. The Issuer may also issue unlisted Bonds.

The Bonds and the guarantees in respect thereof have not been approved or disapproved by the U.S. Securities and Exchange Commission, any state securities commission in the United States or any U.S. regulatory authority nor have any of the foregoing authorities passed upon or endorsed the merits of the offering of the Bonds or the guarantees or the accuracy or adequacy of this Offering Circular. Any representation to the contrary is a criminal offence in the United States.

**See Chapter 6, “Investment Considerations” for a discussion of certain factors to be considered in connection with an investment in the Bonds.**

The Bonds and the guarantees in respect thereof have not been and will not be registered under the U.S. Securities Act of 1933, as amended (the “**Securities Act**”) or with any securities regulatory authority of any State or other jurisdiction of the United States, and the Bonds may include Bearer Bonds that are subject to U.S. tax law requirements. Subject to certain exceptions, the Bonds may not be offered or sold or, in the case of Bearer Bonds, delivered within the United States or to, or for the benefit of, U.S. persons (as defined in Regulation S under the Securities Act (“**Regulation S**”). See Chapter 8, “*Form of the Bonds*” for a description of the manner in which Bonds will be issued. Registered Bonds are subject to certain restrictions on transfer. See Chapter 16, “*Subscription and Sale and Transfer and Selling Restrictions*”).

Each Tranche of the Class A Wrapped Bonds, Class A Unwrapped Bonds and Class B Unwrapped Bonds is expected on issue to have the following credit ratings from the respective credit rating agencies below.

<i>Class</i>	<i>Standard &amp; Poor’s</i>	<i>Moody’s</i>	<i>Fitch</i>
Class A Wrapped Bonds .....	AAA	Aaa	AAA
Class A Unwrapped Bonds .....	A-	A3	A-
Class B Unwrapped Bonds .....	BBB	Baa3	BBB

Any ratings ascribed to the Bonds reflect only the views of Moody’s Investors Service Limited (“**Moody’s**”), Standard & Poor’s Ratings Services, a Division of the McGraw Hill Companies Inc. (“**Standard & Poor’s**”) or “**S&P**”) and Fitch Ratings Ltd (“**Fitch**”) and, together with Moody’s and Standard & Poor’s, the “**Rating Agencies**”). A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, change or withdrawal at any time by the assigning rating agency.

The Obligors may agree with any Dealer and Deutsche Trustee Company Limited (the “**Bond Trustee**”) that Bonds may be issued in a form not contemplated by the Terms and Conditions of the Bonds herein, in which event (in the case of Bonds admitted to the Official List only) supplementary listing particulars or further listing particulars, if appropriate, will be made available which will describe the effect of the agreement reached in relation to such Bonds.

Co-Arrangers

Barclays Capital

Dealers

Schroder Salomon Smith Barney

Barclays Capital  
Deutsche Bank  
Dresdner Kleinwort Wasserstein  
JPMorgan

BNP PARIBAS  
HSBC  
Schroder Salomon Smith Barney  
The Royal Bank of Scotland

## IMPORTANT NOTICE

Each of the Issuer and the other Obligors accepts responsibility for the information contained in or appended to this Offering Circular. To the best of the knowledge and belief of each of the Issuer and the other Obligors (each having taken all reasonable care to ensure that such is the case) the information contained in this Offering Circular is in accordance with the facts and does not omit anything likely to affect the import of such information.

MBIA accepts responsibility for the information contained in Chapter 13, “*Financial Guarantor*” and in the paragraphs relating to MBIA in Sections 17.5, 17.6 and 17.7 of Chapter 17, “*General Information*” and in the financial statements of MBIA appended to this Offering Circular (together, the “*MBIA Information*”). To the best of the knowledge and belief of MBIA (having taken all reasonable care to ensure that such is the case), the MBIA Information is in accordance with the facts and does not omit anything likely to affect the import of such information.

This Offering Circular is being distributed only to, and is directed only at persons who are (i) outside the United Kingdom or (ii) are persons who have professional experience in matters relating to investments falling within Article 19(1) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (the “*Order*”) or (iii) are high net worth entities, and other persons to whom it may lawfully be communicated, falling within Article 49(1) of the Order (all such persons together being referred to as “*relevant persons*”). This Offering Circular, or any of its contents, must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this Offering Circular relates is available only to, and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only, with relevant persons.

A copy of this Offering Circular, which comprises the listing particulars (including Appendix 1 and Appendix 2) approved by the UK Listing Authority as required by the Financial Services and Markets Act 2000, as amended (the “*Listing Particulars*”) in relation to Bonds admitted to the Official List and admitted to trading on the London Stock Exchange’s market for listed securities and issued during the period of 12 months from the date of this Offering Circular, has been delivered for registration to the Registrar of Companies in England and Wales as required by Section 83 of that Act. Copies of each Pricing Supplement (in the case of Bonds to be admitted to the Official List) will be available from FT Business Research Centre, operated by FT Electronic Publishing at Fitzroy House, 13-15 Epworth Street, London EC2A 4DL and from the specified office set out below of each of the Paying Agents (as defined below).

This Offering Circular is to be read in conjunction with all documents which are deemed to be incorporated herein by reference (see “*Documents Incorporated by Reference*” below); provided, however, that such incorporated documents do not form part of the Listing Particulars. This Offering Circular shall, save as specified herein, be read and construed on the basis that such documents are so incorporated and form part of this Offering Circular but not part of the Listing Particulars.

Any reference in this Offering Circular to “*Listing Particulars*” means this Offering Circular excluding all information incorporated by reference. Each of the Obligors has confirmed that any information incorporated by reference including any such information to which readers of this Offering Circular are expressly referred, has not been and does not need to be included in the Listing Particulars to satisfy the requirements of the Financial Services and Markets Act 2000 or the listing rules of the UK Listing Authority. Each of the Obligors believes that none of the information incorporated therein by reference conflicts in any material respect with the information included in the Listing Particulars.

It is envisaged that the first Series of Wrapped Bonds to be issued will have the benefit of a financial guarantee insurance policy or, as the case may be, financial guarantee insurance policies, to be issued by MBIA substantially in the form set out in Chapter 13. Such financial guarantee insurance policy or policies will be entered into and dated as of the issue date of such Series Wrapped Bonds. For any further Tranche of Wrapped Bonds issued, a new financial guarantee insurance policy will be entered into by MBIA or another Financial Guarantor in respect of such Bonds. In the event that such financial guarantee insurance policy is entered into by MBIA, it is envisaged that such financial guarantee insurance policy will be substantially in the form set out in Chapter 13.

In the case of each Tranche of Wrapped Bonds, admission to the Official List and trading on the London Stock Exchange is subject to the issue by MBIA or another Financial Guarantor of a financial guarantee insurance policy (and the endorsement thereto), in respect of such Tranche.

None of the Dealers, MBIA, the Bond Trustee, the Security Trustee, the Hedge Counterparties, the Finance Lessors, the Authorised Credit Providers, the Debt Service Reserve Liquidity Facility Provider, the O&M Reserve Facility Provider, the Original Lenders and the Agents or any Facility Agent (each as defined herein and together, the “Other Parties”) has independently verified the information contained herein (other than, in respect of MBIA, the MBIA Information). Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Dealers, MBIA, the Bond Trustee, the Security Trustee or the Other Parties as to the accuracy or completeness of the information contained or incorporated in this Offering Circular or any other information provided by the Obligors in connection with the Programme (other than, in respect of MBIA, the MBIA Information). None of the Dealers, MBIA, the Bond Trustee, the Security Trustee or the Other Parties accepts any liability in relation to the information contained or incorporated by reference in this Offering Circular or any other information provided by the Obligors in connection with the Programme (other than, in respect of MBIA, the MBIA Information).

No person is or has been authorised by any of the Obligors, any of the Dealers, MBIA, the Bond Trustee, the Security Trustee or the Other Parties to give any information or to make any representation not contained in or not consistent with this Offering Circular or any other information supplied in connection with the Programme or the Bonds and, if given or made, such information or representation must not be relied upon as having been authorised by any of the Obligors, any of the Dealers, MBIA, the Bond Trustee, the Security Trustee or the Other Parties.

Neither this Offering Circular nor any other information supplied in connection with the Programme or any Bonds (i) is intended to provide the basis of any credit or other evaluation or (ii) should be considered as a recommendation by the Obligors, MBIA, the Bond Trustee, the Security Trustee, any of the Dealers or the Other Parties that any recipient of this Offering Circular or any other information supplied in connection with the Programme or any Bonds should purchase any Bonds. Each investor contemplating purchasing any Bonds should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Obligors. Neither this Offering Circular nor any other information supplied in connection with the Programme or the issue of any Bonds constitutes an offer or invitation by or on behalf of any of the Obligors, any of the Dealers, MBIA, the Bond Trustee, the Security Trustee or the Other Parties to any person to subscribe for or to purchase any Bonds.

Neither the delivery of this Offering Circular nor the offering, sale or delivery of any Bonds shall in any circumstances imply that the information contained herein concerning the Obligors or MBIA is correct at any time subsequent to the date hereof or that any other information supplied in connection with the Programme is correct or that there has been no adverse change in the financial position of the Issuer as of any time subsequent to the date indicated in the document containing the same. Neither the Dealers, MBIA, the Bond Trustee, the Security Trustee or the Other Parties expressly undertake to review the financial condition or affairs of any of the Obligors during the life of the Programme or to advise any investor in the Bonds of any information coming to their attention. Investors should review, inter alia, the most recently published documents incorporated by reference into this Offering Circular when deciding whether or not to purchase any Bonds.

This Offering Circular does not constitute an offer to sell or the solicitation of an offer to buy any Bonds in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Offering Circular and the offer or sale of Bonds may be restricted by law in certain jurisdictions. None of the Obligors, the Dealers, MBIA, the Bond Trustee, the Security Trustee or the Other Parties represents that this Offering Circular may be lawfully distributed, or that any Bonds may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assumes any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Obligors, the Dealers, MBIA, the Bond Trustee, the Security Trustee or the Other Parties (save for the approval of this Offering Circular as listing particulars by the UK Listing Authority and delivery of copies of this Offering Circular to the Registrar of Companies in England and Wales) which would permit a public offering of any Bonds or distribution of this Offering Circular in any jurisdiction where action for that purpose is required. Accordingly, no Bonds may be offered or sold, directly or indirectly, and neither this Offering Circular nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Offering Circular or any Bonds may come must inform themselves about, and observe, any such restrictions on the distribution of this Offering Circular and the

offering and sale of Bonds. In particular, there are restrictions on the distribution of this Offering Circular and the offer or sale of Bonds in the United States, the United Kingdom, the Cayman Islands, Japan, Germany and The Netherlands. See Chapter 16, “*Subscription and Sale and Transfer and Selling Restrictions*”.

In making an investment decision, investors must rely on their own examination of the Obligors and, in the case of the Wrapped Bonds, MBIA and the terms of the Bonds being offered, including the merits and risks involved. The Bonds have not been approved or disapproved by the United States Securities and Exchange Commission or any other securities commission or other regulatory authority in the United States, nor have the foregoing authorities approved this Offering Circular or confirmed the accuracy or determined the adequacy of the information contained in this Offering Circular. Any representation to the contrary is unlawful.

None of the Dealers, the Obligors, MBIA, the Bond Trustee, the Security Trustee or the Other Parties makes any representation to any investor in the Bonds regarding the legality of its investment under any applicable laws. Any investor in the Bonds should be able to bear the economic risk of an investment in the Bonds for an indefinite period of time.

## U.S. INFORMATION

This Offering Circular is being submitted on a confidential basis in the United States to a limited number of QIBs or Institutional Accredited Investors (each as defined under Chapter 8, “*Form of the Bonds*”) for informational use solely in connection with the consideration of the purchase of the Bonds being offered hereby. Its use for any other purpose in the United States is not authorized. It may not be copied or reproduced in whole or in part nor may it be distributed or any of its contents disclosed to anyone other than the prospective investors to whom it is originally submitted.

Registered Bonds may be offered or sold within the United States only to QIBs or to Institutional Accredited Investors, in either case in transactions exempt from registration under the Securities Act. Each U.S. purchaser of Registered Bonds is hereby notified that the offer and sale of any Registered Bonds to it may be being made in reliance upon the exemption from the registration requirements of the Securities Act provided by Rule 144A under the Securities Act (“Rule 144A”).

Purchasers of Definitive IAI Registered Bonds will be required to execute and deliver an IAI Investment Letter (as defined under Chapter 9, “*Terms and Conditions of the Bonds*”). Each purchaser or holder of Definitive IAI Registered Bonds, Bonds represented by a Rule 144A Global Bond or any Bonds issued in registered form in exchange or substitution therefor (together “Legended Bonds”) will be deemed, by its acceptance or purchase of any such Legended Bonds, to have made certain representations and agreements intended to restrict the resale or other transfer of such Legended Bonds as set out in Chapter 16, “*Subscription and Sale and Transfer and Selling Restrictions*”. Unless otherwise stated, terms used in this paragraph have the meanings given to them in “*Form of the Bonds*”.

## NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENCE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

## AVAILABLE INFORMATION

To permit compliance with Rule 144A in connection with any resales or other transfers of Bonds that are “restricted securities” within the meaning of the Securities Act, the Issuer and each of the other Obligors has undertaken to furnish, upon the request of a holder of such Bonds or any beneficial interest therein, to such holder or to a prospective purchaser designated by him, the information required to be delivered under Rule 144A(d)(4) under the Securities Act if, at the time of the request, the Issuer is neither a reporting company under Section 13 or 15(d) of the U.S. Securities Exchange Act of 1934, as amended (the “Exchange Act”), nor exempt from reporting pursuant to Rule 12g3-2(b) thereunder.

## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Offering Circular includes “forward-looking statements” within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. All statements other than statements of historical facts included in this Offering Circular, including, without limitation, those regarding AWS’s financial position, business strategy, plans and objectives of management for future operations (including development plans and objectives relating to AWS’s services), are forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of AWS, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-

looking statements. Such forward-looking statements are based on numerous assumptions regarding AWS's present and future business strategies and the environment in which AWS will operate in the future. The important factors that could cause AWS's actual results, performance or achievements to differ materially from those in the forward-looking statements include, among others, legislative, regulatory or other circumstances affecting anticipated revenues, costs or capital expenditure requirements, future climatic and environmental conditions, future economic conditions including changes in customer demand, development of competition within the water supply and sewerage industry and changes in capital market conditions. Additional factors that could cause actual results, performance or achievements to differ materially include, but are not limited to, those discussed under Chapter 6, "*Investment Considerations*". These forward-looking statements speak only as of the date of this Offering Circular. AWS expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained herein to reflect any change in AWS's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

#### SERVICE OF PROCESS AND ENFORCEMENT OF CIVIL LIABILITIES

Each of the Issuer, AWS and AWS Holdings is a corporation organised under the laws of England. All of the officers and directors of the Issuer, AWS and AWS Holdings named herein reside outside the United States and all or a substantial portion of the assets of the Issuer, AWS and AWS Holdings and of such officers and directors are located outside the United States. As a result, it may not be possible for investors to effect service of process outside England upon the Issuer, AWS or AWS Holdings, as the case may be, or such persons, or to enforce judgments against them obtained in courts outside England predicated upon civil liabilities of the Issuer, AWS or AWS Holdings, as the case may be, or such directors and officers under laws other than English law, including any judgment predicated upon United States federal securities laws or securities laws of any state or territory within the United States.

Each of the Issuer, AWS and AWS Holdings has been advised by Linklaters, its counsel, that there is doubt as to the enforceability in England in original actions or in actions for enforcement of judgments of United States courts of civil liabilities predicated solely upon the federal securities laws of the United States.

AWS Overseas Holdings is a corporation organised under the laws of the Cayman Islands. All of the officers and directors of AWS Overseas Holdings named herein reside outside the United States and all or a substantial portion of the assets of AWS Overseas Holdings and of such officers and directors are located outside the United States. As a result, it may not be possible for investors to effect service of process outside the Cayman Islands upon AWS Overseas Holdings or such persons, or to enforce judgments against them obtained in courts outside the Cayman Islands predicated upon civil liabilities of AWS Overseas Holdings or such directors and officers under laws other than Cayman Islands law, including any judgment predicated upon United States federal securities laws or securities laws of any state or territory within the United States.

AWS Overseas Holdings has been advised by Maples and Calder Europe, its counsel, that there is doubt as to the enforceability in the Cayman Islands in original actions or in actions for enforcement of judgments of United States courts of civil liabilities predicated solely upon the federal securities laws of the United States.

## PRESENTATION OF FINANCIAL AND OTHER INFORMATION

Each of the Issuer, AWS Holdings and AWS Overseas Holdings maintains its financial books and records and prepares its financial statements in Sterling in accordance with generally accepted accounting principles in the United Kingdom (“UK GAAP”) which differ in certain important respects from generally accepted accounting principles in the United States (“U.S. GAAP”). See Chapter 18, *“Financial Information – Summary of Significant Differences between UK GAAP and U.S. GAAP”*. MBIA maintained its financial books and records in French Francs prior to 1 January 2002 and has maintained such financial books and records in euros from 1 January 2002. In addition, MBIA prepared its financial statements up to the year ending 31 December 2000 in French Francs and, from the year ending 31 December 2001 MBIA has prepared such financial statements in euros, in each case in accordance with generally accepted accounting principles in France (“French GAAP”), which differ in certain important respects from U.S. GAAP.

All references in this Offering Circular to “Sterling” and “£” refer to pounds sterling, to “U.S. dollars”, “U.S.\$” and “\$” refer to United States dollars, to “FF” refer to French Francs and to “euro” and “€” refer to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended.

### SCHRODER

Schroder is a trademark of Schroders Holdings plc and is used under licence by Salomon Brothers International Limited.

### STABILISATION

In connection with the issue and distribution of any Tranche of Bonds, the Dealer (if any) disclosed as the stabilising manager in the applicable Pricing Supplement or any person acting for him may over-allot or effect transactions with a view to supporting the market price of the Bonds of the Series (as defined below) of which such Tranche forms part at a level higher than that which might otherwise prevail for a limited period after the issue date. However, there may be no obligation on the stabilising manager or any agent of his to do this. Such stabilising, if commenced, may be discontinued at any time and must be brought to an end after a limited period.



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## DOCUMENTS INCORPORATED BY REFERENCE

The following documents published or issued from time to time after the date hereof shall be deemed to be incorporated in, and to form part of, this Offering Circular (provided, however, that such incorporated documents do not form a part of the Listing Particulars):

- (i) the most recently published audited consolidated and non-consolidated annual financial statements and, if published later, the most recently published interim consolidated and non-consolidated financial statements (if any) of each of the Obligors (see Chapter 17, “*General Information*” for a description of the financial statements currently published by each of the Obligors);
- (ii) the most recently published audited annual financial statements of MBIA (see Chapter 17, “*General Information*” for a description of the financial statements currently published by MBIA); and
- (iii) all supplements or amendments to this Offering Circular circulated by the Issuer and/or AWS and/or AWS Overseas Holdings and/or AWS Holdings from time to time,

save that any statement contained herein or in a document which is deemed to be incorporated by reference herein shall be deemed to be modified or superseded for the purpose of this Offering Circular to the extent that a statement contained in any such subsequent document which is deemed to be incorporated by reference herein modifies or supersedes such earlier statement (whether expressly, by implication or otherwise), provided that no such document or modifying or superseding statement shall form part of the Listing Particulars issued in compliance with the listing rules under Section 74 of the Financial Services and Markets Act 2000. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Offering Circular.

Each Obligor will provide, without charge, to each person to whom a copy of this Offering Circular has been delivered, upon the request of such person, a copy of any or all of the documents deemed to be incorporated herein by reference unless such documents have been modified or superseded as specified above. Requests for such documents should be directed to any of the Obligors at their respective offices set out at the end of this Offering Circular. In addition, such documents will be available from the principal office in England of Salomon Brothers International Limited (the “**Authorised Adviser**”) for Bonds admitted to the Official List.

Each of the Obligors has undertaken to the Dealers in the Programme Agreement (as defined in Chapter 16, “*Subscription and Sale and Transfer and Selling Restrictions*”) to comply with Sections 81 and 83 of the Financial Services and Markets Act 2000.

If the terms of the Programme are modified or amended in a manner which would make this Offering Circular, as so modified or amended, inaccurate or misleading, a new offering circular will be prepared.

## SUPPLEMENTARY OFFERING CIRCULAR

The Issuer has undertaken, in connection with the admission of the Bonds to the Official List and to trading on the London Stock Exchange, that, if there shall occur any significant change in the business or financial position of, or any significant new matter has arisen in respect of, the Issuer or any of the other Obligors or MBIA or any change in the information set out in Chapter 9, "*Terms and Conditions of the Bonds*" that is material in the context of the issue of Bonds under the Programme, the Issuer will prepare or procure the preparation of an amendment or supplement to this Offering Circular or, as the case may be, publish a supplement or amendment or a new offering circular for use in connection with any subsequent issue by the Issuer of Bonds to be admitted to the Official List and trading on the London Stock Exchange and will supply to each Dealer such number of copies of the supplementary or new offering circular as such Dealer may reasonably request. The Issuer will also supply to the UK Listing Authority such number of copies of the supplementary or new offering circular as may be required by the UK Listing Authority and will make copies available, free of charge, upon oral or written request, at the specified offices of the Paying Agents (as defined herein).

## GENERAL DESCRIPTION OF THE PROGRAMME

Under the Programme, the Issuer may from time to time issue Bonds denominated in any currency, subject as set out herein. A summary of the terms and conditions of the Programme and the Bonds appears below. The applicable terms of any Bonds will be agreed between the Issuer and the relevant Dealer prior to the issue of the Bonds and will be set out in the Terms and Conditions of the Bonds endorsed on, attached to, or incorporated by reference into, the Bonds, as modified and supplemented by the applicable Pricing Supplement attached to, or endorsed on, such Bonds, as more fully described in Chapter 8, “*Form of the Bonds*”.

This Offering Circular and any supplement will only be valid for listing Bonds on the Official List during the period of 12 months from the date of this Offering Circular in an aggregate nominal amount which, when added to the aggregate nominal amount then outstanding of all Bonds previously or simultaneously issued under the Programme, does not exceed €10,000,000,000 or its equivalent in other currencies. For the purpose of calculating the euro equivalent of the aggregate nominal amount of Bonds issued under the Programme from time to time:

- (i) the euro equivalent of Bonds denominated in another Specified Currency (as specified in the applicable Pricing Supplement in relation to the Bonds, described in Chapter 8, “*Form of the Bonds*”) shall be determined, at the discretion of the Issuer, either as of the date on which agreement is reached for the issue of Bonds or on the preceding day on which commercial banks and foreign exchange markets are open for business in London, in each case on the basis of the spot rate for the sale of euro against the purchase of such Specified Currency in the London foreign exchange market quoted by any leading international bank selected by the Issuer on the relevant day of calculation;
- (ii) the euro equivalent of Dual Currency Bonds, Index Linked Bonds and Partly-Paid Bonds (each as specified in the applicable Pricing Supplement in relation to the Bonds, described in Chapter 8, “*Form of the Bonds*”) shall be calculated in the manner specified above by reference to the original nominal amount on issue of such Bonds (in the case of Partly-Paid Bonds regardless of the subscription price paid); and
- (iii) the euro equivalent of Zero Coupon Bonds (as specified in the applicable Pricing Supplement in relation to the Bonds, described in Chapter 8, “*Form of the Bonds*”) and other Bonds issued at a discount or a premium shall be calculated in the manner specified above by reference to the net proceeds received by the Issuer for the relevant issue.

## CHAPTER 1

### PARTIES

Account Bank:	Barclays Bank PLC, or any person for the time being acting as Account Bank pursuant to the Account Bank Agreement.
Authorised Adviser:	Salomon Brothers International Limited will be the authorised adviser in respect of the Programme.
AWG:	awg plc, a company incorporated under the laws of England and Wales which is admitted to the Official List of the United Kingdom Listing Authority and to trading on the London Stock Exchange, the ultimate holding company of the AWG Group.
AWG Group:	AWG and its subsidiaries (including AWS).
AW:	Anglian Water Plc, a company incorporated under the laws of England and Wales and formerly listed on the London Stock Exchange and a wholly-owned subsidiary of AWG.
AW Group:	The group of companies of AW and its subsidiaries prior to the introduction of AWG as parent company of AW in 2000.
AWS:	Anglian Water Services Limited, a water and sewerage undertaker under the Instrument of Appointment.
AWS Financing Group:	AWS Holdings, AWS Overseas Holdings, AWS and Anglian Water Services Financing Plc (the “ <b>Obligors</b> ”).
AWS Holdings:	Anglian Water Services Holdings Limited, a company incorporated under the laws of England and Wales and a wholly-owned subsidiary of AW.
AWS Overseas Holdings:	Anglian Water Services Overseas Holdings Limited, a company incorporated in the Cayman Islands and a wholly-owned subsidiary of AWS Holdings.
Bond Trustee:	Deutsche Trustee Company Limited for and on behalf of the holders of each Series of Bonds (each, a “ <b>Bondholder</b> ”).
Bridging Facility Provider:	Barclays Bank PLC (as “ <b>Bridging Facility Agent</b> ”) as agent in respect of the bridging facilities (the “ <b>Bridging Facilities</b> ”) provided to the Issuer on the Effective Date, later to be syndicated to other banks or financial institutions (each an “ <b>Original Lender</b> ”) which agree to provide credit facilities to the Issuer.
Cash Manager:	AWS (prior to a Standstill Period) and Barclays Bank PLC (during and following a Standstill Period) will, pursuant to the terms of the Common Terms Agreement, act as cash manager in respect of monies credited from time to time to the Accounts.
Co-Arrangers:	Barclays Bank PLC and Salomon Brothers International Limited are the co-arrangers of the Programme.
Common Depository:	Deutsche Bank AG London will act as common depository for Euroclear Bank S.A. / N.V. as operator of the Euroclear System and Clearstream Banking, <i>société anonyme</i> , in respect of the Programme.
Dealers:	Barclays Bank PLC, BNP Paribas, Deutsche Bank AG London, Dresdner Bank AG London Branch, HSBC Bank plc, J.P. Morgan Securities Ltd., Salomon Brothers International Limited and The Royal Bank of Scotland plc will act as dealers (together with any other dealer appointed from time to time by the Issuer, (the “ <b>Dealers</b> ”)), in respect of the Programme.

Finance Lessors:	Each of Mercantile Leasing Company (No.132) Limited, D-LAF Limited or Moon Leasing Limited (in its capacity as General Partner of Brahms Leasing Limited Partnership (if the D-LAF Existing Finance Lease has been novated to it prior to the Effective Date)), Deutsche Bank AG London, CSC Computer Sciences Limited (which has sold its rights to the receivables under the relevant Existing Finance Lease to Dresdner Kleinwort Wasserstein Limited which in turn has assigned such rights to DrKW Finance Limited) and DrKW Finance Limited (together the “ <b>Existing Finance Lessors</b> ”), which lease plant, machinery and equipment to AWS, under the terms of various finance leases (the “ <b>Existing Finance Leases</b> ”) (and, together with any future finance leases, the “ <b>Finance Leases</b> ”).
Financial Guarantors:	MBIA Assurance S.A. (“ <b>MBIA</b> ”) as initial financial guarantor (in such capacity, the “ <b>Initial Financial Guarantor</b> ”) may, under the terms of financial guarantee insurance policies (and subject to the satisfaction of certain conditions prior to the issue of Class A Wrapped Bonds and/or Class B Wrapped Bonds under the Programme), agree to issue in favour of the Bond Trustee in respect of such Class A Wrapped Bonds and/or Class B Wrapped Bonds a financial guarantee insurance policy (together with any other financial guarantee insurance policies issued by other Financial Guarantors (as defined below), the “ <b>Bond Policies</b> ”), which will unconditionally and irrevocably guarantee the scheduled payment of interest and principal (other than the FG Excepted Amounts) in respect of such Class A Wrapped Bonds and/or Class B Wrapped Bonds (see Chapter 13, “ <i>Financial Guarantor</i> ”). MBIA is under no obligation to issue Bond Policies. Subject to the approval of the Dealers and confirmation of no downgrade of the Wrapped Bonds in issue from at least two of the Rating Agencies, the Issuer may (after 30 September 2002 or upon earlier utilisation in full of the MBIA commitment) arrange for such other financial institution to issue Bond Policies in respect of further Series of Class A Wrapped Bonds and/or Class B Wrapped Bonds (or further Class A Wrapped Debt and/or Class B Wrapped Debt, as the case may be) (MBIA and each such other financial institution, a “ <b>Financial Guarantor</b> ”).
Hedge Counterparties:	Barclays Bank PLC, Citibank, N.A., London Branch, Deutsche Bank AG London, Dresdner Bank AG, HSBC Bank plc and The Royal Bank of Scotland plc (together the “ <b>Existing Hedge Counterparties</b> ” and, together with any future counterparties to Hedging Agreements, the “ <b>Hedge Counterparties</b> ”).
Initial Authorised Credit Provider:	Barclays Bank PLC (the “ <b>Initial Authorised Credit Facility Agent</b> ”) as agent in respect of the revolving working capital and capital expenditure credit facility (the “ <b>Initial Authorised Loan Agreement</b> ”) provided to the Issuer on or before the Effective Date by Barclays Bank PLC, later to be syndicated to certain other banks or financial institutions (each an “ <b>Authorised Credit Provider</b> ”) which agree to provide credit facilities to the Issuer and/or AWS. See Chapter 7, “ <i>Financing Structure</i> ”.
Issuer:	Anglian Water Services Financing Plc has been formed in order to provide debt financing to AWS in relation to its water and sewerage undertakings.
Debt Service Reserve Liquidity Facility Providers:	Barclays Bank PLC (the “ <b>Debt Service Reserve Liquidity Facility Provider</b> ”) has agreed to provide a liquidity facility (the “ <b>Class A Debt Service Reserve Liquidity Facility</b> ”) for interest requirements on Class A Debt and a liquidity facility (the “ <b>Class B Debt Service Reserve Liquidity Facility</b> ”) for interest requirements on Class B Debt and (in certain circumstances) to fund shortfalls in the Class A Debt Service Reserve Account (each a “ <b>Debt Service Reserve Liquidity Facility</b> ”).
O&M Reserve Facility Provider:	Barclays Bank PLC (the “ <b>O&amp;M Reserve Facility Provider</b> ”) has agreed to provide a liquidity facility in respect of operating and maintenance expenditure (the “ <b>O&amp;M Reserve Facility</b> ”).

Obligors:	The following parties will each guarantee certain obligations of each other Obligor in favour of the Security Trustee (for itself and on behalf of the Secured Creditors): (i) AWS Holdings, (ii) AWS Overseas Holdings, (iii) AWS and (iv) the Issuer (each, an “ <b>Obligor</b> ”).
Original Lenders:	Barclays Bank PLC and Citibank, N.A. have agreed to provide the Issuer a Bridging Facility for the purpose (inter alia) of discharging certain financial indebtedness of and within the AW Group, establishing a liquidity reserve, meeting miscellaneous transaction costs and paying any possible Early Redemption Amounts under the USPP 2001 Bonds.
Principal Paying Agent:	Deutsche Bank AG London will act as issuing and principal paying agent and will provide certain paying agency services to the Issuer in respect of Bearer Bonds.
Registrar and Exchange Agent:	Deutsche Bank Trust Company Americas will act as registrar and exchange agent and will provide certain registrar and exchange agent services to the Issuer in respect of Registered Bonds.
Secured Creditors:	means any person who is a party to, or who has acceded to, the STID (as defined in Chapter 19, “ <i>Index of Defined Terms</i> ”) as a Secured Creditor.
Security Trustee:	Deutsche Trustee Company Limited will act as security trustee and will hold, and be entitled to enforce (for itself and on behalf of the Secured Creditors), the Security.
Transfer Agent:	Deutsche Bank AG London will act as transfer agent and will provide certain transfer agency services to the Issuer in respect of the Registered Bonds.

## CHAPTER 2

### SUMMARY OF THE PROGRAMME

*The following summary does not purport to be complete and is taken from, and is qualified in its entirety by, the remainder of this Offering Circular and, in relation to the terms and conditions of any particular Tranche of Bonds, the applicable Pricing Supplement. Words and expressions not defined in this summary shall have the same meanings as defined in Chapter 8, “Form of the Bonds” and in Chapter 9, “Terms and Conditions of the Bonds”.*

Description:	Global Secured Medium Term Note Programme
Programme Size:	Up to €10,000,000,000 (or its equivalent in other currencies calculated as described under “General Description of the Programme” below) aggregate nominal amount of Bonds outstanding at any time.
Issuance in Classes:	<p>Bonds issued under the Programme will be issued in series (each a “<b>Series</b>”), with each Series belonging to one of 4 classes (each a “<b>Class</b>”). The Wrapped Bonds will be designated as either “<b>Class A Wrapped Bonds</b>” or “<b>Class B Wrapped Bonds</b>”. The Unwrapped Bonds will be designated as one of “<b>Class A Unwrapped Bonds</b>” or “<b>Class B Unwrapped Bonds</b>”. Each Series will comprise one or more Tranches (each a “<b>Tranche</b>”) of Bonds, the specific terms of each Tranche being identical in all respects save for the issue dates, interest commencement dates and/or issue prices, to the terms of other Tranches of the same Series.</p> <p>The specific terms of each Tranche of Bonds will be set out in the applicable Pricing Supplement.</p>
Issue Dates:	Such dates (each an “ <b>Issue Date</b> ”) as agreed between the Issuer and the Dealers.
Certain Restrictions:	Each issue of Bonds denominated in a currency in respect of which particular laws, guidelines, regulations, restrictions or reporting requirements apply will only be issued in circumstances which comply with such laws, guidelines, regulations, restrictions or reporting requirements from time to time including the following restrictions applicable at the date of this Offering Circular. See Chapter 16, “ <i>Subscription and Sale and Transfer and Selling Restrictions</i> ”.

#### **Swiss Francs**

Issues of Bonds denominated in Swiss francs or carrying a Swiss franc-related element with a maturity of more than one year (other than Bonds privately placed with a single investor with no publicity) will be effected in compliance with the relevant regulations of the Swiss National Bank based on article 7 of the Federal Law on Banks and Savings Banks of 8 November 1934 (as amended) and article 15 of the Federal Law on Stock Exchanges and Securities Trading of 24 March 1995 in connection with article 2, paragraph 2 of the Ordinance of the Federal Banking Commission on Stock Exchanges and Securities Trading of 2 December 1996. Under the said regulations, the relevant Dealer or, in the case of a syndicated issue, the lead manager (the “**Swiss Dealer**”), must be a bank domiciled in Switzerland (which includes branches or subsidiaries of a foreign bank located in Switzerland) or a securities dealer duly licensed by the Swiss Federal Banking Commission pursuant to the Federal Law on Stock Exchanges and Securities Trading of 24 March 1995. The Swiss Dealer must report certain details of the relevant transaction to the Swiss National Bank no later than the Issue Date of the relevant Bonds.

#### **Bonds with a maturity of less than one year**

Bonds issued on terms that they must be redeemed before their first anniversary will constitute deposits for the purposes of the prohibition on accepting deposits contained in Section 19 of the Financial Services and Markets Act 2000 unless



they are issued to a limited class of professional investors and have a denomination of at least £100,000 or its equivalent. See Chapter 16, “*Subscription and Sale and Transfer and Selling Restrictions*”.

Distribution:	Bonds may be distributed by way of private or public placement and in each case on a syndicated or non-syndicated basis.
Currencies:	Euro, Sterling, U.S. dollars, yen and, subject to any applicable legal or regulatory restrictions, any other currency agreed between the Issuer and the relevant Dealer.
Redenomination:	The applicable Pricing Supplement may provide that certain Bonds may be redenominated in euro. The relevant provisions applicable to any such redenomination will be contained in Condition 6, as amended by the applicable Pricing Supplement.
Maturities:	Such maturities as may be agreed between the Issuer and the relevant Dealer, subject to such minimum or maximum maturities as may be allowed or required from time to time by the relevant central bank (or equivalent body) or any laws or regulations applicable to the Issuer or the relevant Specified Currency.
Issue Price:	Bonds may be issued on a fully-paid or a partly-paid basis and at an issue price which is at par or at a discount to, or premium over, par.
Form of Bonds:	Each Tranche of Bonds will be issued in bearer or registered form as described in Chapter 8, “ <i>Form of the Bonds</i> ”. Registered Bonds will not be exchangeable for Bearer Bonds and vice versa.
Fixed Rate Bonds:	Fixed interest will be payable on such date or dates as may be agreed between the Issuer and the relevant Dealer and on redemption and will be calculated on the basis of such Day Count Fraction as may be agreed between the Issuer and the relevant Dealer.
Floating Rate Bonds:	<p>Floating Rate Bonds will bear interest at a rate determined:</p> <ul style="list-style-type: none"><li>(i) on the same basis as the floating rate under a notional interest rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the 2000 ISDA Definitions (as published by the International Swaps and Derivatives Association, Inc., and as amended and updated as at the Issue Date of the first Tranche of the Bonds of the relevant Series); or</li><li>(ii) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or</li><li>(iii) on such other basis as may be agreed between the Issuer and the relevant Dealer.</li></ul> <p>The margin (if any) relating to such floating rate will be agreed between the Issuer and the relevant Dealer for each Series of Floating Rate Bonds.</p>
Index Linked Bonds:	<p>Payments of principal in respect of Index Linked Redemption Bonds or of interest in respect of Index Linked Interest Bonds will be calculated by reference to such index and/or formula or to changes in the prices of securities or commodities or to such other factors as the Issuer and the relevant Dealer may agree.</p> <p>Index Linked Bonds which are issued as an <i>appel public à l'épargne</i> in France must be issued in compliance with the <i>Principes Généraux</i> from time to time set by the <i>Commission des Opérations de Bourse</i> and the <i>Conseil des Bourses de Valeurs</i> or any successor body thereto.</p>

Other provisions in relation to Floating Rate Bonds and Index Linked Interest Bonds:	Floating Rate Bonds and Index Linked Interest Bonds may also have a maximum interest rate, a minimum interest rate or both.
	Interest on Floating Rate Bonds and Index Linked Interest Bonds in respect of each Interest Period, as agreed prior to issue by the Issuer and the relevant Dealer, will be payable on such Interest Payment Dates, and will be calculated on the basis of such Day Count Fraction, as may be agreed between the Issuer and the relevant Dealer.
Indexation Bonds:	Payments of interest and principal in respect of Indexation Bonds will be adjusted for indexation by reference to the relevant Index Ratio.
Dual Currency Bonds:	Payments (whether in respect of principal or interest and whether at maturity or otherwise) in respect of Dual Currency Bonds will be made in such currencies, and based on such rates of exchange, as the Issuer and the relevant Dealer may agree.
Zero Coupon Bonds:	Zero Coupon Bonds will be offered and sold at a discount to their nominal amount and will not bear interest.
Redemption:	<p>The applicable Pricing Supplement will indicate either that the relevant Bonds cannot be redeemed prior to their stated maturity (other than in specified instalments, or for taxation reasons if applicable, or following an Event of Default) or that such Bonds will be redeemable at the option of the Issuer and/or the Bondholders upon giving notice to the Bondholders or the Issuer, as the case may be, on a date or dates specified prior to such stated maturity and at a price or prices and on such other terms as may be agreed between the Issuer and the relevant Dealer, in each case as set out in the applicable Pricing Supplement.</p> <p>The applicable Pricing Supplement may provide that Bonds may be redeemable in two or more instalments of such amounts and on such dates as are indicated in the applicable Pricing Supplement.</p> <p>Bonds issued on terms that they must be redeemed before their first anniversary are subject to restrictions on their denomination and distribution, see “<i>Certain Restrictions – Bonds with a maturity of less than one year</i>” above.</p> <p>The Financial Guarantors will not guarantee any of the amounts payable by the Issuer upon an early redemption, and their obligation will be to continue to make payments in respect of the Bonds pursuant to the relevant Bond Policy on the dates on which such payments would have been required to be made had such early redemption not occurred.</p> <p>The Issuer shall only be permitted to pay Early Redemption Amounts to the extent that in so doing it will not cause an Event of Default to occur or subsist.</p>
Denomination of Bonds:	<p>Bonds will be issued in such denominations as may be agreed between the Issuer and the relevant Dealer save that the minimum denomination of each Bond will be such as may be allowed or required from time to time by the relevant central bank (or equivalent body) or any laws or regulations applicable to the relevant Specified Currency, see “<i>Certain Restrictions – Bonds with a maturity of less than one year</i>” above.</p> <p>Unless otherwise stated in the applicable Pricing Supplement, the minimum denomination of each Definitive IAI Registered Bond will be U.S.\$500,000 or its approximate equivalent in other Specified Currencies.</p>
Taxation:	Payments in respect of Bonds or under the relevant Bond Policy will be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed or levied by or on behalf of any jurisdiction, unless and save to the extent that the withholding or deduction of such taxes, duties, assessments or governmental

charges is required by law. In that event and to that extent, the Issuer and, to the extent there is a claim under the relevant Bond Policy, the relevant Financial Guarantor will make payments subject to the appropriate withholding or deduction. No additional amounts will be paid by the Issuer or, to the extent there is a claim under the relevant Bond Policy, by the relevant Financial Guarantor in respect of any withholdings or deductions, unless otherwise specified in the applicable Pricing Supplement.

Status of the Bonds: The Bonds will constitute secured obligations of the Issuer. Each Class of Bonds will rank *pari passu* without preference or priority in point of security amongst themselves.

The Bonds represent the right of the holders of such Bonds to receive interest and principal payments from (a) the Issuer in accordance with the Terms and Conditions of the Bonds (the “**Conditions**”) and the trust deed (the “**Bond Trust Deed**”) to be entered into by the Obligors, MBIA and the Bond Trustee in connection with the Programme and (b) in the case of the Wrapped Bonds only, the relevant Financial Guarantor in certain circumstances in accordance with the relevant Bond Policy.

The Class A Wrapped Bonds and the Class A Unwrapped Bonds will rank *pari passu* with respect to payments of interest and principal. However, only the Class A Wrapped Bonds will have the benefit of the relevant Bond Policy. All claims in respect of the Class A Wrapped Bonds and the Class A Unwrapped Bonds will rank in priority to payments of interest and principal due on all Class B Wrapped Bonds and Class B Unwrapped Bonds.

The Class B Wrapped Bonds and the Class B Unwrapped Bonds will rank *pari passu* with respect to payments of interest and principal. However, only the Class B Wrapped Bonds will have the benefit of the relevant Bond Policy.

Covenants: The representations, warranties, covenants (positive, negative and financial) and events of default which will apply to, *inter alia*, the Bonds will be set out in a Common Terms Agreement dated 30 July 2002 (the “**Common Terms Agreement**”).

Guarantee and Security: The Bonds will be unconditionally and irrevocably guaranteed and secured by each Obligor pursuant to a guarantee and security agreement (the “**Security Agreement**”) entered into by each Obligor in favour of the Security Trustee over the entire property, assets, right and undertaking of each Obligor (the “**Security**”), in the case of AWS to the extent permitted by the WIA and Licence. Each such guarantee constitutes a direct, unconditional and secured obligation of each Obligor. The Security will be held by the Security Trustee on trust for the Secured Creditors (as defined below) under the terms of the Security Agreement, subject to the terms of the STID (as defined below).

Intercreditor Arrangements: The Secured Creditors will each be party to a security trust and intercreditor deed (the “**STID**”), which will regulate, *inter alia*, (i) the claims of the Secured Creditors; (ii) the exercise and enforcement of rights by the Secured Creditors; (iii) the rights of the Secured Creditors to instruct the Security Trustee; (iv) the rights of the Secured Creditors during the occurrence of an Event of Default; (v) the Entrenched Rights and Reserved Matters of each Secured Creditor; and (vi) the giving of consents and waivers and the making of amendments by the Secured Creditors. See Section 7.4, “*Financing Structure – Intercreditor Arrangements*”.

Status of Bond Policies: Each financial guarantee insurance policy (each a “**Bond Policy**”) issued in favour of the Bond Trustee in relation to each Tranche of Wrapped Bonds will be an unsubordinated and unsecured obligation of the relevant Financial Guarantor, save for certain mandatory exceptions provided by law, pursuant to which the relevant Financial Guarantor will guarantee the timely payment of

interest and principal (other than the FG Excepted Amounts) on the relevant Tranche of Wrapped Bonds.

Counter Indemnity:	The Issuer will be obliged, pursuant to the terms of an insurance and indemnity agreement with the relevant Financial Guarantor, inter alia, to reimburse such Financial Guarantor in respect of payments made by it under the relevant Bond Policy or Bond Policies. Each such Financial Guarantor will be subrogated to the rights of the relevant Class A Wrapped Bondholders or Class B Wrapped Bondholders, as the case may be, against the Issuer in respect of any payments made under such Bond Policies. See Section 7.9, “ <i>Financing Structure – Financial Guarantor Documents</i> ”.
Authorised Credit Facilities:	Subject to certain conditions being met, the Issuer will be permitted to incur indebtedness, including lease finance, under authorised credit facilities (each an “ <b>Authorised Credit Facility</b> ”) with an Authorised Credit Provider, providing loan, hedging and other facilities. Each Authorised Credit Provider will be party to the CTA and the STID and may have voting rights thereunder. See Chapter 7, “ <i>Financing Structure</i> ”.
Debt Service Reserve Liquidity Facilities:	The Debt Service Reserve Liquidity Facility Providers will make available to the Issuer two 364-day credit facilities for the purpose of meeting certain shortfalls in revenues: (i) for the Issuer to meet (inter alia) its obligations to pay interest on the Bonds or (ii) to make payments under any Authorised Credit Facilities entered. The Issuer is obliged, pursuant to the CTA, to enter into new, or increase its existing liquidity facilities each time it issues further Class A Debt or Class B Debt.
O&M Reserve Facilities:	The O&M Reserve Facility Provider will make available to the Issuer a liquidity facility for the purpose of meeting operating and maintenance expenses.
Listing:	<p>Application has been made to admit Bonds issued under the Programme to the Official List and to admit them to trading on the London Stock Exchange. The Bonds may also be listed on such other or further stock exchange(s) as may be agreed between the Issuer and the relevant Dealer in relation to each Series.</p> <p>Unlisted Bonds may also be issued. The applicable Pricing Supplement will state whether or not the relevant Bonds are to be listed and, if so, on which stock exchange(s).</p>
Ratings:	<p>The ratings assigned to Class A Wrapped Bonds and Class B Wrapped Bonds will be based solely on the debt rating of MBIA and/or any other Financial Guarantor appointed and reflect only the views of the Rating Agencies. The ratings assigned to the Class A Unwrapped Bonds and the Class B Unwrapped Bonds by the Rating Agencies reflect only the views of the Rating Agencies.</p> <p><b>A rating is not a recommendation to buy, sell or hold securities and will depend, amongst other things, on certain underlying characteristics of the business and financial condition of AWS or, in the case of the Class A Wrapped Bonds and/or Class B Wrapped Bonds, of MBIA and/or any other Financial Guarantor from time to time.</b></p>
Governing Law:	The Bonds will be governed by, and construed in accordance with, English law.
Selling Restrictions:	There are restrictions on the offer, sale and transfer of the Bonds in the United States, the United Kingdom, the Cayman Islands, Japan, The Netherlands and Germany and such other restrictions as may be required in connection with the offering and sale of a particular Tranche of Bonds. See Chapter 16, “ <i>Subscription and Sale and Transfer and Selling Restrictions</i> ”.
United States Selling Restrictions:	Regulation S (Category 2), Rule 144A or Section 4(2), TEFRA C or TEFRA D not applicable as specified in the applicable Pricing Supplement.

## CHAPTER 3

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The financial information set forth below has been extracted without material adjustment from and, together with management's discussion and analysis set forth below, should be read in conjunction with, the audited historical financial statements of Anglian Water Services Limited ("AWS" or the "Company") as at and for the years ended 31 March 2002, 2001 and 2000. The financial statements of AWS have been prepared in accordance with UK GAAP. Significant differences exist between UK GAAP and U.S. GAAP which might be material to the financial information herein. AWS has made no attempt to identify or quantify the impact of those differences. Potential investors should consult their own professional advisers for an understanding of the differences between UK GAAP and U.S. GAAP, and how those differences might affect the financial information herein. See Chapter 18, "*Financial Information – Summary of Significant Differences Between UK GAAP and U.S. GAAP*". In making an investment decision, investors must rely upon their own examination of AWS, the terms of the offering and the financial information. Comparative financial data in respect of the year ended 31 March 2001 have been restated to reflect the adoption by AWS of Financial Reporting Standard 19 (Deferred Taxation) ("**FRS 19**") during the financial year ended 31 March 2002. FRS 19 requires full provision to be made for deferred taxes that arise from timing differences between the recognition of gains and losses in financial statements and their recognition for purposes of taxation. In addition, AWS restated comparative financial data as at 31 March 2001 to transfer accruals for water and sewerage income not yet billed from trade debtors to prepayments and accrued income and to transfer deferred grants and contributions due within one year from long-term creditors to short-term creditors. These reclassifications have been made in order to more accurately reflect trade debtors and to classify deferred grants and contributions between long-term creditors and short-term creditors. Historical data for the year ended 31 March 2000 have not been restated to reflect the adoption of FRS 19 or the reclassifications discussed above. For additional information regarding FRS 19, see Chapter 18, "*Financial Information – Anglian Water Services Limited – Financial Information of AWS for the Three Years Ended 31 March 2002 – Notes to the Financial Information – Notes 1(a) and 21*" and for additional information regarding the reclassifications, see "*– Notes 16, 17 and 19*".

## Profit and Loss Data

For the year ended 31 March

	2002			2001 <sup>(1)</sup> (restated)			2000 <sup>(1)</sup>		
	Before exceptional items	Exceptional items <sup>(2)</sup>	Total	Before exceptional items	Exceptional items <sup>(2)</sup>	Total	Before exceptional items	Exceptional items <sup>(2)</sup>	Total
<b>Turnover</b> .....	724.4	—	724.4	694.6	—	694.6	731.5	—	731.5
Operating costs:									
– Operating costs before depreciation .....	(270.1)	(26.9)	(297.0)	(280.7)	(12.2)	(292.9)	(268.0)	(42.4)	(310.4)
– Depreciation net of amortisation of grants and contributions .....	(150.6)	—	(150.6)	(136.5)	—	(136.5)	(121.3)	—	(121.3)
<b>Total operating costs</b> .....	(420.7)	(26.9) <sup>(3)</sup>	(447.6)	(417.2)	(12.2) <sup>(4)</sup>	(429.4)	(389.3)	(42.4) <sup>(5)</sup>	(431.7)
<b>Operating profit</b> .....	303.7	(26.9)	276.8	277.4	(12.2)	265.2	342.2	(42.4)	299.8
Dividends receivable from trade investment.....	—	—	—	0.2	—	0.2	—	—	—
Profit/(loss) on sale of fixed assets <sup>(6)</sup> .....	—	3.3	3.3	—	1.8	1.8	—	(1.0)	(1.0)
<b>Profit on ordinary activities before interest</b> .....	303.7	(23.6)	280.1	277.6	(10.4)	267.2	342.2	(43.4)	298.8
Interest payable (net).....	(102.7)	—	(102.7)	(120.1)	—	(120.1)	(96.3)	—	(96.3)
<b>Profit on ordinary activities before taxation</b> .....	201.0	(23.6)	177.4	157.5	(10.4)	147.1	245.9	(43.4)	202.5
Tax on profit on ordinary activities .....	21.3	7.3	28.6 <sup>(7)</sup>	(38.0)	2.4	(35.6) <sup>(8)</sup>	(41.3)	8.0	(33.3)
<b>Profit on ordinary activities after taxation for the year</b> .....	222.3	(16.3)	206.0	119.5	(8.0)	111.5	204.6	(35.4)	169.2
Dividends payable .....	—	—	—	(923.3)	—	(923.3)	(148.9)	—	(148.9)
<b>Movements in reserves</b> .....	222.3	(16.3)	206.0	(803.8)	(8.0)	(811.8)	55.7	(35.4)	20.3

(1) Comparative financial data for the year ended 31 March 2001 have been restated to reflect the adoption by AWS of FRS 19 during the year ended 31 March 2002. Comparative financial data for the year ended 31 March 2000 have not been restated to reflect the adoption of FRS 19.

(2) Exceptional items are material items which derive from events or transactions that fall within the ordinary activities of the business and which individually or, if of a similar type, in aggregate, need to be disclosed by virtue of their size or incidence if the financial statements are to give a true and fair view.

(3) Includes £22.5 million in debt refinancing costs and £4.4 million in restructuring costs.

(4) Includes £12.2 million in restructuring costs.

(5) Includes £37.3 million in restructuring costs and £5.1 million for Year 2000 IT compliance costs.

(6) The profit/(loss) on sale of fixed assets relates to various sales of surplus land and assets.

(7) Includes a credit of £35.1 million relating to the agreement of prior year computations with the UK Inland Revenue, a £22.3 million corporation tax charge and a credit of £15.8 million in deferred tax (FRS 19).

(8) Includes £26.7 million in corporation tax and £8.9 million in deferred tax (FRS 19).

## Balance Sheet Data

	<i>As at 31 March</i>		
	2002	2001 <sup>(1)</sup> <i>(restated)</i>	2000 <sup>(2)</sup>
	<i>(£m)</i>		
<b>Fixed assets</b>			
Tangible assets .....	3,607.0	3,516.5	3,387.2
Investments.....	0.2	0.2	0.3
	<u>3,607.2</u>	<u>3,516.7</u>	<u>3,387.5</u>
<b>Current assets</b>			
Stocks .....	4.1	4.0	3.9
Debtors .....	558.1	211.6	200.0
Cash and deposits .....	0.8	19.9	27.0
	<u>563.0</u>	<u>235.5</u>	<u>230.9</u>
<b>Creditors: amounts falling due within one year</b>			
Short-term borrowings .....	(257.0)	(96.9)	(321.0)
Other creditors .....	(1,030.5)	(1,174.3)	(359.8)
	<u>(1,287.5)</u>	<u>(1,271.2)</u>	<u>(680.8)</u>
Net current liabilities .....	(724.5)	(1,035.7)	(449.9)
Total assets less current liabilities .....	<u>2,882.7</u>	<u>2,481.0</u>	<u>2,937.6</u>
<b>Creditors: amounts falling due after more than one year</b>			
Loans and other borrowings .....	(1,714.7)	(1,493.5)	(1,153.4)
Other creditors .....	(86.1)	(90.2)	(92.2)
	<u>(1,800.8)</u>	<u>(1,583.7)</u>	<u>(1,245.6)</u>
<b>Provisions for liabilities and charges.....</b>	(114.1)	(135.5)	(29.1)
	<u>967.8</u>	<u>761.8</u>	<u>1,662.9</u>
<b>Capital and reserves</b>			
Called up equity share capital.....	860.0	860.0	860.0
Profit and loss account.....	107.8	(98.2)	802.9
<b>Total shareholder's funds (equity).....</b>	<u>967.8</u>	<u>761.8</u>	<u>1,662.9</u>

(1) Comparative financial data as at 31 March 2001 have been restated to reflect the adoption by AWS of FRS 19 during the year ended 31 March 2002. As a result, capital and reserves (profit and loss account) have been reduced by £98.2 million (£89.3 million for prior year deferred tax and £8.9 million for current year deferred tax) and short-term creditors (amounts falling due within one year – other creditors) have been reduced by £6.0 million. The offsetting £104.2 million adjustment has been booked to provisions for liabilities and charges. In addition, comparative financial data as at 31 March 2001 have been restated to transfer £5.8 million of deferred grants and contributions from long-term creditors (amounts falling due after more than one year – other creditors) to short-term creditors (amounts falling due within one year – other creditors).

(2) The comparative financial data as at 31 March 2000 have not been restated to reflect the adoption of FRS 19 or the reclassification of deferred grants and contributions between long-term creditors and short-term creditors.

## Cash Flow Data

For the year ended 31 March

	2002	2001	2000
		(£m)	
<b>Net cash inflow from operating activities</b> .....	378.7	389.7	455.2
<b>Returns on investments and servicing of finance</b>			
Interest received .....	16.7	6.9	2.3
Interest paid .....	(100.0)	(79.4)	(84.5)
Interest element of finance lease rental payments .....	(10.4)	(11.5)	(10.7)
Dividends received from trade investments .....	—	0.2	—
	(93.7)	(83.8)	(92.9)
<b>Taxation</b>			
Corporation tax paid .....	(46.4)	(7.5)	(23.1)
<b>Capital expenditure and financial investment</b>			
Purchase of tangible fixed assets .....	(262.0)	(272.3)	(338.9)
Grants and contributions received .....	17.9	14.7	15.3
Loan to group undertaking .....	(309.5)	—	—
Disposal of tangible fixed assets .....	4.8	(1.1)	15.4
	(548.8)	(258.7)	(308.2)
<b>Acquisitions and disposals</b>			
Acquisition of trade and certain assets of Hartlepool Water Plc (net of cash acquired) .....	—	(7.3)	—
Disposals of investments .....	—	0.1	—
	—	(7.2)	—
<b>Equity dividends paid</b> .....	(86.9)	(140.6)	(305.6)
<b>Net cash outflow before financing<sup>(1)</sup></b> .....	(397.1)	(108.1)	(274.6)
<b>Financing</b>			
Increase in loans .....	311.1	670.6	301.4
Repayments of amounts borrowed .....	(82.5)	(558.2)	(35.8)
Capital element of finance lease rental payments .....	(19.5)	(11.4)	(10.0)
Net cash inflow from financing .....	209.1	101.0	255.6
<b>Decrease in cash</b> .....	(188.0)	(7.1)	(19.0)

(1) There is a net cash outflow principally as a result of the inclusion in the Cash Flow Data of AWS's capital expenditure programme, provision of loan to group undertaking and dividends paid. For information regarding differences between UK GAAP and U.S. GAAP as regards the presentation of cash flow statements, see Chapter 18, "Financial Information – Summary of Significant Differences Between UK GAAP and U.S. GAAP – Cash flows".



## Net Debt

	<i>For the year ended 31 March</i>		
	<i>2002</i>	<i>2001</i>	<i>2000</i>
		<i>(£m)</i>	
Cash.....	0.8	19.9	27.0
Bank overdrafts.....	(168.9)	—	—
	<u>(168.1)</u>	<u>19.9</u>	<u>27.0</u>
Short-term borrowings.....	(88.1)	(96.9)	(321.0)
Long-term borrowings.....	(1,714.7)	(1,493.5)	(1,153.4)
	<u>(1,970.9)</u>	<u>(1,570.5)</u>	<u>(1,447.4)</u>

## Management's Discussion and Analysis

### Overview

AWS conducts the regulated water and sewerage activities of the AWG Group. AWS's principal activities in the water business include the abstraction, storage, treatment and distribution of water to residential, commercial and industrial customers. AWS's principal activities in the sewerage business involve the collection, treatment and disposal of domestic sewage, trade effluent and water through its network of sewers and treatment plants. AWS serves the largest geographic area of the regional water and sewerage companies in England and Wales, providing water services to approximately 4.3 million people in an area covering approximately 22,000 square kilometres and sewerage services to approximately 5.6 million people in an area covering approximately 27,500 square kilometres.

### Factors affecting Financial Condition and Results of Operations

#### Regulation

AWS operates within a highly regulated industry in England and Wales. The Company's operating revenues, costs of operations and investment decisions are heavily influenced by the regulated tariff rates which the Company may charge its customers as established by its economic regulator, the DGWS (who is assisted in his duties by Ofwat), as well as environmental regulation and the terms of its Licence. Every five years, the DGWS sets a price cap intended to enable water and sewerage companies in England and Wales to finance operations and earn a reasonable return on capital. The pricing regime administered by the DGWS provides for interim reviews in specified, limited circumstances. For additional information on the price cap mechanism, including provisions for adjustments, and on regulation of the water and sewerage industry generally, see Chapter 4, "AWS Business Description" and Chapter 11, "Regulation of the Water and Sewerage Industry in England and Wales".

On 25 November 1999, Ofwat published its final determination of the new tariff rates over the five year period between 2000 and 2005. The revised price limits which came into effect on 1 April 2000 resulted in an initial reduction of 10 per cent. in the weighted average (before adjustment for inflation) of AWS's customer bills for 2000-01. The new price cap reduced AWS's income for the year ended 31 March 2001 by approximately £68 million (which is the maximum additional amount that could have been realised based on the prior price structure during such fiscal year had the new price cap not been introduced). Under the agreed price determination, the DGWS permitted AWS annual average price increases before adjustment for inflation of 1.0 per cent. in 2001-02, 2.2 per cent. in 2002-03 and 2.5 per cent. in both 2003-04 and 2004-05. In addition, under the agreed price determination, the DGWS's plan assumed the following aggregate cost reductions by 31 March 2005 for AWS: a reduction in operating expenditures of 14 per cent. in water services and 17 per cent. in sewerage services; a reduction in capital maintenance of 13 per cent. in water services and 7 per cent. in sewerage services; and a reduction in capital enhancement of 12 per cent. in water services and 14 per cent. in sewerage services. The DGWS's plan also assumed an after-tax cost of capital of 4.75 per cent. applicable over the whole five year period between 2000 and 2005, with an additional allowance on existing assets for embedded debt costs.

## ***Metering***

Another trend which has influenced and is likely to continue to significantly influence the Company's revenues and operating costs as well as those for the water industry in England and Wales is the growth in the number of residential customers in AWS's water supply and sewerage licence areas as in England and Wales generally, who pay for water supply and sewerage services on the basis of actual usage as measured by installed water meters. Historically, water supply and sewerage services in England and Wales were charged on the basis of fixed tariffs based on property values. However, the water regulators in England and Wales identified metering as a beneficial development for consumers, as it promotes greater transparency between price and usage and water companies have to some degree subsidised the installation of water meters in England and Wales. Associated operating costs with respect to metered customers, such as the cost of reading meters, billing metered customers and responding to customer queries, are significantly higher than for unmetered customers. According to data published by Ofwat, over the five year period between 1996 and 2001, the number of metered households in England and Wales rose from 1.4 million in 1996 (or approximately 7 per cent. of households) to 3.9 million in 2001 (or approximately 19 per cent. of households). In AWS's water supply and sewerage licence areas, the number of metered households rose from 0.2 million in 1996 (or 14 per cent. of households) to 0.8 million in 2001 (or 45 per cent. of households).

Typically, the transition by customers towards metered water results in lower aggregate volumes in periods immediately following the transition because customers' bills are directly linked to usage which in turn results in lower gross revenues. However, reductions in usage are factored into the regulatory pricing model, based on projections of numbers of customers and their characteristics as agreed with the DGWS. See Chapter 11, "*Regulation of the Water and Sewerage Industry in England and Wales*". The principal risk to a regulated water and sewerage company's revenues is that actual numbers of customers switching to meters or other reductions in consumption patterns would be greater than anticipated in the price model. As AWS has had a longer track record with a relatively higher proportion of metered customers than other water companies, AWS's management believes this experience has helped reduce its risks of inaccurately forecasting the growth in metered customers and their consumption patterns. See Chapter 4, "*AWS Business Description*" and Chapter 6, "*Investment Considerations*" and in particular, Section 6.1.3, "*Investment Considerations – Competition in the Water Industry*" and Section 6.2, "*Investment Considerations – AWS Revenue Considerations*".

## ***Competition***

Although AWS, like most of its competitors in the water and sewerage industry in England and Wales, currently has a virtual monopoly over water supply and sewerage services within its licence areas, this may change in the future due to initiatives of the UK Government and Ofwat to increase competition in the water and sewerage industry. In November 2001, Ofwat issued a draft future work programme including a number of proposals to extend competition. These include: facilitating so-called "inset" appointments, which allow a company to provide water or sewerage services within another company's water supply or sewerage licence areas; securing competition in the provision of water mains and service pipes; facilitating common carriage, for example, by developing access codes to set out fair terms for common carriage using others' networks; liberalising trade in abstractions licences; and using the new competition law powers under the Competition Act 1998 to prevent abuses of a dominant position and anti-competitive behaviour. Increased competition could affect AWS's virtual monopoly within its region, but would enable it to compete for customers outside its licensed water supply and sewerage areas. See Section 6.1.3, "*Investment Considerations – Competition in the Water Industry*" and Chapter 11, "*Regulation of the Water and Sewerage Industry in England and Wales*" and in particular Section 11.10.1, "*Regulation of the Water and Sewerage Industry in England and Wales – Competition in the Water Industry – General*".

## ***Economic and Demographic Trends***

The population of AWS's water supply and sewerage licence areas was comparatively stable over the last regulatory price review period (with an average growth rate of approximately 0.5 per cent. per year between 1996 and 2001). Moreover, steady growth in population and new housing construction (which would require connection to the water and sewerage networks) have been factored into the Company's revenue forecasts. However, significant changes in macro-economic indicators (such as inflation and employment), could affect levels of new housing construction, reduce the population of the region as well as individual consumption and materially adversely affect the Company's business.

## Turnover and Expenses

The principal sources of AWS's revenues and expenses are as follows:

### *Turnover*

AWS earns revenue for delivering treated water supplies to residential, commercial and large industrial customers and removing and treating sewage and other effluvia through its sewage network. Turnover is accounted for using standard accounting practices under UK GAAP. Turnover generally represents the income receivable (excluding value added tax ("VAT")) in the ordinary course of business for services provided. Income receivable is based on the actual billing for the financial year to the end of the accounting period with an accrual or adjustment at the end of that period. For example, in the case of income from metered users, there is an accrual for income due but not billed based on average customer consumption data. This accrual is subsequently reconciled to actual billing, which takes place over the subsequent six months. In the case of unmetered income which is billed in advance (principally at the start of the financial year) an adjustment is made at the end of each accounting period to take account of the income billed in advance for the subsequent accounting period. Other income (such as charges for connecting customers to AWS's water network) follow these general principles.

### *Operating Costs*

Historically, the principal component of AWS's operating costs is staff costs, which consist of wages and salaries, social security expenses and pension costs. The other major components of AWS's operating costs are raw materials and consumables, which consist of the various inputs required to deliver AWS's water and sewerage services (such as power, cement and chemicals, among others).

### *Depreciation*

For purposes of its statutory accounts which AWS is required to prepare in compliance with the Companies Act (the "**Statutory Accounts**"), AWS depreciates its assets in a manner consistent with that of other regulated water supply and sewerage companies in England and Wales. Depreciable assets are split between infrastructure assets (mains, sewers, reservoirs, dams, sludge pipelines and sea outfalls) and other assets (properties, above ground plant and equipment). In accordance with accepted practice in the water industry in England and Wales, grants and capital contributions received in respect of infrastructure assets are deducted from the cost of these assets. The depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network which is based on AWS's independently certified asset management plan filed with Ofwat. Other assets are depreciated evenly over their estimated economic lives, which are principally as follows:

- Operational structures (40-80 years)
- Buildings (30-60 years)
- Fixed plant (20-40 years)
- Vehicles, mobile plant and computers (3-10 years)

For additional information, see Chapter 18, "*Financial Information – Anglian Water Services Limited – Financial Information of AWS for the Three Years ended 31 March 2002 – Notes to the Financial Information – Note 1(c)*".

Since 1 April 1999, AWS has complied with Financial Reporting Standard 15 (Tangible Fixed Assets) ("**FRS 15**"). FRS 15 permits only the capitalisation of those incremental costs directly attributable to bringing an asset into working condition for its intended use. The application of FRS 15 means that a proportion of costs of fixed overhead departments such as engineering or project management are not permitted to be included as part of the costs of construction of fixed assets and instead must be recorded as costs in the profit and loss account.

### *Exceptional Items*

AWS has incurred significant exceptional items in each of the three financial years under review. In large part, these costs have related to reorganisation of the business and restructuring of its financing arrangements. For example, AWS has been in the process of restructuring its financing through the creation of a proposed AWS Financing Group (see Chapter 7, "*Financing Structure*"), aspects of the engineering function within AWS were centralised, the central payments function was relocated from Norwich to Peterborough, the call centre function was centralised in Lincoln and administrative offices and operational procedures have been rationalised. This has led to increased staff redundancy costs, together with related unfunded early retirement pension obligations, office and staff relocation expenses, legal and advisers' fees and bankers' costs. In particular, AWS's current debt refinancing has resulted in exceptional costs of £22.5 million for the year ended 31 March 2002. Other

exceptional items affecting the financial statements reviewed herein have included costs related to Year 2000 compliance and other IT costs, as well as profit and loss from the sale of surplus land and other assets.

### **Taxation**

For periods commencing after 1 April 2001, the Company has adopted FRS 19 in relation to deferred taxes. FRS 19 requires full provision to be made for such deferred tax assets and liabilities that arise from timing differences between the recognition of gains and losses in the financial statements and their recognition in the tax computation. The deferred tax balances are discounted using the after tax yields to maturity on UK Government bonds with similar maturity dates. Prior to adopting FRS 19, AWS accounted for deferred taxation only to the extent that there was a reasonable probability that such deferred taxation would be payable in the foreseeable future. Comparative financial data in respect of the year ended 31 March 2001 have been restated to reflect the adoption of FRS 19. For additional information, see Chapter 18, “*Anglian Water Services Limited – Financial Information of AWS for the Three Years Ended 31 March 2002 – Notes to the Financial Information – Notes 1(a) and 21*” and “*Summary of Significant Differences between UK GAAP and U.S. GAAP*”.

### **Regulatory Information**

In addition to its Statutory Accounts, as a condition of its Licence, AWS, like all other Regulated Companies in England and Wales, is required to submit regulatory accounts to Ofwat which are filed in June of each year (the “**Regulatory Information**”) which comply with accounting conventions established by Ofwat. The Regulatory Information is to a certain extent used by the DGWS in establishing the five year price cap for AWS. Although AWS’s audited Regulatory Information is included in Chapter 18, “*Financial Information*”, potential investors should be aware that significant differences exist between the Regulatory Information and the Statutory Accounts. AWS has made no attempt to identify or quantify the impact of those differences. Unlike AWS’s Statutory Accounts which are prepared under the historical cost convention, its Regulatory Information values assets relating to its water and sewerage operations at their current cost value to the business (with the exception of assets acquired prior to 31 March 1990 which are valued at the replacement cost of their operating capability). As a result, AWS’s recorded total fixed assets at 31 March 2002 of £18,087.6 million in its Regulatory Information and £3,607.2 million in its Statutory Accounts. In addition to applying different valuation methods for tangible fixed assets, the Regulatory Information also uses different accounting policies with respect to grants and other third party contributions. There is also a corresponding adjustment to depreciation. Furthermore, AWS’s Regulatory Information includes certain additional disclosure required by Ofwat. For additional information on the Regulatory Information, see Chapter 18, “*Financial Information – Regulatory Information Relating to Anglian Water Services Limited*” and the related notes thereto.

### **Results of Operations**

#### ***Year ended 31 March 2002 compared to year ended 31 March 2001***

*Turnover:* In the year ended 31 March 2002, AWS’s turnover increased by £29.8 million or 4.3 per cent. to £724.4 million from £694.6 million in 2001. Turnover was affected by a £22.4 million increase due to the impact of the newly agreed price cap (which permitted price increases for services of 1.0 per cent.) and an increase for inflation of 3.2 per cent. (resulting in an aggregate price increase of 4.2 per cent.) as well as the impact of tariff initiatives. Another factor which contributed to the growth in turnover was the impact of new customers. AWS added approximately 22,100 new water customers and approximately 28,800 new sewerage customers between 31 March 2001 and 31 March 2002, and new customers generated an additional £4.4 million in turnover. The percentage of turnover relating to metered customers increased to 50.5 per cent. for the year ended 31 March 2002 from 46.6 per cent. for the year ended 31 March 2001. In the year ended 31 March 2001, AWS recognised a one-off revenue from the early settlement of an advance provision agreement (an arrangement whereby water and sewerage infrastructure was laid by AWS in advance of the development of housing) relating to the town of Milton Keynes from English Partnerships, a national body for property regeneration and development. This partly offset an otherwise greater increase in revenues for the year ended 31 March 2002.

*Operating costs before depreciation and exceptional items:* Operating costs before depreciation and exceptional items decreased by £10.6 million or 3.8 per cent. to £270.1 million in the year ended 31 March 2002 from £280.7 million in the year ended 31 March 2001. The decrease was mainly due to releases of accruals for business rates of £10.8 million and release of provision for legal claims of £2.0 million. The releases of accruals for business rates relate to provisions that were made for potential rate levies by local councils on AWS’s sewerage and administrative properties. The accruals for business rates became time-barred and consequently were released. This was partly offset by additional operating costs of £4.7 million as a result of inflation,

additional expenses to comply with environmental regulations requiring higher standards for treating bio-solids in sewerage and additional bad debt provisions relating to the new void waste water tariff.

*Exceptional operating costs:* Exceptional operating costs were £26.9 million for the year ended 31 March 2002, which represented an increase of £14.7 million or 120.5 per cent., compared with exceptional operating costs of £12.2 million in the year ended 31 March 2001. This increase was due to exceptional operating costs of £22.5 million incurred as part of AWS's debt refinancing. The increase in exceptional operating costs was partially offset by a decrease in internal restructuring charges from £12.2 million for the year ended 31 March 2001 to £4.4 million for the year ended 31 March 2002.

*Depreciation:* Depreciation (net of amortisation of grants and contributions) increased by £14.1 million or 10.3 per cent. to £150.6 million in the year ended 31 March 2002 from £136.5 million in the year ended 31 March 2001. This increase was due primarily to the increased asset base as a consequence of the company's investment programme. Other factors were accelerated depreciation to write off technologically obsolete IT equipment and other changes in estimated asset lives.

*Operating profit:* Operating profit was £276.8 million for the year ended 31 March 2002, an increase of £11.6 million or 4.4 per cent., compared with operating profit of £265.2 million for the year ended 31 March 2001. Operating profit margin remained unchanged at 38.2 per cent. for the year ended 31 March 2002 compared with the operating profit margin for the year ended 31 March 2001.

*Net interest payable:* Net interest payable was £102.7 million for the year ended 31 March 2002, a decrease of £17.4 million or 14.5 per cent., compared with net interest payable of £120.1 million for the year ended 31 March 2001. This decrease was mainly due to one-off charges in the year ended 31 March 2001. The interest charge for the year ended 31 March 2001 included £6.0 million of indexation charges (charges on two loans from AW that are linked to the rate of inflation) relating to prior years and a one-off premium of £4.3 million on the early redemption of loans (£19.6 million in principal) from English Partnerships. Lower indexation as a result of a lower rate of inflation for the year ended 31 March 2002 and lower interest rates on unhedged debt have also led to a reduction of the interest charge in the year ended 31 March 2002.

*Tax on profit on ordinary activities:* Tax on profit on ordinary activities resulted in a credit of £28.6 million for the year ended 31 March 2002, a decrease of £64.2 million or 180.3 per cent. compared with a charge of £35.6 million for the year ended 31 March 2001 (after restatement for FRS 19). The decrease was principally due to a £35.1 million release of tax overprovided in earlier years, following agreement of prior year tax liabilities and a reduction in the deferred tax charge from £8.9 million for the year ended 31 March 2001 to a credit of £15.8 million for the year ended 31 March 2002 as a result of an increase in discount rates and the recognition of Advance Corporation Tax.

*Profit on ordinary activities after taxation:* Profit on ordinary activities after taxation increased by approximately £94.5 million or 84.7 per cent. to £206.0 million in the year ended 31 March 2002 compared with £111.5 million for the year ended 31 March 2001. This increase was due to the changes described above after taking into account profits from the sale of fixed assets of £3.3 million (2001: £1.8 million).

*Dividends:* No dividends were payable for the year ended 31 March 2002 compared to £923.3 million of dividends which were declared payable in respect of the year ended 31 March 2001. £799.2 million of the £923.3 million will be waived by AW as of the Effective Date.

#### ***Year ended 31 March 2001 compared to year ended 31 March 2000***

*Turnover:* In the year ended 31 March 2001, AWS's turnover decreased by £36.9 million or 5.0 per cent. to £694.6 million from £731.5 million in 2000. The decrease was primarily due to the impact of the newly agreed price cap with the DGWS which accounted for a reduction of approximately £68 million in revenues (which is the maximum additional amount that could have been realised based on the prior price structure during such fiscal year had the new price cap not been introduced). In addition, the percentage of turnover relating to metered customers increased to 46.6 per cent. for the year ended 31 March 2001 from 42.9 per cent. for the year ended 31 March 2000. Although revenues from unmetered customers decreased by £15.9 million, the negative turnover impact of decreases in consumption by metered users was negligible. The negative impact of the revised price cap and lower volumes was mitigated by a number of factors, the most significant of which was the addition of new residential and commercial customers. In 2000-01, AWS connected approximately 20,000 new customers to its water network and installed approximately 23,700 new sewerage connections (within its water supply licence area) which contributed approximately £2.3 million to revenues. The turnover for 2000-01 fully took into account

the price cap reduction of approximately 10 per cent. discussed above and a 1.4 per cent. permitted increase for inflation for an overall price cap effect of 8.6 per cent.

*Operating costs before depreciation and exceptional items:* Operating costs before depreciation and exceptional items increased by £12.7 million or 4.7 per cent. to £280.7 million in the year ended 31 March 2001 from £268.0 million in the year ended 31 March 2000. A significant portion of the increase in operating costs was accounted for by rising inflation over the course of the year for inputs such as salaries, power rates, vehicle and mobile plant fuel which contributed extra costs of £9.4 million. Other factors which contributed to the increase in operating costs in the year ended 31 March 2001 include the additional expenses to comply with new environmental regulations requiring higher standards for treating bio-solids in sewage and costs related to the outbreak of foot and mouth disease in the United Kingdom. The increase in operating expenses was partially offset by efficiency savings resulting from ongoing restructuring programmes.

*Exceptional operating costs:* Exceptional operating costs were £12.2 million for the year ended 31 March 2001, which represented a decrease of £30.2 million or 71.2 per cent., compared with exceptional operating costs of £42.4 million in the year ended 31 March 2000. This decrease was due to the completion of restructuring programmes in which various business units were rationalised and lower exceptional IT costs in connection with Year 2000 compliance measures (AWS incurred no such expenses in 2001 compared to £5.1 million in 2000 as the Year 2000 compliance programme had been completed in the prior year).

*Depreciation:* Depreciation (net of amortisation of grants and contributions) increased by £15.2 million or 12.5 per cent. to £136.5 million in the year ended 31 March 2001 from £121.3 million in the year ended 31 March 2000. This increase was due primarily to capitalising expenditures on major IT system upgrades in 2000, in part to address Year 2000 issues (which amounted to £5.1 million) and to replace a number of disparate financial and management systems with an integrated management system licensed from SAP.

*Operating profit:* Operating profit was £265.2 million for the year ended 31 March 2001, a decrease of £34.6 million or 11.5 per cent., compared with operating profit of £299.8 million for the year ended 31 March 2000. Operating profit margin was 38.2 per cent. for the year ended 31 March 2001, compared with operating profit margin of 41.0 per cent. for the year ended 31 March 2000. This decrease was due primarily to lower revenues from the lower regulated price cap introduced in the financial year to 31 March 2001 coupled with increasing operating costs as outlined above.

*Net interest payable:* Net interest payable was £120.1 million for the year ended 31 March 2001, an increase of £23.8 million or 24.7 per cent., compared with net interest payable of £96.3 million for the year ended 31 March 2000. This increase was primarily due to a higher level of debt (an increase of £116 million) incurred largely to fund the Company's approved capital expenditure programme, higher levels of indexation, lease payments and a one-off premium of £4.3 million on the early redemption of loans (£19.6 million in principal) from English Partnerships, a national body for property regeneration and development.

*Tax on profit on ordinary activities:* The comparative financial data for the year ended 31 March 2000 have not been restated to reflect the adoption by AWS of FRS 19 during the year ended 31 March 2002. The restated tax on profit on ordinary activities was £35.6 million for the year ended 31 March 2001, an increase of 6.9 per cent., compared with income taxes of £33.3 million for the year ended 31 March 2000. On a comparable basis (after elimination of the effect of the adoption of FRS 19 from the financial data for the year ended 31 March 2001), the tax on profit on ordinary activities decreased from £33.3 million for the year ended 31 March 2000 to £26.7 million for the year ended 31 March 2001. Corporation income tax decreased mainly due to lower revenues and an increase in the proportion of interest charges. On a comparable basis, tax as a percentage of profit before tax increased from 16.4 per cent. for the year ended 31 March 2000 to 18.2 per cent. for the year ended 31 March 2001 mainly because of a reduction in the proportion by which capital allowances exceeded depreciation.

*Profit on ordinary activities after taxation:* As noted above, the comparative financial data for the year ended 31 March 2000 have not been restated to reflect the adoption by AWS of FRS 19 during the year ended 31 March 2002. Profit on ordinary activities after taxation decreased by approximately £57.7 million or 34.1 per cent. to £111.5 million in the year ended 31 March 2001 on a restated basis compared with £169.2 million for the year ended 31 March 2000. On a comparable basis (after elimination of the effect of the adoption of FRS 19 from the financial data for the year ended 31 March 2001), the profit on ordinary activities after taxation for the year ended 31 March 2001 was £120.4 million which is a reduction of £48.8 million, or 28.9 per cent. from the year ended 31 March 2000. This decrease was due to the changes outlined above after taking into account dividends

received from AWS's investment in Water Pension Fund Ltd. of £0.2 million (2000: £0) and profits from the sale of fixed assets of £1.8 million (2000: loss of £1.0 million).

*Dividends:* Dividends declared were £923.3 million for the year ended 31 March 2001, an increase of £774.4 million, compared with dividends of £148.9 million for the year ended 31 March 2000. This increase was principally due to the declaration of a £799.2 million special dividend to AW (which has not yet been paid) as part of the planned financial restructuring of the regulated business. On the establishment of the AWS Financing Group, AW will waive the £799.2 million special dividend.

### **Financial Condition**

In the balance sheet of the Statutory Accounts, AWS's asset base consists of tangible assets and investments. Tangible assets consist mainly of the network infrastructure (the underground piping network for both the water supply and sewerage network) and non-network infrastructure (i.e., pumping stations, water treatment plants and sewage treatment plants, etc.).

AWS accounts for supplies of materials used in the water and sewerage business (acquired in advance of requirements to ensure that the materials are readily available as and when required by the business) as stock. Such materials generally include infrastructure supplies such as replacement pipes, chemicals for water purification processes and mechanical and electrical hardware. The stock levels held by AWS are relatively constant year-on-year.

Debtors consist of accounts receivable by AWS. The predominant component of this line item in the Statutory Accounts is charges for use of the network (so-called main charges) levied on customers (residential, commercial/large industrial). Other significant items included within debtors are amounts owed by AWG Group undertakings to AWS (recharges to AWG Group companies for services performed by AWS on their behalf) and pre-payments made to third-party vendors. Pre-payments comprise items such as the Ofwat licence fee (paid annually in advance), contract payments for laboratory services, laboratory rents and service payments to AWS's IT contractor that are paid monthly in advance. Another component of this line item is VAT charges recoverable from the UK Customs and Excise. Under applicable law, water and sewerage charges for residential customers are zero-rated for VAT purposes (residential customers do not pay VAT). Consequently, AWS pays out more VAT than it receives in and can recover the net difference from Customs and Excise.

AWS accounts for portions of its loan portfolio that must be repaid in the next 12 months under short-term borrowings. Other creditors in respect of amounts falling due within one year ("other short-term creditors") consist principally of trade creditors in the ordinary course of business. Other components of short-term creditors include amounts paid in advance by unmetered customers and outstanding corporate taxes owed to the Inland Revenue.

AWS accounts for the portions of its loan portfolio that are repayable in periods beyond the next 12 months under loans and other borrowings.

Other long-term creditors consist of grants and contributions received by AWS principally from new housing developments in connection with extending necessary infrastructure and connections to AWS's network. AWS allocates such grants and contributions between infrastructure-related assets and non-infrastructure-related assets. AWS amalgamates amounts paid in respect of infrastructure-related assets (such as water mains) into the Company's tangible assets. AWS accounts for amounts in respect of non-infrastructure assets (such as water treatment facilities) under long-term creditors.

Provisions for liabilities and charges have historically consisted of two elements: costs associated with restructuring (principally redundancy payments to employees) and additional amounts in respect of certain unfunded supplementary pension obligations for employees that have been made redundant as determined using actuarial assumptions based on those used for the valuation of the AWG Group's pension scheme. The Company's voluntary severance terms changed on 31 March 2000 and new employees made redundant after this date do not increase the Company's unfunded pension liabilities.

### ***As at 31 March 2002 compared with 31 March 2001***

*Total fixed assets:* Total fixed assets at 31 March 2002 were £3,607.2 million, an increase of 2.6 per cent. compared with total fixed assets of £3,516.7 million at 31 March 2001. The increase is primarily due to expenditures on the annual capital investment programme (£264.4 million). This increase has been partially offset by the annual depreciation charge (£156.6 million).

*Stocks:* Stocks at 31 March 2002 were £4.1 million, essentially unchanged from stocks of £4.0 million for the year ended 31 March 2001.

*Debtors:* Debtors at 31 March 2002 were £558.1 million, an increase of £346.5 million or 163.8 per cent. compared with debtors of £211.6 million at 31 March 2001. This increase was principally due to the impact of £309.5 million of privately placed debt issued by AWS in July 2001, the proceeds of which were temporarily on lent to AW on identical terms. The £309.5 million will be repaid to AWS on or before the Effective Date.

*Short-term borrowings:* Short-term borrowings were £257.0 million at 31 March 2002, an increase of £160.1 million or 165 per cent. compared to £96.9 million at 31 March 2001. The increase was principally due to an overdraft of £168.9 million at 31 March 2002 (31 March 2001: £0) and £88.1 million of existing debt due for repayment within the 12 months ending 31 March 2003 being transferred to short-term borrowings from loans and other borrowings. The increase was partly offset by the repayment of £96.9 million of debt which matured during the 12 months ended 31 March 2002.

*Other short-term creditors:* Other short-term creditors at 31 March 2002 were £1,030.5 million, a decrease of 12.2 per cent. compared with other short-term creditors of £1,174.3 million at 31 March 2001. The decrease was mainly due to a reduction in corporation tax liabilities (from £65.9 million at 31 March 2001 to £7.7 million at 31 March 2002) and the payment of £86.9 million of dividends proposed in the prior year. The other short-term creditors still include the £799.2 million of special dividend declared at 31 March 2001 which is to be waived by AW as part of the planned restructuring of the regulated water and sewerage business.

*Other long-term creditors:* Other long-term creditors were £86.1 million at 31 March 2002, a decrease of 4.5 per cent. compared with other long-term creditors of £90.2 million at 31 March 2001. This decrease was principally driven by a reduction in deferred grants and contributions received from developers for connecting new water and sewerage services.

*Provisions:* Provisions at 31 March 2002 were £114.1 million, a decrease of 15.8 per cent. compared with restated provisions of £135.5 million at 31 March 2001. The decrease is mainly driven by a reduction in deferred tax liability from £104.2 million at 31 March 2001 to £88.4 million at 31 March 2002 and utilisation of the restructuring provision of £5.5 million as a result of redundancy payments made during the year ended 31 March 2002 provided for at 31 March 2001.

#### ***As at 31 March 2001 compared with 31 March 2000***

*Total fixed assets:* Total fixed assets at 31 March 2001 were £3,516.7 million, an increase of 3.8 per cent. compared with total fixed assets of £3,387.5 million at 31 March 2000. The increase is primarily due to expenditures on the annual capital investment programme (£262.9 million), and the purchase of the assets of Hartlepool Water Plc (£10.5 million). This increase has been partially offset by the annual depreciation charge (£142.3 million).

*Stocks:* Stocks at 31 March 2001 were £4.0 million, essentially unchanged from stocks of £3.9 million for the year ended 31 March 2000.

*Debtors:* Debtors at 31 March 2001 were £211.6 million, an increase of £11.6 million or 5.8 per cent., compared with debtors of £200.0 million at 31 March 2000. This increase was primarily due to an increase in amounts owed to AWS by other (non-trade) debtors (£2.6 million) and other companies within the AWG Group (£7.5 million). The increased indebtedness of other companies within the AWG Group is due to late cost recharges (£4.2 million) which were made for the first time in 2000-01 and a delay in settlement of other amounts due.

*Short-term borrowings:* Short-term borrowings were £96.9 million at 31 March 2001, a decrease of £224.1 million or 69.8 per cent. compared to £321.0 million at 31 March 2000. The decrease occurred because £321.0 million of debt matured during the 12 months ended 31 March 2001 and had to be repaid whilst at 31 March 2001 £96.9 million of existing debt became due for repayment within the 12 months ending 31 March 2002 and was transferred to short-term borrowings from loans and other borrowings.

*Other short-term creditors:* Other short-term creditors at 31 March 2001 were £1,174.3 million on a restated basis, an increase of 226.4 per cent. compared with other short-term creditors of £359.8 million at 31 March 2000. On a comparable basis (after eliminating the effect of the adoption of FRS 19 which reduced other short-term creditors by £6.0 million and eliminating the transfer of deferred grants and contributions due within one year from other long-term creditors which increased other short-term creditors by £5.8 million), other



short-term creditors at 31 March 2001 were £1,174.5 million, an increase of 226.4 per cent. compared with other short-term creditors at 31 March 2000. The increase was mainly due to the increase in the final dividend payable to AW (from £103.4 million to £886.1 million) as part of the planned restructuring of the regulated water and sewerage business, and an increase in corporation tax liabilities (from £52.7 million to £65.9 million). The corporation tax increase arises from the corporation tax liability for the year ended 31 March 2001 (£26.7 million) being partially offset by payments of tax due.

*Other long-term creditors:* Other long-term creditors were £90.2 million at 31 March 2001, a decrease of 2.2 per cent. compared with other long-term creditors of £92.2 million at 31 March 2000. On a comparable basis (after eliminating the transfer of deferred grants and contributions due within one year of £5.8 million to short-term creditors), other long-term creditors at 31 March 2001 were £96.0 million, an increase of 4.1 per cent. This increase was partly due to an increase in deferred grants and contributions received from developers for connecting new water and sewerage services.

*Provisions:* Provisions at 31 March 2001 were £135.5 million, an increase of 365.6 per cent. compared with provisions of £29.1 million at 31 March 2000. The balance at 31 March 2001 includes provisions for deferred taxes of £104.2 million resulting from the restatement following the adoption of FRS 19. The latest actuarial valuation determined that provisions for unfunded supplementary pension obligations should be increased from £20.4 million to £25.8 million. In addition, restructuring costs fell from £8.7 million to £5.5 million. During the year ended 31 March 2001, as part of AWS's restructuring programme, the second tranche of the redundancy programme was announced and a charge of £7.9 million made to the profit and loss account. Actual payments made against the provision during the year were £11.1 million.

### **Liquidity and Capital Resources**

In the years ended 31 March 2002, 2001 and 2000, net cash inflow from operating activities was £378.7 million, £389.7 million and £455.2 million, respectively. Included in net cash from operations are movements in the Company's working capital. Working capital decreased by £25.1 million in the year ended 31 March 2000 whilst there were net increases of £14.1 million and £32.2 million in the years ended 31 March 2001 and 2002, respectively. The Company generated outflows of £93.7 million, £83.8 million and £92.9 million from investments and servicing of finance in the years ended 31 March 2002, 2001 and 2000, respectively; these outflows principally reflect debt and lease interest payments commensurate with the Company's funding structure as outlined below.

The Company had cash and deposits of £0.8 million, £19.9 million and £27.0 million at 31 March 2002, 2001 and 2000, respectively. In relation to capital expenditure and financial investments, the Company used cash of £548.8 million in the year ended 31 March 2002, £258.7 million in the year ended 31 March 2001 and £308.2 million in the year ended 31 March 2000. AWS's capital outlay consisted principally of investments in fixed assets of £262.0 million, £272.3 million and £338.9 million net of grant receipts of £17.9 million, £14.7 million and £15.3 million in the years ended 31 March 2002, 2001 and 2000, respectively, with the balance being made up of disposal receipts. Additionally, during the year ended 31 March 2002 AWS on-lent proceeds of £309.5 million from U.S. private placements to AW. In connection with acquisitions and disposals of investments the Company used cash of £7.3 million in the year ended 31 March 2001 for the acquisition of trade and certain assets of Hartlepool Water plc. Net cash inflows from financing were £209.1 million, £101.0 million and £255.6 million for the years ended 31 March 2002, 2001 and 2000, respectively. Overall, there were net cash decreases of £188.0 million, £7.1 million and £19.0 million in the years ended 31 March 2002, 2001 and 2000, respectively.

At 31 March 2002 net debt was £1,970.9 million (£1,714.7 million in long-term borrowings, £88.1 million in short-term borrowings, £168.9 million of overdrafts and £0.8 million in cash) and includes the £309.5 million private placement receipts temporarily on-lent to AW and included within debtors at that date. The bank overdraft of £168.9 million and £309.5 million of private placements issued during the year were the principal factors in the increase in net debt from £1,570.5 million (£1,493.5 million in long-term borrowings, £96.9 million in short-term borrowings and £19.9 million in cash) at 31 March 2001. The principal loan repayments in the year ended 31 March 2002 were £50.0 million payable to the European Investment Bank ("EIB") and £20.0 million payable to AW.

Short-term borrowings were £321.0 million at 31 March 2000 compared to £96.9 million at 31 March 2001 while net debt increased from £1,447.4 million (£1,153.4 million in long-term borrowings, £321.0 million in short-term borrowings and £27.0 million in cash) at 31 March 2000 to £1,570.5 million at 31 March 2001. The primary reason for this was that a £300 million loan from AW repaid in September 2000 was replaced by a £229 million loan at LIBOR plus 0.456 per cent. due in 2009, £156 million in index-linked loan stock at 3.875 per cent.

due in 2020 and £21.8 million of floating rate loans due in 2002 (£20 million at LIBOR plus 0.45 per cent. and £1.8 million at LIBOR plus 0.57 per cent.). After taking into account the maturity profile of EIB loans (principally £50 million repayable in the 12 months ending 31 March 2002 moving to short-term borrowings), these new instruments account for the increased long-term borrowings at 31 March 2001. The movement in short-term borrowings at 31 March 2001 is explained by the repayment of the £300 million 6.56 per cent. 2000 loan, the inclusion of a £50 million EIB loan in line with its maturity date and the new £21.8 million floating rate 2001 loans from AW.

### **Capital Expenditure**

The capital expenditure figures set forth below are not derived from the Cash Flow Data set forth in “*Selected Financial Data – Cash Flow Data*” above. They represent accounting expenditures including accruals for the periods or years indicated.

Capital expenditure was £264.4 million, £262.9 million and £338.1 million for the years ended 31 March 2002, 2001 and 2000. The recent price review allowed approximately £1.6 billion over the current five year plan (2000/01 – 2004/05) for improvements to maintain serviceability, meet new demand and further improve the quality of drinking water, bathing and river water. Capital expenditure for the years ended 31 March 2002 and 2001 represented the first two years of the Company’s five year asset management plan agreed with the DGWS. Approximately £99.6 million and £100.5 million was expended on water infrastructure during the years ended 31 March 2002 and 2001, respectively, while a further £164.8 million and £162.8 million was expended across a wide range of individual assets relating to sewerage infrastructure during these periods. Capital expenditure for the year ended 31 March 2000, the last year of the Company’s previously agreed five year asset management plan, was split between approximately £147.5 million on water infrastructure and a further £190.6 million on sewerage infrastructure.

## CHAPTER 4

### AWS BUSINESS DESCRIPTION

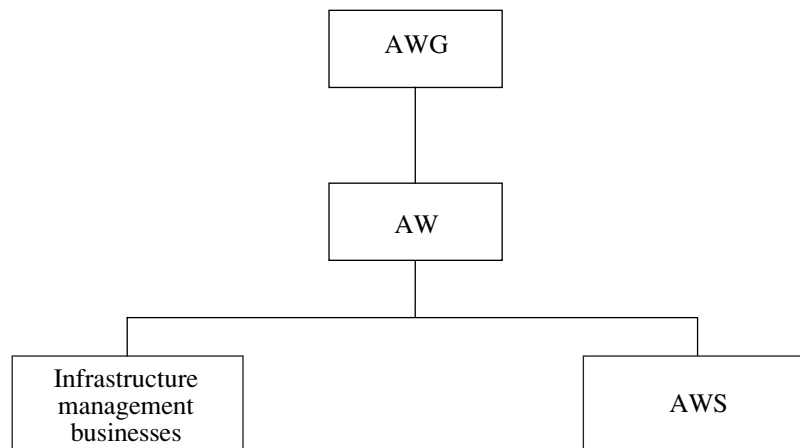
#### The AWG Group

awg plc (“**AWG**”) is the holding company for the AWG Group, a broadly based utility and infrastructure management services group. The shares of AWG are admitted to the Official List and traded on the London Stock Exchange. As at 19 July 2002, AWG had an equity market capitalisation of approximately £1,368 million. AWG’s wholly-owned subsidiary, Anglian Water Services Limited (“**AWS**” or the “**Company**”), operates the AWG Group’s regulated water and sewerage business in England. In addition, subsidiaries of the AWG Group engage in the management of infrastructure in the United Kingdom and elsewhere in the government, utility, transportation and property sectors. In the year ended 31 March 2002, the AWG Group had total assets less current liabilities of £4,256.4 million and recorded net turnover of £1,813.1 million. The AWG Group currently employs over 10,000 people and provides services to approximately 17 million customers both within and outside the UK, mainly in markets in the Asia Pacific region, Europe and South America.

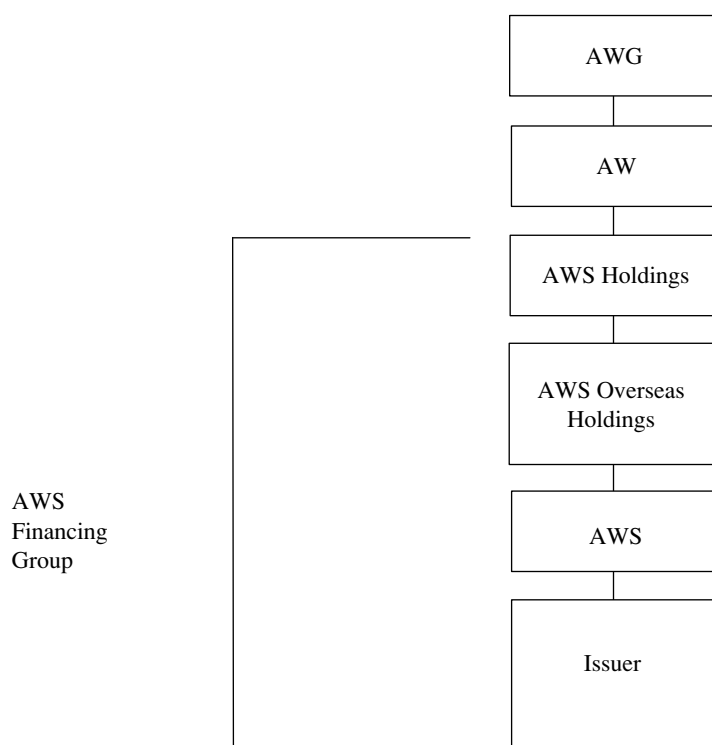
AWG’s long-term strategic objective is to expand its infrastructure management services business lines and deliver more value to stakeholders. To accomplish this objective, AWG is creating two distinct areas within its existing corporate structure, each with its own objectives and financing structures: a regulated water and sewerage business in England and Wales, operated by AWS; and the AWG Group’s infrastructure management services business which will focus on the finance, development and management of infrastructure in the water, gas, electricity, road, rail, telecommunications and local government sectors in the UK and abroad.

To maintain AWS’s position as one of the leading water and sewerage companies in England and Wales, AWG is restructuring the position of AWS within the AWG Group by establishing a new, “ring-fenced” financing group to separate (so far as practicable) AWS financially and operationally from the rest of the AWG Group. AWG’s management believes that the ring-fencing structure will provide significant benefits to AWS, providing better access to the long term debt markets and an opportunity to reduce significantly the cost of capital employed in the regulated business, thereby enhancing shareholder returns. AWG believes that the ring-fencing structure also provides the best operating environment to sharpen management focus in the regulated water supply and sewerage business, align incentives and implement an effective outsourcing policy. AWG’s management believes that the ring-fencing structure will provide greater operational transparency, continued strong operating performance and an efficient capital structure which will strengthen AWS’s position ahead of the next regulatory price review in 2004. See Chapter 5, “*Ring-fencing and the AWS Financing Group*”.

Set out below is the structure of the AWG Group prior to the creation of the AWS Financing Group:



Set out below is the structure of the AWG Group, as of the Effective Date:



The infrastructure and management businesses will continue to be owned by AWG.

## AWS

### Overview

AWS serves the largest geographic area of the regional water and sewerage companies in England and Wales, covering an area that stretches from the Humber bank in the North to the Thames estuary in the South and from Daventry in Northamptonshire to the East Coast as well as to the town of Hartlepool in the North. AWS provides water services to approximately 4.3 million people in an area covering approximately 22,000 square kilometres and sewerage services to approximately 5.6 million people in an area covering approximately 27,500 square kilometres. Based on the latest published Ofwat financial performance and expenditure report (relating to 2000-1), AWS is the fourth largest of the ten regulated water supply and sewerage companies in England and Wales in terms of its regulatory asset value. In addition, on the basis of regulatory accounts which AWS files with Ofwat (the “**Regulatory Information**”), for the year ended 31 March 2002, AWS’s appointed water and sewerage activities generated turnover of £717.9 million and the Company’s net cash inflow from water and sewerage activities was £378.3 million. See Chapter 18, “*Financial Information – Regulatory Information relating to Anglian Water Services Limited*”.

The region in which AWS operates is mainly rural and agricultural but also includes several urban centres such as Cambridge (sewerage only), Peterborough, Norwich, Lincoln, Milton Keynes, Ipswich and Grimsby. Because of the historical development of water supply and sewerage services in AWS’s region, there are a number of areas (mostly in the south), such as Cambridge, Chelmsford and Basildon where AWS provides sewerage services only and local water companies provide water services. However, AWS has also gained four “inset” appointments to operate water services in areas outside its principal water supply licence area, such as a chicken processing factory in Suffolk, and an “inset” appointment to operate sewerage services at a former RAF base in South Yorkshire. For more information relating to “inset” appointments and initiatives by the UK Government to promote competition in the water and sewerage industry in England and Wales, see Chapter 11, “*Regulation of the Water and Sewerage Industry in England and Wales – Competition in the Water Industry*”. Within AWS’s water supply and sewerage licence areas, there are a number of significant industrial customers in the petroleum, electricity and agricultural sectors. The region in East Anglia where AWS principally operates has a relatively stable population, which has grown modestly (at approximately 0.5 per cent. per year between 1996

and 2001). AWS's water supply and sewerage licence areas within East Anglia are part of the driest regions in the UK. Consequently, AWS has invested considerable resources in developing reservoirs and supply management technology to deal with more limited water supplies.

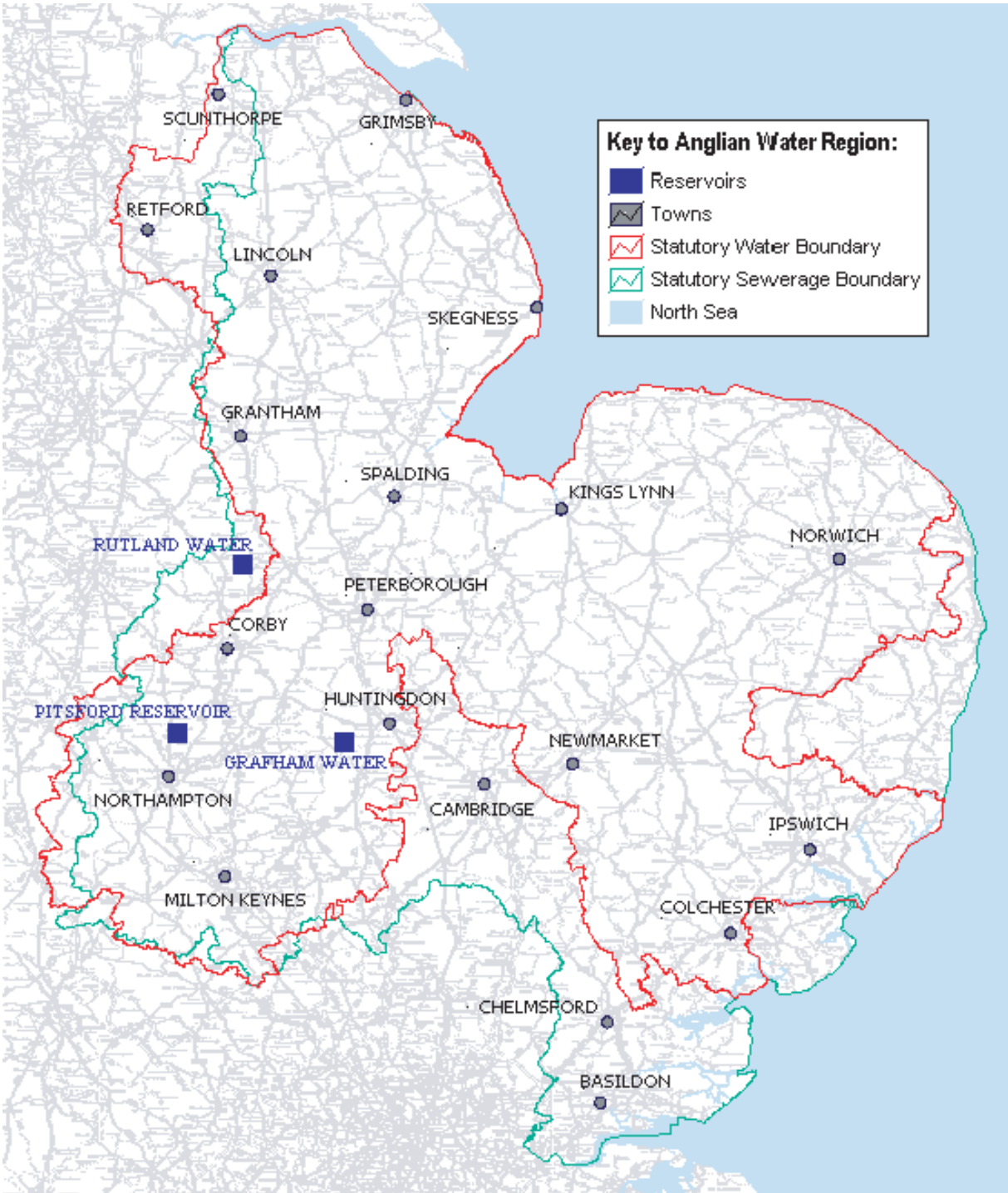
### ***History***

AWS is a limited company registered under the Companies Act under number 2366656, and a subsidiary of AWG plc. AWS was appointed by an Instrument of Appointment dated 24 August 1989 (with effect from 1 September 1989) by the then Secretary of State for the Environment, as a Regulated Company under the provisions of Sections 11 and 14 of the Water Act 1989 (now replaced by Sections 6 and 11 of the Water Industry Act 1991) for a wide area of Eastern England and the Midlands. Before 1 September 1989, the former Anglian Water Authority provided water and sewerage services in those areas. In 1997, AW acquired Hartlepool Water plc. On 1 April 2000, the appointment of Hartlepool Water plc as a water undertaker was merged with that of AWS.

### ***Regulation and Licence***

AWS operates within a highly regulated industry in England and Wales and the Company's operations are strongly influenced by economic, drinking water and environmental regulation. AWS is licensed to operate as a Regulated Company in England and Wales. In particular, the Company's business and results are affected by the regulated tariff rates which the Company may charge its customers as approved by the DGWS (who is assisted in his duties by Ofwat), as well as by drinking water quality and environmental regulations and the terms of its Licence. Every five years, the DGWS sets a price cap intended to enable water and sewerage companies in England and Wales to finance their operations and earn a reasonable return on capital. See Chapter 3, "*Management's Discussion and Analysis of Financial Condition and Results of Operations*", Chapter 11, "*Regulation of the Water and Sewerage Industry in England and Wales*" and Chapter 12, "*Proposed Modifications to AWS's Licence*".

Set out below is a map of AWS’s water supply and sewerage licence areas as at privatisation in 1989. The water supply licence area now includes the town of Hartlepool and four inset appointments: (i) at Buxted Chickens in Flixton, Suffolk; (ii)-(iii) at Wynyard Park and Wynyard South, near Wolviston in Cleveland and (iv) at Kodak in Harrow, in London. An additional inset appointment for water supply at Mill Hill, North London, is expected to become part of the licensed water supply area in the near future. The sewerage licence area now includes one inset appointment at RAF Finningley in South Yorkshire.



## *Strategy*

AWS's objective is to meet and when possible outperform the financial, service and efficiency targets established by the DGWS in its current five year price review period (1 April 2000-31 March 2005) and position the Company to exceed performance criteria to be established by the DGWS during the next five year price review period. To accomplish this aim, AWS's management intends to lower its cost of capital and operational costs through innovative financial and asset management techniques, process efficiencies and competitive tendering of operational activities.

To achieve process efficiency, greater accountability and focus, innovative asset management and to facilitate competitive tendering and outsourcing, AWS's management is currently reorganising the Company into three functions: asset ownership; asset management; and asset operations. Asset ownership will have principal responsibility for the relationship with each of AWS's statutory regulators (Ofwat, the DWI and the EA) and be responsible for AWS's customer strategy. Asset management will manage AWS's infrastructure, IT and procurement policy (including competitive tendering and outsourcing) as well as provide the contracts management expertise to effectively manage the asset operations function. Finally, the asset operations function will deliver the day-to-day service provision, increasingly through outsource providers. AWS's management believes that the restructuring of AWS's business among these three functions will permit a separation of skills and people within AWS into appropriate groupings. The aim of the expanded outsourcing programme will be to reduce costs, achieve greater certainty of costs and improve services.

## *Water Supply Services*

AWS's water supply services to customers consist of the "abstraction" of water and its subsequent treatment and distribution to homes and other premises. Abstraction refers to the removal of water from surface sources, such as reservoirs and rivers, or from underground sources, such as aquifers. Water requires treatment before it can be supplied for domestic purposes. Untreated or partially treated water, however, may be supplied, principally for industrial or agricultural use. The extent of treatment depends on the nature of the source, the quality of the untreated water and its intended use. Water abstracted from rivers requires extensive treatment but water drawn from groundwater sources usually requires less treatment. For surface water, the treatment involves several phases, including coagulation (which involves adding iron salts to the water), sedimentation, filtration and, if necessary, more sophisticated treatment such as exposure to ozone and granular activated carbon before the final phase of disinfection with chlorine. Water is distributed through networks of interconnected mains, service reservoirs and water towers.

## *Water Resources and Supply*

Of the water abstracted by AWS for public supply in its licensed water region, approximately 50 per cent. consists of groundwater abstracted from aquifers, approximately 45 per cent. is abstracted from large raw water storage reservoirs which are refilled by abstraction from rivers and approximately 5 per cent. is abstracted directly to water treatment works from rivers. AWS holds abstraction licences for seven aquifers and operates seven reservoirs, of which the five major reservoirs have 208 million cubic metres of storage capacity.

The mix of water supply resources in the AWS licence area is largely a product of historical development and geology. The region in which AWS operates is underlain by chalk, limestone and sandstone strata which readily absorb and release rainwater and are suitable for cost effective bore hole drilling. In addition, other factors which contribute to AWS's current mix of water supplies are water quality, environmental and cost considerations. Aquifers and reservoirs provide more reliable water supplies than direct river extraction as rainwater can be stored from the winter to maintain supplies during summers and to provide security against drought.

The three largest surface water storage reservoirs of AWS, Rutland Water, Grafham Water and Pitsford Water, are linked through trunk supply mains to form the "Ruthamford" system. This facilitates water management in periods of low rainfall for the major urban areas in the west of AWS's licence area where growth is highest. In addition, AWS relies on water demand modelling to maintain a secure balance of water supply and demand. The demand for water is forecast by considering the components of residential and commercial/ industrial supplies and leakage. This is supported by extensive analysis of domestic water use, economic analysis of trends in industrial demand and the evaluation of the acceptable levels of leakage. The forecasts are revised periodically and agreed with Ofwat, the DGWS and the EA. Forecasts of demand include the distribution and predicted growth of population at local level and the impact of climate on the peak demand for water. While there is generally little significant seasonal fluctuation in the total water put into supply, the quantity of treated water

supplies varies during the year and fluctuations are due to a variety of factors, such as dry weather and burst pipes due to freeze/thaw cycles affecting the ground during winter months.

AWS has historically been recognised as an industry leader in the field of leakage control. Although it serves the largest geographic area in England and Wales, in 2000-01 AWS had one of the lowest levels of leakage in the water industry in England and Wales. In respect of the year ended 31 March 2002, the total recorded leakage level, including leakage from customers' pipes, was 6.1m<sup>3</sup>/km/day. Although no industry leakage data has been published for the same period, the last published industry average for 2000-01 was 9.83m<sup>3</sup>/km/day. This performance is the result of AWS's sustained investment in leakage control technology and its significant water infrastructure renewal strategy. AWS has over 1,600 distribution zone meters, which are devices affixed to points along the water mains that measure water delivery to each of AWS's 1,060 district metered areas. These meters are connected to a telemetry system which enables AWS to quickly identify increased water flows into areas and investigate any associated increase in leakage. AWS's economic level of leakage ("ELL") is assessed at 192 ml/d. AWS achieved and operated at this level until January 2001 when severe frost/thaw conditions caused leakage to rise considerably. Work to reduce leakage back to ELL was however hampered by the exceptionally wet winters of 2000 and 2001 which led to a reduction in leaks reported by the public and deterioration in AWS's capability to pinpoint and repair leaks in those very wet conditions. As a result it is estimated that AWS's current leakage rate is around 16.7 per cent. higher than target. Work is in progress by AWS to rectify the position to ensure that the target for 2002-03 is met.

As a consequence of its strong water resources, internal grid network, water management and historically low levels of leakage, AWS has been able to avoid imposing any restrictions on water usage since 1991, when the use of hosepipes for garden watering was banned in part of AWS's water supply licence area for the whole of that summer.

#### *Customers and Turnover*

During the year ended 31 March 2002, AWS supplied an average of 986.2 megalitres of treated water and 43.7 megalitres of untreated or partially treated water per day to approximately 1.8 million properties in the AWS licence area. In addition, in the same period, AWS installed approximately 20,000 new water connections. AWS's customer base for water services is predominantly residential, accounting for approximately 65 per cent. of AWS's delivered volume. Commercial and large industrial customers represented the balance of AWS's delivered volume.

AWS has over 200 industrial customers who use more than 50 megalitres per year. However, no single customer accounts for more than 0.57 per cent. of AWS's revenues from its water services operations. On the basis of the Regulatory Information for the year ended 31 March 2002, turnover from the water business for that year was £282.4 million and comprised 39.3 per cent. of AWS's turnover (relating to AWS's Regulated Business).

#### *Water Services Infrastructure*

AWS operates 145 water treatment plants and maintains water mains of a total length of approximately 36,536 kilometres. Approximately 34.2 per cent. of the water mains are made of iron, 22.4 per cent. are made of high density polyethylene tubing, 16.8 per cent. polyvinyl chloride and the remainder are made of a variety of materials. To meet regulatory guidelines concerning water quality, AWS has rehabilitated over 2,300 kilometres of iron mains since 1995 and AWS's management intends to complete the rehabilitation of approximately 894 kilometres of iron mains (of which 578 kilometres had already been completed by the end of December 2001) by the end of 2002 under AWS's mains rehabilitation programme. This programme involves replacing the old iron mains with new polyethylene pipes or scraping and relining the interior of the old mains. Management believes this investment will also help to further reduce leakage and the susceptibility of mains to bursting.

#### *Capital Investment*

Between 1 April 1997 and 31 March 2002, AWS invested £671.3 million in capital projects related to improvements in water treatment and water delivery infrastructure, of which £377.6 million was invested in new assets and £293.7 million was invested in maintaining existing infrastructure.

During the current five year price review period, AWS has agreed a £1.6 billion capital investment programme with the DGWS. The principal investment targets related to the Company's water services include: £114 million for maintenance of water treatment works, reservoirs and water pumping stations; £103 million for



investment in installing new meters; £94 million for improved drinking water quality; and £92 million for maintenance related to water mains and related expenditures for new water customers.

#### *Drinking Water Quality and Service Performance*

To assess compliance with drinking water standards established in the Water Quality Regulations, AWS monitors water quality through an extensive programme of regular sampling and analysis. The Water Quality Regulations require that samples must be taken depending on the volume produced or the population served. In addition, all service reservoirs must be sampled weekly. Regulatory analysis at water treatment works and service reservoirs concentrates on microbiological parameters, to ensure that water has been adequately disinfected and is safe to drink.

A more detailed analysis is made from samples taken at the point of consumption (i.e., the customer's tap). This analysis includes all chemical and bacteriological parameters prescribed by the Water Quality Regulations. The frequency with which samples are taken and the analysis made depends on population size. Results of analysis falling outside the prescribed parameters are investigated and reported on a monthly basis to the DWI, which has the power to require improvements or take other enforcement action, although it may refrain from doing so if satisfied that AWS is taking appropriate remedial action.

As a consequence of AWS's continued investment and quality control in drinking water quality, in 2000, the DWI included AWS among the group of water companies with the highest drinking water quality in England and Wales in the Chief Inspector's Report, "Drinking Water 2000".

AWS's performance is reported to Ofwat in an annual return each June. Historically, this includes reporting the water balance, leakage and drought-related measures such as sufficiency of supply and restrictions on water use, none of which has had a significant impact on water supplies to AWS customers in the last 10 years. Comparative performance is reflected in Ofwat's overall performance assessment, which includes all service related measures; AWS has been recently one of the leading water and sewerage companies based on that assessment.

#### *Ofwat measures*

There are separate reports for operational measures of pressure and interruptions to supply that can affect customers. With respect to one area monitored by Ofwat, DG3 ("properties experiencing unplanned supply interruptions"), AWS has historically performed well in comparison with other Regulated Companies. However, for DG2 ("properties at risk of experiencing low water pressure"), AWS has historically lagged behind the industry. More recently, AWS has reported performance that is less than industry average for both DG2 and DG3.

With respect to its DG2 rating, AWS's management believes that the extensive reach of AWS's network, coupled with the largely flat geography in East Anglia, have contributed to its relative performance. However, since privatisation in 1989, the number of properties on AWS's DG2 register has fallen from nearly 40,000 in 1991 to around 5,217 in 2002 as a result of targeted investment, including the installation of booster pumping stations. Under the current capital investment programme, AWS has not allocated any funding to reduce pressure problems, although management believes that some improvements may arise as a consequence of extensive investment in rehabilitating water mains during the current price-review period.

With respect to AWS's DG3 rating, management believes AWS had unusual circumstances in 2001-02 which contributed to its low score. This was partly due to the particular circumstances of pipe material and difficulty of repair in certain individual incidents during the year. However, management has identified a number of opportunities for process and management improvements, which are now being implemented.

#### *Sewerage Services*

AWS's sewerage services consist of the collection and disposal of sewage including domestic sewage, trade effluent and surface water (including highway drainage). Sewage is collected through networks of sewers and pumping stations. Most sewage is either treated at sewage treatment works or discharged in fully or partially treated form through sea and estuarial outfalls.

#### *Customers and Turnover*

For the year ended 31 March 2002, AWS received an estimated flow of 972 megalitres per day of sewage into its sewerage network, which covers approximately 2.4 million properties. This included an average volume of 83 megalitres per day of trade effluent from approximately 4,500 industrial customers. During the year ended

31 March 2002, AWS installed approximately 25,000 new sewerage connections (which includes approximately 20,000 new connections within AWS's water supply licence area and approximately 5,000 outside its water supply licence area). 95 per cent. of AWS's customers are residential and 5 per cent. are industrial/commercial customers. Currently, no single customer accounts for more than 0.21 per cent. of AWS's total revenues from sewerage services. On the basis of the Regulatory Information for the year ended 31 March 2002, turnover from the sewerage business for that year was £435.5 million or 60.7 per cent. of AWS's turnover (relating to AWS's Regulated Business).

#### *Sewerage Network*

AWS is responsible for operating and maintaining 1,070 sewage treatment works, two coastal outfalls and approximately 33,611 kilometres of sewers receiving foul and surface water through a mixture of combined, separate and partially separate drainage systems. There are approximately 4,333 sewage pumping stations within the sewerage region which form an integral part of the sewerage system.

#### *Capital Investment*

In the five year period ended 31 March 2002, AWS had invested approximately £913.3 million in capital projects related to improvements in sewerage infrastructure, of which approximately £566.2 million was for investment in new assets and a further £347.1 million was invested in maintaining existing infrastructure. Specifically, AWS has continued to make significant investments to ensure that its sewage treatment plants are able to comply with discharge standards determined by the EA.

The principal investment targets related to the Company's sewerage operations under the current capital investment programme include: £602 million towards environmental improvement projects related to AWS's sewerage operations; £181 million for maintenance of sewage treatment works and sewage pumping stations; £84 million for maintenance related to sewers; and £125 million for infrastructure and related expenditures for new sewerage customers.

#### *Pollution and Quality Control*

Almost all of the sewage collected in AWS's systems is collected via AWS's sewerage networks and treated at its sewage treatment works. The effluent from sewage treatment works is discharged to environmental waters in accordance with consents issued and regulated by the EA. Another product of sewage treatment is sewage sludge. Approximately 75 per cent. of sewage sludge (bio-solids) processed by AWS is disposed of on agricultural land. The majority of the sludge that is unsuitable for disposal on agricultural land is disposed of in landfill sites. The disposal of sludge produced by sewage treatment works is strictly controlled. Disposal to landfill sites is becoming increasingly restricted due to the lack of available local sites. In addition, all sludge disposed of in this way is subject to a landfill tax. The recycling of treated sludge to agricultural land is controlled by UK regulations, compliance with which is monitored by the EA.

As a result of AWS's continued investment in sewage treatment works, as at December 2001, 99.2 per cent. of AWS's customers were served by sewage treatment works that complied with their regulatory look-up tables, which are used to assess sewage treatment works compliance. See Chapter 11, "*Regulation of the Water and Sewerage Industry in England and Wales – Principal EU Law*".

Improvements to the quality of coastal waters continue to be a priority for AWS's management. There were 43 designated bathing waters in AWS's water supply and sewerage licence areas as at April 2002. The EA tested each of these beaches 20 times during 2001 and more than 99.5 per cent. of samples taken passed the mandatory standard and more than 75 per cent. passed the guideline standard in the Bathing Water Directive. These results meant that the proportion of beaches passing the more stringent guideline standard in the Bathing Water Directive increased from 40.5 per cent. in 2000 to 59.5 per cent. in 2001. However, further improvement to the quality of coastal waters remains a priority for AWS's management as the Company continues to implement its AWS Blue Flag water policy announced in 1997. The European Blue Flag is awarded to beaches annually; to achieve a Blue Flag, bathing water quality must meet the guideline standard set in the Bathing Water Directive and the beach must also meet 25 beach management criteria. Through its Blue Flag water policy, AWS will work towards guideline compliance being achieved at all designated bathing waters in the region by 31 March 2005.

Whilst AWS recognises that the Urban Waste Water Treatment Directive ("*UWWTD*") is resulting in certain improvements to bathing water quality, further work may be required to meet AWS's bathing water objectives in the current periodic review which have been recognised by the DGWS in his price determination for AMP3. Apart from the possibility of major works to supplement the UWWTD work, implementation of the AWS

Blue Flag water policy also requires considerable joint working with local authorities and Ofwat, to identify and agree appropriate actions for sources of contamination other than those controlled by the Company.

### ***Customer Charges***

Charges for water supply and sewerage services are calculated separately based on the average costs of providing each service for each class of customer. Customers with unmetered supplies are billed primarily in advance on an annual basis with payment being annually, half-yearly or by instalments. For supplies of metered water, non-domestic customers are billed periodically depending on the size of their consumption and domestic customers are normally billed half-yearly, in all cases in arrears. See Chapter 3, *“Management’s Discussion and Analysis of Financial Condition and Results of Operations – Turnover”*.

Charges for bulk supplies of water are usually determined on an individual basis, as are charges for some larger commercial water supplies and some industrial sewerage. The charging basis for bulk supplies in some cases provides for annual recalculation by reference to the expenditure associated with the supply. Trade effluent from industrial users is normally charged on a formula basis taking account of the volume of sewage, its strength and costs of removal and treatment.

According to data compiled by Ofwat, the average annual household bill within the water supply and sewerage licence areas served by AWS for the year ended 31 March 2002 was £260, comprising £109 for water supply and £151 for sewerage services. The DGWS sets limits on the rates AWS may charge for its water supply and sewerage services, including the amount of annual weighted average rate increases. On 25 November 1999, the DGWS published his final determination of price limits for the period 2000-05. The price limits which came into effect on 1 April 2000 resulted in an initial reduction of 10 per cent. in the weighted average (before adjustment for inflation) of most customers’ charges for 2000-01. The DGWS permitted AWS annual price increases of 1.0 per cent. in 2001-02, 2.2 per cent. in 2002-03 and 2.5 per cent. in both 2003-04 and 2004-05, before adjustment for inflation. See Chapter 3, *“Management’s Discussion and Analysis of Financial Condition and Results of Operations”* and Chapter 11, *“Regulation of the Water and Sewerage Industry in England and Wales”*.

In England and Wales, for the year ended 31 March 2001, approximately 81 per cent. of residential customers paid for water supply and sewerage services based on the rateable value of their property. The remaining 19 per cent. paid for services on the basis of actual use as measured by water meters. Although the domestic rating system was discontinued in 1990 (under the provisions of the UK Local Government Finance Act 1988), under the WIA, water companies were originally allowed to continue to use rateable values for charging until 1 April 2000. More recently, following a review of water and sewerage charges in England and Wales, the UK Government has allowed companies to continue using the system after that date. At the same time it has made changes designed to encourage the use of water meters on domestic properties. See Chapter 3, *“Management’s Discussion and Analysis of Financial Condition and Results of Operations”* and Chapter 11, *“Regulation of the Water and Sewerage Industry in England and Wales”*.

AWS has the highest proportion of metered customers among the water and sewerage companies in England and Wales (currently approximately 51 per cent. of AWS’s residential customers are metered) and, as a consequence of this experience, AWS has developed and introduced a number of tariff options for domestic customers. Particularly successful has been the development of a low user tariff, which is now believed to be the most popular optional tariff in the water industry. In 1998, AWS was the first regulated water and sewerage company in England and Wales to introduce a tariff which targeted assistance at the more vulnerable customer groups. This idea was later adopted by the UK Government and, under regulations made under the WIA, it is now mandatory for all water and sewerage companies in England to offer a tariff to assist certain vulnerable customer groups.

In the last few years, AWS has expanded the range of tariffs available to non-residential customers with the result that charges more closely reflect the costs of servicing the different types and sizes of customers. Management believes this development makes charges fairer to customers by providing customers with more choices.

AWS offers a range of separate tariffs to industrial customers. Its range of large user tariffs now covers drinking water, sewerage, and trade effluent. Further refinements include separate tariffs for non-potable water, and the availability of an interruptible tariff. The interruptible tariff option is designed to attract large customers willing to accept interruptions to supply in order to ameliorate short-term pressure or supply interruption

problems in the local supply network, thus enabling better overall network efficiency without the need for capital investment.

### *Bad Debts*

Following the introduction of the WIA in 1999, regulated water and sewerage companies were barred from disconnecting residential customers from their water supply for failure to pay bills. Industrial and commercial customers, however, are subject to a number of actions, including disconnection where persistent failure to settle charges occurs. AWS, through the use of a dedicated billing call centre, contacts customers who are in arrears and arranges payment plans wherever possible. Bad debts are measured by AWS as a percentage of AWS's gross turnover (as reported in the Regulatory Information). In the year ended 31 March 2002, AWS's bad debt ratio was 1.78 per cent., compared to the most recently published industry average in England and Wales of 2.05 per cent. in 2001.

### *Suppliers*

AWS relies on a number of key inputs to operate its water and sewerage services which are provided by a number of international, UK and intra-AWG Group companies. The Company relies on (i) IT software and hardware to monitor delivery to and supply from its water and sewerage network and billing of customers, (ii) electricity to operate pumping stations, treatment plants and the piping network, (iii) chemicals for water purification and sewage treatment and (iv) a variety of materials as well as logistics and support services relating to construction of plants, installation of network infrastructure and other capital plant work. In respect of IT services, AWS depends on two specific suppliers, and management believes that a switch to an alternative supplier (if necessary) could not be managed in the short-term without significant risk to AWS's business and potentially significant early termination penalties under the relevant supplier contracts of up to £15 million. In any case, there can be no guarantee that, in the event that a third-party supplier contract is terminated, AWS will be able to find alternative providers on similar terms.

### *Outsourcing*

Like most of its competitors in the water and sewerage industry, AWS outsources the majority of its capital investment programme and some of its day-to-day operations to third-party providers of goods and services. AWS outsources approximately £50 million of its operations every year. Specifically, AWS outsources IT services, training services, facilities management, logistics functions and some minor operations such as certain sewerage contracts. Over 50 per cent. of AWS's capital investment programme is carried out by strategic design and construction partners. These partners are monitored through a number of key performance indicators.

AWS intends to expand its existing outsourcing strategy, with the goal of putting a substantial proportion of its operational activities out to competitive tender prior to the next price review by the DGWS in 2004. The purpose of this expanded outsourcing strategy is to ensure security of cash flow by allocating the operating cost risk on to a 'best in class' provider better able to manage that risk through economies of scale and expertise. AWS also believes that outsourcing will help reduce its operating costs. However, having gone through a competitive tendering exercise, AWS may retain activities in house, if the bids received are not economically advantageous. AWS believes it will further benefit by having a substantial part of its operational activity subject to competitive bids prior to the next price review. This will assist AWS in demonstrating its operating efficiency to the regulator.

Management believes AWS's competitive tendering and outsourcing strategy is well developed and will continue to be refined as the markets for relevant activities develop and best practice evolves. The Common Terms Agreement also sets out parameters that the Company must adhere to in connection with its outsourcing of contracts in the future. See Chapter 7, "*Financing Structure*".

The DGWS has proposed imposing extensive requirements on AWS to act properly and to report in respect of its outsourcing policy. These are contained in the proposed Licence modifications, in particular, new Condition R. See Chapter 12, "*Proposed Modifications to AWS's Licence*".

### *Dividends and Dividend Policy*

AWS intends to distribute substantially all cash inflow from operating activities after net interest payments and capital maintenance expenditure (based on allowances for current cost depreciation and infrastructure renewals charge given by Ofwat at the 1999 Price Review) to AWS's shareholders by way of dividend subject to the covenants set out in the CTA and the availability of distributable reserves. See Section 7.6, "*Financing Structure – Common Terms Agreement*".

## ***Insurance and Risk Management***

AWS maintains insurance coverage consistent with generally accepted practices for prudent Regulated Companies. This insurance is and has historically been maintained as part of the AWG Group insurance programme. The insurance strategy for AWS has been to tailor its insurance cover to address various aspects of AWS's risk profile as well as develop robust risk management systems. With respect to high severity but low probability (catastrophic) events that management believes would significantly impact AWS's business (such as a dam burst), the risk management policy has been to purchase insurance from external carriers.

With respect to medium severity but medium probability events (such as fire and flooding), AWS has pursued a mix of options designed to accomplish cost effective coverage of AWS risks, including purchasing insurance coverage from external carriers and self-insurance with the AWG Group's captive insurance company, Rutland Insurance Limited. With respect to low severity but high probability events, management generally does not view it as cost effective to purchase insurance products for these relatively predictable losses and the Company makes provision for such losses and liabilities from operating profit.

As part of its strategy to ensure effective insurance, AWS's policy is to use Rutland Insurance Limited and only external insurance providers approved by Marsh Limited's Insurance Security Committee who monitor and advise the AWG Group's insurance department of any deterioration in the credit rating of AWS's insurance carriers.

In certain instances, where the insurance coverage is subject to an aggregate limit, this aggregate limit applies to coverage for the AWG Group as a whole.

AWS has various risk control processes in place that management believes effectively monitor operational risks. For example, the Company has a rolling inspection programme for mechanical and electrical equipment. Structural engineers review the condition of dams and other infrastructure. AWS works closely with UK Government departments to ensure that key installations are fully protected and the most significant unmanned premises are monitored by telemetry systems. Moreover, AWS constantly monitors water quality.

As part of the AWG Group's initiative to ring-fence properly AWS's operations from those of the rest of the AWG Group, AWS is currently in the process of completing a systematic review of all the categories of risk applicable to its business. Under the review process which is expected to continue throughout the second half of 2002, the Company has employed external consultants to model financial projections of the potential impact of various risks and the AWG Group insurance department is reviewing various ways to ring-fence insurance coverage for AWS from the AWG Group. See Chapter 5, "*Ring-fencing and the AWS Financing Group*".

The Common Terms Agreement contains provisions requiring AWS's on-going insurance regime to meet various criteria. These are outlined in greater detail in Chapter 7, "*Financing Structure*".

## ***Employment***

AWS currently employs approximately 3,700 employees. As part of the internal restructuring taking place to ring-fence AWS's operations, a number of employees who did not devote substantially all of their time to AWS business have been transferred with effect from 1 July 2002 to other parts of the AWG Group, leaving approximately 3,600 employees within AWS. Where AWS employees continue to provide services to the rest of the AWG Group (e.g. payroll, pensions) such services will be charged out on an arm's length basis.

The costs of any benefits (such as medical expenses insurance) purchased by AWG Group companies (other than AWS) and provided to employees of AWS and other AWG Group companies will similarly be shared on an arm's length, pro rata basis. See Chapter 5, "*Ring-fencing and the AWS Financing Group*".

As part of the competitive tendering and outsourcing programme, the majority of AWS employees are likely to transfer across to the relevant successful contractor in an outsourcing contract by operation of the Transfer of Undertakings (Protection of Employment) Regulations ("**TUPE**") or otherwise by agreement.

AWS has traditionally enjoyed good employee relations with the recognised trade unions through the Company Collective and the various partnership tables established under the Company Collective. As is common in such circumstances where a considerable number of employees are to be outsourced, the employee representatives on the Company Collective have expressed concerns with the competitive tendering and outsourcing programme and are not currently supportive of the proposal. However, dialogue at the Company Collective is continuing.

### ***Litigation***

AWS is currently involved in the following legal or arbitration proceedings which may have, or have had within the previous 12 months, a significant effect on AWS.

(i) EA claim against AWS

Under Section 101A of the WIA, sewerage undertakers must provide a public sewer if certain conditions are met and it is considered appropriate to provide a public sewer. In 2001, AWS succeeded in overturning the EA's decision that sewerage must be provided to four villages.

The EA appealed against this decision of the Court in respect of two of the villages. The Court of Appeal heard the EA's appeal on 18 December 2001 and delivered its judgment on 31 January 2002 in favour of AWS. The EA petitioned the House of Lords for leave to appeal in respect of one of the villages but leave was refused on 10 July 2002.

(ii) Claim by Corton Caravans and Chalets against AWS

This is a valuation dispute relating to a compulsory purchase order concerning land to form part of AWS's sewage treatment works in Lowestoft. AWS's surveyors value the land at £200,000 but the claimant states that the value of the claim is between £2.8 million and £4.25 million. Proceedings were commenced in the Lands Tribunal in March 2001 and are ongoing. A hearing has been set for 24 September 2002 and is estimated to run for 10 days.

(iii) Potential claim relating to fittings installed by AWS

Tests have highlighted that certain internal brass fittings installed as part of customer metering installations by AWS in 1996 could potentially have a high risk of failure. Based on this, the cost to AWS to replace all these internal fittings would be approximately £7.5 million. At present, no litigation has commenced.

## CHAPTER 5

### RING-FENCING AND THE AWS FINANCING GROUP

#### 5.1 Ring-fencing

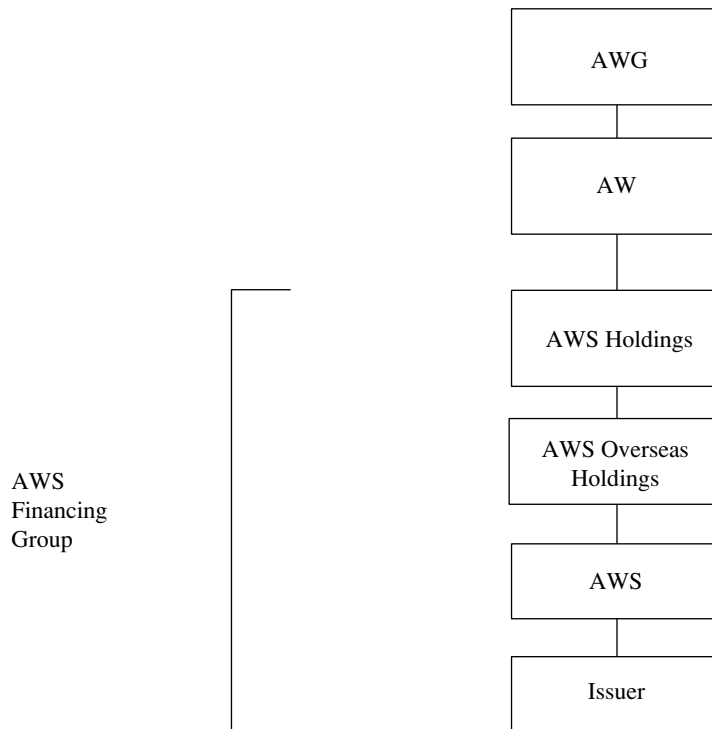
##### 5.1.1 Introduction

As part of its obligations as a Regulated Company, AWS is subject to certain ring-fencing restrictions under its current Licence. See 5.1.2, “*Regulatory Ring-fencing*”. In addition, in January 2002, Ofwat published a consultation paper setting out proposed modifications to AWS’s Licence which should further strengthen the regulatory ring-fencing currently in place. In April 2002, Ofwat published a position paper “*Proposals for the modification of the Conditions of Appointment of Anglian Water Services Limited*”. See Chapter 12, “*Proposed Modifications to AWS’s Licence*”.

In addition, to reduce AWS’s exposure to credit and event risk of other AWG Group companies, the AWG Group intends to reposition AWS within the AWG Group by creating a new “ring-fenced” financing group (being the “**AWS Financing Group**”). These measures also reflect the requirements of the covenant and security package as summarised in Chapter 7, “*Financing Structure*”.

The ring-fencing measures being pursued are intended to ensure: (i) that AWS has the means to conduct its regulated business separately from the AWG Group; and (ii) that all dealings between the AWG Group and the AWS Financing Group are on an arm’s length basis.

The ownership structure of the new AWS Financing Group will be:



The main elements comprising the structural and legal ring-fencing of the AWS Financing Group from the other AWG Group companies are set out below.

### 5.1.2 Regulatory Ring-fencing

Regulatory ring-fencing is common in differing degrees to each of the Regulated Companies in England and Wales pursuant to their respective licences. Under Condition F of its Licence, as supplemented by RAG 5, AWS must ensure that transactions between it and its associated companies in the AWG Group are on an arm's length basis, to prevent cross subsidisation of activities. Failure to comply with RAG 5 may in certain circumstances give rise to a breach of the Licence and possibly the Competition Act 1998. See Chapter 11, "*Regulation of the Water and Sewerage Industry in England and Wales*". Under Condition K of its Licence, AWS must ensure at all times, so far as reasonably practicable, that if a Special Administration Order was made in respect of it, AWS would have available to it sufficient rights and assets (other than financial resources) to enable the Special Administrator to manage its affairs, business and property so that the purposes of such order could be achieved. See Section 11.5, "*Regulation of the Water and Sewerage Industry in England and Wales – Special Administration Orders*".

In January 2002, Ofwat published the consultation paper entitled "*Proposals for the modification of the Conditions of Appointment of Anglian Water Services Ltd.*", proposing modifications to AWS's Licence including modifications designed to strengthen the ring-fencing provisions of the Licence. In April 2002 Ofwat published a position paper "*Proposals for the modification of the Conditions of Appointment of Anglian Water Services Limited*". See Chapter 12, "*Proposed Modifications to AWS's Licence*". In addition in December 2001, Ofwat published a consultation paper, MD 174, which describes various provisions of Regulated Companies' licences (including ring-fencing provisions incorporated or modified as a result of corporate restructurings) and sets forth proposals to standardise certain licence conditions across the water and sewerage industry. See Chapter 12, "*Proposed Modifications to AWS's Licence*".

### 5.1.3 Corporate Structure

The regulatory ring-fencing measures described above will be enhanced by the separation of AWS from the other businesses of the AWG Group through the interposition of two intermediate special purpose holding companies, AWS Holdings, incorporated in England and Wales and AWS Overseas Holdings, incorporated in the Cayman Islands. AWS Holdings is a wholly-owned subsidiary of AW. The principal purpose of AWS Holdings will be to hold all of the shares in AWS Overseas Holdings and the principal purpose of AWS Overseas Holdings will be to hold all of the shares in AWS.

### 5.1.4 Directors

Pursuant to the proposed Licence modifications, each company in the AWS Financing Group will maintain at least three independent non-executive directors. The board of directors of each company in the AWS Financing Group may comprise directors who are also directors of other AWG Group companies outside the AWS Financing Group so long as any executive directors in this category do not constitute a majority of the executive directors of such company. Currently, Chris Mellor (an executive director of AWG) is non-executive Chairman of AWS and Roy Pointer (an executive director of AWG) is the Managing Director of AWS. The Board also currently comprises two other executive directors, David Hipple and Colin Brown neither of whom are directors of any AWG Group companies outside the AWS Financing Group. See 5.2, "*The AWS Financing Group*".

The constitutional documents of each company in the AWS Financing Group will, from the Effective Date, provide that all conflicts of interest of directors must be disclosed. No director may, from the Effective Date, vote on any contract, transaction or arrangement between a company in the AWS Financing Group and any other company in the AWG Group, other than a company in the AWS Financing Group, of which he is a director. All directors will be entitled to vote on the matter of dividends and distributions to AWG Group companies. The general law will also apply to the directors of the AWS Financing Group companies who will be required to act in the interests of those companies.

The Common Terms Agreement provides that following the occurrence of a Trigger Event and if the Trigger Event has not otherwise been remedied or waived, the Security Trustee will be entitled to procure the appointment of additional non-executive directors to the board of AWS and a similar entitlement applies in relation to the other companies in the AWS Financing Group (the



“Security Trustee Directors”). See Section 7.6.8, “*Trigger Event Consequences*”. The articles of association of each company in the AWS Financing Group will provide, from the Effective Date, that the total number of votes capable of being cast by Security Trustee Directors in respect of any question arising at a meeting of the Directors shall not exceed the total number capable of being cast by the other Directors participating in the meeting in respect of that question. Additionally, the articles of association of each company in the AWS Financing Group will provide, from the Effective Date, that no Security Trustee Director may be appointed chairman or vote on any resolutions concerning the appointment or removal of a chairman.

#### **5.1.5 Management Compensation**

Following the implementation of the proposed ring-fencing, the Board of AWS intends to implement a remuneration policy for executive directors (except the Managing Director) and senior management which will create incentives to deliver benefits for lenders, its shareholder and customers. The policy will be twofold as follows:

- (a) an annual bonus scheme will measure AWS, team and individual performance against financial and non-financial targets including:
  - improvements in credit quality, financial strength and the delivery of distributions to its shareholder and customers; and
  - improvements in service performance;
- (b) a longer term scheme will relate to achievement of the following objectives:
  - improvements in financial strength and delivery of distributions to shareholders and customers, covenant compliance and the maintenance of debt ratings; and
  - improvements in operational performance through compliance with Ofwat and other regulatory obligations, in comparison with the level and rate of improvement in the rest of the industry.

Under the policy, executive directors and senior management (other than the Managing Director of AWS who will be incentivised under the AWG Group scheme) will be incentivised on the basis of AWS financial and operating performance and will be eligible for bonuses of a percentage of base salary. A substantial portion of longer term bonuses will be deferred for three years and the deferred bonus will be forfeited if employment is terminated.

#### **5.1.6 Security and Covenant Packages**

In connection with the restructuring of AWS, the AWS Financing Group will provide as full a security package as is commensurate with the limitations imposed by the WIA and the Licence.

Pursuant to the covenant package (as set out in Section 7.6.3, “*Financing Structure – Common Terms Agreement – Covenants*”), dividends, management fees (if any), repayments under the UK Holdco/AWS Loan, Customer Rebates and other such distributions will only be permitted provided that no Trigger Event or Event of Default is continuing and historical and forward-looking interest cover ratios and regulated asset ratios and certain other conditions are met. In addition, the companies in the AWS Financing Group may incur new financial indebtedness to make Restricted Payments only if certain additional ratio tests are met. The security package and the covenant-based ring-fencing restrictions placed on the AWS Financing Group are set out in Chapter 7, “*Financing Structure*”.

#### **5.1.7 Business Separation**

As part of the corporate restructuring, it is intended that AWS will operate as a separate corporate entity from the other AWG Group businesses. The AWG Group intends to achieve this separation to the fullest extent practicable by asset and business transfers and by ensuring that contracts between AWS and AWG Group companies are entered into on an arm’s length basis. In addition, all existing and new debt relating to the regulated water and sewerage business will be transferred to and issued out by the Issuer, or in certain limited circumstances, AWS, thereby severing any financing links between the AWS Financing Group and other companies in the AWG Group.

Pursuant to the proposed ring-fencing, AWS will have access to all employees required to run the regulated business. The majority of such employees are already employed by AWS and will remain employees of AWS unless their duties relate principally to non-regulated functions in which case they will be transferred to the relevant AWG Group company. AWS will have its own specialist teams in areas such as finance, treasury, human resources, legal, information services and communications. In other areas such as insurance where services are provided at AWG Group level, AWS will procure these services on an arm's length basis.

The general health and safety policy for the AWG Group will be set by AWG but AWS-specific policy, procedures and administration will be carried out by AWS.

All transactions entered into by the AWS Financing Group with third parties (including AWG Group companies) will be entered into on an arm's length basis. Any transaction between AWS and the AWG Group will be formally reviewed to ensure compliance with the Licence, RAG 5 and procurement regulations. The DGWS has proposed imposing additional procurement, procedural and reporting requirements upon AWS to act properly and report in respect of its outsourcing policy. See Chapter 12, "*Proposed Modifications to AWS's Licence*".

As part of the ring-fencing, AWS's activities will be restricted to the business of a Regulated Company in England and Wales. However, AWS's management intends to retain some non-regulated business and assets within permitted de minimis levels (for example, providing certain recreational water activities in or around its reservoirs). Under the covenant package, the Security Trustee may permit AWS to enter into limited joint ventures in areas outside the regulated water and sewerage business subject to certain limitations on the aggregate value of all non-regulated business. See Chapter 7, "*Financing Structure*".

Under the covenant package, AWS will be able to acquire assets or make disposals only if conditions relating to each are met (for example, regulated asset ratio requirements in relation to disposals). See Section 7.6.5, "*Financing Structure - Common Terms Agreement - Covenants - General*".

### **5.1.8 Ongoing Trading Relationships with other AWG Group companies**

#### *Pension Scheme*

AWS participates in the same retirement benefit arrangements as other companies in the AWG Group, including in the AWG Pension Scheme ("**AWPS**"). Currently, nearly all AWS employees participate in the AWPS. The ring-fencing programme will not segregate AWS's pension arrangements from those of the AWG Group at this time, as management believes that it is not cost effective to do so. However, AWS's contributions to the AWPS will be made in respect of AWS's employees only. AWS also intends to enter into agreements with the other AWG Group companies participating in the AWPS to provide that these companies will withdraw from the AWPS if they are unable to meet their contribution obligations. Transfer payments made out of the AWPS in respect of employees of the withdrawing employer will reflect any failure on the part of the withdrawing employer to pay contributions. These measures are intended to minimise the risk of any cross-subsidy within the AWPS between AWS and other AWG Group companies.

#### *Information Technology ("IT")*

AWS currently has and will maintain trading relationships with other AWG Group companies for IT services and has significant outsourcing arrangements in place in respect of some systems. See Chapter 4, "*AWS Business Description*" – *Suppliers and Outsourcing*. AWS is the contracting member of the AWG Group in respect of several AWG Group IT systems. AWS intends to continue to grant rights of access and use in certain IT systems to other AWG Group companies after the creation of the AWS Financing Group. Financing arrangements for significant IT systems are considered in Section 7.10.1, "*Existing Finance Leases*".

As part of the proposed ring-fencing, AWS will ensure that AWG Group companies that use IT systems developed or procured by AWS contribute on an arm's length basis to the costs of such IT systems.

Ofwat has queried the relationship between AWS and Geodesys for compliance with RAG 5. To ensure compliance with RAG 5, it has been agreed that the majority of the activities currently

carried out by Geodesys (an AWG subsidiary which provides data management services) on behalf of AWS will in future be carried out by AWS itself.

#### *Intellectual Property (“IP”)*

Other than technology it owns jointly with third parties, AWS does not own any of the intellectual property used in connection with its regulated businesses. However, the AWS water and sewerage businesses do not depend heavily on IP and, apart from software licences, there are no significant “licences-in” of third-party IP. Currently, AWS has organised its IP requirements in conjunction with the AWG Group. As part of an AWG Group IP-pooling arrangement implemented in 1999, AWS and other AWG Group companies assigned their current and future IP (including trade marks, patents and copyright) to AW Creative Technologies Limited (“AWCT”), a wholly-owned subsidiary of AWG. AWS has established sufficient licensing arrangements with AWCT’s licensing subsidiary, AW Licensing Limited, to ensure that AWS will continue to have access to all the IP rights it requires to operate its business. AWS’s management does not believe that there are any significant RAG 5 compliance issues in respect of AWS’s IP arrangements.

## **5.2 The AWS Financing Group**

### **5.2.1 AWS Incorporation, Board of Directors and Corporate Governance**

#### *Company Details*

AWS is a private limited company which was incorporated in England and Wales on 1 April 1989 under the Companies Act with registered number 2366656. The registered office of AWS is at Anglian House, Ambury Road, Huntingdon, Cambridgeshire PE29 3NZ. The AWS headquarters will be based at Henderson House, Ermine Business Park, Huntingdon, Cambridgeshire PE29 6XG.

AWS’s authorised and issued share capital is £860,000,000 divided into 860,000,000 ordinary shares of £1 each. All ordinary shares have been issued and have been fully paid-up.

#### *Directors and Secretary of AWS*

AWS operates under the overall direction of AWS’s Board of Directors (the “**Board**”) which is responsible for policy and strategic matters. The Board currently consists of a non-executive chairman, three executive directors and three independent non-executive directors.

#### *Non-Executive Chairman*

##### **Chris Mellor**

Chris Mellor was appointed chief executive of AWG in August 2000. He was formerly group managing director of AW from 1998-2000 and group finance director of AW from 1990-1998. Mr. Mellor is also chairman of Business in the Community (East Anglia), a member of the CBI Economic Affairs Committee and serves on the Fifth Advisory Committee on Business and the Environment. He is also a director of the Issuer, AWS Holdings and AWS Overseas Holdings.

#### *Executive Directors*

##### **Roy Pointer – Managing Director**

Roy Pointer is on the board of directors of AWG and has been Managing Director of AWS since January 1998. Mr. Pointer is a member of the Executive Committee of AWS. He is a chartered engineer and has over 30 years’ experience in water engineering and operational management. He is also a director of the Issuer, AWS Holdings and AWS Overseas Holdings.

##### **Colin Brown – Asset Management Director**

Colin Brown was previously customer services manager, head of billing, director of customer services and director of business services of AWS. He is a qualified member of the Chartered Institute of Public Finance and Accountancy. He is also a director of the Issuer, AWS Holdings and AWS Overseas Holdings.

##### **David Hipple – Finance Director**

David Hipple previously held the offices of accounting manager, finance and performance manager and head of performance of AWS. He is currently Director of Finance of AWS. He

became a member of the Association of Chartered Accountants in 1981. Mr. Hipple is also a director of the Issuer, AWS Holdings and AWS Overseas Holdings.

#### ***Non-Executive Directors***

##### **Richard Jewson**

Richard Jewson was previously a non-executive director and Deputy Chairman of AWG. He has also been managing director of Jewson Limited and managing director and chairman of Meyer International plc. He is currently chairman of Savills plc, InterX plc and Eastern Counties Newspapers Group Limited and a non-executive director of Grafton Group and Queens Moat Houses plc. He is also chairman of Octagon Healthcare Holdings Limited. Mr. Jewson is also a director of the Issuer, AWS Holdings and AWS Overseas Holdings.

##### **Robert Napier**

Robert Napier previously held the offices of finance director of Fison PLC's global Pharmaceuticals Division and finance director, joint managing director, managing director and chief executive of Redland Plc.

Mr. Napier has also been a non-executive director of United Biscuits Plc and Rentokil Initial Plc and served as president of the National Council of Building Materials and chairman of the CBI Transport Policy Committee. He is currently chief executive of WWF-UK and chairman of Governors for Sedbergh School. He is also a director of the Issuer, AWS Holdings and AWS Overseas Holdings.

##### **Roger Witcomb**

Roger Witcomb previously held the positions of group finance director and director of strategy and planning of National Power PLC. He is also a director of the Issuer, AWS Holdings and AWS Overseas Holdings.

Replacements to fill vacancies on the Board, as well as additional directors, may be appointed by any shareholder holding a majority in nominal value of the issued share capital, or by the directors, or by an ordinary resolution of the shareholders.

Currently, it is intended that AWS remains a wholly-owned subsidiary in the AWG Group.

The business address of the directors of AWS is Henderson House, Ermine Business Park, Huntingdon, Cambridgeshire PE29 6XG.

The auditors of AWS are PricewaterhouseCoopers, chartered accountants.

The secretary of AWS is Juana Tinn.

#### ***Corporate Governance***

Under its memorandum of association, AWS's primary objects will be, from the Effective Date, to act as a holding company of the Issuer and as a Regulated Company.

AWS's independence from its ultimate holding company, AWG, will be, from the Effective Date, enhanced by the inclusion of the following provisions in AWS's articles of association:

- the composition of the board of directors of AWS will include a minimum number of three non-executive directors who are not directors of any company in the AWG Group (outside of the AWS Financing Group) and who are not employees of any company in the AWG Group;
- the board of directors of AWS will not have a majority of executive directors who serve on any other boards within the AWG Group, outside of the AWS Financing Group; and
- any AWS director who serves on any boards of directors within the AWG Group will be disqualified from voting in respect of any contracts, transactions and arrangements between AWS and any other company in the AWG Group (or any subsidiary of it) in which he is interested by virtue of being a director of that other company (save for any contracts,

transactions and arrangements between AWS and the companies in the AWS Financing Group).

Equivalent provisions will be, from the Effective Date, included in the articles of association of the Issuer, AWS Holdings and AWS Overseas Holdings. Subject to the above provisions relating to the composition of the AWS Board, AWG, as ultimate holding company, may appoint the directors of the Board of AWS and of the other companies in the AWS Financing Group. All directors will be entitled to vote on the matter of dividends and distributions to AWG Group companies.

The directors of AWS support high standards of corporate governance and will have due regard to the Combined Code (the Principles of Good Governance and Code of Best Practice appended to the Listing Rules of the Financial Services Authority). To this end, in early 2002, AWS established an Audit Committee. AWS has established management systems to ensure compliance with health and safety and environmental regulations in respect of water quality and sewage disposal. AWS is also subject to the provisions of the Companies Act.

AWS is pursuing a sustainable development strategy and has put in place corporate governance structures to ensure this strategy is implemented and reviewed. A sustainable development report is produced each year which is subject to independent assessment and also to comment by stakeholders including campaign groups and financial institutions.

### ***Directors' Interests***

The interests of the directors of AWS in AWG's share capital are as follows:

<i>Director</i>	<i>Number of Ordinary Shares as at 23 July 2002</i>	<i>Beneficial and Family Interest as at 23 July 2002</i>	<i>Interests in Options as at 23 July 2002</i>
Chris Mellor .....	21,575	97,394	251,833 <sup>(1)</sup>
Roy Pointer .....	25,724	75,099	177,656 <sup>(2)</sup>
Richard Jewson .....	784	—	—
Colin Brown.....	5,615	—	21,759 <sup>(3)</sup>
David Hipple.....	—	—	—
Robert Napier.....	—	—	—
Roger Witcomb.....	—	—	—

Notes:

- (1) Includes 75,819 options under the AWG Group's long-term incentive plan, 173,595 options under its executive share option scheme and 2,419 under its sharesave scheme.
- (2) Includes 49,375 options under the AWG Group's long-term incentive plan, 126,148 options under its executive share option scheme and 2,133 under its sharesave scheme.
- (3) Includes 18,600 options under the AWS Group's long-term incentive plan and 3,159 under its sharesave scheme.

### ***Subsidiaries***

At the Effective Date AWS will have no subsidiaries other than the Issuer.

### **Capitalisation and Indebtedness Statement of AWS**

The following table sets out the capital and reserves and indebtedness of AWS as at 31 March 2002:

	<i>As at 31 March 2002 (£m)</i>
<b>Capital and reserves</b>	
Share capital –	
authorised –	
Ordinary shares of £1 each.....	860.0
Allotted, called up and fully paid –	
Ordinary shares of £1 each.....	860.0
Profit and loss account.....	107.8
<b>Total Shareholders' Funds</b> .....	<b>967.8</b>
<b>Indebtedness<sup>(1)(2)(3)</sup></b>	
Secured –	
Amounts falling due within one year.....	0.1
Amounts falling due after more than one year.....	0.4
Unsecured –	
Amounts falling due within one year.....	244.1
Amounts falling due after more than one year.....	1,526.9
Obligations under finance leases –	
Amounts falling due within one year.....	12.8
Amounts falling due after more than one year.....	187.4
<b>Total Indebtedness</b> .....	<b>1,971.7</b>
<b>Total Capitalisation and Indebtedness</b> .....	<b>2,939.5</b>

Notes:

- (1) The total amount of AW external debt guaranteed by AWS is £804.5 million.
- (2) The total amount of AWS debt guaranteed by a third party is £344.1 million, of which £177.9 million is guaranteed by AWG and £166.2 million is guaranteed by AW.
- (3) AWS has no contingent liabilities.

AWS is an indirect subsidiary of AWG. Its authorised and issued share capital is £860,000,000 divided into 860,000,000 ordinary shares of £1 each. All ordinary shares have been issued and have been fully paid-up.

Save as disclosed herein, there has been no material change in the capitalisation, total indebtedness, guarantees and contingent liabilities of AWS since 31 March 2002.

#### **5.2.2 Anglian Water Services Financing Plc**

The Issuer was incorporated and registered in England and Wales under the Companies Act with limited liability as Precis (2157) Limited, a private limited company, on 28 November 2001 with registered number 4330322. On 10 January 2002, it changed its name to Anglian Water Services Financing Limited. It was re-registered as a public limited company on 7 March 2002. The registered office of the Issuer is at Anglian House, Ambury Road, Huntingdon, Cambridgeshire PE29 3NZ.

The Issuer is a wholly-owned direct subsidiary of AWS and an indirect subsidiary of AWG. Its authorised share capital is £100,000 divided into 100,000 ordinary shares of £1 each and it has an issued share capital of £50,000. 50,000 ordinary shares have been issued, of which 49,998 have been issued quarter paid-up and two are fully paid-up. The Issuer has no subsidiaries.

### ***Directors and Secretary of the Issuer***

The directors of the Issuer are Chris Mellor, Roy Pointer, Colin Brown, David Hipple, Robert Napier, Richard Jewson and Roger Witcomb and their addresses and principal activities are described in 5.2.1, “*AWS Incorporation, Board of Directors and Corporate Governance*”.

The business address of the directors of the Issuer is Henderson House, Ermine Business Park, Huntingdon, Cambridgeshire PE29 6XG.

The secretary of the Issuer is Juana Tinn.

### ***The Activities of the Issuer***

The Issuer has no employees nor does it own any physical assets. Administration and treasury functions are conducted on its behalf by AWS. It is currently intended to conduct all future financing activities (save for financing lease arrangements) for the AWS Financing Group through the Issuer. The Issuer will issue the first series of Bonds on the Effective Date. On or before the Effective Date, the Issuer will enter into: (i) the Debt Service Reserve Liquidity Facility Agreements to enable it to borrow moneys in order to fund liquidity shortfalls in respect of Bonds and other financial indebtedness of the Issuer and the Initial Authorised Loan Facility Agreement; (ii) Hedging Agreements in accordance with the Hedging Policy; (iii) the O&M Reserve Facility Agreement; (iv) the Bridging Facility Agreement; and (v) any other documents incidental to the Programme. See Chapter 7, “*Financing Structure*”.

The Issuer will be, from the Effective Date, empowered under its memorandum and articles of association to enter into the proposed transaction documents to which it is a party and its directors have authority under the Issuer’s articles of association to exercise that power on its behalf.

The Issuer’s auditors are PricewaterhouseCoopers, chartered accountants. No statutory accounts have been prepared or delivered to the Registrar of Companies in England and Wales since the Issuer’s incorporation. Its first statutory accounts will be drawn at and to 31 March 2003, and its accounting reference date will be 31 March of each year.

### ***Capitalisation and Indebtedness Statement of the Issuer***

The capitalisation and indebtedness of the Issuer, as at 23 July 2002, is as follows:

#### **Share Capital**

	£
<i>Authorised:</i>	
100,000 ordinary shares of £1 each.....	100,000
<i>Issued:</i>	
50,000 ordinary shares of £1 each <sup>1</sup> .....	12,502
<b>Total Capitalisation</b> .....	<b>12,502</b>
<b>Indebtedness</b> .....	<b>—</b>
<b>Total Capitalisation and Indebtedness</b> .....	<b>12,502</b>

(1) The issued share capital of the Issuer is 50,000 ordinary shares of £1 each, of which 49,998 have been issued quarter paid-up and two shares are fully paid-up.

Save as disclosed herein, as at 23 July 2002, the Issuer has no loan capital outstanding or created but unissued, no term loans outstanding and no other borrowings or indebtedness in the nature of borrowings guaranteed or unguaranteed, secured or unsecured nor any contingent liabilities.

### 5.2.3 Anglian Water Services Overseas Holdings Limited

AWS Overseas Holdings was incorporated in the Cayman Islands on 16 January 2002 as an exempted company with limited liability, with registered number 115224.

AWS Overseas Holdings is a wholly-owned subsidiary of AWS Holdings and an indirect subsidiary of AWG. Its authorised share capital is £300,000,000 divided into 300,000,000 ordinary shares of £1 each. Currently one share has been issued and is fully paid-up. AWS Overseas Holdings has no other equity or debt capital.

AWS Overseas Holdings has its registered office at P.O. Box 309, Uglund House, South Church Street, George Town, Grand Cayman, Cayman Islands.

#### *Directors and Secretary of AWS Overseas Holdings*

The directors of AWS Overseas Holdings are Chris Mellor, Roy Pointer, Colin Brown, David Hipple, Robert Napier, Richard Jewson and Roger Witcomb and their principal activities are described in 5.2.1, “*AWS Incorporation, Board of Directors and Corporate Governance*”.

The business address of the directors of AWS Overseas Holdings is Henderson House, Ermine Business Park, Huntingdon, Cambridgeshire PE29 6XG.

The secretary of AWS Overseas Holdings is Juana Tinn.

#### *The Activities of AWS Overseas Holdings*

AWS Overseas Holdings will be managed in such a way as to ensure that it is resident for tax purposes in the United Kingdom. AWS Overseas Holdings has no employees nor does it own any physical assets other than its shares in AWS. Administration and treasury functions are conducted on its behalf by AWS and certain third parties, including the Cayman Islands law firm Maples and Calder.

The principal activity of AWS Overseas Holdings is to hold the shares of AWS and to enter into documents incidental to the Programme. AWS Overseas Holdings has no direct subsidiaries other than AWS. AWS Overseas Holdings will be, from the Effective Date, empowered under its memorandum and articles of association to enter into the proposed transaction documents to which it is party and its Directors have authority under the company’s articles of association to exercise that power on its behalf.

The activities of AWS Overseas Holdings will be restricted in the Common Terms Agreement. See Section 7.6.5, “*Financing Structure – Common Terms Agreement – Covenants – General*”.

AWS Overseas Holdings, being an exempted company incorporated with limited liability under the laws of the Cayman Islands, is not obliged by statute but nevertheless has decided to prepare audited accounts. The auditors of AWS Overseas Holdings are PricewaterhouseCoopers, chartered accountants.

#### *Capitalisation and Indebtedness Statement of AWS Overseas Holdings*

The capitalisation and indebtedness of AWS Overseas Holdings, as at 23 July 2002, is as follows:

<b>Share Capital</b>	<b>£</b>
<i>Authorised:</i>	
300,000,000 ordinary shares of £1 each.....	300,000,000
<i>Issued:</i>	
1 ordinary share of £1 each .....	1
<b>Total Capitalisation</b> .....	<b>1</b>
<b>Indebtedness</b> .....	<b>—</b>
<b>Total Capitalisation and Indebtedness</b> .....	<b>1</b>

Note: In creating the AWS Financing Group, on the Effective Date, AWS Overseas Holdings will allot and issue to AW 299,999,999 ordinary shares of £1 each credited as fully paid, after which AW will transfer the entire issued share capital of 300,000,000 ordinary shares to AWS Holdings.



Save as disclosed herein, as at the date of this Offering Circular, AWS Overseas Holdings has no loan capital outstanding or created but unissued, no term loans outstanding and no other borrowings or indebtedness in the nature of borrowings guaranteed or unguaranteed, secured or unsecured, nor any contingent liabilities.

#### **5.2.4 Anglian Water Services Holdings Limited**

AWS Holdings was incorporated in England and Wales under the Companies Act as a limited liability company on 28 November 2001 under the name of Precis (2158) Limited, with registered number 4330144. AWS Holdings changed its name to Anglian Water Services Holdings Limited on 10 January 2002. The registered office of AWS Holdings is at Anglian House, Ambury Road, Huntingdon, Cambridgeshire PE29 3NZ.

AWS Holdings is a wholly-owned direct subsidiary of AW and an indirect subsidiary of AWG. Its authorised share capital is £100 divided into 100 ordinary shares of £1 each. Two ordinary shares have been issued to AW and are fully paid-up.

##### ***Directors and Secretary of AWS Holdings***

The directors of AWS Holdings are Chris Mellor, Roy Pointer, Colin Brown, David Hipple, Robert Napier, Richard Jewson and Roger Witcomb and their principal activities are described in 5.2.1 “*AWS Incorporation, Board of Directors and Corporate Governance*”.

The business address of the directors of AWS Holdings is Henderson House, Ermine Business Park, Huntingdon, Cambridgeshire PE29 6XG.

The secretary of AWS Holdings is Juana Tinn.

##### ***The Activities of AWS Holdings***

AWS Holdings has no employees nor does it own any physical assets other than its shares in AWS Overseas Holdings. Administration and treasury functions are conducted on its behalf by AWS.

The principal activity of AWS Holdings will be, from the Effective Date, to hold the shares of AWS Overseas Holdings and to enter into documents incidental to the Programme. AWS Holdings has no direct subsidiaries other than AWS Overseas Holdings.

AWS Holdings is empowered under its memorandum and articles of association to enter into the proposed transaction documents to which it is a party and its Directors have authority under the company’s articles of association to exercise that power on its behalf.

The activities of AWS Holdings will be restricted in the Common Terms Agreement. See Section 7.6.5, “*Financing Structure – Common Terms Agreement – Covenants – General*”.

AWS Holdings’s auditors are PricewaterhouseCoopers, chartered accountants. No statutory accounts have been prepared or delivered to the Registrar of Companies in England and Wales since AWS Holdings’s incorporation. Its first statutory accounts will be drawn at and to 31 March 2003, and its accounting reference date will be 31 March of each year.

**Capitalisation and Indebtedness Statement of AWS Holdings**

The capitalisation and indebtedness of AWS Holdings, as at 23 July 2002, is as follows:

<b>Share Capital</b>	£
<i>Authorised:</i>	
100 ordinary shares of £1 each.....	100
	<hr/>
<i>Issued:</i>	
2 ordinary shares of £1 each.....	2
	<hr/>
<b>Total Capitalisation</b> .....	<b>2</b>
	<hr/> <hr/>
<b>Indebtedness</b> .....	—
	<hr/> <hr/>
<b>Total Capitalisation and Indebtedness</b> .....	<b>2</b>
	<hr/> <hr/>

Save as disclosed herein, as at 23 July 2002, AWS Holdings has no loan capital outstanding or created but unissued, no term loans outstanding and no other borrowings or indebtedness in the nature of borrowings guaranteed or unguaranteed, secured or unsecured nor any contingent liabilities.

## CHAPTER 6

### INVESTMENT CONSIDERATIONS

The following is a summary of certain aspects of the issue of the Bonds and related transactions about which prospective Bondholders should be aware. The occurrence of one or more of the events discussed below could have a material adverse impact on the business, financial condition or results of operations of the Issuer or the other Obligor or their ability to meet their obligations (including the payment of principal and interest) under the Bonds.

This summary is not intended to be exhaustive and prospective Bondholders should read the detailed information set out elsewhere in this document prior to making any investment decision. Further, any prospective Bondholder should take their own legal, financial, accounting, tax and other relevant advice as to the structure and viability of their investment.

#### 6.1 Regulatory and Competition Considerations

The water industry is subject to extensive legal and regulatory controls, and AWS must comply with all applicable laws, regulations and regulatory standards. The application of these laws, regulations and regulatory standards and the policies of the DGWS could have a material adverse impact on the operations and financial condition of AWS.

In this context, in particular, potential investors should be aware of the following:

##### 6.1.1 Licence

Under the WIA, the conditions of AWS's Licence may be modified by the DGWS with or, following a reference to the Competition Commission which concludes that there are effects adverse to the public interest which can be remedied or prevented by modifications, without the consent of AWS. See Section 11.3.3, "*Regulation of the Water and Sewerage Industry in England and Wales – Modification of a Licence*". In addition, the Secretary of State has a power to veto certain proposed modifications agreed by the DGWS and AWS and other proposed modifications which have been agreed by the DGWS and AWS may be vetoed if it appears to the Secretary of State that the modifications should be made, if at all, after a reference to the Competition Commission (hence causing the DGWS to refer the modifications to the Competition Commission).

The area of appointment of AWS can also be varied in accordance with a so-called "inset" appointment. Modifications to the Licence may also be made without AWS's consent by the Secretary of State by order following an adverse finding by the Competition Commission after it has investigated and reported on a monopoly or merger situation under other enactments. Any restrictive modification to the Licence could have a material adverse impact on AWS.

Ofwat has proposed certain modifications to AWS's Licence concerning procurement of services, control of operations, strengthening of the financial ring-fence, maintenance of an investment grade corporate credit rating, corporate governance and the availability of market and other information. AWS has agreed to consent to such modifications subject to changes agreed with Ofwat and on the basis of representations from Ofwat as to how certain of such new or modified Licence conditions will be interpreted and applied by Ofwat. If the Licence conditions, as modified, are not interpreted and applied in that way this could have a material adverse impact on AWS. See Section 12.2, "*Proposed Modifications to AWS's Licence – Proposed Licence Modifications*".

The period of public consultation on the proposed Licence modifications closed on 8 February 2002. Having considered comments made, Ofwat published its position paper in April 2002 and has confirmed that it is seeking no further modifications of AWS's Licence other than those which were the subject of the consultation and recent discussions with AWS, as described in Section 12.2, "*Proposed Modifications to AWS's Licence – Proposed Licence Modifications*".

A failure by AWS to comply with the conditions of its Licence, as from time to time modified, may lead to the making of an enforcement order by the DGWS or the Secretary of State, which could have an adverse impact on AWS. Failure by it to comply with an enforcement order (as well

as certain other defaults) may lead to the making of a Special Administration Order (as described below). See Section 11.5, “*Regulation of the Water and Sewerage Industry in England and Wales – Special Administration Orders*”.

Under the terms of the Licence, the Secretary of State may terminate AWS’s appointment without its consent on or after 1 September 2014, provided that notice of at least 10 years has been given. Upon expiry of the Licence, there can be no assurance that AWS would be re-appointed. AWS’s Licence may also be transferred from AWS at any time following the making of a Special Administration Order. The termination, non-renewal or transfer of the Licence could have a material adverse impact on AWS, including on its ability to meet its obligations (including the payment of principal and interest) under the Bonds.

### **6.1.2 Draft Water Bill**

On 6 November 2000, a draft Water Bill, which contained certain proposed changes to the regulatory system applicable to the water industry, was published for consultation. One of the most significant proposed changes in the draft Water Bill was a new power for the DGWS and the Secretary of State to fine a Regulated Company up to 10 per cent. of its turnover if it breaches its licence or fails to meet standards of performance or certain other obligations. There was also a proposed amendment to the duties of the DGWS and the Secretary of State who would be required to protect customers’ interests by promoting effective competition in relation to water and sewerage services whenever appropriate as a primary rather than a secondary duty. See Section 11.11, “*Regulation of the Water and Sewerage Industry in England and Wales – The Draft Water Bill*” for further details of these and other proposed changes. In addition, the Water Bill as drafted provides that abstraction licences may in certain circumstances be revoked or modified in the interests of environmental protection. The enactment of legislation including any such modifications could have a material adverse impact on AWS.

### **6.1.3 Competition in the Water Industry**

The Competition Act contains prohibitions relating to anti-competitive agreements and conduct and powers of investigation and enforcement. See Section 11.10, “*Regulation of the Water and Sewerage Industry in England and Wales – Competition in the Water Industry*”. These powers include powers for the DGWS to enforce directions bringing an infringement to an end and to impose fines of up to 10 per cent. of UK group-wide turnover for each year of infringement up to a maximum of three years.

Each Regulated Company under its licence effectively holds a geographical monopoly in its appointed area for the provision of water and sewerage services. However, there is certain limited competition for the provision of water and sewerage services and the UK Government has indicated that it hopes to increase the scope for competition. Furthermore, the DGWS has stated that he will use his powers under the Competition Act to investigate and prohibit anti-competitive practices, agreements and abuses of a dominant position to ensure a level playing field in the industry.

Current and proposed methods for introducing or extending competition are outlined in Section 11.10, “*Regulation of the Water and Sewerage Industry in England and Wales – Competition in the Water Industry*”. It is not possible to assess if, or how, such methods will affect the interests of Bondholders. Either the extension of competition within the water industry or the bringing of proceedings against AWS in respect of its competitive position in the area in which it operates could have a material adverse impact on AWS.

## **6.2 AWS Revenue Considerations**

Although: (i) the DGWS has a duty to exercise his powers in the manner that he considers is best calculated, inter alia, to ensure that AWS is able to finance the proper carrying out of its functions; and (ii) certain changes in circumstances can trigger adjustments to price limits between Periodic Reviews under the Interim Determination provisions of the Licence, as with any Regulated Company, no assurance can be given that the revenues generated by AWS from its water and sewerage business will be sufficient to enable it to make full and timely payment of amounts due, in respect of the Bonds. See Chapter 4, “*AWS Business Description – Customer Charges*”. In addition to the regulatory and competition risks described above which could adversely affect the revenues of AWS, other potential events which could

have a material adverse impact on AWS or result in it having insufficient revenues to meet its financing obligations include:

### **6.2.1 Price Review**

Periodic reviews of price limits are carried out at five yearly intervals by the DGWS. The last review took place in 1999. There is no assurance that current and/or future price limits will permit the generation of sufficient revenues to enable AWS to carry out its functions. Although the methodology introduced in the 1994 review – in particular the derivation of the “regulatory asset value” as the measure of capital to be remunerated – was also applied with modifications in 1999, the DGWS is not required to apply the same or a similar methodology in future reviews. To arrive at his conclusions, the DGWS makes estimates of the scope for operating and capital cost efficiencies using a wide range of comparative techniques. Judgements are also applied in estimating the sector cost of capital and in determining whether or not to make allowance for the “embedded” costs of fixed rate debt. If a Regulated Company disputes the DGWS’s price determination, it may require the DGWS to refer the matter to the Competition Commission for determination by it (after making necessary investigations).

As described in Section 11.8.5, “*Regulation of the Water and Sewerage Industry in England and Wales – Interim Determinations of K*”, Interim Determinations of price limits may be made between five yearly reviews in specified circumstances. In contrast to Periodic Reviews, the methodology to be applied for Interim Determinations is set out in detail in AWS’s Licence and the scope for discretion is narrower. Also, if a Regulated Company disputes the DGWS’s Interim Determination, it can require the DGWS to refer the determination to the Competition Commission. There can, however, be no assurance that if an adjustment is made it will provide adequate revenue compensation to AWS. Either type of determination could have a material adverse impact on AWS.

### **6.2.2 Deviation from DGWS’s Projections**

Under Condition B of the Licence, the RPI+K price cap limits the annual “weighted average increase” in the standard charges of AWS. This, in turn, is calculated by reference to the “tariff basket formula”, which is constructed so as to provide some compensation in respect of certain risks (for example, high rateable value customers opting for a meter), but not others, including movements in the number of customers or movements in volumes consumed/discharged by customers. Accordingly, at Periodic Reviews the DGWS factors into his projections assumptions about numbers of customers and volumes consumed/discharged. Until the following Periodic Review, AWS bears the risk that actual numbers of customers and volumes consumed/discharged will fall short of the assumptions reflected in the RPI+K price cap. See Section 11.8.3, “*Regulation of the Water and Sewerage Industry in England and Wales – Price Control*”.

### **6.2.3 Optional Metering**

The WIA provides that as from 1 April 2000 in the case of a residential customer opting to pay for water services on a metered basis, the Regulated Company may not recover the expenses of installing the meter. Any resulting shift from unmetered to metered use may lead to short-term revenue losses to AWS, although any loss may be mitigated by the treatment of unmetered charges in the tariff basket formula used to calculate the annual change in AWS’s standard charges. See Chapter 3, “*Management’s Discussion and Analysis of Financial Condition and Results of Operations – Metering*”. In 1999 the DGWS determined that the costs and revenue effects of any excess metering above the levels he assumed for each Regulated Company in his five year price determination would be eligible for an Interim Determination. See Section 11.8.5, “*Regulation of the Water and Sewerage Industry in England and Wales – Interim Determinations of K*”. However, in December 2000, Ofwat denied AWS’s application for an Interim Determination in respect of a number of items, including higher than anticipated growth in the number of metered customers and the need for more revenues to pay for increased monitoring of water quality on the grounds that AWS’s additional costs did not pass the materiality threshold in Condition B of the Licence. The shift from unmetered to metered use could have a material adverse impact on the financial condition or operations of AWS.

#### **6.2.4 Weather**

AWS is also at risk during periods of heavy rainfall. Regulated Companies have a duty to undertake works to minimise the risk of damage from sewage flooding. AWS has in place a rolling programme of works to reduce the risk of internal and external sewerage flooding. However, at the last price review in 1999, Ofwat would not allow the cost of AWS's proposed remedial programme to mitigate future sewer flooding and allowed only £1 million (at May 1999) prices. Following this decision, AWS continues to incur certain expenditure in this area in part in response to representations from customers, and is addressing coastal flooding problems as part of a coastal programme to improve the quality of bathing water. See Section 11.9, "*Regulation of the Water and Sewerage Industry in England and Wales – Drinking Water and Environmental Regulation*" below.

As a consequence of the recent decision of the UK Court of Appeal in *Marcic v Thames Utilities Ltd*, handed down on 7 February 2002, sewerage undertakers such as AWS may find themselves liable for damages where discharges of surface or foul water from their sewers cause flooding on customers' land or third party land. Thames Utilities Ltd has been granted leave to appeal to the House of Lords but the appeal is unlikely to be heard until the beginning of 2003. Although it is possible that this decision could be overturned, at the present time, as a result of the Court of Appeal's decision AWS is effectively under a duty to take all reasonably practicable measures to prevent damage caused by such discharges and could find itself liable to pay compensation where damage is caused. Any compensation claims could have a material impact on AWS.

AWS is also at risk from the effects of prolonged periods of drought. If there are supply shortfalls, additional costs may be incurred to provide emergency reinforcement to supplies in areas of shortage. Restrictions on water use may adversely affect revenues from metered customers and may lead to compensation having to be paid to customers who suffer interruptions in supply under Condition Q of the Licence. See Section 11.12.4, "*Regulation of the Water and Sewerage Industry in England and Wales – Guaranteed Standards*".

### **6.3 Certain Legal Considerations**

#### **6.3.1 Security**

AWS's ability to grant security over its assets and the enforcement of such Security are restricted by its Licence and the WIA. The substantial majority of AWS's assets by value are tangible property which is either Protected Land, (as defined in the WIA) and/or are assets which are required for the carrying out of AWS's Regulated Business and cannot therefore be effectively secured (at least, in the case of Protected Land, without the prior consent of the DGWS). The extent of AWS's ability to grant security over its intangible property (including receivables) is also uncertain. In addition, AWS's ability to generate receivables is dependent, in any event on its continuing to hold the Licence.

The DGWS has confirmed that the guarantees given under the Security Documents will not be prohibited under the proposed modifications to Condition F6.11(1A) of AWS's Licence but he has not been asked to consent, and has not consented to, the granting of the Security. The DGWS has requested that AWS and the Issuer make clear to all investors that all security granted by AWS over the assets of the Regulated Business is subject to the WIA and to ensure that all investors understand that this, in effect, means that such security could not be enforced. This reflects the opinion of Ofwat which is not necessarily a definitive statement of the legal position in all respects and circumstances but investors should not over-estimate the value of the security created by AWS nor under-estimate the difficulties that may be incurred if ever they wish to enforce that security.

The Secretary of State and the DGWS have rights under the WIA to appoint a Special Administrator in certain circumstances in respect of AWS and its business. The appointment of a Special Administrator effectively places a moratorium upon any holder of security from enforcing that security. Under the WIA, there is no right to block the appointment of a special administrator equivalent to the right that a holder of a floating charge over the whole or of substantially the whole of the business of a non regulated company has to block the appointment of a conventional Insolvency Act administrator.

There are also certain legal restrictions which arise under the WIA and the Licence affecting the enforcement of the security created under the Security Agreement executed by AWS. For

example, such enforcement is prohibited unless the person enforcing the security has first given 14 days' notice to the DGWS or the Secretary of State hence giving time for him to exercise his rights under the WIA if he is so able and so chooses. See 6.3.2, "*Special Administration*" below. See also Section 11.7, "*Regulation of the Water and Sewerage Industry in England and Wales – Security*".

Accordingly, the security provided over the assets of AWS to the Secured Creditors affords significantly less protection to the Secured Creditors than would be the case if AWS were not a Regulated Company subject to the WIA and its Licence.

The considerations described above do not apply to the fixed and floating charges comprised in the Security Agreement executed by AWS Overseas Holdings, AWS Holdings and the Issuer. The enforcement of security over the shares in any company in the AWS Financing Group, (other than the Issuer) including those granted by any holding company of AWS, would not be subject to the moratorium on the enforcement of security rights imposed upon Secured Creditors under the WIA if a Special Administrator is appointed, nor would the enforcement of those share charges be an event which would itself result in the making of a Special Administration Order. However, it is anticipated that any intended enforcement directly or indirectly of the Security Agreement executed by AWS Overseas Holdings and AWS Holdings or the security over, and subsequently any planned disposal of, the shares in AWS (over which a fixed equitable charge is being granted) would require consultation with the DGWS.

In addition, no notice of the security created pursuant to the Security Documents is to be given to customers of AWS prior to the occurrence of an Event of Default. No charge over AWS's land purported to be granted is intended to be (or, indeed in most cases, capable of being) registered with HM Land Registry and the security interests granted in favour of the Security Trustee over the shares of the Obligors are not to be legally perfected. Such security interests will, until perfected or registered, as the case may be, take effect (if at all) in equity only and thus will be subject to prior equities and certain after acquired legal-rights arising.

If any Obligor were to go into administration or liquidation within two years of the granting of the security then any floating charge created could be invalid except to the extent of monies paid, or services supplied to it at the same time or after the creation of the Security.

As a result, the amount and nature of the security interest provided in respect of the Bonds may not be sufficient to provide payment of amounts due and owing in respect of the Bonds.

### **6.3.2 Special Administration**

The WIA contains provisions enabling the Secretary of State or the DGWS, with the consent of the Secretary of State, to secure the general continuity of water supply by petitioning the Court for the appointment of a Special Administrator in certain circumstances (for example, including where AWS is unable, or is unlikely to be able, to pay its debts or is in breach of the terms of its Licence). In addition, in certain circumstances, a petition by a creditor of AWS to the Court for the winding-up of AWS might result in the appointment of a Special Administrator. See Section 11.5, "*Regulation of the Water and Sewerage Industry in England and Wales – Special Administration Orders*".

During the period of a Special Administration Order, AWS would have to be managed by the Special Administrator for the purposes of the order and in a manner which protects the interests of members, customers and creditors. While the order is in force, no steps may be taken to enforce any security over AWS's property except with the consent of the Special Administrator or the leave of the Court. Subject to the WIA, the Licence and, in particular Condition K, a Special Administrator would be able to dispose of assets free of any floating charge existing in relation to them.

The purposes of a Special Administration Order consist of: (i) transferring to one or more other companies as much of the business of the Regulated Company in Special Administration as is necessary in order to ensure that the functions which have been vested in such Regulated Company by virtue of its licence are properly carried out; and (ii) pending the transfer, the carrying out of those functions. Accordingly, the Special Administrator may not accept an offer to purchase the assets on a break-up basis in circumstances where the purchaser would be unable properly to carry out the relevant functions of a Regulated Company, even if such offer were at a

higher price. See Section 11.5, “*Regulation of the Water and Sewerage Industry in England and Wales – Special Administration Orders*”.

### 6.3.3 Enterprise Bill

In July 2000, the UK Government published a white paper entitled “*Productivity and Enterprise – Insolvency – a Second Chance*” (the “**White Paper**”) in which it proposed a number of reforms to UK legislation relating to bankruptcy. In particular, the White Paper proposed that administrative receivership “*should cease to be a major insolvency procedure*”. Instead secured creditors will be able to appoint an administrator.

On 27 March 2002 the Government published the Enterprise Bill. The Explanatory Notes to the Bill state that inter alia its purpose is to amend insolvency law “by streamlining the administration procedure and restricting the ability of lenders to appoint an administrative receiver to the holders of pre-existing floating charges and certain capital market and other transactions”.

Once these provisions are brought into force a Secured Creditor will only be able to appoint an administrative receiver in the following circumstances: (i) pursuant to a charge created prior to a date to be appointed by the Secretary of State; and (ii) pursuant to an agreement which falls within the ambit of one of certain specified exceptions, one such exception being a “capital market exception” (the final form of which has not yet been settled).

In any event the ability to appoint an administrative receiver to prevent administration (i) is unlikely to be of significance in the case of an entity such as the Issuer which is subject to substantial contractual restrictions on its activities and (ii) will not be relevant in the case of AWS which is a water and sewerage undertaker subject to a special administration regime (but may be relevant in the case of other members of the AWS Financing Group (granting security in respect of AWS’s obligations) which are not water and sewerage undertakers).

The Explanatory Notes also state that the Government intends to “remove the Crown’s preferential rights in all insolvencies and make provision to ensure unsecured creditors are major beneficiaries”. These provisions are set out at Section 242 of the Bill. Under this section the unsecured creditors will have recourse to the floating charge assets up to a fixed amount (the “prescribed part”) in priority to the holder of the floating charge. The prescribed part will be set out by order of the Secretary of State in a statutory instrument. The order will apply to all floating charges created after its commencement regardless as to whether they fall within a prescribed exception or not.

### 6.3.4 Insolvency Act 2000

The UK Insolvency Act 2000 (the “**Insolvency Act 2000**”) received Royal Assent on 30 November 2000 and is due to be brought into force by order of the Secretary of State on a date yet to be appointed. As currently drafted, the Insolvency Act 2000 may limit the Security Trustee’s ability to enforce the security granted by the Obligors under the Bonds since, inter alia, it amends Part I of the UK Insolvency Act 1986 so that a company which meets certain eligibility criteria (an “**eligible company**”) can take steps to obtain a moratorium the effect of which, inter alia, would prevent any creditor enforcing security or taking proceedings to recover its debt for the period in which the moratorium is in force. A court may consider the Issuer to be an eligible company. The Secretary of State has the ability to amend the eligibility criteria by way of statutory instrument and is presently considering whether to use this jurisdiction prior to the commencement of the Insolvency Act 2000 in such a way that special purpose vehicles such as the Issuer, AWS Overseas Holdings and AWS Holdings could no longer be considered to be eligible companies. It is possible that the Secretary of State could in the future extend the eligibility criteria to cover larger companies such as AWS.

## 6.4 Environmental and Insurance Considerations

### 6.4.1 Environmental

AWS’s water supply and sewerage operations are subject to a number of laws and regulations relating to the protection of the environment and human health governed primarily by the DWI and the EA as described in Chapter 11, “*Regulation of the Water and Sewerage Industry in England and Wales*”.



Although AWS believes that it is in material compliance with all such laws and regulations, it is likely that it will in future incur significant costs in complying with upgrading requirements imposed under existing or future laws and regulations. Although the costs of complying with changes in legal requirements are eligible for the purposes of the Interim Determination provisions, there can be no certainty as to how and whether future laws and regulation will impact the business of AWS and/or the interests of the Bondholders. It is possible that a proportion of the costs incurred by AWS in complying with such laws and regulations will not be covered by funding allowed by the regulator and will, therefore, have to be borne directly by AWS.

Given the nature of AWS's operations there is a risk that drinking water quality and environmental pollution incidents may occur, the possible consequences of which may be criminal prosecution leading to the imposition of fines on AWS and/or civil liability in damages to third parties and/or a requirement to clean up any contamination and/or an operational requirement to upgrade plant and equipment. Such incidents could also give rise to prosecutions against the directors of AWS. The imposition of fines, civil liability, clean-up costs or upgrade costs may materially and adversely affect the financial position of AWS. Any such incidents may also give rise to breaches of any operational environmental consents held by AWS. For further information in relation to prosecutions brought against AWS, see Section 11.9, "*Regulation of the Water and Sewerage Industry in England and Wales – Drinking Water and Environmental Regulation*".

There is also a risk that AWS may incur liability to clean up contamination caused by historical activities at its sites, whether or not AWS caused the contamination in question. The costs of cleaning up contamination of land and/or water may be significant. Such contamination may also result in claims by third parties such as neighbouring landowners.

In addition to environmental costs imposed upon AWS by law or regulation, AWS may be subject to additional costs resulting from public concern regarding environmental matters. For example, farms that use sludge from AWS's sewerage operations are increasingly requiring higher levels of treatment of this sludge in response to demands from the buyers of their crops. This in turn results in higher capital and operating costs for AWS.

#### **6.4.2 Insurance**

Although AWS maintains insurance (including business interruption insurance) to protect against certain risks, the proceeds of such insurance may not in certain circumstances be adequate to cover reduced revenues, increased expenses or other liabilities which may arise. Nor is it certain that Complete ring-fencing of AWS's insurance coverage and limits from those of the rest of the AWG Group will only be achieved during 2003. Moreover, there can be no assurance that such insurance coverage will be available in the future at commercially reasonable rates or at all.

### **6.5 Future Financing**

The Issuer will need to raise further debt from time to time in order to finance future capital enhancements to AWS's asset base, to refinance any other debt (including for liquidity or working capital purposes) the terms of which have become inefficient or which have a scheduled partial or final maturity prior to the final maturity of the Bonds and, on each Interest Payment Date on which principal is required to be repaid, and on the expected Maturity Date of the relevant class of Bonds, to refinance Bonds. Whilst the Programme contemplates the terms and conditions on, and circumstances under, which such additional debt can be raised, there can be no assurance that the Issuer will be able to raise sufficient funds, or funds at a suitable interest rate, or on suitable terms, at the requisite time such that all amounts then due and payable on the Bonds or any other maturing debt will be capable of being so paid when due.

In addition, the DGWS has stated that he will assess the cost of debt at future price reviews on the basis of a hypothetical efficiently-financed company. According to the DGWS, such a company would retain the flexibility to respond to changing market conditions, and hold a balanced portfolio of debt. There is no guarantee, therefore, that allowance would be made for the costs of then existing fixed-rate debt if current forward-looking rates at the time were lower, if the DGWS took the view that such debt had not been prudently incurred.

## 6.6 High Leverage

AWS has indebtedness that is substantial in relation to its shareholders equity. As part of this MTN Programme, AWS anticipates issuing new Class A and Class B debt to increase AWS's gross indebtedness to approximately £3.4 billion. The AWS Financing Group is expected to be leveraged to 89 per cent. as a percentage of total debt to RAV. Taking into account retained cash reserves, the net leverage is expected to be up to 86 per cent. of RAV. The ability of AWS to improve its operating performance and financial results will depend upon economic, financial, competitive, regulatory and other factors beyond its control, including fluctuations in interest rates and general economic conditions in the United Kingdom.

The anticipated level of debt of AWS will have several important effects on its future operations, including the following: (a) AWS will have significant cash requirements to service debt; (b) AWS may be restricted in the future from obtaining additional financing, whether for capital expenditures, working capital or other purposes; and (c) AWS will be required to comply with certain financial covenants and other restrictions contained in the Bonds and its other indebtedness, further restricting its financial and operational flexibility.

Accordingly, there can be no assurance as to AWS's ability to meet its financing requirements and no assurance that AWS's high degree of leverage will not have a material adverse impact on its ability to pay amounts that will be due and owing in respect of the Bonds. Incurrence of additional indebtedness by AWS, the Issuer or the Obligors which is permitted under the terms and conditions of the Bonds, may materially affect the ability of AWS, the Issuer or the Obligors to pay amounts due and owing in respect of the Bonds.

## 6.7 Outsourcing Considerations

As described in Chapter 4 under "*AWS Business Description – Outsourcing*", AWS intends to expand its outsourcing activities. In this regard, Ofwat has proposed the inclusion in AWS's Licence of a condition dealing with the procurement of services. Part of this condition requires a procurement plan to be submitted to the DGWS at various intervals, detailing the activities concerned and AWS's plans for ensuring that it will retain control over the outsourced operations. Any outsourcing undertaken by AWS must also be undertaken in compliance with relevant legislation, including procurement legislation. Ofwat's proposed licence modifications prohibit AWS from delegating responsibility for the proper performance of its statutory functions to any contractor. They also preclude AWS, in the event of prosecution for an alleged offence, from raising any defence of due diligence which consisted wholly in it having exercised due diligence in the appointment of its contractors. In the light of these, the expansion of outsourcing activities may expose AWS to a number of additional risks, including (i) the non-performance or insolvency of, or the abandonment of obligations by a contractor, and the failure by AWS to secure a replacement contractor in a timely manner following termination of a contract, any of which may cause AWS to breach its obligations, which may lead to an increase in the number of convictions suffered by AWS and in the amount of fines imposed on it and to other enforcement action; (ii) the possibility that best market prices available for the purposes of any replacement contracts exceed the costs of a previous outsourcing contract, and/or the equivalent amounts assumed by the DGWS at periodic reviews; and (iii) that AWS may breach any of its obligations under any outsourcing contract which would expose it to potentially unlimited liabilities. As a result of the competitive tendering and outsourcing programme, the majority of AWS's employees are likely to be transferred to service providers over the projected five year period of the programme. All transfers will comply with relevant legislation, including TUPE. Whilst AWS will make every effort when selecting contractors to ensure that future employers share AWS's core values in the way in which they treat employees, there can be no assurances that future redundancies will not arise within the contractors' organisations post transfer and it is therefore a possibility that some form of industrial action could result which could have a material adverse impact on AWS. As discussed in Chapter 4, the employee representatives on the Company Collective do not currently support the competitive tendering and outsourcing policy. Discussions are ongoing with the Company Collective to discuss the basis on which they would be involved in the implementation of the outsourcing programme.

## 6.8 Financial Projections and Financial Ratios

### 6.8.1 Financial Projections

The financial projections set out in Chapter 18, "*Financial Information – Illustrative Financial Projections of AWS*" have been prepared for illustrative purposes only. Actual events and circumstances may vary materially from the assumptions. No representation is made or intended,

nor should any be inferred, with respect to the likely occurrence or existence of any particular fact or circumstance. If facts or circumstances occur which are less favourable than those projected, or if the assumptions used in formulating the financial projections prove to be incorrect, AWS may be unable to satisfy its obligations under, inter alia the Intercompany Loan Arrangements, which may result in turn in the Issuer being unable to meet its obligations under the Bonds.

### **6.8.2 Financial Ratios**

The Common Terms Agreement will allow AWS (following a Periodic Review or any material change in the regulation of the water industry in the United Kingdom) to amend any financial ratio contained within the covenants, Trigger Events or Events of Default provided that each Financial Guarantor and the Security Trustee (acting on the instructions of the Majority Creditors) agree and the Rating Requirements have been met.

## **6.9 Issuer and Bond Considerations**

### **6.9.1 Special Purpose Vehicle Issuer**

The Issuer is a special purpose financing entity with no business operations other than the incurrence of financial indebtedness, including the issuance of Bonds, entering into certain Authorised Credit Facilities and lending the proceeds of such financial indebtedness to AWS under the Intercompany Loan Arrangements. The Issuer's principal source of funds will be the funds available to it pursuant to the Authorised Credit Facilities and payments made to it by AWS pursuant to the Intercompany Loan Arrangements. Therefore, the Issuer is, insofar as concerns the Intercompany Loan Arrangements, subject to all the restrictions relating to revenues to which AWS is subject. Such restrictions could limit funds available to AWS to enable it to satisfy in full and on a timely basis its obligations under the Intercompany Loan Arrangements and/or guarantee under the Security Agreement.

### **6.9.2 Bondholder rights subject to STID**

The Bonds are subject to the provisions of the STID. The STID contains provisions enabling the Security Trustee to implement various modifications, consents and waivers in relation to the Finance Documents and the Bonds, subject to Entrenched Rights and Reserved Matters. See Section 7.4.18, "*Financing Structure – Intercreditor Arrangements – Entrenched Rights and Reserved Matters*" below. The Security Trustee is authorised to act on the instructions of the Class A DIG, or following repayment of the Class A Debt, the Class B DIG. A Bondholder (other than (i) a USPP Bondholder holding a certain amount of Class A or Class B USPP Bonds prior to the occurrence of certain events; or (ii) after the occurrence of such events, any holder of USPP Bonds, as the case may be) will not be entitled to vote.

Prior to a Default Situation, the Bond Trustee may vote on behalf of the Unwrapped Bondholders (other than the USPP Bondholders) and (if an FG Event of Default has occurred and is continuing) the Wrapped Bondholders as part of the Instructing Group. However, the Bond Trustee will not be obliged to vote and will not be entitled to convene a meeting of Bondholders to seek directions in respect of such vote. Accordingly, subject to Entrenched Rights and Reserved Matters of the Bondholders, prior to a Default Situation, the Outstanding Principal Amount of the Wrapped Bonds (following the occurrence of an FG Event of Default) and the Unwrapped Bonds (other than the USPP Bonds) will not be voted as part of the Class A DIG or Class B DIG, as the case may be, in circumstances where the Bond Trustee is unable or unwilling to exercise its discretion.

During a Default Situation the Bond Trustee shall be entitled to vote and will be entitled to seek directions from the relevant Bondholders in respect of such vote. However, the Bond Trustee may be prevented from voting if a valid Emergency Instruction Notice is delivered to the Security Trustee. See Section 7.4.9, "*Emergency Instruction Procedure*". In respect of a vote relating to Entrenched Rights and Reserved Matters, the Bond Trustee will be required to seek directions from the Bondholders of each affected Series of Bonds in respect of such vote.

Accordingly, subject to the Entrenched Rights and Reserved Matters of the Bondholders, decisions relating to and binding upon the Bonds may be made by persons with no interest in the Bonds and the Bondholders may be adversely affected as a result. See Section 7.4, "*Financing Structure – Intercreditor Arrangements*".

Under the terms of the STID and the CTA any further issues of debt securities by members of the AWS Financing Group must be made subject to the intercreditor arrangements contained in the CTA and the STID (to which the Bonds are also subject). No alteration of the rights of priority of the holders of Class A Bonds, or, as the case may be, the Class B Bonds may be made without the consent of the relevant Bondholders.

### **6.9.3 Financial Guarantee**

A Financial Guarantor will guarantee to the relevant Class A Wrapped Bondholders and Class B Wrapped Bondholders only the payment of scheduled principal and interest of those Wrapped Bonds it has guaranteed; it will not guarantee the FG Excepted Amounts.

### **6.9.4 Limited Liquidity of the Bonds; Absence of Secondary Market for the Bonds**

Notwithstanding the fact that an application has been made for the Bonds to be admitted to the Official List and for such Bonds to be admitted to trading on the London Stock Exchange market for listed securities, there is currently no market for the Bonds. There can be no assurance that a secondary market will develop, or, if a secondary market does develop for any of the Bonds, that it will provide the holder of the Bonds with liquidity or that any such liquidity will continue for the life of the Bonds. Consequently, any purchaser of the Bonds must be prepared to hold such Bonds for an indefinite period of time or until final redemption or maturity of the Bonds.

The liquidity and market value at any time of the Bonds is affected by, among other things, the market view of the credit risk of such Bonds and will generally fluctuate with general interest rate fluctuations, general economic conditions, the condition of certain financial markets, international political events, the performance and financial condition of AWS, developments and trends in the water industry generally and events in AWS's water supply and sewerage licence areas.

### **6.9.5 Rating of the Bonds**

The ratings assigned to the Class A Wrapped Bonds and the Class B Wrapped Bonds are based solely on the debt rating of MBIA and/or any other Financial Guarantor and reflect only the views of the Rating Agencies. The ratings assigned to the Class A Unwrapped Bonds and the Class B Unwrapped Bonds by the Rating Agencies reflect only the views of the Rating Agencies.

**A rating is not a recommendation to buy, sell or hold securities and will depend, amongst other things, on certain underlying characteristics of the business and financial condition of AWS or, in the case of the Class A Wrapped Bonds and/or Class B Wrapped Bonds of MBIA and/or any other Financial Guarantor from time to time.**

There is no assurance that any such ratings will continue for any period of time or that they will not be reviewed, revised, suspended or withdrawn entirely by the Rating Agencies (or any of them) as a result of changes in, or unavailability of, information or if, in the Rating Agencies' judgement, circumstances so warrant. If any rating assigned to the Bonds is lowered or withdrawn, the market value of the Bonds may be reduced. Future events, including events affecting AWS and/or circumstances relating to the water industry generally, could have an adverse impact on the ratings of the Bonds.

Where any Rating Agency is requested to confirm the then current ratings of the Bonds, or the shadow ratings of the Wrapped Bonds, or to confirm that such ratings or shadow ratings will not be downgraded following any particular event, or that a particular act or omission meets certain criteria of the Rating Agency, such confirmation may or may not be given at the sole discretion of the Rating Agency. Furthermore, it may not be possible or practicable for the Rating Agency to give such confirmation or to do so within any particular time period.

Confirmation, if and when given, will be given on the basis of the facts and circumstances prevailing at the relevant time, and in the context of cumulative changes to the transactions contemplated under the Programme since the Effective Date.

No assurance can be given that a requirement to seek any such confirmation from a Rating Agency will not have a subsequent impact upon the business of any member of the AWS Financing Group.

A confirmation of ratings represents only a restatement of the opinions given at the Effective Date, and cannot be construed as advice for the benefit of any parties to the transactions contemplated under the Programme.

#### **6.9.6 Withholding Tax under the Bonds**

In the event withholding taxes are imposed by or in any jurisdiction in respect of payments due under the Bonds, the Issuer is not obliged to gross-up or otherwise compensate Bondholders (except for holders of USPP Bonds (as defined herein)) for the fact that the Bondholders will receive, as a result of the imposition of such withholding taxes, cash amounts which are less than those which would otherwise have been the case. The Issuer will, in such event, have the option (but not the obligation) of: (i) redeeming all outstanding Bonds in full; (ii) arranging for the substitution of another company in an alternative jurisdiction (subject to certain conditions); or (iii) taking such other appropriate action as is reasonable to mitigate such tax. The Issuer's option described in the preceding sentence will not apply to the USPP Bonds. See Chapter 9, "*Terms and Conditions of the Bonds*".

Likewise, in the event withholding taxes are imposed in respect of payments due under the Wrapped Bonds and MBIA and/or any other Financial Guarantor is called upon under any Bond Policy to make payments in respect of such payments, neither MBIA nor such other Financial Guarantor is obliged to gross-up or otherwise compensate Wrapped Bondholders for the fact that such Wrapped Bondholders will receive, as a result of the imposition of such withholding taxes, cash amounts which are less than those which would otherwise have been the case.

#### **6.9.7 Adoption of Proposed European Directive on the Taxation of Savings**

The EU is currently considering proposals for a new directive regarding the taxation of savings income. Subject to a number of important conditions being met, it is proposed that a Member State will be required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to an individual resident in that other Member State, subject to the right of certain Member States to opt instead for a withholding system for a transitional period in relation to such payments.

#### **6.9.8 Change of Law**

The structure of the transaction and, inter alia, the issue of the Bonds and ratings assigned to the Bonds are based on law, tax and administrative practice in effect at the date hereof, and having due regard to the expected tax treatment of all relevant entities under such law, tax and administrative practice. No assurance can be given that there will not be any change to such law, tax or administrative practice after the Effective Date which change might impact on the Bonds and the expected payments of interest and repayment of principal.

#### **6.9.9 European Monetary Union**

Prior to the maturity of the Bonds, the UK may become a participating member state in the Economic and Monetary Union and the euro may become the lawful currency of the UK. Adoption of the euro by the UK may have the following consequences: (i) all amounts payable in respect of the Sterling denominated Bonds may become payable in euro; (ii) the introduction of the euro as the lawful currency of the United Kingdom may result in the disappearance of published or displayed rates for deposits in sterling used to determine the rates of interest on the Bonds or changes in the way those rates are calculated, quoted and published or displayed; and (iii) the Issuer may choose to redenominate the Bonds into euro and take additional measures in respect of the Bonds. The introduction of the euro could also be accompanied by a volatile interest rate. It cannot be said with certainty what effect, if any, adoption of the euro by the United Kingdom will have on investors in the Bonds.

#### **6.9.10 Hedging Risks**

The Issuer may be left exposed to interest rate risk or currency risk in the event that there is an early termination of a Hedging Agreement. A Hedging Agreement may be terminated in the circumstances described in Section 7.11, "*Hedging Agreements*". If a Hedging Agreement is terminated and the Issuer is unable to find a replacement Hedge Counterparty, then the funds available to the Issuer may be insufficient to meet fully its obligations under the Bonds.

### 6.9.11 Subordination of Class B Notes

The Class A Bonds and other Class A Debt will rank in priority to payments of principal and interest due on all Series of the Class B Bonds.

If, on any Interest Payment Date, prior to delivery of an Enforcement Notice, there are insufficient funds available to pay accrued interest on the Class B Bonds the Issuer's liability to pay such accrued interest will be treated as not having fallen due and will be deferred until the earlier of (i) the next following Interest Payment Date on which the Issuer has, in accordance with the cash management provisions of the CTA, sufficient funds available to pay such deferred amounts (including any interest accrued thereon); and (ii) the date upon which all Class A Debt has been paid in full. Interest will, however, accrue on such deferred interest.

Notwithstanding the subordination of, and credit enhancement provided by, the Class B Bonds to the Class A Debt the Issuer may optionally redeem some or all of the Class B Bonds provided that the original issue ratings assigned by any two of the Rating Agencies rating the Class A Bonds and the Class B Bonds would not be adversely affected.

It should be noted that all of the Payment Dates for the various different types of Class A Debt and Class B Debt will not necessarily coincide and that, until a Standstill Period has commenced, there is no obligation to ensure that a payment made to a Class B Bondholder pursuant to the Bond Trust Deed (or any other Class B Debt Provider pursuant to any other Class B Debt) will not lead to a deficiency of funds to make payments in respect of Class A Debt that fall due on a later date.

### 6.10 Catastrophe Risk

Catastrophic events such as dam bursts, fires, earthquakes, floods, droughts, terrorist attacks, diseases, plant failure or other similar events could result in personal injury, loss of life, pollution or environmental damage, severe damage or destruction of AWS's water or sewage treatment works, pumping stations, water mains, sewers or service pipes. Any resulting damage or suspension of operations of AWS, to the extent not covered by insurance, could have a material adverse impact on the ability of AWS to meet its financing and regulatory obligations.

**The Issuer believes that the risks described above are the principal risks inherent in the Programme. However, the inability of the Issuer to pay interest or repay principal on the Bonds, or the ability of MBIA or any other Financial Guarantor to pay scheduled interest or repay scheduled principal on the Class A Wrapped Bonds and/or the Class B Wrapped Bonds, may occur for other reasons, and the Issuer does not represent that the above statements of the risks of holding the Bonds are exhaustive. While the various structural elements described in this document are intended to lessen some of these risks for holders of the Bonds, there can be no assurance that these measures will ensure that the holders of the Bonds receive payment of interest or repayment of principal from the Issuer in respect of such Bonds, or from MBIA or any other Financial Guarantor in respect of the Class A Wrapped Bonds and/or the Class B Wrapped Bonds on a timely basis or at all.**

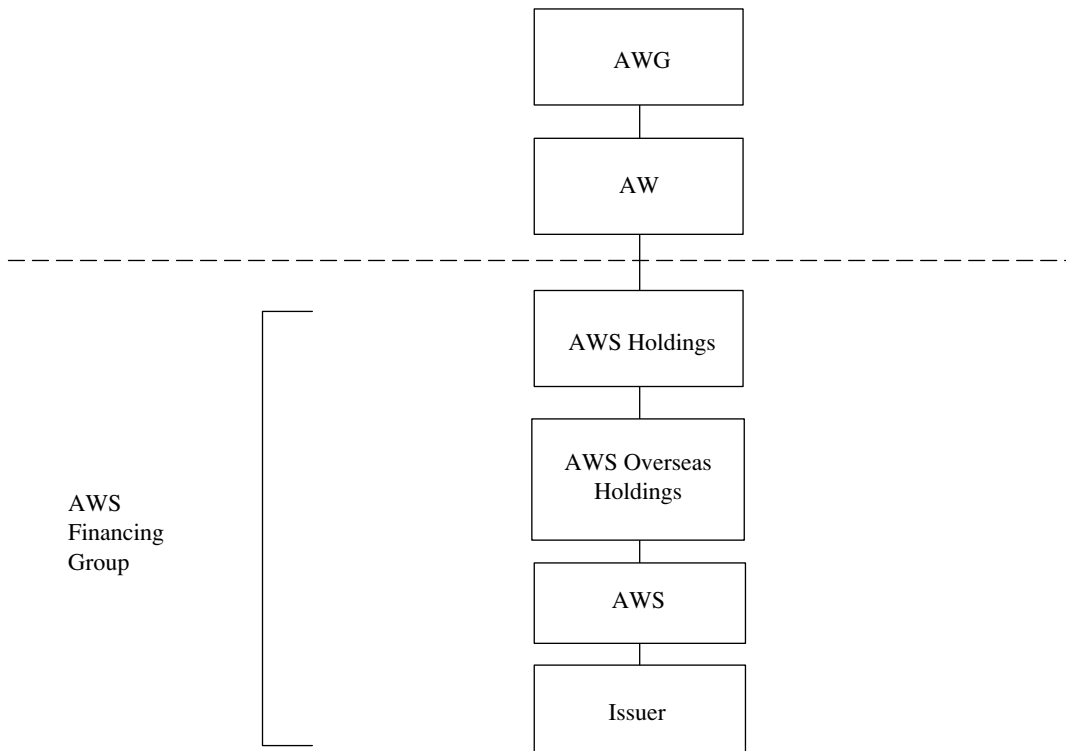
## CHAPTER 7

### FINANCING STRUCTURE

#### 7.1 The AWS Financing Group

AWG is proposing to implement a significant corporate restructuring and financing through the creation of the new AWS Financing Group within the AWG Group. The AWS Financing Group consists of AWS Holdings, AWS Holdings' wholly-owned subsidiary, AWS Overseas Holdings, AWS Overseas Holdings' wholly-owned subsidiary, AWS and AWS's wholly-owned subsidiary, Anglian Water Services Financing plc (see diagram, "*Ownership Structure of AWS Financing Group*" below). The creation of the AWS Financing Group within the AWG Group will facilitate the refinancing and future financing of AWS through, inter alia, the issuance of Bonds and other financial indebtedness incurred by the Issuer. AW's and/or AWS's obligations under the Existing Bonds and the Transferred USPP Bonds (and the rights and obligations under Hedging Agreements hedging those Bonds) will be transferred to the Issuer in return for the granting by AWS of loan notes in favour of the Issuer and the assignment to the Issuer and the amendment of certain existing intercompany loans. Further, the Issuer will be funded by proceeds of Bonds issued under the Programme and other financial indebtedness (which may include the Bridging Facility). This will be lent by the Issuer to AWS pursuant to the Issuer/AWS Loan Agreement (see 7.5, "*Intercompany Loan Arrangements*" below). AWS will on-lend certain of the moneys borrowed by it from the Issuer to AWS Holdings pursuant to an interest-bearing loan and AWS Holdings will use the proceeds of the borrowings to satisfy its obligations to pay to AW the consideration for the acquisition by it of shares in AWS Overseas Holdings. AWS will retain approximately £205 million to fund cash and certain reserves required to be maintained by it. The balance of the proceeds will be used by AWS to settle debt not transferring to the new AWS Financing Group, to pay transaction costs, and to settle outstanding intra-group indebtedness.

#### Ownership Structure of AWS Financing Group



## 7.2 Sources of Funds and Debt Transfer

### 7.2.1 Sources of funds

On the Effective Date the Issuer will have available to it financial accommodation from the following sources:

- (i) the Bridging Facility;
- (ii) the Bonds issued for cash on the Effective Date;
- (iii) the Initial Authorised Loan Facility;
- (iv) the Existing Hedging Agreements;
- (v) the Debt Service Reserve Liquidity Facilities; and
- (vi) the O&M Reserve Facility.

The Issuer is also permitted, subject to the terms of the Common Terms Agreement to incur additional Permitted Financial Indebtedness including issuing Bonds under the Programme and such additional Permitted Financial Indebtedness may either be secured Class A Debt or Class B Debt (provided the lender accedes to the CTA and STID) (see 7.4, “*Security Trust and Intercreditor Deed*” and 7.6, “*Common Terms Agreement*”).

The Issuer may also (subject to the terms of the CTA) enter into certain unsecured financing arrangements.

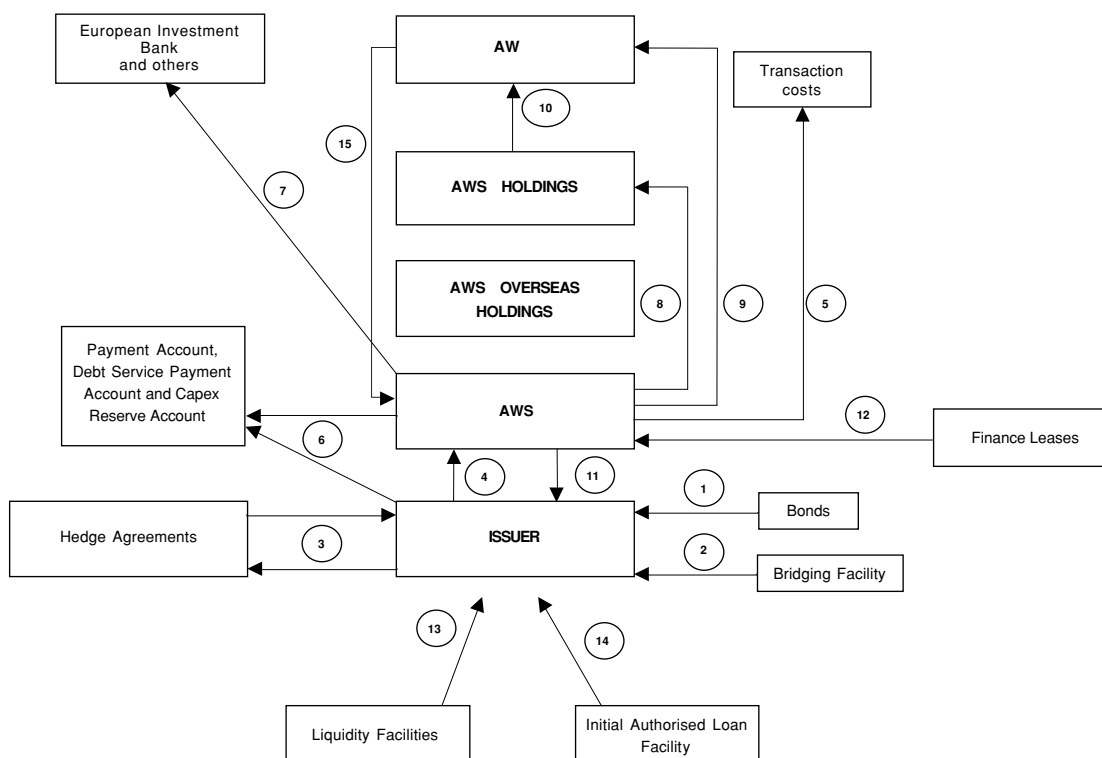
All monies borrowed by the Issuer will be automatically on-lent to AWS under the Intercompany Loan Arrangements (see 7.5, “*Intercompany Loan Arrangements*”). The Intercompany Loan Arrangements will provide for payments to become due from AWS to the Issuer on dates and in amounts that match the obligations of the Issuer to its various financiers under its financial arrangements plus a management fee. To further reinforce the ability of the income of AWS to be utilised in repayment of the Issuer’s debt, AWS has guaranteed the obligations of the Issuer to the Secured Creditors and has executed a Security Agreement in favour of the Security Trustee to secure its obligations under that guarantee (see 7.8, “*Security Agreement*”).

The financial accommodation available to the AWS Financing Group will also include Finance Leases which will be made available to AWS. The purpose of the guarantee referred to above and the provisions of the STID are, inter alia, to prevent any structural subordination of other Secured Creditors to the Finance Lessors that may otherwise result.

Hedging arrangements will be entered into by the Issuer and the effect of these will be passed on to AWS via the Intercompany Loan Arrangements (see 7.5, “*Intercompany Loan Arrangements*”).



## 7.2.2 Cashflow and Debt Structure on Effective Date



### Notes

The steps described below all relate to the cashflow and debt structure of the AWS Financing Group on the Effective Date:

1. receive net proceeds of new Bonds issued for cash on the Effective Date;
2. receive proceeds of any drawdown under Tranche A of the Bridging Facility;
3. swap any proceeds received in a currency (other than Sterling) for Sterling;
4. loan the proceeds of the Bonds and of any drawdown under the Bridging Facility to AWS under the Issuer/AWS Loan Agreement;
5. pay fees of MBIA and other costs associated with the financing arrangements described in this Offering Circular (including any related debt transfer costs);
6. fund the initial payments into the Payment Account and Capex Reserve Account of AWS and the Debt Service Payment Account of the Issuer;
7. repay the European Investment Bank loans and certain of the USPP Bonds issued pursuant to the Note Purchase Agreement;
8. loan an amount equal to the purchase price for shares in AWS Overseas Holdings pursuant to the UK HoldCo/AWS Loan;
9. repay existing intercompany debt;
10. pay the purchase price for shares in AWS Overseas Holdings;
11. AWS issues the loan notes and procures the assignment and amendment of certain existing intercompany loans, in each case to the Issuer as consideration for the assumption by the Issuer of the primary obligations under the Existing Bonds, the Transferred USPP Bonds and the related Hedging Agreements;
12. existing Finance Leases remain with AWS subject to the provisions of the CTA and STID;
13. Debt Service Reserve Liquidity Facilities and O&M Reserve Facility made available to the Issuer for debt service and certain operating and maintenance expenditure requirements;
14. Initial Authorised Loan Facility made available to the Issuer for working capital and capital expenditure requirements; and
15. amount to be paid to AWS by AW as consideration for AWS assuming certain of AW's indebtedness which has not been on-lent to AWS.

## 7.2.3 Debt Transfer

On the Effective Date the Issuer will be substituted as the issuer in respect of the Existing Bonds (previously issued by AW pursuant to the Existing Bond Trust Deeds) pursuant to a prior consent solicitation of the holders of such Existing Bonds. In addition the Issuer will issue the Transferred USPP Bonds (other than the USPP 2001 Bonds) under the Programme to the relevant holders thereof in exchange for the related bonds held by such holders and previously issued by AW, pursuant to exchange agreements entered into between the Issuer, AW and such holders on or around the Effective Date. The Issuer will also assume pursuant to an assumption agreement

executed in accordance with the terms of the Note Purchase Agreement, all the obligations of AWS in respect of the USPP 2001 Bonds. The consideration for the assumption by the Issuer of the primary obligations under the Existing Bonds, the Transferred USPP Bonds, and the related Hedging Agreements shall be the issue by AWS to the Issuer of the loan notes and the assignment to the Issuer and amendment of certain existing intercompany loans (AWS having been simultaneously released by AW from intercompany indebtedness in an amount corresponding to such Existing Bonds and Transferred USPP Bonds (other than the USPP 2001 Bonds)) (see 7.5.1, “AWS Loan Notes”).

### 7.3 Description of the Bridging Facility

The Issuer entered into a Bridging Facility with Barclays Bank PLC and Citibank, N.A. on 18 April 2002.

The Bridging Facility comprises a loan of (i) tranche A, up to £750,000,000 to finance the purposes set out below (“**Tranche A**”) and (ii) tranche B, of up to £320,000,000 to enable AWS to fulfil its obligation under the CTA to ensure that a facility in an amount equal to the Maximum Early Redemption Amount is available to the Issuer to be drawn to fund payments of the Make-Whole Amount following an Early Redemption Event under the USPP 2001 Bonds (see 7.6.5(iv)(x) “Covenants – General” below) (“**Tranche B**”).

Tranche A of the Bridging Facility is divided into two. Tranche A1 in a maximum amount of £375,000,000 (“**Tranche A1**”) is a 364 day facility that gives the Borrower the opportunity to select a 6-month interest period in respect of all amounts outstanding on the last day of the Bridging Facility; and tranche A2 in a maximum amount of £375,000,000 (“**Tranche A2**”) is available for drawing for 364 days but if drawn may be borrowed for up to 5 years from 22 March 2002.

Tranche B is a 364 day facility that operates in the same manner as Tranche A1.

Each tranche of the Bridging Facility bears interest at a rate over LIBOR from time to time.

The conditions to drawdown under the Bridging Facility are set out in the CP Document. Drawings under the Bridging Facility will be on-lent to AWS. Tranche A of the Bridging Facility will be utilised by AWS for the following purposes:

- (i) will be utilised to repay existing credit facilities of AWS not transferring into the new AWS Financing Group;
- (ii) to fund the Capex Reserve Account, Debt Service Reserve Account, and any other Account requiring funding on the Effective Date or on the Issue Date;
- (iii) to pay all costs, fees and expenses due and payable by the Obligors in connection with the financing arrangements described in this Offering Circular; and
- (iv) the remainder will be on-lent to AWS Holdings in order that AWS Holdings may pay part of the consideration required to be paid by AWS Holdings to AW for the purchase of AWS Overseas Holdings, which funds will be utilised by AW or AWG to repay credit facilities or debt not transferring to the new AWS Financing Group and/or for working capital purposes.

Of Tranche A, £150,000,000 will be Class B Debt. The remainder of amounts drawn under the Bridging Facility will be Class A Debt.

The Class B Debt will be on-lent by the Issuer to AWS and by AWS to AWS Holdings. AWS Holdings will utilise such sums to pay part of the consideration for the purchase of AWS Overseas Holdings. AW will utilise those funds only for its working capital requirements and those of its subsidiaries or will pass such funds to AWG for AWG’s working capital purposes. AW and AWG will, pursuant to a deed of charge, guarantee the Class B Debt made available under the Bridging Facility and will secure that obligation by placing moneys (up to a maximum of £150,000,000) into a secured bank account with the Account Bank whilst ensuring that they will have sufficient cash available to meet working capital requirements and meet demands from their creditors. The guarantee and security in respect of the Class B Debt made available under the Bridging Facility will (notwithstanding standstill provisions in the STID) be enforceable by the Bridging Facility Providers alone if (a) an Event of Default occurs in respect of AWS; (b) AW or AWG becomes insolvent or steps are taken for its winding up; (c) AW or AWG defaults on its other indebtedness; (d) AW or AWG utilises the funds made available to it to acquire any shares or

business or otherwise outside its usual course of trading without consent; or (e) AWG pays a dividend in excess of its publicly stated dividend policy as at 22 March 2002, provided that, in such circumstances, the accelerated claim is limited to the value realised from the Security granted by AW and AWG under a deed of charge. There is no obligation upon the Bridging Facility Providers to share the proceeds of such Security with other Class A Debt Providers or Class B Debt Providers.

## 7.4 Security Trust and Intercreditor Deed

### 7.4.1 General

The intercreditor arrangements in respect of the AWS Financing Group (the “**Intercreditor Arrangements**”) are contained in the STID and the CTA. The Intercreditor Arrangements bind each of the Secured Creditors and each of the Obligor.

The Secured Creditors will include the Class A Debt Providers and the Class B Debt Providers. Any new Authorised Credit Provider (or in respect of Bondholders (other than holders of the USPP 2001 Bonds), the Bond Trustee) will be required to accede to the STID and the CTA as a Class A Debt Provider or a Class B Debt Provider. The Local Authority Loan will not be subject to the Intercreditor Arrangements.

Unsecured creditors will not become parties to the Intercreditor Arrangements and although ranking behind the Secured Creditors in an administration or other enforcement will have unfettered, independent rights of action in respect of their debts. However, the aggregate amount of unsecured debt will be restricted to levels acceptable to the Secured Creditors. See 7.6, “*Common Terms Agreement*”.

The purpose of the Intercreditor Arrangements is to regulate, inter alia: (i) the claims of the Secured Creditors; (ii) the exercise, acceleration and enforcement of rights by the Secured Creditors; (iii) the rights of the Secured Creditors to instruct the Security Trustee; (iv) the rights of the Secured Creditors during a Standstill Period (see 7.4.13, “*Standstill*” below); (v) the Entrenched Rights and the Reserved Matters of the Secured Creditors; and (vi) the giving of consents and waivers and the making of modifications to the Finance Documents.

The Intercreditor Arrangements provide for the ranking in point of payment of the claims of the Secured Creditors and for the subordination of all intra AWS Financing Group claims (other than claims in respect of the Intercompany Loan Arrangements).

### 7.4.2 Undertakings of Secured Creditors

Pursuant to the terms of the STID, each Secured Creditor (other than the Security Trustee and the Bond Trustee) will undertake that it will not, unless the Majority Creditors otherwise agree:

- (i) permit or require any Obligor to discharge any of the Secured Liabilities owed to it, save to the extent permitted by the CTA and the STID;
- (ii) permit or require any Obligor to pay, prepay, repay, redeem, purchase, early or voluntarily terminate or otherwise acquire any of the Secured Liabilities owed to it, save to the extent permitted by the CTA and the STID;
- (iii) other than the security granted by AW and AWG in respect of the Class B Debt portion of the Bridging Facility, take, accept or receive the benefit of any security interest, guarantee, indemnity or other assurance against financial loss from any of the Obligors in respect of any of the Secured Liabilities owed to it, except the Security and the Bond Policies or pursuant to the terms of the Finance Documents;
- (iv) take or receive from any of the Obligors by cash receipt, set-off, any right of combination of accounts or in any other manner whatsoever, the whole or any part of the Secured Liabilities owed to it, save to the extent permitted by the CTA and the STID; or
- (v) except as described in 7.4.5, “*Modifications, Consents and Waivers*” below, agree to any modification to, or consent or waiver under or in respect of, the Finance Documents to which it is a party.

### 7.4.3 Undertakings of Obligors

- (i) Pursuant to the terms of the STID, each Obligor will undertake that it will not, unless the Majority Creditors otherwise agree:
  - (a) discharge any of the Secured Liabilities owed by it, save to the extent permitted by the CTA and the STID;
  - (b) pay, prepay, repay, redeem, purchase, early or voluntarily terminate or otherwise acquire any of the Secured Liabilities owed by it, save to the extent permitted by the CTA and the STID;
  - (c) other than pursuant to the Security granted by AW and AWG pursuant to the Class B portion of the Bridging Facility create or permit to subsist any Security Interest over any of its assets for, or any guarantee, indemnity or other assurance against financial loss in respect of, any of the Secured Liabilities owed by it, except the Security and the Bond Policies or pursuant to the terms of the Finance Documents;
  - (d) discharge any of the Secured Liabilities by cash payment, set-off, any right of combination of accounts or in any other manner whatsoever, save to the extent permitted by the CTA and the STID;
  - (e) without the consent of the Security Trustee or, where applicable, each relevant Secured Creditor (as described in 7.4.5, “*Modifications, Consents and Waivers*” below), agree to any modification to, or consent or waiver under or in respect of, any term of any Finance Document to which it is a party; or
  - (f) take or omit to take any action whereby any subordination contemplated by the STID may be impaired.
  
- (ii) In addition, pursuant to the terms of the STID, each Obligor will undertake that it will not until all the Secured Liabilities have been discharged in full, unless the Majority Creditors otherwise agree:
  - (a) discharge any of the Subordinated Liabilities owed by it or require any other Obligor to discharge any of the Subordinated Liabilities owed to it, save to the extent permitted by the CTA and the STID;
  - (b) pay, prepay, repay, redeem or make any distribution in respect of, or purchase or acquire, any of the Subordinated Liabilities owed by it or permit any other Obligor to do so in respect of any of the Subordinated Liabilities owed to it;
  - (c) create or permit to subsist any Security Interest over any of its assets for, or any guarantee, indemnity or other assurance against financial loss in respect of, any of the Subordinated Liabilities owed by it or take, accept or receive the benefit of any Security Interest for, or any guarantee, indemnity or other assurance against financial loss in respect of, any of the Subordinated Liabilities owed to it;
  - (d) discharge any of the Subordinated Liabilities owed by it by cash payment, set-off, any right of combination of accounts or in any other manner whatsoever or take or receive from, or permit the discharge by, any of the Obligors by cash receipt, set-off or in any other manner whatsoever, the whole or any part of the Subordinated Liabilities owed to it; or
  - (e) take or omit to take any action whereby the subordination contemplated by the STID may be impaired.

The Obligors shall (unless the Security Trustee directs otherwise) be entitled without Majority Creditor consent to pay any scheduled amounts due and payable pursuant to the terms of the UK Holdco/AWS Loan and/or the Intercompany Loan Arrangements.

#### 7.4.4 Ranking of Secured Liabilities

The underlying principle of the Intercreditor Arrangements is that the Class A Debt will rank in point of payment prior to any payment in respect of the Class B Debt at all times (including both prior to and during any Standstill Period, after acceleration of the Secured Liabilities and upon any enforcement of the Security). Prior to a Standstill Period payment dates for Class A Debt and Class B Debt may fall on different dates.

#### 7.4.5 Modifications, Consents and Waivers

Subject to the Entrenched Rights and Reserved Matters (see 7.4.18, “*Entrenched Rights and Reserved Matters*”), the Security Trustee shall only agree to any modification of or grant any consent or waiver under the Finance Documents or (subject to restrictions during a Standstill Period) take Enforcement Action with the consent of or if so instructed by the Majority Creditors. Not all proposals which require the consent of the Majority Creditors will be sent to all Secured Creditors (or their Secured Creditor Representatives, as the case may be). In certain circumstances, the Security Trustee is authorised to consult with the DIG Representatives only.

Subject to the Entrenched Rights and Reserved Matters (see 7.4.18, “*Entrenched Rights and Reserved Matters*”), the Security Trustee may make modifications to the Finance Documents without the consent of any other Secured Creditor if such modifications are to correct manifest errors or are of a formal, minor or technical nature.

#### 7.4.6 Class A Debt Instructing Group

Both prior to and during any Standstill Period, after acceleration of the Secured Liabilities and upon any enforcement of the Security, only the Qualifying Class A Debt Providers will be eligible to exercise the rights of the Majority Creditors. Prior to repayment in full of the Class A Debt, decisions of such Majority Creditors will bind all of the Secured Creditors in all circumstances, save for certain Entrenched Rights and Reserved Matters that are fundamental to particular Secured Creditors (see 7.4.18, “*Entrenched Rights and Reserved Matters*” below).

The Qualifying Class A Debt Providers will exercise their rights through the following representatives which will together be entitled to vote on certain proposals as part of the “**Class A Debt Instructing Group**” or the “**Class A DIG**”. The Class A DIG will be comprised of the following representatives (each, a “**Class A DIG Representative**”):

- (i) in respect of each Series of Class A Wrapped Bonds (if no FG Event of Default has occurred and is continuing), the Financial Guarantor;
- (ii) in respect of each Series of Class A Wrapped Bonds (after an FG Event of Default has occurred and is continuing in respect of the Financial Guarantor of those Class A Wrapped Bonds) and each Series of Class A Unwrapped Bonds (other than USPP Bonds), the Bond Trustee;
- (iii) in respect of Class A USPP Bonds, (a) prior to the occurrence of an Event of Default, any USPP Bondholder who has outstanding to it or any of its affiliates more than US\$70,000,000 of Class A USPP Bonds or (b) after an Event of Default has occurred and is continuing, any USPP Bondholder;
- (iv) in respect of Tranche A1 and Tranche B and the Class A portion of Tranche A2 of the Bridging Facility, the Bridging Facility Agent;
- (v) in respect of the Initial Authorised Loan Agreement, the Initial Authorised Credit Facility Agent;
- (vi) in respect of any Existing Finance Leases, the relevant Finance Lessor; and
- (vii) in respect of any other Secured Liabilities of the type referred to in paragraphs (i) to (vi) above or (with the approval of the Majority Creditors) other types of Secured Liabilities that rank *pari passu* with all other Class A Debt, the relevant representative appointed under the terms of the relevant Finance Document and named in the relevant Accession Memorandum to the STID and the CTA as the Class A DIG Representative.

Each Class A DIG Representative will be required to provide an indemnity to the Security Trustee each time it votes as part of the Class A DIG irrespective of whether it is a Majority Creditor.

Unless a Default Situation has occurred and is continuing, the Bond Trustee shall not be entitled to convene a meeting of any Series of Bonds to consider any proposal to be voted on by the Class A DIG.

Decisions of the Majority Creditors will be determined by votes on a pound for pound basis (based on the Outstanding Principal Amount of the Qualifying Class A Debt voted by the Class A DIG Representatives). Subject to Entrenched Rights and Reserved Matters, the Security Trustee will be entitled to act on the instructions of the Majority Creditors of those Class A DIG Representatives which have actually voted by the specified date for voting which must be not less than 10 business days (or in certain circumstances 5 business days) (or, where the Bond Trustee is a DIG Representative and a Default Situation is continuing (subject to the Emergency Instruction Procedure – see 7.4.9, “*Emergency Instruction Procedure*” below), such later date (not later than 2 months after such date) as is requested of the Security Trustee by the Bond Trustee should the Bond Trustee consider it necessary to convene a meeting of any one or more Series of Bondholders to seek directions) or, if earlier, as soon as Class A DIG Representatives in respect of more than 50 per cent. of the Qualifying Class A Debt have voted in favour of the relevant proposal.

#### **7.4.7 Class B Debt Instructing Group**

Following repayment in full of the Class A Debt, the Qualifying Class B Debt Providers will be eligible to exercise the rights of the Majority Creditors. After repayment in full of the Class A Debt, decisions of such Majority Creditors will bind all of the Secured Creditors in all circumstances, save for certain Entrenched Rights and Reserved Matters that are fundamental to particular Secured Creditors. See 7.4.18, “*Entrenched Rights and Reserved Matters*”.

The Qualifying Class B Debt Providers will exercise their rights through a group of representatives which will together be entitled to vote on certain proposals as part of the “**Class B Debt Instructing Group**” or the “**Class B DIG**”. The Class B DIG will be comprised of the following representatives (each, a “**Class B DIG Representative**”):

- (i) in respect of each Series of Class B Wrapped Bonds (if no FG Event of Default has occurred and is continuing), the Financial Guarantor;
- (ii) in respect of each Series of Class B Wrapped Bonds (after an FG Event of Default has occurred and is continuing in respect of the Financial Guarantor of those Class B Wrapped Bonds) and each Series of Class B Unwrapped Bonds, the Bond Trustee;
- (iii) in respect of the Class B portion of Tranche A2 of the Bridging Facility, the Bridging Facility Agent; and
- (iv) in respect of any other Secured Liabilities of the type referred to in paragraphs (i) to (iii) above or (with the approval of the Majority Creditors) other types of Secured Liabilities that rank pari passu with all other Class B Debt, the relevant representative appointed under the terms of the relevant Finance Document and named in the relevant Accession Memorandum as the Class B DIG Representative.

Each Class B DIG Representative will be required to provide an indemnity to the Security Trustee each time it votes as part of the Class B DIG irrespective of whether it is a Majority Creditor.

Unless a Default Situation has occurred and is continuing, the Bond Trustee shall not be entitled to convene a meeting of any Series of Bonds to consider any proposal to be voted on by the Class B DIG.

Decisions of the Majority Creditors will be determined by votes on a pound for pound basis (based on the Outstanding Principal Amount of the Qualifying Class B Debt voted by the Class B DIG Representatives). Subject to Entrenched Rights and Reserved Matters, the Security Trustee will be entitled to act on the instructions of the Majority Creditors of those Class B DIG Representatives which have actually voted by the specified date for voting which must be not less than 10 business

days (or in certain circumstances 5 business days) (or, where the Bond Trustee is a DIG Representative and a Default Situation is continuing (subject to the Emergency Instruction Procedure – see 7.4.9, “*Emergency Instruction Procedure*” below), such later date (not later than 2 months after such date) as is requested of the Security Trustee by the Bond Trustee should the Bond Trustee consider it necessary to convene a meeting of any one or more Series of Bondholders to seek directions) or, if earlier, as soon as Class B DIG Representatives in respect of more than 50 per cent. of the Qualifying Class B Debt have voted in favour of the relevant proposal.

#### **7.4.8 Voting by the Bond Trustee as DIG Representative of the Bondholders**

Where the Bond Trustee acts as the DIG Representative of the Wrapped Bondholders (following the occurrence of an FG Event of Default which is continuing) and/or the Unwrapped Bondholders (other than the USPP Bondholders), the Bond Trustee may, both prior to a Default Situation and/or whilst a Default Situation is continuing, in its absolute discretion, vote on a STID Proposal or a DIG Proposal (without reference to any Bondholders) in respect of the total Outstanding Principal Amount of some or all such Series of Bonds, but shall not, prior to a Default Situation, be entitled to convene a meeting of Bondholders to seek directions.

Additionally whilst a Default Situation is continuing, where the Bond Trustee acts as the DIG Representative in respect of the Bonds, the Bond Trustee:

- (i) subject to (ii) below, may, in its absolute discretion, direct the Security Trustee in respect of the total Outstanding Principal Amount of any Series of Wrapped Bonds (following the occurrence of an FG Event of Default in respect of the Financial Guarantor of such Series of Wrapped Bonds, which is continuing) and/or Unwrapped Bonds (other than USPP Bonds); and
- (ii) shall not be entitled to convene a meeting of the Bondholders to direct the Security Trustee in accordance with an extraordinary resolution of any such Series of Bonds after the presentation of a valid Emergency Instruction Notice pursuant to the terms of the STID. See 7.4.9, “*Emergency Instruction Procedure*” below.

#### **7.4.9 Emergency Instruction Procedure**

Whilst a Default Situation is subsisting, certain decisions and instructions may be required in a timeframe which does not allow the Bond Trustee to convene Bondholder meetings. To cater for such circumstances, the Intercreditor Arrangements provide for an emergency instruction procedure (the “**Emergency Instruction Procedure**”) which is subject to Entrenched Rights and Reserved Matters. The Security Trustee will be required to act upon instructions contained in an emergency instruction notice (an “**Emergency Instruction Notice**”). An Emergency Instruction Notice must be signed by DIG Representatives (the “**EIN Signatories**”) representing 66⅔ per cent. or more of the aggregate Outstanding Principal Amount of the Qualifying Class A Debt (or following the repayment in full of the Class A Debt, the Qualifying Class B Debt) after excluding the proportion of Qualifying Debt in respect of which the Bond Trustee is the DIG Representative and in respect of which the Bond Trustee in its absolute discretion has not voted. The Emergency Instruction Notice must specify the emergency action which the Security Trustee is being instructed to take and must certify that in their reasonable opinion, unless such action is taken within the timeframe specified in the Emergency Instruction Notice, the interests of the EIN Signatories will be materially prejudiced.

#### **7.4.10 Hedge Counterparties**

Each Hedge Counterparty will be a Secured Creditor party to the STID and each Hedging Agreement will constitute Class A Debt.

The Hedge Counterparties will not form part of the Class A DIG. However, the Hedge Counterparties will generally rank in the Payment Priorities senior to or pari passu with interest and principal payments on the Class A Bonds. See 7.7, “*Cash Management*” and 7.11, “*Hedging Agreements*”.

#### 7.4.11 Liquidity Facility Providers

Each Liquidity Facility Provider will be a Secured Creditor party to the STID and each Liquidity Facility Agreement will constitute Class A Debt.

The Liquidity Facility Providers will not form part of the Class A DIG. However, the Liquidity Facility Providers will rank in the Payment Priorities senior to interest and principal payments on the Class A Bonds. See 7.7, “Cash Management” and 7.10.4, “The Liquidity Facilities”.

#### 7.4.12 Finance Lessors

Each Finance Lessor will be a Secured Creditor party to the STID and all amounts arising under the Finance Leases will constitute Class A Debt.

Existing Finance Lessors will form part of the Class A DIG. Amounts due and payable under the Finance Leases are dealt with in 7.7, “Cash Management” and 7.10.1, “Existing Finance Leases”.

#### 7.4.13 Standstill

The STID will provide for an automatic standstill of the claims of the Secured Creditors against AWS and the Issuer (the “**Standstill**”) immediately following notification to the Security Trustee of an Event of Default.

The Standstill is designed to reduce or postpone the likelihood of a Special Administration Order being made against AWS on the grounds of its insolvency or otherwise. Although not binding on unsecured and trade creditors and hence potentially giving such unsecured and trade creditors a position of greater strength upon an Event of Default, it is intended to allow time for the Secured Creditors to restore the financial condition of AWS.

During the Standstill Period:

- (i) other than any action taken in relation to Permitted Accelerations, none of the Secured Creditors will be entitled to give any instructions to the Security Trustee to take any Enforcement Action (but without prejudice to the ability of the Secured Creditors to demand payment) in relation to the Security granted by the Issuer or AWS;
- (ii) the Security granted by AWS Holdings and AWS Overseas Holdings may be enforced at any time by the Security Trustee at the direction of the Majority Creditors;
- (iii) save as provided in sub-paragraphs (i) and (ii) above and other than Permitted Accelerations, no Enforcement Action may be taken;
- (iv) any monies received by AWS or the Issuer will be applied in accordance with the cash management provisions contained in the CTA (see 7.7, “Cash Management” below) and in accordance with the Payments Priorities (see 7.7.6, “Cash Management – Debt Service Payment Account” below); and
- (v) the Secured Creditors will benefit from the Liquidity Facilities.

Notwithstanding the Standstill, the Secured Creditors will be entitled to accelerate their claims to the extent required to apply proceeds of enforcement of the share pledges provided by AWS Holdings and AWS Overseas Holdings under the Security Documents and in the case of the Original Lenders to the extent required to apply the proceeds towards the Class B portion of the Bridging Facility.

The period of the Standstill (the “**Standstill Period**”) will be 18 months unless the Standstill Period is extended beyond 18 months (see 7.4.14, “Standstill Extension” below) or any of the following occur prior to the expiry of the relevant Standstill Period:

- (i) the date on which an order is made for the Special Administration of AWS or any steps are taken to commence insolvency proceedings against any other Obligor other than proceedings that are commenced by the Security Trustee;
- (ii) (during the first 18 months of the Standstill Period) the date on which Class A DIG Representatives in respect of 66% per cent. or more of the aggregate Outstanding Principal



Amount of the Qualifying Class A Debt or (following the repayment in full of the Class A Debt) Class B DIG Representatives in respect of 66% per cent. or more of the aggregate Outstanding Principal Amount of the Qualifying Class B Debt vote to terminate the Standstill Period and (after the first 18 months) the date on which the Standstill Period terminates (see 7.4.14, “*Standstill Extension*” below);

- (iii) the date of waiver of the relevant Event of Default or the date of remedy of the Event of Default giving rise to the Standstill Period.

#### **7.4.14 Standstill Extension**

The Standstill Period shall automatically be extended beyond 18 months:

- (i) for a further 120 days unless Class A DIG Representatives in respect of 50 per cent. or more of the aggregate Outstanding Principal Amount of Qualifying Class A Debt vote at any time prior to or during such further 120 days to terminate the Standstill Period;
- (ii) following the period referred to in sub-paragraph (i), for a further 60 days unless Class A DIG Representatives in respect of 33½ per cent. or more of the aggregate Outstanding Principal Amount of Qualifying Class A Debt vote at any time prior to or during such further 60 days to terminate the Standstill Period;
- (iii) following the period referred to in sub-paragraph (ii), for a further 60 days unless Class A DIG Representatives in respect of 10 per cent. or more of the aggregate Outstanding Principal Amount of Qualifying Class A Debt vote at any time prior to or during such further 60 days to terminate the Standstill Period; and
- (iv) following the period referred to in sub-paragraph (iii), for successive periods each of 60 days unless Class A DIG Representatives in respect of 10 per cent. or more of the aggregate Outstanding Principal Amount of Qualifying Class A Debt vote at any time prior to or during such further 60 days to terminate the Standstill Period and a vote shall be taken of the relevant Class A DIG Representatives on the expiry of each subsequent period of 60 days for so long as the Standstill Period continues as to whether the Standstill Period should continue for a further period of 60 days.

The Bond Trustee shall not form part of the Class A DIG in respect of any vote to terminate the Standstill Period, unless directed or requested to vote in such manner (i) by an Extraordinary Resolution of the relevant Series of Class A Bonds or (ii) in writing by Bondholders holding not less than the Outstanding Principal Amount of the relevant Series of Class A Bonds as specified in Condition 19(a) or the equivalent condition of the relevant Existing Bonds.

When the Class A Debt has been fully repaid, the rights to terminate the Standstill Period as described above shall be vested in the Class B DIG Representatives.

#### **7.4.15 Enforcement**

Subject to certain matters and to certain exceptions, following an enforcement, any proceeds of enforcement or other monies held by the Security Trustee under the STID will be applied by the Security Trustee in accordance with the Payment Priorities (see 7.7.6, “*Debt Service Payment Account*” below).

The Secured Creditors do not (with certain limited exceptions outlined in this Offering Circular) have the right independently to accelerate their claims under their own facilities and agreements prior to termination of a Standstill Period. The Security Trustee will take all enforcement action and will be instructed by the Majority Creditors. Immediately upon notification to the Security Trustee of any Event of Default, the Standstill Period will commence, during which period no Secured Creditor may take any action to recover their debt or enforce the Security granted by AWS or the Issuer. The Security granted by AWS Holdings and AWS Overseas Holdings may be enforced by the Security Trustee with the consent of the Majority Creditors as prescribed in the STID.

#### **7.4.16 Accession of Additional Secured Creditors**

The STID requires that, to the extent that AWS and/or the Issuer wishes any Authorised Credit Provider (or in respect of Bonds, its Secured Creditor Representative) or other person to obtain the benefit of the Security, such Authorised Credit Provider or other person (other than Bondholders (excluding holders of USPP 2001 Bonds)) must sign an Accession Memorandum whereby it agrees to be bound by the terms of the STID and the CTA, including those provisions which prohibit individual Secured Creditors from taking actions without the consent of the Majority Creditors.

#### **7.4.17 Activities of the Security Trustee**

Subject to its Entrenched Rights and Reserved Matters and certain exceptions, the Security Trustee will only be required to take any action if instructed to do so by the Majority Creditors or, in particular cases, other specified parties and indemnified to its satisfaction.

Subject to certain exceptions, when granting any consent or waiver or exercising any power, trust, authority or discretion relating to or contained in the STID, the Finance Documents or any ancillary documents, the Security Trustee will act in accordance with its sole discretion (where granted such right) or as directed, requested or instructed by or subject to the agreement of the Majority Creditors or, in particular cases, other specified parties and in accordance with the provisions of the STID.

#### **7.4.18 Entrenched Rights and Reserved Matters**

Modifications, consents and waivers will be agreed by the Security Trustee, in accordance with votes of the Majority Creditors, subject to Entrenched Rights and Reserved Matters. Such modifications, consents and waivers will be binding on all of the Secured Creditors, subject to Entrenched Rights and Reserved Matters. No Entrenched Right or Reserved Matter will operate to override the provisions contained in the CTA which allow AWS (following a Periodic Review or as a result of any material change in the regulation of the water industry in the United Kingdom) to amend any financial ratio contained within the covenants, Trigger Events or Events of Default provided that each Financial Guarantor and the Security Trustee (acting on the instructions of the Majority Creditors) agree and the Rating Requirements have been met.

Lists of Entrenched Rights and Reserved Matters are contained in 7.4.19, “*Entrenched Rights*” and 7.4.20, “*Reserved Matters*”, below.

#### **7.4.19 Entrenched Rights**

Entrenched Rights are rights that cannot be modified or waived in accordance with the STID without the consent of the Secured Creditor having the Entrenched Right.

The Entrenched Rights of the Class A Debt Providers will include, subject to certain provisions of the CTA including the right to amend financial ratios following a Periodic Review or as a result of a material change in the regulation of the water industry in the United Kingdom, any proposed modification to, or consent or waiver under or in respect of the STID or any other Finance Document which:

- (i) the relevant Class A Debt Provider (or, where applicable, its Secured Creditor Representative) has demonstrated to the satisfaction of the Security Trustee would increase or adversely modify its obligations or liabilities thereunder or in connection therewith;
- (ii) (a) would release of any of the Security (unless equivalent replacement security is taken at the same time) unless such release is permitted in accordance with the terms of the STID and the relevant Security Document or (b) would alter the rights of priority of or the enforcement by the relevant Class A Debt Provider (or, where applicable, its Secured Creditor Representative) under the Security Documents other than as expressly contemplated therein;
- (iii) would change or would relate to the Payment Priorities;

- (iv) would change or would relate to the Entrenched Rights or the Reserved Matters or, where applicable, the relevant Class A Debt Provider's Entrenched Rights or Reserved Matters;
- (v) would change or would relate to (a) the definitions of "Class A DIG", "Class A DIG Representatives", "DIG Proposal", "DIG Directions Request", "Majority Creditors", "Qualifying Class A Debt" or "Voted Qualifying Class A Debt", (b) those matters expressly requiring the consent, approval or agreement of, or directions or instructions from, or waiver by the Majority Creditors or the Security Trustee or (c) the percentages of Outstanding Principal Amount of Qualifying Class A Debt required to terminate a Standstill;
- (vi) would delay the date fixed for payment of principal, interest or Make-Whole Amount in respect of the relevant Class A Debt Provider's Class A Debt or of any fees or premia in respect thereof or would reduce the amount of principal, interest or Make-Whole Amount payable in respect of such Class A Debt or the amount of any fees or premia in respect thereof;
- (vii) would bring forward the date fixed for payment of principal, interest or Make-Whole Amount in respect of Class A Debt or Class B Debt or any fees or premia in respect thereof or would increase the amount of principal, interest or Make-Whole Amount payable on any date in respect of Class A Debt or Class B Debt or any fees or premia in respect thereof;
- (viii) would result in the exchange of the relevant Class A Debt Provider's Class A Debt for, or the conversion of such Class A Debt into, shares, bonds or other obligations of any other person;
- (ix) would change or would relate to the currency of payment due under the relevant Class A Debt Provider's Class A Debt (other than due to the United Kingdom joining the euro);
- (x) would change AWS's information and reporting covenants or (in respect of the USPP Bondholders only) the additional information and reporting covenants and covenants relating to inspection rights contained in the documents relating to the USPP Bonds in issue on the Effective Date;
- (xi) would change the change of control undertakings;
- (xii) would change or would relate to AWS's negative pledge, financial indebtedness and restricted payments covenants;
- (xiii) would change or would relate to, but not waive (subject to (xiv) below), the Trigger Events, Trigger Event Consequences, Trigger Event Remedies or Events of Default;
- (xiv) would result in a waiver of the credit downgrade Trigger Event (see 7.6.7(ii), "*Trigger Events – Credit Rating Downgrade*"), a non-payment Event of Default in respect of any Obligor, Events of Default relating to financial ratios and credit rating downgrades (see 7.6.10(i), (xix) and (xx), "*Events of Default*" including their effect as a Trigger Event);
- (xv) would change or would relate to the rights of the relevant Class A Debt Provider to receive any sums owing to it for its own account in respect of premia, fees, costs, charges, liabilities, damages, proceedings, claims and demands in relation to any Finance Document to which it is a party (excluding, for the avoidance of doubt, the principal, interest or Make-Whole Amount payable to the relevant Class A Debt Provider);
- (xvi) would change or would relate to any existing obligation of an Obligor to gross up any payment in respect of the relevant Class A Debt Provider's Class A Debt in the event of the imposition of withholding taxes;
- (xvii) would relate to a substitution of the Issuer in circumstances where the relevant USPP Bondholder has demonstrated to the satisfaction of the Security Trustee that such substitution would adversely affect the tax treatment of their holding of USPP Bonds; or
- (xviii) would have the effect of changing certain notice, reporting and solicitation provisions relating to the USPP Bonds.

The Entrenched Rights of the Class B Debt Providers will include, subject to certain provisions of the CTA including the right to amend financial ratios following a Periodic Review or as a result of a material change in the regulation of the water industry in the United Kingdom, any proposed modification to, or consent or waiver under or in respect of, the STID or any other Finance Document which:

- (i) the relevant Class B Debt Provider (or, where applicable, its Secured Creditor Representative) has demonstrated to the satisfaction of the Security Trustee would increase or adversely modify its obligations or liabilities thereunder or in connection therewith;
- (ii) (a) would release any of the Security (unless equivalent replacement security is taken at the same time) unless such release is permitted in accordance with the terms of the STID and the relevant Security Document or (b) would alter the rights of priority of or the enforcement by the relevant Class B Debt Provider (or, where applicable, its Secured Creditor Representative) under the Security Documents other than as expressly contemplated therein;
- (iii) would change or would relate to the Payment Priorities;
- (iv) would change or would relate to the Entrenched Rights or the Reserved Matters or, where applicable, the relevant Class B Debt Provider's Entrenched Rights or Reserved Matters;
- (v) would change or would relate to (a) the definitions of "Class B DIG", "Class B DIG Representatives", "DIG Proposal", "DIG Directions Request", "Majority Creditors", "Qualifying Class B Debt" or "Voted Qualifying Class B Debt", (b) those matters expressly requiring the consent, approval or agreement of, or directions or instructions from, or waiver by the Majority Creditors or the Security Trustee or (c) the percentages of Outstanding Principal Amount of Qualifying Class B Debt required to terminate a Standstill;
- (vi) would delay the date fixed for payment of principal, interest or Make-Whole Amount in respect of the relevant Class B Debt Provider's Class B Debt or any fees or premia in respect thereof or would reduce the amount of principal, interest or Make-Whole Amount payable on any date in respect of such Class B Debt or any fees or premia in respect thereof;
- (vii) would bring forward the date fixed for payment of principal, interest or Make-Whole Amount in respect of Class A Debt or Class B Debt or any fees or premia in respect thereof or would increase the amount of principal, interest or Make-Whole Amount payable on any date in respect of Class A Debt or Class B Debt or any fees or premia in respect thereof;
- (viii) would result in the exchange of the relevant Class B Debt Provider's Class B Debt for, or the conversion of such Class B Debt into, shares, bonds or other obligations of any other person;
- (ix) would change or would relate to the currency of payment under the relevant Class B Debt Provider's Class B Debt (other than due to the United Kingdom joining the euro);
- (x) would change AWS's information and reporting covenants;
- (xi) would change the change of control undertakings;
- (xii) would change or would relate to AWS's negative pledge, financial indebtedness and restricted payments covenants;
- (xiii) would change or would relate to, but not waive (subject to (xiv) below), the Trigger Events, Trigger Event Consequences, Trigger Event Remedies or Events of Default;
- (xiv) would result in a waiver of the credit downgrade Trigger Event (see 7.6.7(ii), "*Trigger Events – Credit Rating Downgrade*"), a non-payment Event of Default in respect of any Obligor, Events of Default relating to financial ratios and credit rating downgrades (see 7.6.10(i), (xix) and (xx), "*Events of Default*" including their effect as a Trigger Event);

- (xv) would change or would relate to the rights of the relevant Class B Debt Provider to receive any sums owing to it for its own account in respect of premia, fees, costs, charges, liabilities, damages, proceedings, claims and demands in relation to any Finance Document to which it is a party (excluding, for the avoidance of doubt, the principal, interest or Make-Whole Amount payable to the relevant Class B Debt Provider); and
- (xvi) would change or would relate to any existing obligation of an Obligor to gross up any payment in respect of the relevant Class B Debt Provider's Class B Debt in the event of the imposition of withholding taxes.

The Entrenched Rights of the Finance Lessors include, in addition to the Entrenched Rights of the Class A Debt Providers set out above, any proposed modification to, or consent or waiver under or in respect of the STID or any other Finance Document which would change or relate to:

- (i) any sale, transfer or other disposal (whether deemed or otherwise) of any of the Equipment;
- (ii) the affixing of any Equipment to any land or building to which AWS or the Issuer (as applicable) does not have an interest in such land for the purposes of the Capital Allowances Act 2001;
- (iii) the creation or subsistence of any encumbrance, lien, mortgage or other Security Interest over any Equipment;
- (iv) any of the covenants or representations and warranties set out in the Finance Documents which relate to the maintenance or condition of the Equipment;
- (v) any provision(s) contained in the Finance Documents pertaining to any damage, destruction or total loss of any of the Equipment;
- (vi) any elections filed with the United Kingdom Inland Revenue by AWS or the Issuer (as applicable) and any Finance Lessor under the Finance Leases pursuant to Sections 177 and/or 227 of the Capital Allowances Act 2001 in respect of the Equipment and the relevant Finance Lessor's expenditure on the Equipment;
- (vii) the obligations of AWS or the Issuer (as applicable) to reserve amounts monthly, as set out in the cash management arrangements, that reduces the amount which it is required to reserve;
- (viii) the provisions relating to the calculation of rental payments and/or sums due upon termination of the leasing of any Equipment; and
- (ix) any changes to the Entrenched Rights of the Finance Lessors set out in paragraph (i) to (viii) above.

The Entrenched Rights of the Class A Debt Providers, the Class B Debt Providers and the Finance Lessors (where applicable) will be exercised through their Secured Creditor Representatives.

The Bond Trustee, the Security Trustee and the Financial Guarantor will have certain other limited Entrenched Rights in relation to any provisions of the Finance Documents that generally affect them to a greater extent than others.

#### **7.4.20 Reserved Matters**

Reserved Matters are matters which, subject to the Intercreditor Arrangements and the CTA, a Secured Creditor is free to exercise in accordance with its own facility arrangements and so are not exercisable by or by direction of the Majority Creditors.

Those Reserved Matters which the Secured Creditors reserve to themselves to decide are each and every right, power, authority and discretion of, or exercisable by, the Secured Creditors at any time:

- (i) to receive any sums owing to it for its own account in respect of premia, fees, costs, charges, liabilities, damages, proceedings, claims and demands in relation to any Finance Document to which it is a party (as permitted under the CTA);
- (ii) to make determinations of and require the making of payments due and payable to it under the provisions of the Finance Documents (as permitted under the CTA);
- (iii) to exercise the rights vested in it or permitted to be exercised by it under and pursuant to the CTA and the STID;
- (iv) to receive notices, certificates, communications or other documents or information under the Finance Documents or otherwise;
- (v) in the case of each Finance Lessor, to inspect the relevant Equipment, to make calculations under the financial schedules to the relevant Finance Lease (or the equivalent provisions thereunder relating to the calculation of Rental or termination sums) and to terminate the relevant Finance Lease provided such termination is a Permitted Lease Termination;
- (vi) in the case of each Hedge Counterparty, to terminate the relevant Hedging Agreement provided such termination is a Permitted Hedge Termination;
- (vii) in the case of the Original Lenders to accelerate the Class B Debt portion of the Bridging Facility provided such acceleration is a Permitted Acceleration (as set out in the STID); and
- (viii) in the case of any Secured Creditor to accelerate their claims, to the extent necessary to apply proceeds of enforcement of the share pledges provided by AWS Holdings and AWS Overseas Holdings pursuant to the terms of the Security Documents.

The Bond Trustee, the Security Trustee and the Financial Guarantor each have certain additional Reserved Matters which each has reserved to itself to decide. For the Bond Trustee and the Financial Guarantor, these include rights vested in it pursuant to the terms of the Bond Trust Deed and the Bond Policy and for the Security Trustee, these include rights vested in it pursuant to the terms of the STID.

Those Reserved Matters which the Bond Trustee reserves to itself are every right, power, authority and discretion of, or exercisable by, the Bond Trustee (in respect of paragraphs (o) to (u) below, in relation to any Series of Class A Unwrapped Bonds (other than USPP 2001 Bonds) or Class B Unwrapped Bonds and (where an FG Event of Default has occurred and is continuing) Class A Wrapped Bonds or Class B Wrapped Bonds), whether expressed as a right, power, authority or discretion of the Bond Trustee or obligation of any other party:

- (a) to make any determination contemplated or required under the Bond Trust Deed or the relevant Existing Bond Trust Deed as to the occurrence or otherwise of an FG Event of Default, in relation to its Reserved Matters and in relation to its Entrenched Rights;
- (b) to agree to make any amendment or any waiver or consent which has the effect of resulting in or permitting any amendment to the provisions of any Bond Policy;
- (c) to make any claim under, or enforce any provision of, any Bond Policy;
- (d) which is provided for the purpose of enabling the Bond Trustee to protect its own position and interests in its personal capacity (including its own personal financial interests) or which the Bond Trustee determines to be necessary or appropriate to exercise for the protection of its own position and interests in its personal capacity;
- (e) to determine amounts due in relation to and to claim under indemnities in favour of the Bond Trustee in its own capacity or for and on behalf of Bondholders under the Finance Documents;
- (f) to receive any amounts owing to it for its own account in accordance with the provisions of the Finance Documents;

- (g) to determine the amount of sums due in relation to expenses and stamp duties pursuant to the Finance Documents;
- (h) to make a claim for expenses under the Finance Documents;
- (i) to receive notices, certificates, communications or other documents or information under the Finance Documents or otherwise;
- (j) which relieves or exempts the Bond Trustee from liability and exculpates or exonerates it (including, without limitation, any right of the Bond Trustee under any of the Finance Documents to make assumptions as to, or rely on any notice, certificate or other communication confirming, the existence or non-existence of any act, circumstance or event);
- (k) against or in relation to the relevant Bondholders;
- (l) to agree any amendment to Part 2 (Bond Trustee Reserved Matters) of Schedule 3 of the STID;
- (m) under the Third Schedule (Provisions for Meetings of Bondholders) of the Bond Trust Deed or the equivalent schedule of the relevant Existing Bond Trust Deed;
- (n) the right to appoint a co-trustee or to retire under, as the case may be, Clause 23 (New Bond Trustee) and Clause 24 (Bond Trustee's Retirement and Removal) of the Bond Trust Deed or the equivalent clauses of the relevant Existing Bond Trust Deed;
- (o) the publication of an Interest Rate or Interest Amount, as the case may be, in accordance with Condition 7(b)(iv) or the equivalent condition of the relevant Existing Bonds;
- (p) the determination of amounts, as the case may be, in accordance with Condition 7(b)(vi) or the equivalent condition of the relevant Existing Bonds;
- (q) the selection of an Indexation Adviser, as the case may be, in accordance with Condition 9(c)(ii)A or the equivalent condition of the relevant Existing Bonds;
- (r) the consideration and approval in relation to a substitute index figure, as the case may be, in accordance with Condition 9(c)(ii) or the equivalent condition of the relevant Existing Bonds;
- (s) the approval in relation to the Issuer being required to deduct or withhold amounts, as the case may be, in accordance with Condition 11;
- (t) the variation, termination and appointment of Agents, as the case may be, in accordance with Condition 16 or the equivalent condition of the relevant Existing Bonds; and
- (u) to consent to any proposed amendment to, as the case may be, the Bond Trust Deed or the relevant Existing Bond Trust Deed, the relevant Conditions or any Finance Document to which it is a party whether such consent is sought to correct a manifest error or is of a formal, minor or technical nature (and, for the avoidance of doubt, any other matter referred to in Clause 19 (Waiver, Authorisation and Determination) of the Bond Trust Deed or the equivalent Clause of the relevant Existing Bond Trust Deed involving the decision of the Bond Trustee to waive or modify any provisions of the documents referred to therein will be subject to the directions of the Majority Creditors).

Those Reserved Matters which the Financial Guarantor reserves to itself are each and every right, power, authority and discretion of, or exercisable by, the relevant Financial Guarantor at any time in respect of the Class A Wrapped Bonds or Class B Wrapped Bonds for which it has issued a Bond Policy (prior to an FG Event of Default which is continuing) in relation to:

- (a) the publication of an Interest Rate or Interest Amount in accordance with Condition 7(b)(iv) or the equivalent condition of the relevant Existing Bonds;
- (b) the determination of amounts in accordance with Condition 7(b)(vi) or the equivalent condition of the relevant Existing Bonds;
- (c) the selection of an Indexation Adviser in accordance with Condition 9(c)(ii)A or the equivalent condition of the relevant Existing Bonds;
- (d) the consideration and approval in relation to a substitute index figure in accordance with Condition 9(c)(ii) or the equivalent condition of the relevant Existing Bonds;
- (e) the approval in relation to the Issuer being required to deduct or withhold amounts in accordance with Condition 11;
- (f) the variation, termination and appointment of Agents in accordance with Condition 16 or the equivalent condition of the relevant Existing Bonds; and
- (g) any amendment to Part 3 (Financial Guarantor Reserved Matters) of Schedule 3 of the STID.

Those Reserved Matters which the Security Trustee reserves to itself are each and every right, power, authority and discretion of, or exercisable by, the Security Trustee, whether expressed as a right, power, authority or discretion of the Security Trustee or an obligation of any other party:

- (a) pursuant to the STID;
- (b) to receive any sums owing to it for its own account in respect of fees, costs, charges, liabilities, damages, proceedings, claims and demands in performing its powers and exercising its discretions under the STID and any other Finance Document to which the Security Trustee is a party;
- (c) which is provided for the purpose of enabling the Security Trustee to protect its own position and interests in its personal capacity (including its own personal financial interest) or which the Security Trustee determines to be necessary or appropriate to exercise for the protection of its own position and interests in its personal capacity;
- (d) except as otherwise specifically provided herein to apply any of the sums referred to in Clause 15 (Activities of the Security Trustee) of the STID in accordance with such Clause;
- (e) to receive notices, certificates, communications or other documents or information, to direct that such notices, certificates, communications or other documents or information must be provided (or must not be provided) to it or any other party, or, where applicable, to determine the form and content of any notice, certificate, communication or other document;
- (f) which relieves or exempts the Security Trustee from liability or exculpates or exonerates it (including, without limitation, any right of the Security Trustee under any of the Finance Documents to make assumptions as to, or rely on any notice, certificate or other communication confirming, the existence or non-existence of any act, circumstance or event);
- (g) to agree to any amendment to Part 1 (Security Trustee Reserved Matters) of Schedule 3 of the STID;
- (h) to determine amounts due in relation to and to claim under indemnities in favour of the Security Trustee under Clause 15.5 (Indemnification of the Security Trustee) or Clause 16 (Remuneration and Indemnification of the Security Trustee) of the STID or pursuant to any other Finance Documents;



- (i) to appoint a co-trustee or to retire under Clause 17 (Appointment of Additional Trustees) and Clause 19.6 (Resignation of the Security Trustee) of the STID; and
- (j) to agree modifications to, or give any consent or grant any waiver under or in respect of, any term of the STID or any other Finance Document to which the Security Trustee is a party or over which it has Security under the Security Documents in accordance with Clause 8.1 (Procedures for Modifications, Consents and Waivers) of the STID.

#### **7.4.21 Substitution of the Issuer**

The Security Trustee shall implement any STID Proposal proposing the substitution in place of the Issuer, or any substituted Issuer, as the principal debtor under the Finance Documents of any other company incorporated in any other jurisdiction meeting the criteria for such a single purpose company established from time to time by the Rating Agencies.

### **7.5 Intercompany Loan Arrangements**

Under the terms of the licence modifications, AWS is prohibited from entering into loans with its associates without the consent of the Director General. The Director General has confirmed that he will not treat the following as being in breach of those conditions.

#### **7.5.1 AWS Loan Notes**

AWS will issue loan notes to the Issuer on the Effective Date in an aggregate amount equal to the Sterling equivalent of the aggregate Outstanding Principal Amount of the Existing Bonds and the Transferred USPP Bonds other than the £100,000,000 5½ per cent. index-linked loan stock due 2008 and the £150,000,000 3.875 per cent. index-linked guaranteed notes due 2020, in each case of AW (the “**Existing Index-Linked Bonds**”). In addition, AWS shall procure the assignment to the Issuer and subsequent amendment of AW’s rights under the existing intercompany loans from AW to AWS relating to such Existing Index-Linked Bonds. The issue of the loan notes and the assignment and amendment of such intercompany loans shall comprise the consideration for the assumption by the Issuer of the primary obligations under the Existing Bonds, the Transferred USPP Bonds and the related Hedging Agreements. References to such loan notes issued by AWS and the rights of the Issuer under such assigned intercompany loans are hereinafter referred to as the “**AWS Loan Notes**”.

Each series of bonds comprising the Existing Bonds and Transferred USPP Bonds is represented by a separate AWS Loan Note. The interest rate in respect of each such AWS Loan Note will be equivalent to the rate of interest on the corresponding series of bonds, or if hedged, at the hedged rate. Similarly, each AWS Loan Note will be redeemed (in whole or in part) immediately prior to the date upon which any payment of principal is to be made on the corresponding series of bonds. The Issuer will charge AWS an annual management fee in respect of holding the AWS Loan Notes.

#### **7.5.2 Issuer/AWS Loan Agreement**

The Issuer will on-lend an amount equal to the Sterling equivalent of the gross proceeds of issue of each Series of Bonds and each drawing or other obligation for Financial Indebtedness under each Authorised Credit Facility (as adjusted by any applicable Hedging Agreements) entered into on or after the Effective Date to AWS under the terms of a loan agreement (the “**Issuer/AWS Loan Agreement**” and, together with the AWS Loan Notes, the “**Intercompany Loan Arrangements**”). All advances to be made by the Issuer under the Issuer/AWS Loan Agreement will be in Sterling and at rates of interest set out in the relevant Pricing Supplement or, if hedged in accordance with the Hedging Policy (see 7.11, “*Hedging Agreements*” below) at the hedged rate. The Issuer will charge AWS an annual management fee in respect of entering into the Issuer/AWS Loan Agreement.

#### **7.5.3 Initial Advance**

The first advance under the Issuer/AWS Loan Agreement will comprise an amount equal to the Sterling equivalent of the gross proceeds of the issue of Bonds under the Programme, the gross proceeds of drawings under Tranche A of the Bridging Facility and drawings under the Initial

Authorised Loan Facility on the Effective Date, after having exchanged the proceeds of any Series of Bonds denominated in a currency other than Sterling pursuant to the initial currency exchange under the Currency Hedging Agreements with the Existing Hedge Counterparties in respect of such Series of Bonds.

#### **7.5.4 Fees Generally**

Under the terms of the Intercompany Loan Arrangements, AWS will be required to pay fees to the Issuer in an amount equal to all premia, fees, costs, charges and other expenses payable by the Issuer in connection with financial accommodation provided to AWS.

#### **7.5.5 UK Holdco/AWS Loan**

On the Effective Date, AWS will enter into the UK Holdco/AWS Loan with AWS Holdings. This will enable AWS Holdings to satisfy obligations to pay to AW the consideration for the acquisition of shares in AWS Overseas Holdings. The UK Holdco/AWS Loan will bear interest at a commercial rate. Interest under the UK Holdco/AWS Loan will be payable subject to restrictions. See 7.6.5(iv)(v)(E), “*Covenants – General*” below.

#### **7.5.6 Subordinated Liabilities**

All present and future liabilities payable or owing by one member of the AWS Financing Group to another member of the AWS Financing Group comprise subordinated liabilities other than liabilities under the Intercompany Loan Arrangements.

### **7.6 Common Terms Agreement**

#### **7.6.1 General**

Each of the Existing Finance Lessors, the Existing Hedge Counterparties, the Security Trustee, the Cash Manager, the Original Lenders, the Liquidity Facility Providers, the Initial Authorised Credit Providers, each Obligor, the Bond Trustee, the Initial Financial Guarantor, the Registrar, the Principal Paying Agent, the Transfer Agent, the Exchange Agent, and the USPP 2001 Bondholders and others will, inter alios, on or before the Effective Date, enter into a common terms agreement (the “**Common Terms Agreement**” or “**CTA**”). The Common Terms Agreement will set out the representations, covenants (positive, negative and financial), Trigger Events and Events of Default which will apply to each Authorised Credit Facility (including for the avoidance of doubt the Intercompany Loan Arrangements, Existing Finance Leases, Existing Hedging Agreements and any other document entered into in connection with an Authorised Credit Facility).

It will be a term of the Common Terms Agreement that any representations, covenants (to the extent of being able to declare an Event of Default), Trigger Events and Events of Default contained in any document which is in addition to those in the Common Terms Agreement will (save for limited exceptions which will, inter alia, include covenants relating to indemnities, covenants to pay, remuneration, costs and expenses, covenants in each Series of Bonds issued on the Effective Date, those contained in the Programme Agreement, the Bond Trust Deed, the Indemnification Deed, the Tax Deed of Covenant and the Agency Agreement to the extent such apply to any Series of Bonds, certain provisions under the Hedging Agreements, the Finance Leases and the mandatory prepayment rights and obligations under the Bridging Facility) be unenforceable. The Common Terms Agreement will further provide that no representation, covenant, Trigger Event or Event of Default will be breached or triggered as a result of certain permitted post closing events (including, but not limited to certain transaction fees not paid on the Effective Date, payment of cash amounts payable in relation to the repayment or transfer of certain existing debt after the Effective Date, certain payments under the UK Holdco/AWS Loan and repayments of certain outstanding Financial Indebtedness between any Obligor and the AWG Group and any other payments as may be agreed by AWS and the Security Trustee in writing). The Common Terms Agreement will allow AWS (following a Periodic Review or any material change in the regulation of the water industry in the United Kingdom) to amend any financial ratio contained within the covenants, Trigger Events or Events of Default, provided that each Financial Guarantor and the Security Trustee (acting on the instructions of the Majority Creditors) agree and the Rating Requirement has been met.

The Common Terms Agreement will also set out the cash management arrangements to apply to AWS Financing Group (see 7.7, “Cash Management” below). It will be a requirement of the Common Terms Agreement that future providers of Class A Debt and Class B Debt must also accede to the Common Terms Agreement and the STID.

A summary of the representations, covenants, Trigger Events and Events of Default to be included in the Common Terms Agreement is set out below.

#### 7.6.2 Representations

On the Effective Date, (and in respect of certain representations on each Issue Date, each Payment Date, on the date of the Initial Bond Policy, on the day any new Authorised Credit Facility or any new Tier 1 Material Agreement is entered into and only in relation to such agreements, and on each date for payment of a Restricted Payment into the Distributions Account or Customer Payments Account or for a payment of a UK Holdco Debt Service Distribution), each Obligor will make a number of representations in respect of itself to each Finance Party. These representations will (amongst others) include (subject, in some cases, to agreed exceptions and qualifications as to materiality and reservations of law) representations as to:

- (i) its corporate status, power and authority (a) to enter into and perform its obligations under the Transaction Documents and (b) to own, lease and operate its assets and to carry on its business;
- (ii) its obligations under the Transaction Documents being its legal, valid and enforceable obligations;
- (iii) its entry into and performance under the Transaction Documents not conflicting with any document which is binding upon its assets, its constitutional documents or any material applicable law;
- (iv) the preparation of its financial statements in accordance with Applicable Accounting Principles;
- (v) the validity and admissibility in evidence of the Finance Documents in any proceedings in the jurisdiction of its incorporation;
- (vi) the Security Documents to which it is party conferring the Security Interests they purport to confer and such Security Interests not being subject to any prior or *pari passu* Security Interest (other than Permitted Security Interest);
- (vii) the conduct of its business not violating any judgment, law or regulation, which if enforced would have a Material Adverse Effect;
- (viii) no Default or Potential Trigger Event being outstanding;
- (ix) the obtaining by it prior to the Effective Date of all consents and approvals necessary for the conduct of AWS’s business and the transactions in the Finance Documents;
- (x) its ownership of, or interests in, the assets over which it has created Security Interests under the Security Documents and which are material to the operation of its business;
- (xi) insurances required to be maintained under any Finance Document being in full force and effect;
- (xii) there being no insolvency event in relation to it;
- (xiii) the ownership structure of the AWS Financing Group;
- (xiv) the due payment of all its taxes (save to the extent any tax payment is being disputed in good faith);
- (xv) under the laws of its jurisdiction of incorporation and tax residence in force on the Effective Date, it not (other than as disclosed) being required to make any deduction or withholding from any payment of interest in circumstances where, under current United Kingdom law, no United Kingdom withholding tax would be imposed on the payment;

- (xvi) subject to certain reservations as to matters of law, the choice of English law being recognised and enforced in proceedings against AWS Overseas Holdings;
- (xvii) the claims of Secured Creditors ranking prior to the claims of its other unsecured and unsubordinated creditors;
- (xviii) no Security Interest having been created, or allowed to exist, other than Permitted Security Interests and no indebtedness incurred other than Permitted Financial Indebtedness or any Permitted Volume Trading Arrangements;
- (xix) the Bonds constituting (or constituting upon execution, due authentication and delivery) legal and valid obligations binding on the Issuer and enforceable against it in accordance with its terms and constituting evidence of direct, secured and unconditional obligations of the Issuer;
- (xx) no litigation or other proceedings current, or to its knowledge pending or threatened against it or its assets;
- (xxi) limits on its powers not being exceeded as a result of the borrowing, leasing, granting of security or giving or guarantees contemplated by the Transaction Documents;
- (xxii) compliance with environmental laws and having obtained all environmental permits necessary for conduct of its business and no environmental claim having been commenced;
- (xxiii) loans not having been made to other persons other than pursuant to Finance Documents, the UK Holdco/AWS Loan, Permitted Volume Trading Arrangements and the Intercompany Loan Arrangements;
- (xxiv) Treasury Transactions not having been entered into other than the Hedging Agreements;
- (xxv) all arrangements or contracts with any person (including Affiliates) being on arm's length basis and on terms no less favourable to it than would reasonably be expected to be obtained in a comparable arm's length transaction with a person not being an Affiliate, unless permitted under the Finance Documents, as a result of a Permitted Emergency Action, certain disclosed transactions up to the next Periodic Review or save as disclosed in this Offering Circular; and
- (xxvi) on the Effective Date, no member of the AWS Financing Group being liable in any manner in respect of any Financial Indebtedness (including by way of primary obligor, guarantor, surety or any other manner) that is not either Class A Debt or Class B Debt, the providers of which have executed the CTA and the STID, or Permitted Financial Indebtedness falling within the category listed in paragraphs (a), (b), (d) or (e) of the definition of Permitted Financial Indebtedness.

Additionally, AWS will (subject, in some cases, to agreed exceptions and qualifications as to materiality and reservations of law) represent:

- (i) to the best of its knowledge, it has the right to use intellectual property rights necessary to conduct its Business;
- (ii) to the best of its knowledge (and save as disclosed to the Security Trustee) all parties to Transaction Documents are in compliance with the Transaction Documents;
- (iii) assumptions used in respect of financial ratio calculations having been made in good faith, after due and careful consideration and being consistent with Applicable Accounting Principles and Good Industry Practice;
- (iv) it is not aware of any Special Administration Order having been made in respect of it; and
- (v) the accuracy (in all material respects) of certain written information provided by AWS and the accuracy of this Offering Circular.

The representation referred to in sub-paragraph (ii) will be made by AWS on the date of the Common Terms Agreement and on the date of each Investors Report, directors certificate, compliance certificate or interim compliance certificate. The representation referred to in sub-paragraph (iv) will be made by AWS on the date of the Common Terms Agreement, and, subject to minor amendments, on each date when any new Authorised Credit Facility is entered into when it is generally syndicated.

Additionally, the other members of the AWS Financing Group have represented that they have not carried on any business since the date of their incorporation other than that required in connection with their formation and capitalisation and/or as envisaged by the Transaction Documents.

### **7.6.3 Covenants**

The Common Terms Agreement will contain certain covenants from each of the Obligors. A summary of the covenants which will (amongst others) be included (subject, in some cases, as to agreed exceptions, de minimis amounts and qualifications as to materiality and reservations of law) in the Common Terms Agreement is set out below in 7.6.4, “*Information – Covenants*”, 7.6.5, “*Covenants – General*” and 7.6.6, “*Financial Covenants*”.

### **7.6.4 Information – Covenants**

- (i) So far as permitted by any applicable law or any binding confidentiality obligation, AWS will undertake to supply to the Security Trustee certain information such as:
  - (a) a copy of all information, which would reasonably be expected to be material to an Authorised Credit Provider to the AWS Financing Group, which it supplies to the Director General;
  - (b) as soon as reasonably practicable after becoming aware, details of any proposed material changes to the Instrument of Appointment or any proposed changes to the constitutional documents of any member of the AWS Financing Group;
  - (c) promptly upon becoming aware, details of any actual or potential enquiry, investigation or proceeding commenced by any government, court, regulatory agency or authority, if such enquiry, investigation or proceeding would be reasonably likely to have a Material Adverse Effect;
  - (d) as soon as reasonably practicable after receipt, any material notice (including an enforcement notice) from any governmental authority or industry regulator (including Ofwat) received by AWS;
  - (e) copies of all certificates and responses provided by AWS or any member of the AWS Financing Group to any industry regulator (including Ofwat) which would reasonably be expected to be material and adverse and which relates to the creditworthiness of AWS or AWS’s ability to perform its duties under the Instrument of Appointment;
  - (f) copies of all reports and information provided by the operator and/or service provider to it under any Material Agreement which would be material or adverse in relation to the creditworthiness of AWS or to AWS’s ability to perform its duties under the Instrument of Appointment, and AWS shall use reasonable endeavours to procure that any such Material Agreements permit such reports and information to be disclosed to the Secured Creditors;
  - (g) a semi-annual Investors Report;
  - (h) such material information about the business and financial condition of AWS as a Secured Creditor may reasonably and properly request, from time to time, on the request of the Security Trustee (as directed by such Secured Creditor); and
  - (i) details of any Bondholder accepting the offer of prepayment following the occurrence of an Early Redemption Event and the aggregate Early Redemption Amount payable.

- (ii) AWS will further agree to provide information regarding a UK Holdco Change of Control to the Security Trustee and the Financial Guarantor as soon as it becomes aware of any such proposal and to use all reasonable endeavours to procure that the Security Trustee and such Financial Guarantor have been given a reasonable opportunity to express views on the identity and role of any such proposed new Controlling person under a UK Holdco Change of Control.
- (iii) AWS will further agree to use all reasonable endeavours to supply any information due to, or requested by, the Director General within the time period provided for supply of such information. If no time period is specified, AWS must provide the required information as soon as reasonably practicable. This is subject to action AWS reasonably believes is consistent with prudent management as part of negotiation with the Director General.
- (iv) Additionally, each Obligor will undertake to supply to the Security Trustee:
  - (a) its audited financial statements and, in the case of AWS, its audited consolidated financial statements, for each of its financial years and, in the case of AWS, its unaudited consolidated financial interim statements, for the first half-year of each of its financial years;
  - (b) copies of all material documents despatched by it to its shareholders or creditors generally; and
  - (c) as soon as reasonably practicable after becoming aware or available, details of:
    - (A) any litigation or other proceedings (which alone or in aggregate could reasonably be expected to give rise to a claim against AWS of £5,000,000 (indexed)), which are current, threatened or pending and would be reasonably likely, if adversely determined, to have a Material Adverse Effect;
    - (B) the periodic information relating to it (such as AWS's annual charges scheme, a summary of AWS's strategic business plan at each Periodic Review, AWS's procurement plans, AWS's annual drinking water quality report, AWS's annual environmental report and AWS's annual conservation and access report);
    - (C) any event which could reasonably be expected to give rise to an insurance claim in excess of £4,000,000 (indexed);
    - (D) any Material Entity Event (see 7.6.11, "*Material Entity Events*" below) and/or Emergency which would be reasonably likely to have a Material Adverse Effect;
    - (E) any non-compliance with any law or regulation which would be reasonably likely to have a Material Adverse Effect;
    - (F) any other event which would be reasonably likely to have a Material Adverse Effect; and
  - (d) such material information as is reasonably and properly requested by any Secured Creditor; and
  - (e) notification of any Default or Potential Trigger Event relating to it promptly upon becoming aware of its occurrence (and the steps, if any, being taken to remedy it).
- (v) Additionally, each of AWS and the Issuer will undertake inter alia:
  - (a) to supply a compliance certificate signed by two authorised signatories of the Issuer and two independent non-executive directors of AWS (subject to any vacancies arising out of exceptional circumstances not in the normal course of business, in which case, the signature of only one independent non-executive director of AWS will be required); such compliance certificate to be accompanied by a statement as

to what the historical financial ratios which are required to be calculated under the Common Terms Agreement are, a short summary of the manner in which the historical financial ratios have been calculated and a certification of compliance in relation to projected financial ratios;

- (b) to permit the Security Trustee to investigate the calculations contained in any accompanying statement to a compliance certificate and to call for other substantiating evidence if it certifies to AWS or the Issuer that it has reason to believe that the historical ratios set out in the statement are incorrect or misleading or in the event that there is a deterioration in the historical ratios and will have the right to call for further information if it considers that AWS can have no reasonable grounds for confirming that it is in compliance with all forward looking ratios; and
  - (c) to deliver to the Security Trustee promptly after any reasonable request made by the Security Trustee, a certificate signed on its behalf by two of its authorised signatories (a) certifying that no Default or Potential Trigger Event is outstanding of which it is aware, having made all reasonable enquiries, or if it is outstanding, specifying the Default or Potential Trigger Event and the steps (if any) taken or proposed to be taken to remedy such event.
- (vi) In addition, each Obligor in respect of information delivered electronically:
- (a) may deliver any information under the Common Terms Agreement to a Secured Creditor by posting it on an electronic website, provided the Obligor and the Security Trustee have designated a website and the Obligor has notified the Security Trustee and each relevant Secured Creditor of the address and password for such website; and
  - (b) must notify the Security Trustee if (i) the website cannot be accessed or the website or any information on it is infected for a period of 5 consecutive days, in which case the Obligor must supply the Security Trustee with all information required under the Common Terms Agreement in paper form with copies as requested by any Finance Party or (ii) if the password is changed.

#### **7.6.5 Covenants – General**

- (i) Each Obligor will undertake inter alia:
  - (a) to do all such things as are necessary to maintain its corporate status where failure would be reasonably likely to have a Material Adverse Effect or otherwise adversely affect the Security Interests of the Secured Creditors;
  - (b) to comply with its cash management obligations (if any) set out in the Common Terms Agreement;
  - (c) to ensure that the claims of Secured Creditors against it under the Finance Documents will rank (subject to certain reservations as to matters of law) prior to or at least *pari passu* with the claims of all its other unsecured and unsubordinated creditors save for those whose claims are preferred solely by law;
  - (d) to operate and maintain, or ensure the operation and maintenance of, its business in a safe, efficient and business-like manner and in accordance with its memorandum and articles of association or other constitutional documents, Good Industry Practice (taking its Business as a whole), the Finance Documents and the UK Holdco/AWS Loan and, in the case of AWS, the Instrument of Appointment and the WIA;
  - (e) to comply with the terms of the Transaction Documents to which it is a party;
  - (f) to maintain and take all reasonable steps to enforce its rights and exercise its discretions under the Transaction Documents and Tier 2 Material Agreements in accordance with Good Industry Practice;

- (g) to ensure that, save as otherwise agreed by the Security Trustee and each Financial Guarantor save for any Permitted Joint Venture, the corporate ownership structure of the AWS Financing Group (other than the ownership or Control of AWS Holdings) remains as at the date of the Common Terms Agreement;
- (h) so far as permitted by applicable law and regulatory requirements, to execute all such further documents and do all such further things as the Security Trustee (acting reasonably) may consider necessary to give effect to the Finance Documents;
- (i) (A) to take all such action as the Security Trustee may reasonably require for the purpose of perfecting, protecting and preserving the rights of the Security Trustee under the Security Documents and the Security Interests under the Security Documents; and (B) to take all actions as the Security Trustee may require, following the making of any acceleration, cancellation or demand under the Intercompany Loan Arrangements or the termination of, or prepayment of the rentals relative to, the leasing of the Equipment in each case after the occurrence of a Default for facilitating the exercise of the rights of the Security Trustee under the Security Documents and/or the realisation of any Security Interests under the Security Documents; and (C) to use all reasonable endeavours to receive acknowledgments of assignment from such counterparties as the Security Trustee may nominate;
- (j) not to incur any Financial Indebtedness other than Permitted Financial Indebtedness or, in the case of AWS, indebtedness under Permitted Volume Trading Arrangements (Permitted Financial Indebtedness will include indebtedness incurred under the Intercompany Loan Arrangements, any Finance Document, Treasury Transactions entered into in accordance with the Hedging Policy, the Local Authority Loan and any further indebtedness which complies with certain conditions);
- (k) not to enter into any amalgamation, demerger, merger, consolidation or reconstruction other than (in the case of AWS) a Permitted Joint Venture, or otherwise as agreed by the Security Trustee and each Financial Guarantor;
- (l) not to (i) acquire or invest, other than Permitted Acquisitions, Authorised Investments and Permitted Joint Ventures; or (ii) establish any subsidiary (other than as set out in the Common Terms Agreement) or any joint venture other than a Permitted Joint Venture without the prior written consent of the Security Trustee and each Financial Guarantor;
- (m) not to, or to permit any Permitted Joint Venture to, be a creditor in respect of any Financial Indebtedness or issue any guarantee or indemnity in respect of the obligations of any other person except for (A) credit or indemnity provided under any Finance Document (B) any loan made under the Intercompany Loan Arrangements (C) any loan provided to AWS subordinated to the Authorised Credit Facilities on terms acceptable to the Security Trustee (D) any guarantee in the Finance Documents (E) the UK Holdco/AWS Loan (F) single loans by AWS to employees of less than £250,000 (indexed) or loans by AWS to employees in aggregate less than £750,000 indexed; (G) other loans by AWS in aggregate of less than £500,000 (indexed) not falling in (A) to (F) above and (H) in the case of AWS Permitted Volume Trading Arrangements and, in each case (other than for paragraph (B)), provided that no Default or Potential Trigger Event is continuing at the time any such credit or loan or guarantee is proposed to be made or issued;
- (n) not to change its memorandum or articles of association or other constitutional documents in a way which would be reasonably likely to have a Material Adverse Effect or otherwise prejudice the Security Interests created pursuant to the Security Documents without the prior written consent of the Security Trustee;



- (o) not to propose any resolution for, or agree to any material amendments to, variation, modification, waiver, suspension, revocation, termination of any Material Agreement save in accordance with the Outsourcing Policy without the prior written consent of the Security Trustee;
- (p) not to enter into any Treasury Transaction other than Hedging Agreements entered into in accordance with the Hedging Policy;
- (q) except for a Permitted Tax Loss Transaction, not to enter, without the consent of the Security Trustee and each Financial Guarantor, into any arrangements with any other company or person (other than a taxation authority in respect of the taxation liabilities of such Obligor or any other Obligor) relating to tax;
- (r) not to compromise or settle any claim, litigation or arbitration without prior notification to the Security Trustee if any such compromise or settlement would be reasonably likely to have a Material Adverse Effect;
- (s) (A) to promptly obtain, maintain and comply with the terms of all applicable laws, regulations and orders and obtain and maintain all governmental and regulatory consents, licences, authorisations and approvals (including the Instrument of Appointment) necessary for the conduct of its business, for entry into and performance of the Finance Documents, and for the leasing of the Equipment, as a whole in accordance with Good Industry Practice and (B) to do nothing which would lead to the termination, suspension or revocation of any such consents, licences, authorisations and approvals, in each case where such failure would be reasonably likely to have a Material Adverse Effect;
- (t) to maintain separate bank accounts;
- (u) to use reasonable endeavours to comply in all material respects with all laws and regulations to which it is subject;
- (v) to pay all taxes and other outgoings prior to penalties being incurred unless payment of those taxes is being contested in good faith by appropriate means which permit the deferral of payment and/or an adequate reserve has been set aside for payment of those taxes;
- (w) not to create or allow to exist any Security Interest on the Equipment or any of its present or future revenues or assets other than Permitted Security Interests; or
- (x) not to (A) (i) sell, transfer or otherwise dispose of any of its assets on terms where it is or may be leased to or re-acquired or acquired by a member of the AWS Financing Group other than (in the case of the Issuer or AWS) pursuant to a Finance Lease; or (ii) sell, transfer or otherwise dispose of any of its receivables (other than Permitted Book Debt Disposals); or (iii) purchase any asset on terms providing for a retention of title by the vendor or on conditional sale terms or on terms having a like substantive effect to any of the foregoing except for assets acquired in the ordinary course of its business carried on in the normal course, in each case, in circumstances where the transaction is entered into primarily as a method of raising Financial Indebtedness or of financing the acquisition of an asset nor (B) enter into any such transaction in (A) above in circumstances where the transaction is not entered into primarily as a method of raising finance to the extent that the consideration in respect of such sales, leases, transfers or disposals is not received in cash payable in full at the time or exceeds an amount of 0.13 per cent. of RAV in aggregate at any time;
- (y) not to dispose of all or any part of the Equipment or its undertaking, revenues, business or assets other than a Permitted Disposal or Permitted Joint Venture;
  - (aa) not to change its tax residence from the United Kingdom;

- (bb) not to (A) redeem, repurchase, defease, retire or repay any of its share capital or resolve to do so; (B) issue any shares which by their terms are redeemable or convertible or exchangeable for Financial Indebtedness; or (C) issue any share capital to any person, other than where any such action or transaction; (i) is in furtherance of a Restricted Payment and the amount of the Restricted Payment is permitted to be paid pursuant to the Finance Documents or (ii) is expressly allowed under the Finance Documents or (iii) has received the prior written consent of the Security Trustee and each Financial Guarantor; and
  - (cc) other than as a result of Permitted Emergency Action (in which case AWS shall use reasonable endeavours to ensure that all contracts entered into will be on an arm's length basis, although AWS will not be required to obtain alternative competitive quotes), not to enter into any arrangement or contract with any person otherwise than on an arm's length basis save as has been disclosed or unless expressly permitted under the Finance Documents.
- (ii) Additionally, each of AWS Holdings and AWS Overseas Holdings will undertake:
- (a) not to: (aa) carry on or transact any business or other activity other than (A) ownership of the shares in members of the AWS Financing Group held by it on the Effective Date; (B) the giving of guarantees in accordance with the Finance Documents entered into by it on the Effective Date; and (C) the performance of obligations required under the UK Holdco/AWS Loan or the Finance Documents; (bb) own any asset or incur any liabilities except for the purposes of carrying on that business in accordance with the Finance Documents entered into by it on the Effective Date; (cc) suspend, abandon or cease to carry on its business; (dd) declare, make or pay Restricted Payments otherwise than as permitted under the Finance Documents and the UK Holdco/AWS Loan; or (ee) take any steps to enforce any claims it may have against any other Obligor without the prior written consent of the Security Trustee;
  - (b) not to make any Restricted Payments otherwise than out of monies received by it (directly or indirectly) from AWS which have been properly paid by AWS out of the Distributions Account or as set out under the Common Terms Agreement; and
  - (c) to make a UK Holdco Debt Service Distribution in accordance with those provisions referred to in sub-paragraph (v)(E) of paragraph (iv) below immediately once AWS has made a UK Holdco Debt Service Distribution.
- (iii) Each of AWS, AWS Holdings and AWS Overseas Holdings will further undertake to maintain at least 3 non-executive directors who are not employees or directors of any member of the AWG Group (other than the Obligors) on its board of directors and ensure that, at all times, the directors of any member of the AWG Group (other than the Obligors) do not constitute a majority of the executive directors (subject to temporary vacancies arising out of exceptional circumstances).
- (iv) Additionally, AWS will undertake inter alia:
- (a) to ensure that the nature of its business is limited to the Business;
  - (b) to conduct its Regulated Business in the name of AWS only and to ensure that separation from the AWG Group is maintained at all times by holding AWS out as a separate entity, correcting any misunderstanding as to identity and using stationery, invoices and cheques separate from any other person or entity;
  - (c) not to permit, agree to or recommend any suspension or the abandonment of all or a material part of the operation of its Business unless such suspension or abandonment is in accordance with its Instrument of Appointment;
  - (d) if it exceeds the Permitted Non-Statutory Business Limits, to dispose of or reduce all or part of its Permitted Non-Statutory Business within six months so that the

Permitted Non-Statutory Business Limits are complied with at the next Calculation Date;

- (e) to comply in all material respects with the Instrument of Appointment;
- (f) not to agree to any amendment or variation of the Instrument of Appointment which would reasonably be expected to have a Material Adverse Effect (without the prior written consent of the Security Trustee);
- (g) to comply with applicable relevant environmental laws and environmental approvals applicable to it, where failure to do so would be reasonably likely to have a Material Adverse Effect;
- (h) as soon as reasonably practicable upon becoming aware of the same, notify the Security Trustee of: (A) any environmental claim that is current or, to the best of its knowledge and belief, is threatened; or (B) any facts or circumstances which will or are reasonably likely to result in an environmental claim being commenced or threatened against it, which, in either case if substantiated, is reasonably likely either to have a Material Adverse Effect or result in any material liability for a Finance Party;
- (i) to effect and maintain those insurances in connection with its Business as are set out in the Common Terms Agreement;
- (j) to take all reasonable action to safeguard and maintain such present and future rights in accordance with intellectual property rights necessary for its Business including observing all covenants and stipulations relating thereto and obtaining all necessary registrations;
- (k) (A) to comply with the Outsourcing Policy which shall become effective on and from the Effective Date and apply it to each Outsourcing Agreement and Capex Contract entered into by AWS (to the extent that it is not entered into pursuant to or under an Existing Framework Agreement) on and from the Effective Date; (B) during the period from the Effective Date until the commencement of the AMP4 Period that all outsourcing is carried out in accordance with Good Industry Practice; (C) subject to (A), to procure that any Outsourcing Agreement and Capex Contract entered into on and from the Effective Date complies with the Public Procurement Rules and the Outsourcing Policy; (D) where an Emergency is continuing, to use its best endeavours to rectify such Emergency (any Permitted Emergency Action will not breach the Outsourcing Policy); (E) to procure that on the commencement of the AMP4 Period, all Existing Framework Agreements (other than Extended Outsourcing Agreements) are terminated or brought into compliance with the Outsourcing Policy; (F) not to materially alter, amend or modify any Extended Outsourcing Agreement without the consent of the Security Trustee and each Financial Guarantor; and (G) to at all times use Good Industry Practice in exercising its rights and performing its obligations under any Extended Outsourcing Agreement;
- (l) to ensure it has adequate financial and management resources to enable it to discharge its core obligations under the Instrument of Appointment and under the Transaction Documents and, in respect of performance obligations which are either passed on to a Contractor or a Permitted Joint Venture or outsourced, it has retained sufficient control to discharge its obligations under the Instrument of Appointment and under the Transaction Documents;
- (m) following receipt of notice of termination of the Instrument of Appointment, AWS must use its reasonable endeavours to ensure that subject to its obligations under the WIA: (A) a Transfer Scheme is agreed between AWS, the transferee and the Director General by a date no less than 2 years prior to the expiration of such notice; and (B) any such Transfer Scheme will not be prejudicial to the interests of the Secured Creditors;

- (n) to use all reasonable endeavours to ensure that the Security Trustee is joined in the consultation process with the Director General if AWS becomes subject to any Transfer Scheme;
- (o) subject to its obligations under the WIA, not to agree to any Transfer Scheme without the consent of the Security Trustee and each Financial Guarantor;
- (p) to ensure that there are no agreements in force or corporate resolutions passed which call for the present or further issue or allotment of, or grant to any person other than AWS Overseas Holdings, the right (whether conditional or otherwise) to call for the issue or allotment of any share (or equivalent) loan note or loan capital of AWS (including an option or right of pre-emption or conversion);
- (q) in the event that the counterparty to the Local Authority Loan commences proceedings for the winding up of any Obligor, to repay such Local Authority Loan in full, no later than 3 days after the commencement of such proceedings;
- (r) in the event that it breaches any of its non-monetary performance obligations under any Existing Finance Lease and such breach would be reasonably likely to have a Material Adverse Effect and has not been remedied or waived, to, within 10 Business Days of becoming aware of such breach, give notice to the relevant Existing Finance Lessor of such breach and prepay all applicable termination sums or rental payable under such Existing Finance Lease upon which the leasing of any and all Equipment under such Existing Finance Lease will terminate immediately and, subject to the terms of the STID, to comply with certain clauses of the Existing Finance Leases as if the relevant Existing Finance Lessor had already served notice of the termination of the leasing of the relevant Equipment on AWS;
- (s) in the event it breaches any of its non-monetary obligations under any Existing Finance Lease and such breach would not be reasonably likely to have a Material Adverse Effect, to indemnify the relevant Existing Finance Lessor in respect of any liabilities suffered or incurred by reason of such breach and if it fails to provide such indemnification (within 60 days of receiving written notice from such Existing Finance Lessor giving written notice and demanding payment), to prepay all rental payments payable under the relevant Existing Finance Lease as if such breach had had a Material Adverse Effect and sub-paragraph (r) above applied;
- (t) except for any Existing Joint Ventures and certain joint venture proposals made by AWS to which both the Security Trustee gives its consent in accordance with the procedure and on the terms set out in the Common Terms Agreement (the Security Trustee's consent only to be given if it is satisfied inter alia that the liabilities capable of being incurred by AWS as a result of the implementation of the joint venture proposal will not be materially prejudicial to the Secured Creditors and that the net disposal of any asset or right pursuant to the relative joint venture proposal and all net revenues arising from the joint venture proposal are paid to the Receipts Account) and the consent of each Financial Guarantor, not to be unreasonably withheld, has been given, not to enter into any joint venture or other arrangements with other persons whereby the losses and/or profits arising from any activity are incurred by AWS or shared with that other person save where those arrangements are permitted or contemplated by the Outsourcing Policy, or;
- (u) to execute and do all such assurances, acts and things as the Security Trustee may request for perfecting or protecting any security intended to be created under or pursuant to the Security Documents (including, for the avoidance of doubt, any security over any assets or rights which are to form part of the property pursuant to any Permitted Joint Venture);
- (v) to only:
- (A) pay Customer Rebates at a time when no Event of Default is subsisting and only to the extent it has funds available in the Customer Payment Account;

- (B) pay any Distribution at a time when no Event of Default is subsisting and only to the extent it has funds available in the Distributions Account;
- (C) transfer monies to the Distributions Account or Customer Payment Account at any time: (i) when no Default is subsisting and each representation which repeats is correct; (ii) after a duly constituted board meeting has been held approving the declaration of such Distribution; (iii) during the period of 45 days after the date upon which a compliance certificate or interim compliance certificate has been delivered (and an interim compliance certificate must (if issued) be issued within 45 days after the end of any month to which an unaudited profit and loss account has been drawn and as at which an unaudited balance sheet has been produced and must be accompanied by those financial statements and must certify the financial ratios set out therein as at the most recently occurring Calculation Date up to the date of those financial statements). Further the amount that may be transferred shall be limited to an amount equal to the aggregate balance of the Receipts Account and the Payment Account after payment of all prior amounts in accordance with the order set out in the cash management provisions of the CTA (summarised in 7.7.6, “*Debt Service Payment Account*” below) on the 31 March or 30 September to which that compliance certificate relates; or (in the case of a transfer within 45 days after delivery of an interim compliance certificate) the date of the accounts to which that interim compliance certificate relates, and then only provided that on the day of such transfer:
  - (a) no drawings are outstanding under the Liquidity Facilities, other than Standby Drawings;
  - (b) the transfer is to take place within 45 days after delivery to the Security Trustee of a compliance certificate;
  - (c) two directors of AWS have certified to the Security Trustee that:
    - (i) no Trigger Event is continuing unremedied;
    - (ii) in respect of any Calculation Date falling prior to 31 March 2004 the Senior RAR is less than or equal to 0.86:1 and in respect of any Calculation Date falling after that date, the Senior RAR is less than or equal to 0.85:1 (in each case) for each Test Period in respect of the most recently occurring Calculation Date (after deducting the proposed payment from available cash);
    - (iii) no Default persists or will result from the payment and the representations which repeat are, and will following such payment, remain correct provided that if such Default arises as a result of a notice to terminate the Instrument of Appointment having been served then such Default shall be deemed to be cured if an independent financial adviser shall have certified to the Security Trustee that a Transfer Scheme or other satisfactory security has been established that will not be materially prejudicial to the interests of Class A Debt Providers or Class B Debt Providers (as the case may be); and
    - (iv) to the extent that the payment is to be made to the Distributions Account to enable a Special Distribution to be made or paid, the Senior RAR and Class A RAR as adjusted to take account of that payment do not exceed levels 0.015 below those figures in paragraph (c)(ii) (in the case of the Senior RAR) above and the Trigger Event ratio level set out in paragraph (i)(b) (in the case of Class A RAR) of 7.6.7, “*Trigger Events*”, respectively.
- (D) the criteria listed in paragraphs (v)(A) to (C) above will also apply to payments of Subordinated Debt;

- (E) make a UK Holdco Debt Service Distribution quarterly each year and then only provided that the following conditions are met:
  - (a) no Default is subsisting or will result from such payment and each representation which repeats is correct and will, following such payment, remain correct;
  - (b) the payment is made by way of dividend declared and paid in an amount in each financial year equal to such amount as will ensure that AWS Overseas Holdings receives a net amount equal to the amount that it will be required to declare and pay by way of dividend to ensure that AWS Holdings receives a net payment equal to all sums due and payable by AWS Holdings to AWS under the UK Holdco/AWS Loan;
  - (c) AWS Overseas Holdings declares, makes and pays the dividend referred to in (b) above and AWS Holdings fulfils its payment obligations then due under the UK Holdco/AWS Loan on a same day basis with AWS's payment referred to in (b) above;
  - (d) the payment is made from the Payment Account to the Account of AWS Overseas Holdings at the Account Bank in London subject to the Account Bank having received irrevocable instructions (A) from AWS Overseas Holdings to transfer such sums immediately upon receipt to the Account of AWS Holdings at the Account Bank in London; and (B) from AWS Holdings to transfer such sums immediately upon receipt into the Account to the Payment Account; and
  - (e) all transfers of monies between the Accounts referred to in (d) above occur simultaneously;
- (w) to comply with the obligations to provide information under any surveillance letter with a Financial Guarantor or any Authorised Credit Facility;
- (x) to ensure that a facility in an amount not less than the Maximum Early Redemption Amount to fund the payment of Early Redemption Amounts will continue to be available to be drawn by the Issuer as Permitted Financial Indebtedness under a Finance Document at all times until:
  - (i) the day after the last day on which the Early Redemption Event may occur or,
  - (ii) if the Early Redemption Event occurs, the payment of all Early Redemption Amounts;
- (y) to assist with the syndication of any Authorised Credit Facility; and
- (z) to ensure its pension provisions comply with certain ring-fencing requirements.
- (v) Additionally, AWS and the Issuer will undertake inter alia:
  - (a) to maintain a rating of the Class A Debt and Class B Debt and a shadow rating of Class A Wrapped Debt with any two of the Rating Agencies;
  - (b) to agree to co-operate with the Rating Agencies in connection with any reasonable request for information in respect of the maintenance of a shadow rating or rating and with any review of its business which may be undertaken by one or more of the Rating Agencies after the date of the Common Terms Agreement;
  - (c) to ensure that there are installed and maintained accounting, management information, financial modelling and cost control systems which are of such a standard which can produce the information required within the time set out in the Finance Documents and procure that there are maintained books of account and other records adequate to reflect fairly and accurately its financial condition, the

results of its operations and to provide the reports required to be delivered pursuant to the Finance Documents;

- (d) to authorise the Auditors to communicate directly with the Security Trustee at such time as such parties may reasonably require (and whilst any Default is outstanding at any time) regarding its accounts and operations and furnish to the Security Trustee a copy of such authorisation, subject to the Auditors' agreement to communicate at such time and upon agreed conditions;
  - (e) to inform the Security Trustee of any change to the Auditors, as soon as reasonably practicable;
  - (f) to only replace the Auditors without the prior written approval of the Security Trustee if the replacement Auditors are a firm of independent public accountants of international standing; and
  - (g) not to change its financial year end without the prior written consent of the Security Trustee such consent not to be refused if Ofwat requires the relevant financial year to be changed in which case AWS will change the financial covenant calculations in such manner as the Security Trustee deems necessary to enable such calculations to continue to be calculated from the relevant financial statements of AWS.
- (vi) Additionally, the Issuer will undertake inter alia:
- (a) not to (A) carry on any business other than the raising of funds to provide debt financing to AWS for the purposes of its Business in accordance with the Finance Documents or any Treasury Transaction in accordance with the Hedging Policy; (B) own any assets or incur any liabilities except as required or permitted pursuant to the Finance Documents; (C) suspend, abandon or cease to carry on its business; or (D) take any steps to enforce any claims it may have against any other Obligor without the prior written consent of the Security Trustee;
  - (b) to enter into the interest rate hedging arrangements contemplated in the Hedging Policy, in accordance with the terms of the Hedging Policy;
  - (c) to ensure that (A) no more than 20 per cent. of its aggregate nominal outstanding Financial Indebtedness shall fall due for scheduled final repayment within any period of 24 consecutive months; and (B) no more than 40 per cent. (increased proportionately to the extent that the period from one Periodic Review to the next Periodic Review is greater than 5 years) of its aggregate nominal outstanding Class A Debt shall fall due for scheduled repayment within the period from one Periodic Review to the next Periodic Review;
  - (d) to use all reasonable endeavours to procure the admission of all listed Bonds for trading on the London Stock Exchange, or such other stock exchange approved by the dealers under the Programme Agreement and the Bond Trustee, and to maintain such admission until none of the relevant listed Bonds is outstanding;
  - (e) upon receiving a written request from the Bond Trustee, to deliver to the Bond Trustee a certificate of the Issuer setting out inter alia details of the aggregate principal amount outstanding under the outstanding Bonds purchased by the Issuer and as are held by any person for the benefit of any member of the AWS Financing Group, any Financial Guarantor or, so far as the Issuer is aware, any of their respective Affiliates, holding companies and subsidiaries;
  - (f) to send or procure to be sent (not less than three days prior to the date of publication) to the Bond Trustee for the Bond Trustee's approval, one copy of each notice to be given to the Bondholders in accordance with the Conditions and not to publish such notice without such approval and, upon publication, send to the Bond Trustee two copies of such notice (such approval, unless so expressed, not to constitute approval for the purpose of Section 21 of the Financial Services and

Markets Act 2000 of such notice as an investment advertisement (as therein defined));

- (g) procure that the Principal Paying Agent notifies the Bond Trustee forthwith if it does not, on or before the due date for payment in respect of the Bonds, receive unconditionally the full amount in the correct currency of the monies payable on such due date;
- (h) to forthwith give notice to the Bondholders of payments made after their due date to the Principal Paying Agent, the Registrar or the Bond Trustee;
- (i) not less than the number of days specified in the relevant Conditions prior to the redemption or repayment date in respect of any Bond, to give to the Bond Trustee notice in writing of the amount of such redemption or repayment pursuant to the Conditions;
- (j) prior to giving notice to the Bondholders that it intends to redeem the Bonds pursuant to Condition 10(b) (*Early Redemption for Index Reasons*), 10(c) (*Redemption for Tax Reasons*) or 10(d) (*Redemption at the Option of the Issuer (Issuer Call)*), provide such information to the Bond Trustee and the Financial Guarantors as the Bond Trustee and the Financial Guarantors require in order to satisfy themselves of the matters referred to in those Conditions;
- (k) to promptly give notice to the Bond Trustee and to the Security Trustee (A) if it is required by law to effect a deduction or withholding of tax in respect of any payment due in respect of any Bonds listed on a recognised stock exchange within the meaning of Section 841 of the Income and Corporation Taxes Act 1988; or (B) if a Hedge Counterparty is required to make a deduction or withholding of tax in respect of any payment due under the relevant Hedging Agreement; or (C) if it would not be entitled to relief for tax purposes, in any jurisdiction in which it carries on business or is resident for tax purposes, for any material amount which it is obliged to pay under the Finance Documents and which is or has been assumed in the AWS Business Financial Model to be available for relief for tax purposes, and in each case, take such action as may be required by the Bond Trustee and Security Trustee in respect thereof;
- (l) while any of the Bonds remain outstanding, to give notice, or procure that notice is given, to each of the Rating Agencies of (A) any proposed amendment to the Finance Documents other than ones that the Bond Trustee considers to be of a formal, minor or technical nature or made to correct a manifest error or necessary or desirable for clarification; (B) the Bonds of any Series being repaid in full; (C) the termination of the appointment of the Cash Manager; (D) the appointment of a replacement Bond Trustee or Security Trustee or the appointment of any new or replacement Agents; (E) any Default; (F) the delivery of an Enforcement Notice; (G) the occurrence of any AWS Change of Control; and (H) the occurrence of any UK Holdco Change of Control;
- (m) to observe and comply with its obligations, and use all reasonable endeavours to procure that the Agents observe and comply with all their obligations, under the Agency Agreement and procure that the Registrar maintains the Register and notify the Bond Trustee immediately if it becomes aware of any material breach or failure by an Agent in relation to the Bonds;
- (n) to give not less than 14 days' prior notice to the Bondholders of any future appointment or any resignation or removal of any Agent or of any change by any Agent of its specified office;
- (o) if, before an Interest Payment Date for any Bond, it becomes subject generally to the taxing jurisdiction of any territory or any political sub-division thereof or any authority therein or thereof having power to tax other than or in addition to the United Kingdom, to notify (immediately upon becoming aware thereof) the Bond



Trustee of such event and enter into a deed supplemental to the Bond Trust Deed, the Existing Bond Trust Deeds or the assumption agreement in relation to the USPP 2001 Bonds entered into, on, or around the Effective Date, with the substitution for (or, as the case may be, the addition to) the references therein to the United Kingdom of references to that other or additional territory to whose taxing jurisdiction, or that of a political subdivision thereof or any authority therein or thereof, the Issuer becomes subject as aforesaid, such supplemental deed also to modify Condition 10(c) or any equivalent provision of the Existing Bonds or the USPP 2001 Bonds so that such Condition shall make reference to that other or additional territory; and

- (p) to notify the Bond Trustee of any amendment to the Programme Agreement and not agree to any such amendment prior to the delivery of a legal opinion to the Security Trustee if so required.

#### **7.6.6 Financial Covenants**

- (i) AWS will undertake, inter alia:
    - (a) to deliver, with each compliance certificate and each Investors Report, a statement confirming that it has calculated each of the following ratios as at the Calculation Date immediately prior to the date of delivery of that compliance certificate, specifying the results of such calculations and providing a short summary of the manner in which these ratios have been calculated:
      - (A) a Class A ICR for each Test Period;
      - (B) a Senior PMICR for each Test Period;
      - (C) a Class A PMICR for each Test Period;
      - (D) a Senior Average PMICR;
      - (E) a Class A Average PMICR;
      - (F) a Senior RAR for each Test Period;
      - (G) a Class A RAR for each Test Period;
      - (H) the ratio of Net Cash Flow minus Capital Maintenance Expenditure to Class A Debt Interest;
    - (b) at each Periodic Review and on making each IDOK application, to apply to the Director General for a price determination which in the reasonable opinion of the AWS directors would allow, at a minimum, a credit rating in the A category to be achieved and maintained for the Class A Unwrapped Debt and a shadow rating in the A category to be achieved and maintained for the Class A Wrapped Debt, in each case such credit rating or shadow credit rating to be from at least two of the Rating Agencies;
    - (c) to apply to the Director General for an IDOK when permitted under the Instrument of Appointment (or use any other means available to apply for an IDOK):
      - (A) in all circumstances which are appropriate in accordance with Good Industry Practice;
      - (B) if the Class A PMICR for any Test Period up to and including the Date Prior is, or is projected to be, less than 1.3:1;
      - (C) if the Senior RAR for any Test Period up to and including the Date Prior is, or is projected to be, equal to or greater than 0.9:1;
      - (D) if an event has occurred which has caused or which is likely to cause a material reduction in its current or projected Net Cash Flow,
- provided that any such application is consistent with prudent management;

- (d) to levy charges to customers which, together with other available amounts, are as far as possible sufficient, within the constraints of the current price control framework, to enable AWS to meet its operational, investment and financial obligations on a timely basis under the Instrument of the Appointment and its obligations in respect of Financial Indebtedness.
- (ii) The Issuer will further undertake to maintain:
  - (a) Debt Service Reserve Liquidity Facilities available for drawing which (when aggregated with all amounts (including the value of any Authorised Investments)) standing to the credit of the Debt Service Reserve Accounts are not less than the amount of interest (including Lease Reserve Amounts and adjusted Lease Reserve Amounts) payable on its Class A Debt and Class B Debt for the next succeeding 12 month period; and
  - (b) an O&M Reserve Facility available for drawing which when aggregated with amounts standing to the credit of the O&M Reserve Account amount to not less than 10 per cent. of Projected Operating Expenditure and Capital Maintenance Expenditure for the next succeeding 12 month period as forecast in the AWS Business Financial Model.

### 7.6.7 Trigger Events

The Common Terms Agreement will also set out certain Trigger Events. The specific Trigger Events and the consequences which flow from the occurrence of those events (the “**Trigger Event Consequences**”, as described more particularly in 7.6.8, “*Trigger Event Consequences*” below) are summarised below.

The occurrence of any of the following events will be a Trigger Event:

#### (i) **Financial Ratios**

On any date when any of the following ratios are calculated in accordance with the Common Terms Agreement to breach the relevant level specified below (reach a “**Trigger Event Ratio Level**”) as at the most recently occurring Calculation Date:

- (a) the Senior RAR for any Test Period is estimated to be more than 0.9:1; or
- (b) the Class A RAR for any Test Period is or is estimated to be more than 0.75:1;
- (c) the Senior PMICR for any Test Period is or is estimated to be less than 1.1:1;
- (d) the Class A PMICR for any Test Period is or is estimated to be less than 1.3:1;
- (e) the Senior Average PMICR is or is estimated to be less than 1.2:1; or
- (f) the Class A Average PMICR is or is estimated to be less than 1.4:1.

#### (ii) **Credit Rating Downgrade**

- (a) The shadow credit rating of any Class A Wrapped Debt given by any two of the Rating Agencies falls to BBB, Baa2 or BBB or below or any Obligor is placed on credit watch with negative implications and it is reasonably likely that such rating given by such Rating Agencies will fall to such levels;
- (b) the credit rating of any Class A Unwrapped Debt by any two of the Rating Agencies falls to BBB, Baa2 or BBB respectively or below or any Obligor is placed on credit watch with negative implications and it is reasonably likely that such rating given by such Rating Agencies will fall to such levels;
- (c) the shadow credit rating of the Class B Wrapped Debt by any two of the Rating Agencies falls below investment grade or any Obligor is placed on credit watch

with negative implications and it is reasonably likely that such rating given by such Rating Agencies will fall to such levels; or

- (d) the credit rating of the Class B Unwrapped Debt by any two of the Rating Agencies falls below investment grade or any Obligor is placed on credit watch with negative implications and it is reasonably likely that such rating given by such Rating Agencies will fall to such levels.

Each credit rating referred to above is the “**Trigger Credit Rating**” for the relevant Class of Bonds.

(iii) **Debt Service Payment Account Shortfalls**

The failure to maintain the required credit balance in the Debt Service Payment Account on the required day and within one Business Day of being notified of any shortfall.

(iv) **Material Deviation in Projections**

On any Calculation Date, the estimated actual capital expenditure over any five year period between Periodic Reviews exceeds the capital expenditure for that period assumed by the Director General in the last Periodic Review (adjusted to take account of any subsequent IDOK and Out-turn Inflation) in respect of AWS by 10 per cent. or more.

In each case, deviations resulting from variances in real construction prices from assumed construction prices or additional capital expenditure incurred or to be incurred in respect of items for which AWS is entitled to make an application for an IDOK shall be ignored for the purposes of determining whether the 10 per cent. threshold deviation level has been breached.

(v) **Liquidity for Capital Expenditure and Working Capital**

If, as at any Calculation Date, the aggregate of (i) AWS’s operating cash flows including monies standing to the credit of the Payment Account and the Receipts Account available or forecast to be available to meet capital expenditure and working capital requirements for the next Test Period; (ii) Authorised Credit Facilities (excluding Liquidity Facilities) available to be drawn in the next 12 month period; and (iii) all amounts standing to the credit of the Capex Reserve Account are less than AWS’s (a) forecast capital expenditure projected for the next 12 month period; (b) forecast working capital requirements projected for the next 12 month period; and (c) the maximum total amount of Financial Indebtedness which is or is projected to be outstanding during the next succeeding 12 month period which falls within paragraph (e) of the definition of Permitted Financial Indebtedness.

(vi) **Drawdown on Debt Service Reserve Liquidity Facilities and O&M Reserve Facility**

- (a) If, at any time, the aggregate of all amounts available for drawing under any Debt Service Reserve Liquidity Facility and all amounts standing to the credit of the Debt Service Reserve Accounts is less than an amount equal to the next 12 months interest (or in the case of the Finance Leases, Lease Reserve Amounts or adjusted Lease Reserve Amounts) payable in respect of Class A Debt and Class B Debt (although it will not be a Trigger Event if it is triggered as a direct result of a banking error and remedied by such amount being repaid within 3 Business Days without such repayment being funded by a further drawing under a Debt Service Reserve Liquidity Facility).
- (b) The Issuer draws down under the O&M Reserve Facility or withdraws funds from the O&M Reserve Account to pay its maintenance costs and not, in the case of the O&M Reserve Facility, just in order to fund the O&M Reserve Account.

(vii) **Enforcement Order**

An Enforcement Order (as defined under the WIA) is issued under Part II, Chapter 11 of the WIA against AWS which would have a Material Adverse Effect if not complied with.

- (viii) **Circumstances leading to a Special Administration Order**  
Any indication arising from notices and/or correspondence issued by, or during correspondence with, the Director General or any other circumstance of which AWS is aware that would reasonably be expected to lead to an application by the Director General or the Secretary of State for a Special Administration Order to be made in respect of AWS.
- (ix) **Termination of Instrument of Appointment**  
The giving of a notice to terminate the Instrument of Appointment under the WIA.
- (x) **Event of Default**  
An Event of Default is continuing.
- (xi) **Material Entity Event**
- (a) A Material Entity Event occurs: (A) in relation to a Tier 1 Material Agreement or a Contractor and/or AWS under a Tier 1 Material Agreement and which continues unremedied for 60 days (other than a Material Entity Event under sub-paragraph (i) 7.6.11(i), "*Material Entity Events*" below which continues unremedied for 45 days or (ii) a Material Entity Event which is capable of remedy under sub-paragraphs (ii) or (iii) of 7.6.11, "*Material Entity Events*" below which continues unremedied for 30 days) from the date from which AWS could be reasonably expected to become aware of such Material Entity Event; or (B) in relation to a Tier 2 Material Agreement or a Contractor and/or AWS under a Tier 2 Material Agreement which continues unremedied for six months from the date from which AWS could be reasonably expected to become aware of such Material Entity Event;
- (b) During the period from the Effective Date until the commencement of the AMP4 Period, a Material Entity Event occurs in respect of a Tier 1 Agreement pursuant to sub-paragraphs (iv), (v), (vi), (vii) or (viii) of 7.6.11, "*Material Entity Events*" which is capable of remedy and which continues unremedied for 60 days.
- unless in either case, the relevant Contractor has been replaced in accordance with the Outsourcing Policy.
- (xii) **Referral**  
A referral is made under sub-paragraph 14.3 of Condition B in Schedule 2 (Shipwreck) to the Instrument of Appointment (or any successor or equivalent paragraph) as a result of any adverse event.
- (xiii) **Audit Qualification**  
The Auditors qualify their report on any audited Statutory Accounts of any member of the AWS Financing Group in a manner which causes the Security Trustee to believe that the financial ratios calculated in accordance with the Common Terms Agreement may not reflect the true position of AWS.
- (xiv) **Adverse Governmental Legislation**  
The commencement of the final reading of draft legislation in the House of Lords or the House of Commons (whichever occurs later) of legislation relating to or impacting upon Relevant Undertakers (as that term is defined in the WIA) and such legislation could if enacted reasonably be expected to lead to a breach of the financial ratios referred to in 7.6.7(i), "*Financial Ratios*" above or cause a material deviation as set out in 7.6.7(iv), "*Material Deviations in Projections*" above, in each case taking into account any actions available to AWS to mitigate the same.
- (xv) **Modification or Replacement of Instrument of Appointment**  
Within three months of an announcement setting out clear proposals by Ofwat for the modifications or replacement of the Instrument of Appointment which, if implemented, could reasonably be expected to have a Material Adverse Effect and a timetable for the implementation of such proposals, AWS has not obtained confirmation from Ofwat that the

proposed modification or replacement is not expected to be implemented or is expected to be implemented in a form which is not reasonably expected to have a Material Adverse Effect.

(xvi) **Conduct of Business**

The Permitted Non-Statutory Business Limits are breached.

(xvii) **Breach of Outsourcing Policy**

AWS fails duly to perform or comply with its obligations as required under the Outsourcing Policy (other than as a result of Permitted Emergency Action) and fails to remedy such breach within 90 days of AWS becoming aware of such breach.

(xviii) **No Rating Confirmation on Change of Control after Permitted Demerger**

At any time after a Permitted Demerger a person acquires Control of AWS Holdings or there is any change in the identity of the person who Controls AWS Holdings and a Rating Confirmation on Change of Control has not been obtained in relation to that change of Control.

### 7.6.8 Trigger Event Consequences

Following the occurrence of a Trigger Event and at any time until such Trigger Event has been waived by the Security Trustee, remedied in accordance with Trigger Event Remedies (see 7.6.9, “*Trigger Events Remedies*” below) or otherwise remedied to the satisfaction of the Security Trustee, the provisions set out below will apply:

(i) **No Restricted Payments**

No Obligor may make Restricted Payments and, in respect of Customer Rebates, if these have not yet been implemented, AWS must stop their implementation and must not declare any Customer Rebates.

(ii) **Further Information and Remedial Plan**

(a) AWS must provide such information as to the relevant Trigger Event (including its causes and effects) as may be requested by the Security Trustee.

(b) AWS must discuss with the Security Trustee its plans for appropriate remedial action and the timetable for implementation of such action. AWS and the Security Trustee may agree a Remedial Plan (with the agreement of the Security Trustee not to be unreasonably withheld or delayed) and any agreed Remedial Plan must then be implemented by AWS.

(iii) **Independent Review**

(a) The Security Trustee may (acting on the instructions of the Majority Creditors), commission an Independent Review to be undertaken on the timetable stipulated by the Security Trustee. The Independent Review will be conducted by technical advisers to the Security Trustee appointed from time to time or such other person as the Security Trustee may decide.

(b) The Independent Review will examine the causes of the relevant Trigger Event and recommend appropriate corrective measures.

(c) Each of the Issuer and AWS must co-operate with the person appointed to prepare the Independent Review including providing access to its books and records and personnel and facilities as may be required for those purposes.

(iv) **Consultation with Ofwat**

The Security Trustee shall be entitled to discuss the relevant Trigger Event and any Remedial Plans with Ofwat at any time.

(v) **Appointment of additional non-executive directors**

If the relevant Trigger Event has not otherwise been remedied or waived within six months from the date of its occurrence or such longer period as the Security Trustee, each Financial Guarantor and AWS may agree in a Remedial Plan, the Security Trustee will be entitled to procure the appointment of additional non-executive directors to the board of AWS provided that the additional non-executive directors appointed by the Security Trustee under this paragraph do not constitute a majority of the board of AWS.

(vi) **Appointment of additional Directors**

No Obligor may make any additional appointments to the board of any member of the AWS Financing Group other than to replace directors upon dismissal, retirement, sudden resignation, death or temporary vacancies unless the Security Trustee and each Financial Guarantor agrees.

In respect of any of the Trigger Event Consequences described above which requires the Security Trustee to exercise its discretion, it must do so upon instructions of the relevant Majority Creditors and any reference to reasonableness and reasonable time will be interpreted accordingly. The Security Trustee is entitled to assume that no Trigger Event has occurred unless informed otherwise.

Even if unremedied, a Trigger Event by itself will not constitute an Event of Default.

#### **7.6.9 Trigger Event Remedies**

At any time when the Issuer or AWS (as the case may be) believes that a Trigger Event has been remedied by virtue of any of the following, it shall serve notice on the Security Trustee to that effect, and the Security Trustee must respond within 10 days (or such longer period as it may reasonably stipulate within 5 Business Days of receipt of notice from the Issuer or AWS (as the case may be) to certify that the Issuer or AWS (as the case may be) believes the relevant Trigger Event to have been remedied) confirming that the relevant Trigger Event has, in its reasonable opinion, been remedied or setting out its reasons for believing that such Trigger Event has not been remedied (in which case, such event shall continue to be a Trigger Event until such time as the Security Trustee is reasonably satisfied that the Trigger Event has been remedied).

The following shall constitute remedies to the Trigger Events:

(i) **Financial Ratios**

The occurrence of a Trigger Event referred to in paragraph 7.6.7(i) of “*Trigger Events*” above shall be remedied if, on any date when the relevant ratio or ratios are calculated in accordance with the Common Terms Agreement such ratio or ratios come within the relevant level or levels specified below as at the most recently occurring Calculation Date:

- (a) the Senior RAR for each Test Period is or is estimated to be less than 0.9:1;
- (b) the Class A RAR for each Test Period is or is estimated to be less than 0.75:1;
- (c) the Senior PMICR for each Test Period is or is estimated to be greater than 1.1:1;
- (d) the Class A PMICR for each Test Period is or is estimated to be greater than 1.3:1;
- (e) the Senior Average PMICR is or is estimated to be greater than 1.2:1; or
- (f) the Class A Average PMICR is or is estimated to be greater than 1.4:1.

(ii) **Credit Rating Downgrade**

The occurrence of a Trigger Event referred to in paragraph 7.6.7(ii) of “*Trigger Events*” above shall be remedied if the credit rating of the relevant class of debt given by any two of the Rating Agencies is above the Trigger Credit Rating or the credit watch is removed and the credit rating of relevant class of debt given by any two of the Rating Agencies remains above the Trigger Credit Rating.

- (iii) **Debt Service Required Payment Shortfall**  
The occurrence of a Trigger Event referred to in paragraph 7.6.7(iii) of “*Trigger Events*” above will be remedied if payment of the required amount is paid into the Debt Service Payment Account.
- (iv) **Material Deviation in Projections**  
The occurrence of a Trigger Event referred to in paragraph 7.6.7(iv) of “*Trigger Events*” above will be remedied if the deviations referred to in that paragraph, on any subsequent date, are less than 10 per cent.
- (v) **Liquidity for Capital Expenditure and Working Capital**  
The occurrence of a Trigger Event referred to in paragraph 7.6.7(v) of “*Trigger Events*” above will be remedied if on any subsequent date the amounts referred to in sub-paragraphs (i) to (iii) of that paragraph are in aggregate equal to or greater than the aggregate of the amounts referred to in sub-paragraphs (a) to (c) of that paragraph.
- (vi) **Drawdown on Debt Service Reserve Liquidity Facility and O&M Reserve Facility**
  - (a) The occurrence of a Trigger Event referred to in paragraph 7.6.7(vi)(a) of “*Trigger Events*” above will be remedied if the amount available for drawing under a Debt Service Reserve Liquidity Facility when aggregated with all amounts standing to the credit of the relevant Debt Service Reserve Account is restored to the required level.
  - (b) The occurrence of a Trigger Event referred to in paragraph 7.6.7(vi)(b) of “*Trigger Events*” above will be remedied if the amount available for drawing under the O&M Reserve Facility, when aggregated with all amounts standing to the credit of the O&M Reserve Account is restored to the required level.
- (vii) **Enforcement Order**  
The occurrence of a Trigger Event referred to in paragraph 7.6.7(vii) of “*Trigger Events*” above will be remedied if AWS has complied with the terms of the relevant Enforcement Order to the reasonable satisfaction of the Security Trustee or if the Enforcement Order has been effectively withdrawn or if, in the opinion of the Security Trustee (acting reasonably), the relevant fine will not have a Material Adverse Effect or that the Instrument of Appointment will not be terminated.
- (viii) **Circumstances leading to a Special Administration Order**  
The occurrence of a Trigger Event referred to in paragraph 7.6.7(viii) of “*Trigger Events*” above will be remedied if (a) a Special Administration Order is not made within six months of the relevant Trigger Event occurring or (b) the Security Trustee is reasonably satisfied that a Special Administration Order will not be made in respect of AWS.
- (ix) **Termination of Instrument of Appointment**  
The occurrence of a Trigger Event referred to in paragraph 7.6.7(ix) of “*Trigger Events*” above will be remedied by agreement by AWS to the extent such Transfer Scheme requires any implementation prior to the termination of the Instrument of Appointment of a Transfer Scheme which is reasonably satisfactory to the Security Trustee.
- (x) **Event of Default**  
The occurrence of a Trigger Event referred to in paragraph 7.6.7(x) of “*Trigger Events*” above will be remedied if the Event of Default is remedied to the reasonable satisfaction of the Security Trustee.
- (xi) **Material Entity Event**  
The occurrence of a Material Entity Event referred to in paragraph 7.6.7(xi) of “*Trigger Events*” above will be remedied:

- (a) if it is remedied to the satisfaction of the Security Trustee and each Financial Guarantor;
- (b) if the Contractor has been replaced in accordance with the Outsourcing Policy; or
- (c) upon the acceptance by the Security Trustee and each Financial Guarantor of a Remedial Plan for as long as it is being complied with in all respects.

(xii) **Referral**

The occurrence of a Trigger Event referred to in paragraph 7.6.7(xii) of “*Trigger Events*” above will be remedied if:

- (a) the financial ratios set out in paragraph 7.6.7(i) of “*Trigger Events*” above are continuing to be complied with in the absence of any determination or forecast of the determination of the Director General; or
- (b) the Director General has made a determination that restores the financial ratios referred to in (xii)(a) above to the level specified in paragraph 7.6.7(i) of “*Trigger Events*” above.

(xiii) **Audit Qualification**

The occurrence of a Trigger Event referred to in paragraph 7.6.7(xiii) of “*Trigger Events*” above will be remedied if the Security Trustee is satisfied that such qualification does not affect the veracity of the financial ratios calculated in accordance with the Common Terms Agreement or AWS produces a further set of audited Statutory Accounts which are not qualified.

(xiv) **Adverse Governmental Legislation**

The occurrence of the Trigger Event referred to in paragraph 7.6.7(xiv) of “*Trigger Events*” above will be remedied if the draft bill fails to become an act of parliament or becomes an act in a form which will not cause a breach of the financial ratios set out in paragraph 7.6.7(i) above or the financial ratios are otherwise reinstated to the Trigger Event Ratio Levels as referred to in paragraph 7.6.7(i) of “*Trigger Events*” above or the Director General has confirmed that the capital expenditure which would otherwise have led to a material deviation as referred to in paragraph 7.6.7(iv) of “*Trigger Events*” above is allowable under adjustments to the RAV.

(xv) **Modification or Replacement of Instrument of Appointment**

The occurrence of a Trigger Event referred to in paragraph 7.6.7(xv) of “*Trigger Events*” above will be remedied if an independent expert on behalf of the Security Trustee determines that the modifications to the Instrument of Appointment or, as the case may be, the replacement licence or licences to be granted to AWS will or do contain equivalent terms which permit AWS to carry on its water and sewerage business substantially as carried on as of the Effective Date taking into account any changes in the regulatory environment since the Effective Date and in the opinion of the Security Trustee such terms will not be reasonably likely to:

- (a) have a Material Adverse Effect; or
- (b) result in a breach of the financial ratios as referred to in paragraph 7.6.7(i) “*Financial Ratios*” above.

(xvi) **Conduct of Business**

Within 6 months of the date of the occurrence of the Trigger Event referred to in paragraph 7.6.7(xvi) of “*Trigger Events*” above, AWS disposes of all or part of the Permitted Non-Statutory Business so that the Permitted Non-Statutory Business Limits will be complied with as at, and for the period ending on, the next Calculation Date.



(xvii) **Breach of Outsourcing Policy**

The occurrence of the Trigger Event referred to in paragraph 7.6.7(xvii) of “*Trigger Events*” above will be remedied if AWS takes such action as necessary so that it is in compliance with the Outsourcing Policy.

(xviii) **No Rating Confirmation on Change of Control after Permitted Demerger**

The occurrence of a Trigger Event referred to in paragraph 7.6.7(xviii) of “*Trigger Events*” above will be remedied if a Rating Confirmation on Change of Control is obtained or any downgrade as is referred to in the definition of “Rating Confirmation on Change of Control” which gave rise to that Trigger Event is reversed or such Trigger Event is waived by the Security Trustee and the Initial Financial Guarantor.

In respect of any of the Trigger Event remedies described above which require the Security Trustee to exercise its discretion, it must do so upon instructions of the relevant Majority Creditors, and any reference to reasonableness and reasonable time will be interpreted accordingly.

### **7.6.10 Events of Default**

The Common Terms Agreement will contain a number of events of default (the “**Events of Default**”) which will be Events of Default under each Finance Document (other than under the Hedging Agreements). Subject, in some cases, to agreed exceptions, materiality qualifications, reservations of law and grace periods, Events of Default will include (amongst others):

- (i) non-payment of amounts due under the Finance Documents within 3 Business Days of the due date;
- (ii) non-compliance with other obligations under the Finance Documents;
- (iii) material misrepresentation;
- (iv) any Financial Indebtedness not being paid when due (after the expiry of any applicable grace period) or any Financial Indebtedness being declared due and payable prior to its specified maturity as a result of an event of default;
- (v) an Insolvency Event or Insolvency Proceedings in relation to the Obligors other than AWS and in relation to AWS, an insolvency event or insolvency proceedings as set out further in the CTA;
- (vi) AWS transferring the Instrument of Appointment without the Security Trustee’s consent or AWS receiving notice that the Instrument of Appointment will be revoked or terminated and a scheme of transfer not being approved by the Secretary of State or the Director General on or before the date falling 2 years prior to the expiration of such notice;
- (vii) the Instrument of Appointment being terminated and not replaced immediately by a further licence on equivalent terms taking into account any changes in the regulatory environment since the Effective Date;
- (viii) insufficient liquidity (from operating cash flows, the Authorised Credit Facilities and the Capex Reserve Account) to meet AWS’s forecast capital expenditure and working capital requirements projected for the next 6 month period;
- (ix) attachment, sequestration, distress or execution involving sums in excess of £500,000 (indexed);
- (x) it becoming unlawful for any Obligor to perform its obligations under any Finance Document;
- (xi) an AWS Change of Control occurs;
- (xii) Security becoming invalid, unenforceable or unlawful;

- (xiii) governmental intervention or nationalisation which would be reasonably likely to have a Material Adverse Effect;
- (xiv) an Obligor failing to comply with a judgment involving sums in excess of £500,000 (indexed);
- (xv) other than in the case of a Permitted Lease Termination, an Obligor not having legal power to perform its obligations under the Finance Documents or any obligation of any Obligor under a relevant Finance Document (other than stamp duty indemnities) ceasing to be legal, binding and enforceable and the absence of compliance has a Material Adverse Effect;
- (xvi) AWS failing to comply with its obligations under the Outsourcing Policy (and such failure has a Material Adverse Effect);
- (xvii) an Obligor ceasing to carry on the Business (or any substantial part of the Business) it carries on as at the date of the Common Terms Agreement or as contemplated by the Finance Documents;
- (xviii) litigation being started against an Obligor or its assets or revenues which would be reasonably likely to be adversely determined and, if so adversely determined, would have a Material Adverse Effect;
- (xix) the shadow rating of the Class A Wrapped Bonds or the rating of the Class A Unwrapped Bonds in each case ascribed by two rating agencies being less than the minimum required for Investment Grade;
- (xx) the Class A ICR being less than 1.6:1, the Senior RAR being more than 0.95:1 and/or the ratio of Net Cash Flow minus Capital Maintenance Expenditure to Class A Debt Interest is less than 1:1;
- (xxi) an Obligor amending its memorandum or articles of association (and, in the case of any amendment to AWS's memorandum or articles, in a manner which is reasonably likely to have a Material Adverse Effect or diminish the Security interest granted in favour of the Security Trustee);
- (xxii) a Material Entity Event (as described in 7.6.11 "*Material Entity Events*" below) occurring which has a Material Adverse Effect.

In respect of each Event of Default requiring any action or discretion on the part of the relevant creditor, the Security Trustee will (save in respect of certain Entrenched Rights and Reserved Matters (see 7.4.18, "*Entrenched Rights and Reserved Matters*" above)) act in accordance with the instructions of the relevant Majority Creditors in accordance with the STID (see 7.4, "*Security Trust and Intercreditor Deed*" above).

Immediately upon the notification to the Security Trustee of an occurrence of an Event of Default, a Standstill Period will commence in accordance with the STID (see 7.4.13, "*Standstill*" above).

#### **7.6.11 Material Entity Events**

The Common Terms Agreement will (subject, in some cases to reservations of law and grace periods) provide that each of the following will constitute a Material Entity Event in respect of any Contractor under a Material Agreement or, as the case may be, AWS, to the extent that such Material Entity Event would be reasonably likely to have a Material Adverse Effect:

- (i) failure to pay any amount in excess of £500,000 (indexed) due from the Contractor or AWS unless payment is made within 15 days of an Obligor becoming aware of such failure or save if such payment is being disputed in good faith;
- (ii) any material representation or statement made or deemed to be made by a Contractor or AWS in any Material Agreement is or proves to have been incorrect or misleading in any material respect when made or deemed to be made and such failure, if capable of remedy,

is not remedied by the Contractor or AWS within 30 days of it becoming aware that such representation was incorrect or misleading in any material respect;

- (iii) the Contractor or AWS fails duly to perform or comply with any other obligation expressed to be assumed by it in any Material Agreement and such failure, if capable of remedy, is not remedied by such Contractor or AWS, within 30 days of becoming aware of such breach;
- (iv) the Contractor:
  - (A) ceases or suspends generally payment of its debts or publicly announces an intention to do so or is unable to pay its debts as they fall due or is deemed to be insolvent; or
  - (B) commences negotiations with or makes a proposal to any one or more of its creditors concerning its solvency, with a view to the readjustment or rescheduling of any indebtedness;
- (v) an Insolvency Event or equivalent event occurs in relation to a Contractor to a Material Agreement;
- (vi) the Contractor fails to comply with or pay any sum due from it under any judgment or any order made or given by any court of competent jurisdiction when such sums exceed £500,000 (indexed) (or its equivalent) in aggregate at any time except where such judgment is being appealed in good faith to a higher court;
- (vii) any Material Agreement to which the Contractor and AWS is a party or any material obligation purported to be contained therein or the security or credit enhancement intended to be effected in relation to any of the Material Agreements to which it is a party is repudiated by it or it does or causes to be done any act or thing evidencing an intention to repudiate, abandon, cancel, suspend or terminate any Material Agreement to which it is a party or the security or credit enhancement related thereto or any such material obligation or any such security or subordination effected under any of the Material Agreements to which it is a party or any Material Agreement is not or ceases to be in full force and effect or the legal validity or applicability thereof to any sums due or to become due thereunder is disaffirmed by it or on behalf of it; and
- (viii) the Contractor, AWS or any provider of security or credit enhancement therefor does not have the legal power to perform any of its material obligations under the Material Agreements or, as the case may be, such security or credit enhancement or to own any material assets or to carry on any material part of its business or at any time it is or becomes unlawful for the Contractor, AWS or any provider of security or credit enhancement therefor to perform or comply with any of its material obligations under any Material Agreement or any of the material obligations of the Contractor or any provider of security or credit enhancement thereunder are not or cease to be legal, valid, binding and enforceable.

#### **7.6.12 Conditions Precedent**

The conditions precedent to the signing of the Common Terms Agreement and the Bridging Facility, the Effective Date and to the issue of Bonds after the Effective Date will all be set out in the CP Document as agreed between, inter alios, the Bond Trustee, the Security Trustee and the Obligors.

### **7.7 Cash Management**

#### **7.7.1 Accounts**

The Common Terms Agreement will require AWS to open and maintain the following Accounts:

- (a) the Receipts Account;
- (b) the Payment Account;

- (c) the Customer Payment Account;
- (d) the O&M Reserve Account;
- (e) the Distributions Account;
- (f) the Capex Reserve Account; and
- (g) the Compensation Account.

It will further require the Issuer to open and maintain the following Accounts: (a) the Debt Service Payment Account; (b) the Class A Debt Service Reserve Account; and (c) the Class B Debt Service Reserve Account, and AWS Holdings and AWS Overseas Holdings to each open and maintain a chequing account.

Each of the above accounts together with any bank account of any member of the AWS Financing Group are collectively referred to as the “**Accounts**”. Each of the Accounts will be held with the Account Bank pursuant to the Account Bank Agreement. Each Obligor will agree in the Common Terms Agreement to comply with the Account Bank Agreement and the provisions of the Common Terms Agreement applying to its Accounts.

### **7.7.3 Receipts Account**

Under the Common Terms Agreement, AWS will agree to ensure that all of its revenues (excluding any interest or investment income from Authorised Investments and excluding the proceeds of any Financial Indebtedness raised at any time when there are amounts outstanding under the Bridging Facility, which proceeds shall be applied immediately in repayment or prepayment of amounts outstanding under the Bridging Facility) will be paid into the Receipts Account or transferred from an existing receipts account to the Receipts Account within one Business Day of receipt. Any payment may be made directly to the Payment Account. Save for refunds of monies received incorrectly and/or compensation payments made to customers in the ordinary course of business, monies credited from time to time to the Receipts Account will be transferred periodically at the discretion of AWS to the Payment Account but not otherwise.

### **7.7.4 Payment Account**

The Payment Account will be the principal current account of AWS through which all operating and capital expenditure or any taxes incurred by AWS and (subject to the terms of the Finance Documents) payments in respect of Financial Indebtedness of the AWS Financing Group which are not permitted to be satisfied out of monies in the Debt Service Payment Account will be cleared (including any Distributions in respect of the UK HoldCo/AWS Loan). Operating expenditure will be funded by cash transfers from the Receipts Account and, if applicable, through direct payments into the Payment Account and through drawings, as and when required and permitted by the Finance Documents, under any Authorised Credit Facility or other Permitted Financial Indebtedness. Capital expenditure will be funded out of monies standing to the credit of the Payment Account or Receipts Account or, to the extent such sums are insufficient, out of cash transfers made from the Capex Reserve Account and/or the O&M Reserve Account. AWS and the Issuer will agree to direct on the Effective Date that an amount equal to £50,000,000 will be paid into the Payment Account.

Under the Common Terms Agreement, AWS will agree that on the opening of business on the first Business Day of each month until the Discharge Date an amount equal to 1/12th (or, pro rata in the case of the first Test Period) of AWS’s Annual Finance Charge for the time being will be transferred from the Payment Account to the Debt Service Payment Account (the “**Monthly Payment Amount**”). If in any month AWS pays an amount into the Debt Service Payment Account to meet payments of AFC Amounts falling due in such month, this will be treated as a prepayment of future Monthly Payment Amounts payable during such Test Period. Accordingly, future Monthly Payment Amounts for that Test Period will be pro-rata reduced to reflect such prepayment.

The Annual Finance Charge shall be calculated by AWS on the Effective Date and annually thereafter on 31 March of each year (or, if such day is not a Business Day, the immediately

preceding Business Day) and details included in the next following Investors Report (including any adjustments or recalculations thereto).

AWS shall recalculate the Annual Finance Charge and the Monthly Payment Amount if, during the course of any Test Period, there occurs any increase (whether as a result of any increase in the rate of applicable interest, any drawing under any Authorised Credit Facility, any deferral of interest, any upwards adjustment of rentals under any Finance lease, or otherwise) or decrease (whether as a result of any downwards adjustment of rentals under any Finance Lease or any prepayment or repayment of the debt under which the relevant liabilities arise or accrue or otherwise) and shall adjust the Monthly Payment Amount for the remaining months in the relevant Test Period accordingly.

AWS will be prohibited from withdrawing any monies in the Payment Account except on account of the following expenditure and then only in the following order (and provided all prior amounts under previous sub-paragraphs have been paid) (i) operating and capital expenditure of AWS and taxes of any Obligor, (ii) payments to the Debt Service Payment Account in respect of the Monthly Payment Amount, (iii) by way of payment of Class A Debt required under section 7.7.6, “*Debt Service Payment Account*”, (iv) for the purpose of transferring monies to the Capex Reserve Account or to the Class A Debt Service Reserve Account in respect of Class A Debt as required under section 7.7.6 and/or the O&M Reserve Account (in each case to the extent required to prevent a breach of covenant or Trigger Event under the Common Terms Agreement), (v) by way of payment of Class B Debt required under section 7.7.6, (vi) for the purpose of transferring monies to the Class B Debt Service Reserve Account in respect of Class B Debt as required under section 7.7.6 (to the extent required to prevent a breach of covenant or Trigger Event under the Common Terms Agreement, (vii) from time to time for the purpose of making payments in respect of Financial Indebtedness which are not to be satisfied out of monies in the Debt Service Payment Account (including sums due as a result of a Permitted Hedge Termination and/or a Permitted Lease Termination) or (viii) to pay UK HoldCo Debt Service Distributions or (ix) by way of transfer to the Customer Payment Account or Distributions Account provided that the conditions for making such payments as set out in the Common Terms Agreement (as summarised in paragraph (iv)(v) of 7.6.5, “*Covenants – General*” above) have been satisfied.

#### **7.7.5 Capex Reserve Account and O&M Reserve Account**

AWS and the Issuer shall on the Effective Date direct that an amount equal to £155,000,000 will be paid into the Capex Reserve Account.

AWS may not withdraw any monies from the Capex Reserve Account or the O&M Reserve Account except for the purpose of any transfer to the Payment Account on account of AWS’s forecast capital expenditure (in the case of the Capex Reserve Account) or operating and maintenance expenditure (in the case of the O&M Reserve Account) for the quarter in which such transfer occurs. In no circumstances shall AWS transfer in any quarter any monies from the Capex Reserve Account or the O&M Reserve Account to the Payment Account in excess of AWS’s forecast capital expenditure or operating and maintenance expenditure (as the case may be) for that quarter.

The Issuer and AWS will agree to ensure that the proceeds of any advance under any Authorised Credit Facility for the purpose of funding capital expenditure is lent to AWS under the Issuer/AWS Loan Agreement and is paid directly into the Capex Reserve Account or the Payment Account.

The Issuer and AWS will further agree to ensure that the proceeds of any advance under the O&M Reserve Facility is lent to AWS under the Issuer/AWS Loan Agreement and is paid directly into the O&M Reserve Account or the Payment Account.

AWS shall not be entitled to withdraw any monies credited to the O&M Reserve Account to make payment of any capital expenditure or operating and maintenance expenditure unless at the time of such withdrawal there are no funds standing to the credit of the Payment Account or the Receipts Account.

#### 7.7.6 Debt Service Payment Account

AWS and the Issuer shall, on the Effective Date, direct that a pro rata amount will be paid into the Debt Service Payment Account in satisfaction of the Monthly Payment Amount for the month in which the Effective Date falls.

AWS will agree in the Common Terms Agreement that (i) each transfer of or in respect of the Monthly Payment Amount from the Payment Account and (ii) upon the commencement of a Standstill Period, the aggregate amount then credited to the Customer Payment Account and the Distributions Account will be paid directly into the Debt Service Payment Account.

The Common Terms Agreement will provide that on each Payment Date, monies credited to the Debt Service Payment Account (and to the extent such amount is insufficient) monies credited to the Payment Account and/or the Receipts Account shall be applied by AWS and the Issuer in the following order and that AWS shall repay the Intercompany Loan Arrangements to such extent as is required for the purpose of enabling the following payments (“**Permitted Payments**”) to be made in the following order of priority (the “**Payment Priorities**”):

- (i) first (to the extent there are insufficient monies standing to the credit of all other Accounts and/or available for drawing under any Liquidity Facility), in or towards satisfaction of all operating costs and budgeted maintenance costs;
- (ii) second, in or towards satisfaction of the remuneration, costs and expenses of the Security Trustee and the Bond Trustee;
- (iii) third, in or towards satisfaction of, on a pro rata basis: (a) the remuneration, costs and expenses of the Agent Bank, the USPP Paying Agent, each Paying Agent, each Registrar, each Transfer Agent, each Exchange Agent, the Listing Agent and any other agents appointed under the Agency Agreement or otherwise (each an “**Agent**”), the Account Bank under the Account Bank Agreement, each Debt Service Reserve Liquidity Facility Provider under the relevant Liquidity Facility Agreement, the O&M Reserve Facility Provider under the O&M Reserve Facility, each Authorised Credit Provider under the relevant Authorised Credit Facility, the Cash Manager; and (b) the remuneration, costs and expenses of and premia of each Financial Guarantor pursuant to the relevant I&I Agreement;
- (iv) fourth, pro rata according to the respective amounts thereof, in or towards satisfaction of: (a) all amounts of fees, interest and principal (other than any Subordinated Liquidity Facility Amounts) due or overdue to each Debt Service Reserve Liquidity Facility Provider under the relevant Liquidity Facility Agreement; (b) all amounts of fees, interest and principal (other than Subordinated O&M Reserve Facility Amounts) due or overdue to the O&M Reserve Facility Provider under the O&M Reserve Facility; and (c) all amounts of interest and principal due or overdue to each Authorised Credit Provider under the relevant Authorised Credit Facility to the extent that the Financial Indebtedness was incurred to fund a New Money Advance;
- (v) fifth, pro rata according to the respective amounts thereof, in or towards satisfaction of all scheduled amounts payable to each Hedge Counterparty under any Interest Rate Hedging Agreement (subject to paragraphs (vi) and (xv) below);
- (vi) sixth, pro rata according to the respective amounts thereof, in or towards satisfaction of: (a) all amounts of interest, (including the Lease Reserve Amounts and adjusted Lease Reserve Amounts) and commitment commissions due or overdue in respect of the Class A Debt (other than Subordinated Coupon Amounts and Subordinated Authorised Loan Amounts); (b) any amounts (including termination amounts) due and payable to each Hedge Counterparty under any Interest Rate Hedging Agreement (subject to paragraphs (v) above and (xv) below); (c) all scheduled amounts payable to each Hedge Counterparty under any Currency Hedging Agreement and (following termination of a Standstill Period other than due to remedy or waiver by the Majority Creditors of the Event of Default giving rise to the Standstill Period) all amounts payable to each Hedge Counterparty under any Currency Hedging Agreement (subject to paragraph (xv) below); (d) all amounts of underwriting commissions due or overdue in respect of the Class A Debt; and (e) all reimbursement

sums (if any) owed to each Financial Guarantor under the relevant I&I Agreement in respect of payments of interest on any Class A Bonds of the relevant Series guaranteed by such Financial Guarantor;

- (vii) seventh, pro rata according to the respective amounts thereof, in or towards satisfaction of: (a) all amounts of principal due or overdue in respect of the Class A Debt (including in respect of Finance Leases, those amounts payable in respect thereof which do not fall within paragraph (vi) above and do not fall due as a result of the operation of any indemnity or fee reimbursement provision of a Finance Lease); (b) all principal exchange amounts due and payable to each Hedge Counterparty under any Currency Hedging Agreement; (c) any termination amounts or other sums due and payable to each Hedge Counterparty under any Currency Hedging Agreement (subject to paragraph (vi) above and paragraph (xv) below); and (d) all reimbursement sums (if any) owed to each Financial Guarantor under the relevant I&I Agreement in respect of payments of principal on any Class A Bonds of the relevant Series guaranteed by such Financial Guarantor;
- (viii) eighth, pro rata according to the respective amounts thereof, in or towards satisfaction of any Make-Whole Amount due and payable on the Class A Debt and any MBIA Make-Whole Amount;
- (ix) ninth, (to the extent required under the Common Terms Agreement) in payment to the Class A Debt Service Reserve Account;
- (x) tenth, (to the extent required under the Common Terms Agreement) in payment to the O&M Reserve Account;
- (xi) eleventh, pro rata according to the respective amounts thereof, in or towards satisfaction of all amounts of: (a) interest and commitment commissions due or overdue in respect of the Class B Debt (other than any Subordinated Coupon Amounts); (b) all amounts of underwriting commissions (other than Subordinated Commissions) due or overdue in respect of the Class B Debt; and (c) all reimbursement sums (if any) owed to each Financial Guarantor under the relevant I&I Agreement in respect of payments of interest on any Class B Bonds of the relevant Series guaranteed by such Financial Guarantor;
- (xii) twelfth, pro rata according to the respective amounts thereof, in or towards satisfaction of: (a) all amounts of principal due or overdue in respect of the Class B Debt; and (b) all reimbursement sums (if any) owed to each Financial Guarantor under the relevant I&I Agreement in respect of payments of principal on any Class B Bonds of the relevant Series guaranteed by such Financial Guarantor;
- (xiii) thirteenth, pro rata according to the respective amounts thereof, in or towards satisfaction of any Make-Whole Amounts due and payable on the Class B Debt;
- (xiv) fourteenth, (to the extent required under the Common Terms Agreement) in payment to the Class B Debt Service Reserve Account;
- (xv) fifteenth, pro rata according to the respective amounts thereof, in or towards satisfaction of: (a) any other amounts (not included in paragraphs (vi) and (vii) above), due and/or overdue to the Finance Lessors; and (b) any termination payment due or overdue to a Hedge Counterparty under any Hedging Agreement which arises as a result of a default by such Hedge Counterparty or as a result of a downgrade in the credit rating of such Hedge Counterparty;
- (xvi) sixteenth, pro rata according to the respective amounts thereof, in or towards satisfaction of: (a) all Subordinated Liquidity Facility Amounts due or overdue to each Liquidity Facility Provider under the relevant Liquidity Facility Agreement in respect of Class A Bonds; (b) all Subordinated O&M Reserve Facility Amounts due or overdue to the O&M Reserve Facility Provider under the O&M Reserve Facility; (c) all Subordinated Authorised Loan Amounts due or overdue to each Authorised Credit Provider under the relevant Authorised Credit Facility in respect of Class A Debt; (d) any other indemnified amounts due or overdue to each Financial Guarantor under the relevant I&I Agreement in respect of any Class A Bonds of the relevant Series guaranteed by such Financial

Guarantor; and (e) any amounts payable in respect of Class A Debt not referred to in other paragraphs of the Payment Priorities;

- (xvii) seventeenth, pro rata according to the respective amounts thereof, in or towards satisfaction of: (a) all Subordinated Liquidity Facility Amounts due or overdue to each Liquidity Facility Provider under the relevant Liquidity Facility Agreement in respect of Class B Bonds; (b) all Subordinated Authorised Loan Amounts due or overdue to each Authorised Credit Provider under the relevant Authorised Credit Facility in respect of Class B Debt; (c) any other indemnified amounts due or overdue to each Financial Guarantor under the relevant I&I Agreement in respect of any Class B Bonds of the relevant Series guaranteed by such Financial Guarantor; and (d) any amounts payable in respect of Class B Debt not referred to in other paragraphs of the Payment Priorities;
- (xviii) eighteenth, pro rata according to the respective amounts thereof, in or towards satisfaction of all Subordinated Coupon Amounts due or overdue in respect of any Class A Bonds;
- (xix) nineteenth, in or towards satisfaction of all Subordinated Coupon Amounts due or overdue in respect of any Class B Bonds;
- (xx) twentieth (to the extent required in the Common Terms Agreement) shall remain in the Debt Service Payment Account.

For so long as a Standstill Event has not occurred or has occurred and has been cured or an Early Redemption Shortfall is not subsisting, AWS will, on the date which is seven Business Days prior to each Payment Date (such date, a “**Determination Date**”), determine whether the aggregate amount of monies then credited to the Debt Service Payment Account is at least equal to the aggregate Financial Indebtedness falling due and payable on such Payment Date (such aggregate amount, “**Scheduled Debt Service**”). If the balance on the Debt Service Payment Account is less than the amount of Scheduled Debt Service, then AWS will promptly transfer sums standing to the credit of the Payment Account and/or the Receipts Account to the Debt Service Payment Account. To the extent that the aggregate of all such sums paid or transferred to the Debt Service Payment Account is less than the Scheduled Debt Service, the Issuer shall promptly request a drawing under the Liquidity Facility. Any proceeds raised by the Issuer in accordance with the terms of the Finance Documents (excluding any permitted post closing events) shall be paid under the Intercompany Loan Arrangements by the Issuer to AWS. Amounts raised (a) to fund capital expenditure shall be paid into the Capex Reserve Account, (b) to refinance existing Financial Indebtedness of the Issuer or AWS, shall be paid into the Debt Service Payment Account (and to that extent will not require a drawing on the Debt Service Reserve Liquidity Facility) and (c) for any other purposes, shall be paid into the Payment Account.

Until such time as a Standstill Event has occurred and remains unremedied, and/or an Early Redemption Shortfall is subsisting, all amounts payable on any Payment Date shall be paid strictly in the order referred to above, to the intent that no amounts falling to be paid under any sub-paragraph may be paid until such time as the amounts falling to be paid on the same date or earlier under each preceding sub-paragraph have been paid in full.

#### **7.7.7 Debt Service Reserve Accounts**

AWS will be allowed (subject to and in accordance with the order for payment specified in 7.7.6, “*Debt Service Payment Account*” above) to transfer monies standing to the credit of the Receipts Account or Payment Account to the Class A Debt Service Reserve Account or the Class B Debt Service Reserve Account, as required.

AWS will agree to procure that on any Payment Date the aggregate of (i) all amounts available for drawing under the Debt Service Reserve Liquidity Facilities; and (ii) all amounts standing to the credit of the Debt Service Reserve Accounts are equal to the next 12 months’ interest forecast to be due on the Financial Indebtedness of the AWS Financing Group.

#### **7.7.8 Compensation Account**

- (i) The Common Terms Agreement will require AWS to ensure that:



- (a) all proceeds of insurance in excess of £1,000,000 (indexed) per claim, receivable by it or to its order (other than in respect of delay in start up, business interruption or anticipated loss in revenue or third party claims) are paid directly into the Compensation Account; and
  - (b) any such amounts which are not paid directly into the Compensation Account are paid into the Compensation Account immediately upon receipt by (or to the order of) AWS; and
  - (c) any amounts required under the terms of the Common Terms Agreement to be deposited into the Compensation Account following a notice of termination from a Hedge Counterparty are so deposited.
- (ii) Subject to paragraph (iii) below, the Common Terms Agreement will provide that AWS may only withdraw amounts from the Compensation Account: (A) in the case of moneys representing the proceeds of claims under physical loss or damage policies, for application in meeting payments which are due and payable in respect of the restoration, reinstatement or replacement of the asset lost or damaged or in payment of any Class A Debt falling due on the same day as any Permitted Lease Termination arising as a consequence of the loss of such asset; or (B) in the case of moneys paid to AWS's order to be paid direct to a third party on account of whose claim those insurance proceeds are payable, by way of payment to such third party; or (C) in the case of amounts referred to under paragraph (i)(c) above, in meeting termination sums due under the relevant Hedging Agreement and/or (D) in paying to the Payment Account any amount deposited which is, at any time, in excess of the amount required to be so deposited.
- (iii) If AWS has paid sums to reinstate, restore or replace effects lost or damaged or to meet claims by third parties out of moneys withdrawn from the Receipts Account or Payment Account, then the Common Terms Agreement will allow AWS to transfer moneys representing the proceeds of the claim to the Payment Account.

#### **7.7.9 Customer Payment Account**

Subject to complying with the Common Terms Agreement, AWS will be allowed to credit to the Customer Payment Account such amounts as are permitted to be transferred to the Customer Payment Account pursuant to the terms of the Common Terms Agreement and, in particular, pursuant to the provisions thereof dealing with Restricted Payments (see 7.6.5, "*Covenants – General*", above).

AWS will agree to ensure that in respect of each Financial Year in which Customers Rebates are given, the balance on the Customer Payment Account is at all times during such Financial Year equal to the Customer Payment Account Required Balance. To the extent that the balance on the Customer Payment Account is at any time greater than the Customer Payment Account Required Balance, AWS shall withdraw from the Customer Payment Account an amount equal to such excess and transfer such amount to the Payment Account.

Subject to the above, AWS will be entitled, at any time prior to the occurrence of a Standstill Event, to apply monies credited to the Customer Payment Account in and towards settlement of a Restricted Payment that is a Customer Rebate.

#### **7.7.10 Distributions Account**

The Common Terms Agreement will provide that AWS may only transfer amounts from the Payments Account to the Distributions Account strictly in accordance with the provisions of the Common Terms Agreement (and, in particular, in accordance with the covenant dealing with payments into the Distributions Account (see 7.6.5, "*Covenants – General*", above)).

AWS will be able to withdraw amounts properly standing to the credit of the Distributions Account at any time for payment into the Payment Account or, provided no Event of Default is subsisting, for payment for any purpose.

### 7.7.11 Authorised Investments

The Common Terms Agreement will allow AWS and the Issuer to invest in certain eligible Authorised Investments such part of the amounts standing to the credit of any of the Accounts as is prudent and in accordance with certain provisions to be set out in the Common Terms Agreement including that deposits constituting Authorised Investments will only be permitted to the extent that the Authorised Investment is with a bank or financial institution which has agreed, that (i) the Authorised Investment is held to the order of AWS; (ii) any payment in respect of the Authorised Investment will be remitted (in full and without any deduction, withholding or retention of any kind, except to the extent required by law) to the Account Bank; (iii) the Authorised Investment is subject to the Security Interests created by the Security Documents; and (iv) it will not exercise, and will hold the Authorised Investment free of, any Security Interest, right of set-off, counterclaim or other interest which it may have.

### 7.7.12 Cash Management during a Standstill Period

The arrangements described in “*Debt Service Payment Account*” above shall continue to apply until the occurrence of a Standstill Event. The Common Terms Agreement will provide that, following the occurrence of a Standstill Event and for so long as it continues unremedied, and/or for so long as an Early Redemption Shortfall is subsisting and provided no Enforcement Action (other than a Permitted Hedge Termination, a Permitted Lease Termination or a permitted share pledge acceleration) has occurred, the Cash Manager shall assume control of the Accounts, pay operating expenditure when it falls due and, on a monthly basis calculate the aggregate of all payments falling to be made during the next following period of 12 months and shall calculate all net revenues received and/or expected to be received over that 12 month period. To the extent that there is a shortfall in the forecast revenues, the Cash Manager shall notionally apply those forecast revenues to each category in the order set out in 7.7.6, “*Debt Service Payment Account*” until the revenue that is forecast to be available is insufficient to meet all of the payments in any subparagraph of 7.7.6, “*Debt Service Payment Account*” above (the “**Shortfall Paragraph**”) and shall, in respect of those categories of payment falling within the Shortfall Paragraph, divide the anticipated revenues remaining pro-rata between those amounts. Throughout the Standstill Period and/or for so long as an Early Redemption Shortfall is subsisting, any payments falling to be made within a category of payment falling within a Shortfall Paragraph shall be satisfied by a payment of the pro-rata share of that payment so calculated and no payments falling in a category which (in accordance with the order of priority set out in 7.7.6, “*Debt Service Payment Account*”) falls after a Shortfall Paragraph shall be made (and the balance of the payments not made shall remain outstanding).

The proceeds of enforcement of the Security which is permitted to be enforced during a Standstill Period will also be applied in accordance with the above Payments Priorities. In circumstances where such enforcement occurs during a Standstill Period or following an Enforcement Action (other than a Permitted Hedge Termination or a Permitted Lease Termination) under the STID the proceeds of enforcement will be applied in accordance with the above Payment Priorities but excluding in these circumstances payments under 7.7.6(i) (ix) and (xiv).

## 7.8 Security Agreement

### 7.8.1 Security

Each Obligor will, on or before the Effective Date enter into the security agreement (the “**Security Agreement**”) with the Security Trustee pursuant to which they will each guarantee the obligations of each other Obligor under the Finance Documents to the Security Trustee as security trustee for the Secured Creditors and each secure their property, assets and undertakings to the Security Trustee as trustee for the Secured Creditors. The creation, perfection and enforcement of such security will (in respect of the Security granted by AWS) be subject to the WIA, the Instrument of Appointment and requirements thereunder. As a result of the restrictions placed upon AWS in respect of the giving of security and the Special Administration procedure contained in the WIA, the value, effect and enforceability of the security granted by AWS is severely limited (see Chapters 6 “*Investment Considerations*” and 11 “*Regulation of the Water and Sewerage Industry in England and Wales*” of this Offering Circular for a more detailed discussion of these issues). The Security Agreement will, to the extent applicable, incorporate the provisions of the Common Terms Agreement and the STID.

The security constituted by the Security Agreement will be expressed to include:

- (i) first fixed charges over:
  - (a) the shares in AWS, AWS Overseas Holdings and the Issuer;
  - (b) each Obligor's right, title and interest from time to time in and to:
    - (A) any real property interests currently owned by it or acquired after the date of the Security Agreement (other than certain excluded property not exceeding in aggregate £10 million (indexed));
    - (B) the proceeds of disposal of any land;
  - (c) all present and future plant, machinery, office equipment, computers, vehicles and other chattels;
  - (d) its accounts;
  - (e) any intellectual property rights owned by it (excluding immaterial information technology licence agreements);
  - (f) any goodwill and rights in relation to the uncalled capital;
  - (g) each investment;
  - (h) all shares of any person owned by the Obligor including all dividends, interest and other monies payable in respect thereof and all other rights related thereto;
  - (i) all present and future book and other debts and all moneys standing to the credit of its accounts and the debts represented thereby;
- (ii) an assignment of each Obligor's right, title and interest from time to time in and to:
  - (a) the proceeds of any insurance policies (other than motor insurance, employer's liability insurance and any other third party liability insurance) and all rights related thereto;
  - (b) all Transaction Documents and any other document or agreement to which an Obligor is a party (subject to certain exceptions); and
- (iii) a first floating charge of the whole of the undertaking, property, assets and rights whatsoever and wheresoever present and future of each Obligor,

except that the security will not include any Protected Land (see Section 11.6, "*Protected Land*") or any of AWS's other assets, property and rights to the extent, and for so long as, the taking of any such security would contravene the terms of the Instrument of Appointment and requirements thereunder or the WIA.

The security will be held on trust by the Security Trustee for itself and on behalf of the Secured Creditors in accordance with and subject to the terms of the STID.

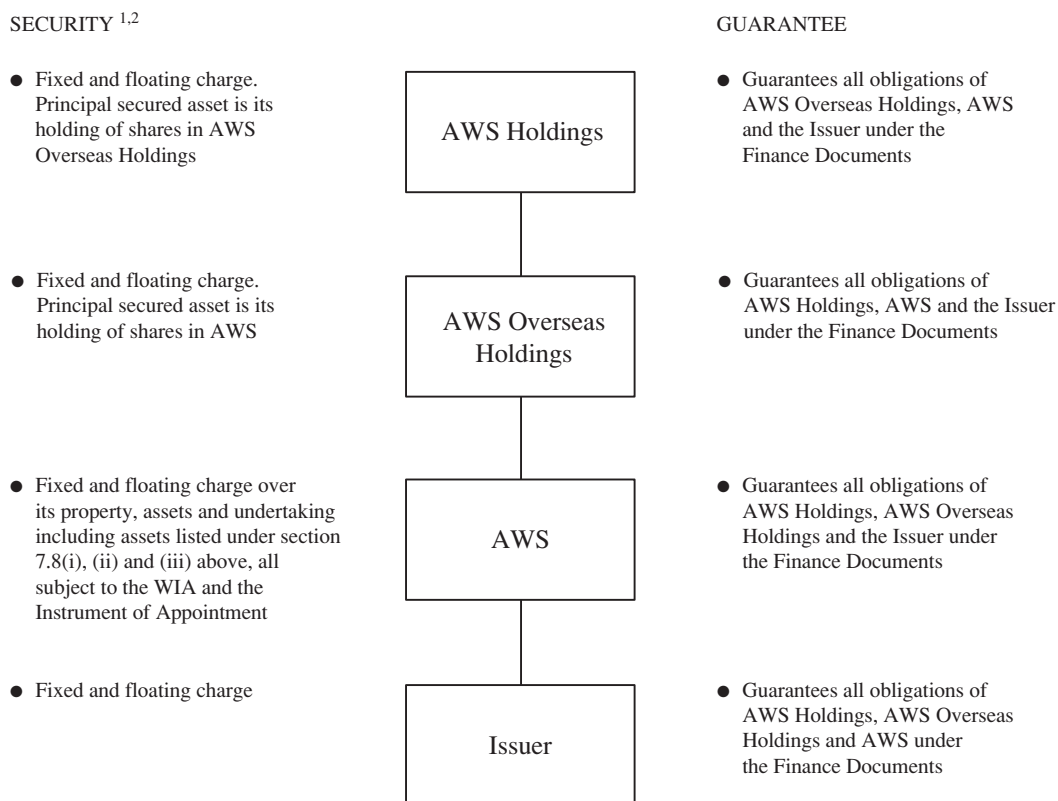
For a description of certain limitations on the ability of AWS to grant security and certain limitations and restrictions on the security purported to be granted, see Section 6.3.1, "*Certain Legal Considerations – Security*" and Section 11.7.1, "*Regulation of the Water and Sewerage Industry in England and Wales – Restrictions on the granting of security*".

Notice of the creation of the security will not be given initially to customers or to contractual counterparties in respect of contracts (other than certain material contracts) and each charge over land as purported to be granted will take effect in equity only. Accordingly, until notice of the creation of the Security is given to the relevant customers or contractual counterparties or registration is effected with HM Land Registry in respect of registered land or certain other action is taken in respect of unregistered land, to the extent possible any such security or charge may be or become subject to prior equities and/or other legal rights arising in relation thereto.

None of AWS Holdings or AWS Overseas Holdings is expected to have any significant assets other than the shares in their respective subsidiaries.

## 7.8.2 Security Structure

The following shows the security provided by the AWG Financing Group in favour of the Security Trustee on behalf of the Secured Creditors:



### Notes

1. All security is granted to the Security Trustee as security trustee for the Secured Creditors.
2. AWS Holdings, AWS Overseas Holdings, AWS and the Issuer grant all security pursuant to the Security Agreement.

## 7.9 Financial Guarantor Documents

### 7.9.1 The Bond Policies

The form of Bond Policy to be issued by MBIA (upon fulfilment or waiver by MBIA of certain conditions precedent to be contained in the CP Document) in respect of the issue of Class A Wrapped Bonds to be issued under the Programme is set out in full in Chapter 13, “*Financial Guarantor*” under “*MBIA’s Bond Policy*”. To the extent that MBIA or any other Financial Guarantors issue Bond Policies in respect of any further Series of Class A Wrapped Bonds and/or Class B Wrapped Bonds, such Bond Policies are expected to be issued by such Financial Guarantor(s) on terms substantially similar thereto.

Upon an early redemption of the relevant Class A Wrapped Bonds or an acceleration of the relevant Class A Wrapped Bonds, MBIA’s obligations will continue to be to pay the Insured Amounts as they fall Due for Payment (as defined in MBIA’s Bond Policy) on each Payment Date. MBIA will not be obliged under any circumstances to accelerate payment under its Bond Policies. However, if it does so, it may do so in its absolute discretion in whole or in part, and the amount payable by MBIA will be the outstanding principal amount (or pro rata amount that has become due and payable) of the relevant Class A Wrapped Bonds together with accrued interest (excluding always the FG Excepted Amounts). Any amounts due in excess of such outstanding principal amount (and any accrued interest thereon) will not be guaranteed by MBIA or any other Financial Guarantor under any of the Bond Policies.

The Bond Trustee as party to the Bond Policies to be issued by MBIA will have the right to enforce the terms of such Bond Policies, and any right of any other person to do so is expressly excluded.

### **7.9.2 Insurance and Indemnity Agreements**

On each relevant Issue Date, the Issuer and AWS will enter into an insurance and indemnity agreement (each an “**I&I Agreement**”) with the relevant Financial Guarantor, pursuant to which the Issuer will be obliged, inter alia, to reimburse such Financial Guarantor in respect of the payments made by it under the relevant Bond Policy and to pay inter alia any premia and fees and expenses of such Financial Guarantor in respect of the provision of the relevant Bond Policy. Insofar as a Financial Guarantor makes payment under the relevant Bond Policy in respect of Insured Amounts (as defined in such Bond Policy), it will be subrogated to the present and future rights of the relevant Wrapped Bondholders against the Issuer in respect of any payments made.

### **7.9.3 AWG Side Letter**

On or before the Effective Date AWG and MBIA will enter into a letter agreement under which AWG will agree that it will not voluntarily cease to have Control of AWS Holdings unless it has first obtained a confirmation from at least two Rating Agencies that such event will not cause the shadow rating of the Class A Wrapped Debt to be downgraded to, or below, BBB+ by Fitch and S&P or, as the case may be, Baa1 by Moody’s. AWG also undertakes to procure (unless it is unable to do so by reason of any law, judgment, court order, regulation, directive or any regulatory or licence requirement), that any person who gains Control of AWS Holdings will enter into a letter with MBIA on equivalent terms.

## **7.10 Additional Resources Available**

### **7.10.1 Existing Finance Leases**

This section sets out the provisions contained in various Existing Finance Leases that AWS has entered into. The Financing Documents also allow AWS to enter into new Finance Leases in the future, subject to certain limits and provided that any new Finance Lessor accedes to the CTA and the STID.

#### **(i) Supply of Equipment**

Certain leasing companies have acquired equipment and systems and AWS has sold or otherwise procured the supply of certain equipment and systems to leasing companies (or in respect of Equipment which constitutes Fixtures (as defined below) has been reimbursed for capital expenditure in respect thereof), in each case for the purpose of AWS leasing such equipment and systems from the leasing companies.

The Equipment acquired by or sold or supplied to such leasing companies consists mainly of plant and machinery and other equipment used in the water and sewerage operations of AWS, as well as computer software systems and computer hardware. The Equipment is comprised of movable equipment (“**Movables**”) and fixed equipment (that is Equipment which is so affixed to real estate so as to become part of that real estate as a matter of law (“**Fixtures**”)).

#### **(ii) Lease Agreements**

Each of the Existing Finance Lessors has leased the Equipment sold or supplied to AWS on the terms and subject to the conditions set out in the following lease agreements between AWS as lessee and the respective leasing company as lessor (each an “**Existing Finance Lease**” and, together, the “**Existing Finance Leases**”). AWS is currently party to leases with the following Existing Finance Lessors: (a) Mercantile Leasing Company (No. 132) Limited (“**Mercantile**”); (b) D-LAF Limited or Moon Leasing Limited (in its capacity as general partner of Brahm’s Leasing Limited Partnership (if the D-LAF Existing Finance Lease has been novated to it prior to the Effective Date)) (“**D-LAF**”); (c) Deutsche Bank AG London Branch (“**Deutsche Bank**”); (d) CSC Computer Sciences Limited, which has sold its right to the receivables under the Existing Finance Lease to Dresdner Kleinwort Wasserstein Limited which in turn has assigned such rights to DrKW Finance Limited (“**DrKW Finance**”); and (e) DrKW Finance which purchased the interest, and received an assignment of the rights, of DrKW Industrial Finance Limited (“**DrKW Industrial Finance**”) under its Existing Finance Lease (which Existing Finance Lease is also

referred to herein as the “**DrKW Industrial Finance Existing Finance Lease**”). The DrKW Finance Existing Finance Lease, together with the DrKW Industrial Finance Existing Finance Lease are referred to as “**DrKW Existing Finance Leases**”.

The existence of the purchase options in the DrKW Existing Finance Leases (see 7.10.1(xi), “*Repossession of Movables on Termination*” below) probably means that these leases are more properly characterised as hire purchase agreements.

In relation to Fixtures, because no title passes to the relevant Existing Finance Lessors (or if it does that title reverts to the landowner on affixation to real estate of the relevant Equipment), AWS and each relevant Existing Finance Lessor has elected to deem that ownership is in that Existing Finance Lessor and that there is a deemed lease of the Fixtures in question.

(iii) **Lease periods**

The primary lease period under the D-LAF Existing Finance Lease is 15 years from the commencement of such lease period and this period is extended, automatically in the case of Movables and at the Existing Finance Lessor’s discretion in the case of Fixtures, for another 35 years. Under the Mercantile Existing Finance Lease the primary period is for 25 years from the lease commencement date and this period may be extended, automatically in the case of Movables and at the Existing Finance Lessor’s discretion in the case of Fixtures for another 25 years. Under the Existing Finance Lease with Deutsche Bank the primary lease period runs from the lease commencement date until 30 March 2005 at which date AWS is entitled to extend the lease period for another 10 years. Under the DrKW Finance Existing Finance Lease the primary lease period is for 49 months, which, subject to early termination, is renewed automatically on expiry for an indefinite period. In the DrKW Industrial Finance Existing Finance Lease the lease periods are 5 years from the lease commencement date in respect of the hardware and 7 years from the lease commencement date in respect of the software.

(iv) **Subject to Common Terms Agreement and STID**

Each Existing Finance Lease will be amended as of the Effective Date so as to be subject to the CTA. In this way the representations, warranties, covenants and events of default set out in the Common Terms Agreement will apply in respect of the Existing Finance Lessors for each Existing Finance Lease. The Existing Finance Leases will also be subject to the STID which will regulate the claims of the Existing Finance Lessors against AWS and termination and enforcement rights under the Existing Finance Leases. Certain of the material terms of the Existing Finance Leases (in addition to those incorporated from the CTA) are outlined below (see 7.10.1(vii), “*AWS Obligations*” below).

(v) **Rental**

AWS is obliged to make regular rental payments (“**Rental**”) under each Existing Finance Lease, annually in advance under the Mercantile Existing Finance Lease and the Deutsche Bank Existing Finance Lease, six monthly in advance under the D-LAF Existing Finance Lease and quarterly in advance under the DrKW Existing Finance Leases.

The primary period Rental payable under each of the Existing Finance Leases (except the DrKW Existing Finance Leases) is calculated by reference to a number of assumptions made at the time of execution of the relevant Existing Finance Lease (including a specific assumed rate of interest) and if any such assumption proves to be incorrect, the primary rental payments under the relevant Existing Finance Lease are adjusted to levels that seek to (or if all those rentals have been paid additional rentals or rebates of rental are made in order to) preserve the relevant Existing Finance Lessors agreed after-tax rate of return on its acquisition cost of the Equipment leased under that Existing Finance Lease. The rental payments payable during any secondary period are also set out in the relevant Existing Finance Lease.

The assumptions set out in the Mercantile Existing Finance Lease, the D-LAF Existing Finance Lease and in the Deutsche Bank Existing Finance Lease are the type of tax and financial assumptions customarily found in leases of this kind and include (inter alia) matters such as the rate of corporation tax, the rate of writing down allowances, the amount of group relief on tax losses which may be claimed by the lessor and other changes in applicable law or regulation.

Rental under the DrKW Finance Existing Finance Lease is fixed for a minimum period of 49 months from 31 March 2000 and then continues automatically beyond the expiry of the minimum period until terminated in accordance with the DrKW Finance Existing Finance Lease. If AWS continues the DrKW Finance Existing Finance Lease past the minimum period then AWS has to pay a one-off payment of £10. There is no set expiry date beyond the minimum period. AWS may voluntarily terminate the lease of the Systems by payment of a termination payment to the Existing Finance Lessor. The amount of such termination payment is referred to in 7.10.1(x), “*Additional Termination Rights under Existing Finance Leases*”.

Rental under the DrKW Industrial Finance Existing Finance Lease is also fixed although a separate payment is required (i) by AWS to the Existing Finance Lessor if the actual rate of interest (calculated by reference to sterling deposit rates) on DrKW Industrial Finance’s investment balance is greater than the assumed rate (set at 5.7318 per cent. per month) or (ii) by the Existing Finance Lessor to AWS if the actual rate is less than the assumed rate.

AWS will pay any VAT (if payable) due in respect of any payments under the Existing Finance Leases.

(vi) **General Payment Provisions**

Default interest is payable under each Existing Finance Lease in respect of any late payment.

All Rental and other payments under each Existing Finance Lease (other than the DrKW Finance Existing Finance Lease) are required to be made free and clear of, and without withholding or deduction for, tax, if any, applicable to such payments unless such withholding or deduction is required by law. In that event, AWS will be obliged to pay such additional amounts as will result in the receipt by the relevant Existing Finance Lessor of such amount that the relevant Existing Finance Lessor would have received if no such withholding or deduction had been required.

The Existing Finance Leases (other than the DrKW Finance Existing Finance Lease) provide that if the relevant Existing Finance Lessor determines in its absolute discretion that it has received or has been granted a credit against or remission from any tax payable which is attributable to such additional amounts payable by AWS then the Existing Finance Lessor shall reimburse such amount as shall leave the Existing Finance Lessor after such reimbursement in no worse position than the Existing Finance Lessor would have been in if the deduction or withholding had not been required.

(vii) **AWS Obligations**

In addition to the representations and warranties made by AWS, and the covenants applying to AWS, under the CTA, the Existing Finance Leases also impose certain customary finance lease representations, warranties and covenants on AWS.

In particular, AWS is typically required, in accordance with the Existing Finance Leases, although not always in each case, inter alia, (1) to keep the Equipment in good repair condition and working order, (2) to ensure the Equipment is used in a skilful and proper manner, (3) to make good all damage to the Equipment and (4) to maintain third party liability and property insurances in respect of the Equipment.

A breach of any of these representations or covenants in an Existing Finance Lease which would be reasonably likely to have a Material Adverse Effect will, to the extent not remedied or waived, oblige AWS to prepay all sums due and payable under the relevant Existing Finance Lease (as outlined above, see 7.6.5 “*Covenants – General*” paragraphs (iv)(r) and (s)) and will be subject to the CTA and the STID. If AWS does not make such prepayment in accordance with the CTA and the STID, it will constitute an Event of Default (to the extent not remedied by AWS or waived (upon notice of that event to the Security Trustee) by the Existing Finance Lessor in question) with the result that the Standstill Period will automatically commence.

(viii) **General Indemnities**

Each Existing Finance Lease (other than the DrKW Finance Existing Finance Lease) contains a general indemnity whereby AWS agrees to indemnify the relevant Existing Finance Lessor against, inter alia, all losses, and damages (excluding taxes), in any way associated with the

transactions contemplated in the relevant Existing Finance Lease other than those arising as a result of (inter alia) the wilful misconduct of the relevant Existing Finance Lessor.

Other than the DrKW Finance Existing Finance Lease, each Existing Finance Lease typically (but not in all cases) provides that AWS shall indemnify under the Existing Finance Leases the relevant Existing Finance Lessor against all losses incurred or suffered by it, inter alia, in relation to the Equipment or as a result of failure by AWS to comply with its obligations under the relevant Existing Finance Lease.

Under the DrKW Finance Existing Finance Lease, AWS indemnifies the relevant Existing Finance Lessor against, inter alia, all losses and damages arising generally out of its acts or omissions.

(ix) **Tax Indemnities**

Under the terms of the Existing Finance Leases (other than the DrKW Finance Existing Finance Lease), AWS is required to indemnify the Existing Finance Lessors for certain tax liabilities arising in relation thereto, either by way of variation of the Rental payment amounts (see 7.10.1(v), “*Rental*” above) or contractual indemnity payments.

Typically, these indemnities survive any termination of the leasing of the Equipment and the termination of the Existing Finance Leases themselves.

(x) **Additional Termination Rights under Existing Finance Leases**

The Existing Finance Leases contain termination rights on the part of the Existing Finance Lessor in addition to the Events of Default set out in the CTA and those outlined in 7.10.1(vii), “*AWS Obligations*” above. These include: a right to terminate following a total loss of any Equipment (other than in respect of the DrKW Existing Finance Leases where AWS has an option to elect to pay a termination payment or replace the lost Equipment) or illegality (in the case of the Deutsche Bank Existing Finance Lease only). In these circumstances, subject to the terms of the CTA, the STID and the Existing Finance Leases (as amended and supplemented), each Existing Finance Lessor may terminate the leasing of the Equipment under its Existing Finance Lease and charge a termination sum in the circumstances outlined above, save that AWS in each case will not make any payment if (i) an Acceleration of Liabilities has occurred or (ii) a Default Situation is subsisting or would occur as a result of such payment. If AWS fails or is unable to make any prepayment in accordance with the CTA and the STID an Event of Default will arise under the CTA and upon notice of that event to the Security Trustee the Standstill Period will automatically commence.

AWS may voluntarily terminate the leasing of all or part of the Equipment under any Existing Finance Lease and pay, inter alia, all Rentals due thereunder in advance of the expiry of the relevant lease period provided that (i) no Acceleration of Liabilities has occurred and (ii) no Default Situation is subsisting or would occur as a result of such payment.

The Existing Finance Leases (other than the DrKW Existing Finance Leases) provide that upon termination, a termination payment becomes payable as calculated pursuant to the financial schedule attached to the relevant Existing Finance Lease or, in the case of the Deutsche Bank Existing Finance Lease, the relevant rental clause. The termination payment payable is calculated by a reference to a number of assumptions which if subsequently proven to be incorrect may give rise to a further payment or a rebate in the future.

In the Existing Finance Leases (other than the DrKW Existing Finance Leases) termination payments may vary according to the termination event which takes place and the date thereof. They are calculated, broadly speaking, by the production of a revised cash flow as at the date of the relevant termination based upon certain assumptions. Broadly the termination payment will be an amount equal to the aggregate of (i) sums due and payable under the relevant Existing Finance Lease and (ii) an amount equal to the balance of the relevant Existing Finance Lessor’s investment in the relevant Existing Finance Lease and so as to preserve the Existing Finance Lessor’s net after-tax return. Additionally the Mercantile Existing Finance Lease and the D-LAF Existing Finance Lease require a termination fee to be paid if termination occurs within a period specified therein.



The DrKW Existing Finance Leases also provide for payment of termination payments to the relevant Existing Finance Lessors upon termination of the leases. The termination payments include (inter alia) amounts for all arrears of Rental and sums due and unpaid, a sum equal to the total of all future Rentals which would have fallen due under the relevant Existing Finance Lease (in the case of the DrKW Industrial Finance Existing Finance Lease only during the specified minimum hire period) discounted to the date of termination, and breakage costs.

(xi) **Repossession of Movables on Termination**

To the extent the Existing Finance Leases relate to Fixtures there is no ability to repossess the relevant Equipment but both the Mercantile Existing Finance Lease and the D-LAF Existing Finance Lease provide that, after termination of the hiring of the Equipment for whatever reason, the Existing Finance Lessor may require AWS to dismantle, dispose, or store and maintain until sold, any “Surplus Equipment” (i.e. so much of the Movables as is then no longer required to ensure that the functions of AWS under the WIA may be properly carried out). Upon the termination of the hiring of any Surplus Equipment, and so long as no termination event has occurred (or, if it has occurred, is not continuing or has been remedied) AWS shall at its own expense be entitled and bound to act as the exclusive sales representative of the Existing Finance Lessor for a period of one year after termination of the hiring of the Surplus Equipment and thereafter as non-exclusive sales representative to find a purchaser of the Surplus Equipment. Following a sale of any Surplus Equipment the Existing Finance Lessor shall rebate (by way of rebate of Rentals) any proceeds of sale (less the Existing Finance Lessor’s termination payments and other amounts due) to AWS.

The Deutsche Bank Existing Finance Lease provides that if AWS is not in default of any of its obligations under the lease, AWS shall act as the Existing Finance Lessor’s agent for the purpose of selling the Equipment (defined in the lease as the “Goods”) (other than any software) after the Existing Finance Lessor has recovered possession of any of the Goods being the subject of a termination. AWS may be entitled to a rebate of Rentals upon a termination of the hiring of Goods provided the Existing Finance Lessor receives such amounts as are required to maintain the agreed rate of return as set out in the Existing Finance Lease.

Pursuant to the DrKW Industrial Finance Existing Finance Lease, upon any termination of the provision of the computerised billing system known as NBS (as the assets are so defined in the DrKW Industrial Finance Existing Finance Lease), or expiry of the lease period, AWS shall immediately return the hardware to the Existing Finance Lessor. AWS has the option to purchase NBS (£10 for hardware and £10 for software). If AWS, does not purchase NBS, then the Existing Finance Lessor is obliged to use all reasonable endeavours to sell it and then if AWS has paid all amounts due to the Existing Finance Lessor, then the Existing Finance Lessor shall pay to AWS as a rebate of Rental so much of the proceeds of sale (less any costs and expenses) received by the Existing Finance Lessor as does not exceed the total of the rental and termination payments paid by AWS.

Pursuant to the DrKW Finance Existing Finance Lease, upon any termination of the provision of the Equipment (defined as the “Systems” in the DrKW Finance Existing Finance Lease), AWS shall immediately return the Systems to the Existing Finance Lessor. AWS also has the option to purchase the Systems for £10. Further, if the option to purchase is not exercised by AWS, the Existing Finance Lessor is obliged to use all reasonable endeavours to sell the Systems. If AWS has paid all amounts due to the Existing Finance Lessor and the Systems are sold, then the Existing Finance Lessor shall pay to AWS as a rebate of Rental so much of the proceeds of sale (less any costs and expenses) received by the Existing Finance Lessor as does not exceed the total of the Rental and termination payments paid by AWS.

(xii) **Insurance and Total Loss**

The Existing Finance Leases (other than the DrKW Existing Finance Leases) provide that AWS is to effect and maintain insurance against all risk of loss of or damage to the Equipment (or, in the case of the Deutsche Bank Existing Finance Lease, against all usual risks). The DrKW Existing Finance Leases provide that AWS shall bear all risk of loss of or damage to the Systems and indemnify the Existing Finance Lessor on demand against such risk.

The Mercantile Existing Finance Lease and the D-LAF Existing Finance Lease provide that AWS shall effect and maintain in full force and effect third party liability insurance cover in respect of all the Equipment in accordance with and to the extent and in the amounts required to comply with good and prudent water industry insurance practice in the United Kingdom.

Upon a total loss of certain items of Equipment, the leasing of such items will terminate and AWS must pay a termination payment (from insurance proceeds or otherwise) within a specified number of business days following such total loss or within a certain number of business days after the date of receipt of insurance proceeds in relation to such Equipment.

AWS bears the full risk of any total loss of or any damage to all or a material part of the Equipment (except in relation to the DrKW Existing Finance Leases where AWS has the option to replace the Systems or pay the Existing Finance Lessor a termination payment).

(xiii) **Related Guarantee**

The payment obligations of AWS under each of the Mercantile Existing Finance Lease and the D-LAF Existing Finance Lease are guaranteed by AW plc. Each of these guarantees will be released and discharged on or before the Effective Date.

(xiv) **Capital Allowances**

The Existing Finance Lessors will constitute Secured Creditors and will obtain the benefit of the security package which the Obligors grant under the Security Agreement. Although leading counsel has advised that section 225 of the Capital Allowances Act 2001 (“**Section 225**”) should not apply, there is a risk that the available benefit of the security package could cause Section 225 to apply to the D-LAF Existing Finance Lease and the Mercantile Existing Finance Lease. If Section 225 did apply in this way, the Existing Finance Lessors under those Existing Finance Leases would not be able to claim capital allowances in relation to the capital expenditure they have incurred on the leased Equipment. Under the terms of the relevant Existing Finance Leases, the cost of this inability to claim capital allowances would be passed on to AWS in the form of higher Rentals.

### **7.10.2 The Local Authority Loan**

AWS has an outstanding loan of approximately £195,000 from Castle Point Borough Council which has not acceded, and will not be required to accede, to the CTA or the STID.

### **7.10.3 Authorised Loan Facilities**

The Issuer will enter into a facility agreement (an “**Initial Authorised Loan Facility**”) with an aggregate facility amount of £225,000,000 with the Initial Authorised Credit Provider(s) on or about the Effective Date. The Initial Authorised Loan Facility is a revolving credit facility which is available to the Issuer for working capital and capital expenditure requirements from the Effective Date until the final Maturity Date of the day before the third anniversary of the Effective Date.

Drawings under the Initial Authorised Loan Facility may be subject to various conditions precedent as set out in the CP Document, including that no Default is subsisting (in relation to the capital expenditure element of the Initial Authorised Loan Facility only) and no Event of Default is subsisting (in relation to the working capital element of the Initial Authorised Loan Facility) and each repeating representation is correct at the time of requesting and making the drawing.

Interest will accrue on any drawing under the Initial Authorised Loan Facilities calculated at a daily rate by reference to applicable sterling LIBOR plus a margin and mandatory costs.

The Issuer makes representations and warranties covenants and undertakings to the Initial Authorised Credit Providers on terms as set out, respectively, in the Common Terms Agreement.

The Events of Default under the Common Terms Agreement will apply under the Initial Authorised Loan Facility (see 7.6, “*Common Terms Agreement*” above).

The ability of the Initial Authorised Credit Providers to accelerate any sums owing to them under the Initial Authorised Loan Facility upon or following the occurrence of an Event of Default thereunder is subject to the STID.

The Issuer may enter into further Authorised Credit Facilities on terms similar to those in the Initial Authorised Loan Facility. Each additional Authorised Credit Provider will be given the benefit of the Security and will be required to accede to the STID and the CTA.

#### **7.10.4 The Liquidity Facilities**

There will be three Liquidity Facilities in place on the Effective Date, the Debt Service Reserve Liquidity Facilities (as defined below) and the O&M Reserve Facility (as defined below), each of which will be maintained by the Issuer, the proceeds of which will be on-lent to AWS under the Intercompany Loan Arrangements.

The Issuer will enter into agreements (each a “**Debt Service Reserve Liquidity Facility Agreement**”), with one or more Liquidity Facility Providers, establishing liquidity facilities (each a “**Debt Service Reserve Liquidity Facility**”). The Issuer will establish Debt Service Reserve Liquidity Facilities in connection with Bonds and other debt issued and incurred.

Under the terms of each Debt Service Reserve Liquidity Facility Agreement, one or more Liquidity Facility Providers will provide a 364-day commitment in an aggregate amount specified in each Debt Service Reserve Liquidity Facility Agreement to permit drawings to be made by the Issuer, in circumstances where AWS has or will have insufficient funds available on a Payment Date to pay scheduled interest under the Intercompany Loan Arrangements, to enable the Issuer to make payments due on a Series of Bonds or other Senior Debt (a “**Liquidity Shortfall**”).

The Issuer will also enter into agreements (each an “**O&M Reserve Facility Agreement**”) with one or more Liquidity Facility Providers establishing liquidity facilities (each an “**O&M Reserve Facility**”) proceeds of which will be on-lent to AWS to meet AWS’s operating and capital maintenance expenditure requirements to the extent that AWS has insufficient funds available to it to meet these requirements.

Under the terms of the O&M Reserve Facility, one or more Liquidity Facility Providers will provide a 364 day commitment in an aggregate amount specified in each such agreement.

Each Liquidity Facility Provider must be a bank which as at the relevant Issue Date has a Minimum Short-Term Rating and a minimum long-term ratings at a level of at least “A” from Fitch and S&P and at least “A2” from Moody’s from at least two of the Rating Agencies (the “**Liquidity Facility Requisite Ratings**”). The Initial Liquidity Facility Provider will be Barclays Bank PLC.

The Liquidity Facility Provider may be replaced at any time provided that such Liquidity Facility Provider is replaced by a bank with the Liquidity Facility Requisite Ratings and all amounts outstanding to such Liquidity Facility Provider are repaid in full.

Each Debt Service Reserve Liquidity Facility Agreement will provide that amounts repaid by the Issuer may be redrawn.

Each Liquidity Facility Agreement will provide that if (i) at any time the rating of the relevant Liquidity Facility Provider falls below the Liquidity Facility Requisite Ratings or (ii) the relevant Liquidity Facility Provider does not agree to renew such Liquidity Facility prior to the expiry of the 364-day period, the Issuer will:

- (a) use all reasonable endeavours to replace the relevant Liquidity Facility Provider with a party having the Liquidity Facility Requisite Ratings (whether by way of novation of the relevant Liquidity Facility Agreement or by entering into a new Liquidity Facility Agreement with a party having the Liquidity Facility Requisite Ratings); and
- (b) if a replacement is not made within the relevant time period specified in the relevant Liquidity Facility Agreement) be entitled to require such Liquidity Facility Provider to pay into the relevant Liquidity Account or other such agreed account to which such Liquidity

Facility relates, an amount equal to the affected party's undrawn commitment under such Liquidity Facility (a "**Standby Drawing**").

If the Issuer does not request a renewal of the Liquidity Facility from the relevant Liquidity Facility Provider, (b) above will not apply.

Unless otherwise agreed by the Issuer, the Security Trustee and each Financial Guarantor:

- (a) liquidity in respect of Class A Debt will be applied in making payments in respect of Class A Debt only and liquidity in respect of Class B Debt will be applied in making payments in respect of Class B Debt only; and
- (b) amounts repaid under a Debt Service Reserve Liquidity Facility provide liquidity for Class A Debt to the extent necessary to ensure that the amount available under Debt Service Reserve Liquidity Facilities providing liquidity for Class A Debt and the amount standing to the credit of the Class A Debt Service Reserve Account equals the next 12 months interest forecast on Class A Debt, with any surplus providing liquidity in respect of Class B Debt.

The Standby Drawing will generally be repayable only if the relevant Liquidity Facility Provider is re-rated with the Liquidity Facility Requisite Ratings or confirmation is received from each of the Rating Agencies that either (i) the terms of a replacement Liquidity Facility or (ii) the absence of any such facility, in each case, as applicable will not lead to a ratings downgrade of the Bonds from the relevant Rating Agencies. The proceeds of the Standby Drawing will be placed in an Account over which security has been granted pursuant to the terms of the Security Agreement.

Interest will accrue on any drawing (including a Standby Drawing) made under the Liquidity Facility provided by the Initial Liquidity Facility Provider at a reference rate per annum plus a margin. Under the Liquidity Facility Agreements, the Issuer will also be required to pay additional amounts if: (i) a withholding or deduction for or on account of tax is imposed on payments made by it to the relevant Liquidity Facility Provider; or (ii) if the relevant Liquidity Facility Provider suffers an increase in the cost of providing the relevant Liquidity Facility. Drawings under any further Liquidity Facilities will accrue interest subject to the specific terms of the relevant Liquidity Facility Agreement.

Upon the enforcement of the Security pursuant to the STID, all indebtedness outstanding under any Liquidity Facility (other than Subordinated Liquidity Facility Amounts) will rank in priority to the Bonds.

## **7.11 Hedging Agreements**

### **7.11.1 Hedging Policy**

The Hedging Policy provides that the AWS Financing Group must enter into Hedging Agreements in accordance with an agreed Hedging Policy and that the only member of the AWS Financing Group that may enter into Hedging Agreements is the Issuer, provided that the Issuer may enter into back-to-back swap arrangements with AWS in respect of Hedging Agreements entered into by the Issuer to hedge the obligations of AWS under the Existing Finance Leases or which are otherwise not directly linked to the raising of new debt under an Authorised Credit Facility. The Hedging Policy, inter alia, requires that the AWS Financing Group enter into appropriate hedging instruments (with hedge counterparties with appropriate credit ratings) to limit their exposure to currency and interest rate fluctuations and to inflation to a prudent level. It further requires that all Hedging Agreements are entered into or novated under an agreement in the form of the 1992 ISDA Master Agreement (Multicurrency - Cross Border) (an "**ISDA Master Agreement**") and that the Hedging Agreements provide, inter alia, for "*two way payments*" or payments under the "*Second Method*" in the event of an early termination and set out the circumstances in which a Hedge Counterparty may designate an Early Termination Date (as defined in the relevant Hedging Agreement) with respect to the relevant Hedging Agreement. If an Early Termination Date occurs in circumstances where both interest rate hedging transactions and currency hedging transactions are being terminated, amounts payable under interest rate hedging transactions and currency hedging transactions will be treated separately to enable the Issuer to comply with the Payment Priorities. The AWS Financing Group is prohibited from entering into hedging transactions for the

purpose of speculation or otherwise than in accordance with the agreed Hedging Policy. The Hedging Policy may only be amended by agreement between the Security Trustee and AWS. Subject to such agreement being reached, the Hedging Policy will be reviewed from time to time by the AWS Financing Group and amended (subject to Entrenched Rights and Reserved Matters and in accordance with provisions of the STID) as appropriate in accordance with market developments, Good Industry Practice and regulatory developments.

### 7.11.2 Hedging Agreements

Prior to the Effective Date, AW and AWS have entered into certain hedging transactions with the Existing Hedge Counterparties to establish a hedge in relation to currency and interest rate exposures arising under certain debt instruments and the Existing Finance Leases. AWS has also entered into certain additional hedging transactions with the Existing Hedge Counterparties to hedge against the Issuer's interest rate exposure in relation to the Bonds to be issued on the Effective Date and other Financial Indebtedness to be incurred. The rights and obligations of AW and AWS under such transactions will either be cancelled or novated to the Issuer by AW or AWS, as the case may be. Payments will be made between the Issuer and the Existing Hedge Counterparties under the Existing Hedging Agreements on the relevant Payment Dates.

The Hedge Counterparties will be obliged to make payments under the Hedging Agreements without any withholding or deduction of taxes, unless required by law. If any such withholding or deduction is required by law, the Hedge Counterparties will be required to pay any such additional amount as is necessary to ensure that the net amount received by the Issuer will equal the full amount the Issuer would have received had no such deduction or withholding been required. The Issuer will make payments under the Hedging Agreements subject to any withholding or deduction of taxes required by law, but will not be required to pay any additional amount to any Hedge Counterparty in respect thereof. However, in either case, if a withholding or deduction is required due to any action by a taxing authority, or change in tax law after the date on which a transaction is entered into, which cannot be avoided, the Hedge Counterparty may terminate the relevant Hedging Agreement.

The Issuer will have rights to terminate a Hedging Agreement, in certain circumstances, relating to the relevant Hedge Counterparty (or, if applicable, any Credit Support Provider or Specified Entity (as defined in the relevant Hedging Agreement) relating to it) including: a failure to pay amounts when due, the occurrence of an insolvency event, a breach of a term of the Hedging Agreement or any Credit Support Document (as defined in the relevant Hedging Agreement); a merger without assumption; a default under a Specified Transaction (as defined in the relevant Hedging Agreement); and in the event of Illegality (as defined in the relevant Hedging Agreement).

Other than in certain limited circumstances (set out in paragraphs 9 and 21(c) of Schedule 8 of the CTA), each Hedge Counterparty's rights to terminate its Hedging Agreement will be limited to the following circumstances: (i) a failure by the Issuer to make payments under the Hedging Agreement when due; (ii) certain insolvency-related events with respect to the Issuer, (iii) Illegality (as defined in the relevant Hedging Agreement); (iv) where either the Hedge Counterparty or the Issuer is required to withhold for tax, which cannot be avoided ("Tax Event" as defined in the Hedging Agreements); and (v) a Standstill Period has ended otherwise than in accordance with Clause 13.4(a)(iii) of the STID (and in this event, termination will be automatic).

Pursuant to paragraph 21(c) of Schedule 8 to the CTA, but only in respect of any Hedging Agreements entered into before the Effective Date or Hedging Agreements entered into on the Effective Date which replace such Hedging Agreements, the Hedge Counterparties will be entitled to exercise any right they may have to terminate such Hedging Agreement pursuant to any break clause or right of optional early termination contained in that Hedging Agreement (but not, for the avoidance of doubt, an Event of Default, Tax Event Upon Merger or Credit Event Upon Merger (as such terms are defined in the Hedging Agreement) or as a result of a change in the Instrument of Appointment or in the regulatory status of AWS) provided that:

- (i) no Default is continuing or would result from such termination; and
- (ii) all amounts payable by the Issuer as a result of such termination are capable of being paid out of existing revenues of the AWS Financing Group or otherwise out of Permitted Financial Indebtedness.

The Hedging Policy will provide that the Issuer may enter into Treasury Transactions with Hedge Counterparties where each relevant Hedge Counterparty has the right to terminate the relevant Treasury Transaction on the tenth anniversary of the effective date of such Treasury Transaction and thereafter no more frequently than at five yearly intervals provided that such right of termination is exercised in accordance with paragraph 9 of Schedule 8 to the CTA. The Issuer shall not enter into any Treasury Transactions for a period in excess of 10 years other than to the extent that at any date the aggregate notional amount and/or currency amounts (as applicable) of relevant Treasury Transactions to which the Issuer is a party and which have unexpired terms in excess of 10 years would not exceed an amount equal to 15 per cent. of RAV in each case as computed in accordance with the Hedging Policy.

Each Existing Hedge Counterparty will be party to the STID and the CTA and its rights (including, in particular, its rights to receive any termination payment) will be subject thereto. Accordingly, any termination payment will be paid to a Hedge Counterparty in accordance with the cash management arrangements set out in the CTA and summarised in 7.7, “*Cash Management*”.

In the event that the short-term unsecured and unsubordinated debt obligations of a Hedge Counterparty (or its successor, assignee or transferee) or of its Credit Support Provider (as defined in the relevant Hedging Agreement) (or the successor, assignee or transferee of any such Credit Support Provider) cease to be rated at least as high as P-1 by Moody’s or A-1 by S&P or F-1 by Fitch and, as a result of such downgrade, the then current rating of the Class A Unwrapped Bonds (or if no Class A Unwrapped Bonds are outstanding, the then current shadow rating of the Class A Wrapped Bonds, or if there are no Class A Bonds outstanding, the then current rating of the Class B Unwrapped Bonds or, if there are no Class A Bonds and no Class B Unwrapped Bonds outstanding, the then current shadow rating of the Class B Wrapped Bonds) is downgraded or placed under review for possible downgrade by the Rating Agencies, then the relevant Hedge Counterparty will either: (i) provide collateral for its obligations, (ii) arrange for its rights and obligations under the relevant Hedging Agreement to be transferred to an appropriate third party with the required credit ratings; (iii) arrange for the appointment of a co-obligor in respect of the obligations of the relevant Hedge Counterparty or take such other action as will result in the rating of the relevant Bonds then outstanding following the taking of such action being rated no lower than the rating of the relevant Bonds immediately prior to such downgrade; or (iv) take such other action that will result in the rating of the relevant Bonds being maintained or restored to the level they would have been at immediately prior to such downgrade. If the relevant Hedge Counterparty does not take the measures described above, such failure shall constitute an Additional Termination Event with respect to the relevant Hedge Counterparty. The Issuer and the Security Trustee shall endeavour to put into place credit support documentation as may satisfy the Rating Agencies with respect to the operation and management of the collateral provided pursuant to (i) above and enter into such documents as may reasonably be requested by the relevant Hedge Counterparty in connection with the provision of such collateral.

## **7.12 Other Transaction Documents**

### **7.12.1 Account Bank Agreement**

Pursuant to the Account Bank Agreement, the Account Bank will agree to hold the Accounts and operate them in accordance with the instructions of the Cash Manager. The Cash Manager will manage the Accounts on behalf of the AWS Financing Group pursuant to the Common Terms Agreement (see 7.7, “*Cash Management*” above).

### **7.12.2 Corporate Services Agreement**

Pursuant to a corporate services agreement (the “**AWS Overseas Holdings Corporate Services Agreement**”), Maples and Calder will provide certain corporate services to AWS Overseas Holdings.

### **7.12.3 Tax Deed of Covenant**

Under the terms of the Tax Deed of Covenant, each Obligor will give certain representations and covenants as to its tax status and to the effect that it has not taken and, save in certain permitted circumstances, will not take any steps which might reasonably be expected to give rise to a liability to tax for an Obligor which is primarily the liability of another person. AWG will

covenant and represent that it has not taken and will not take any steps that might cause the Obligor to breach such covenants and representations.

With a view to avoiding a liability to tax for an Obligor which is primarily the liability of another person, AWG and each Obligor will, under the Tax Deed of Covenant, incur certain obligations in relation to specified disposal events and any change in tax residence of the Obligor. For example, the Tax Deed of Covenant provides that if (other than in compliance with an obligation the Obligor incurs under a Finance Document) an Obligor intends to dispose of any of its material assets to another person, AWG can be required, as a condition of that disposal, to deposit an amount in a trust account equal to the estimated tax liability (if any) arising or likely to arise in the Obligor as a result of the disposal. The money deposited could then be used to pay the tax liability of the Obligor if the Obligor failed to pay the liability itself.

## CHAPTER 8

### FORM OF THE BONDS

The Bonds of each Series will be in either bearer form, with or without interest coupons (“**Coupons**”) attached, or registered form, without interest coupons attached. Bearer Bonds will be issued outside the United States in reliance on Regulation S under the Securities Act (“**Regulation S**”) and Registered Bonds will be issued both outside the United States in reliance on the exemption from registration provided by Regulation S and within the United States in reliance on Rule 144A or Regulation D under the Securities Act.

#### **Bearer Bonds**

Each Tranche of Bearer Bonds will be initially issued in the form of either a temporary bearer global bond (a “**Temporary Bearer Global Bond**”) or a permanent bearer global bond (a “**Permanent Bearer Global Bond**”) as indicated in the applicable Pricing Supplement, which, in either case, will be delivered on or prior to the original issue date of the Tranche to a common depository (the “**Common Depository**”) for Euroclear Bank S.A./N.V. as operator of the Euroclear System (“**Euroclear**”) and Clearstream Banking, *société anonyme* (“**Clearstream, Luxembourg**”). Whilst any Bearer Bond is represented by a Temporary Bearer Global Bond and subject to TEFRA D selling restrictions, payments of principal, interest (if any) and any other amount payable in respect of the Bonds due prior to the Exchange Date (as defined below) will be made against presentation of the Temporary Bearer Global Bond only to the extent that certification (in a form to be provided) to the effect that the beneficial owners of interests in such Bearer Bond are not U.S. persons or persons who have purchased for resale to any U.S. person, as required by U.S. Treasury regulations, has been received by Euroclear and/or Clearstream, Luxembourg and Euroclear and/or Clearstream, Luxembourg, as applicable, has given a like certification (based on the certifications it has received) to the Principal Paying Agent.

On and after the date (the “**Exchange Date**”) which is 40 days after a Temporary Bearer Global Bond is issued, interests in such Temporary Bearer Global Bond will be exchangeable (free of charge) upon a request as described therein either for (i) interests in a Permanent Bearer Global Bond of the same Series or (ii) for definitive Bearer Bonds of the same Series with, where applicable, receipts, Coupons and talons attached (as indicated in the applicable Pricing Supplement and subject, in the case of definitive Bearer Bonds, to such notice period as is specified in the applicable Pricing Supplement), in each case against certification of beneficial ownership as described above unless such certification has already been given, provided that purchasers in the United States and certain U.S. persons will not be able to receive definitive Bearer Bonds. The holder of a Temporary Bearer Global Bond will not be entitled to collect any payment of interest, principal or other amount due on or after the Exchange Date unless, upon due certification, exchange of the Temporary Bearer Global Bond for an interest in a Permanent Bearer Global Bond or for definitive Bearer Bonds is improperly withheld or refused.

Payments of principal, interest (if any) or any other amounts on a Permanent Bearer Global Bond will be made through Euroclear and/or Clearstream, Luxembourg against presentation or surrender (as the case may be) of the Permanent Bearer Global Bond without any requirement for certification.

The applicable Pricing Supplement will specify that a Permanent Bearer Global Bond will be exchangeable (free of charge), in whole but not in part, for definitive Bearer Bonds with, where applicable, receipts, Coupons and talons attached upon either (i) not less than 60 days’ written notice from Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Bearer Global Bond) to the Principal Paying Agent as described therein or (ii) only upon the occurrence of an Exchange Event. For these purposes, “**Exchange Event**” means that (i) an Event of Default (as set out in Schedule 7 of the Common Terms Agreement (as defined in Chapter 9, “*Terms and Conditions of the Bonds*”)) has occurred and is continuing, (ii) the Issuer has been notified that both Euroclear and Clearstream, Luxembourg have been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or have announced an intention permanently to cease business or have in fact done so and no successor clearing system is available or (iii) the Issuer has or will become subject to adverse tax consequences which would not be suffered were the Bonds represented by the Permanent Bearer Global Bond in definitive form and a certificate to such effect signed by two Directors of the Issuer is given to the Bond Trustee. The Issuer will promptly give notice to Bondholders in accordance with Condition 18 if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Bearer Global Bond) or the Bond Trustee may give notice to the Principal Paying Agent requesting exchange and, in the event of the occurrence of an Exchange Event as described in (iii) above, the Issuer may also give notice to the Principal Paying Agent requesting exchange. Any such exchange shall occur not later than 45 days after the date of receipt of the first relevant notice by the Principal Paying Agent.



The following legend will appear on all Bearer Bonds which have an original maturity of more than 365 days and on all receipts and interest coupons relating to such Bonds:

“ANY UNITED STATES PERSON WHO HOLDS THIS OBLIGATION WILL BE SUBJECT TO LIMITATIONS UNDER THE UNITED STATES INCOME TAX LAWS, INCLUDING THE LIMITATIONS PROVIDED IN SECTIONS 165(j) AND 1287(a) OF THE INTERNAL REVENUE CODE.”

The sections referred to provide that United States holders, with certain exceptions, will not be entitled to deduct any loss on Bearer Bonds, receipts or interest coupons and will not be entitled to capital gains treatment of any gain on any sale, disposition, redemption or payment of principal in respect of such Bonds, receipts or interest coupons.

Bonds which are represented by a Bearer Global Bond will only be transferable in accordance with the rules and procedures for the time being of Euroclear or Clearstream, Luxembourg, as the case may be.

### **Registered Bonds**

The Registered Bonds of each Tranche offered and sold in reliance on Regulation S, which will be sold to non-U.S. persons outside the United States, will initially be represented by a global bond in registered form, without Receipts or Coupons, (a “**Regulation S Global Bond**”). Prior to expiry of the distribution compliance period (as defined in Regulation S) applicable to each Tranche of Bonds, beneficial interests in a Regulation S Global Bond may not be offered or sold to, or for the account or benefit of, a U.S. person save as otherwise provided in Condition 2 and may not be held otherwise than through Euroclear or Clearstream, Luxembourg and such Regulation S Global Bond will bear a legend regarding such restrictions on transfer.

The Registered Bonds of each Tranche may only be offered and sold in the United States or to U.S. persons in private transactions (i) to “qualified institutional buyers” within the meaning of Rule 144A under the Securities Act (“**QIBs**”) or (ii) to “accredited investors” (as defined in Rule 501(a)(1), (2), (3) or (7)) under the Securities Act that are institutions (“**Institutional Accredited Investors**”) who agree to purchase the Bonds for their own account and not with a view to the distribution thereof. The Registered Bonds of each Tranche sold to QIBs will be represented by a global bond in registered form (a “**Rule 144A Global Bond**” and, together with a Regulation S Global Bond, the “**Registered Global Bonds**”).

Registered Global Bonds will either (i) be deposited with a custodian for, and registered in the name of a nominee of, DTC or (ii) be deposited with a common depository for, and registered in the name of a common nominee of, Euroclear and Clearstream, Luxembourg, as specified in the applicable Pricing Supplement. Persons holding beneficial interests in Registered Global Bonds will be entitled or required, as the case may be, under the circumstances described below, to receive physical delivery of definitive Bonds in fully registered form.

The Registered Bonds of each Tranche sold to Institutional Accredited Investors will be in definitive form, registered in the name of the holder thereof (“**Definitive IAI Registered Bonds**”). Unless otherwise set forth in the applicable Pricing Supplement, Definitive IAI Registered Bonds will be issued only in minimum denominations of U.S.\$500,000 and integral multiples of U.S.\$1,000 in excess thereof (or the approximate equivalents in the applicable Specified Currency). Definitive IAI Registered Bonds will be subject to the restrictions on transfer set forth therein and will bear the restrictive legend described in Chapter 16 under “*Subscription and Sale and Transfer and Selling Restrictions*”. The Rule 144A Global Bond and the Definitive IAI Registered Bonds will be subject to certain restrictions on transfer set forth therein and will bear a legend regarding such restrictions.

Payments of principal, interest and any other amount in respect of the Registered Global Bonds will, in the absence of provision to the contrary, be made to the person(s) shown on the Register (as defined in Condition 7) as the registered holder(s) of the Registered Global Bonds. None of the Obligors, any Paying Agent or the Registrar will have any responsibility or liability for any aspect of the records relating to or payments or deliveries made on account of beneficial ownership interests in the Registered Global Bonds or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Payments of principal, interest or any other amount in respect of the Registered Bonds in definitive form will, in the absence of provision to the contrary, be made to the persons shown on the Register on the relevant Record Date (as defined in Condition 8) immediately preceding the due date for payment in the manner provided in that Condition.

Interests in a Registered Global Bond will be exchangeable (free of charge), in whole but not in part, for definitive Registered Bonds without receipts, Coupons or talons attached only upon the occurrence of an

Exchange Event. For these purposes, “**Exchange Event**” means that (i) an Event of Default has occurred and is continuing, (ii) in the case of Bonds registered in the name of a nominee for DTC, either DTC has notified the Issuer that it is unwilling or unable to continue to act as depository for the Bonds and no alternative clearing system is available or DTC has ceased to constitute a clearing agency registered under the Exchange Act, (iii) in the case of Bonds registered in the name of a nominee for a common depository for Euroclear and Clearstream, Luxembourg, the Issuer has been notified that both Euroclear and Clearstream, Luxembourg have been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or have announced an intention permanently to cease business or have in fact done so and, in any such case, no successor clearing system is available or (iv) the Issuer has or will become subject to adverse tax consequences which would not be suffered were the Bonds represented by the Registered Global Bond in definitive form and a certificate to such effect signed by two Directors of the Issuer is given to the Bond Trustee. The Issuer will promptly give notice to Bondholders in accordance with Condition 18 if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, DTC, Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Registered Global Bond) or the Bond Trustee may give notice to the Registrar requesting exchange and, in the event of the occurrence of an Exchange Event as described in (iv) above, the Issuer may also give notice to the Registrar requesting exchange. Any such exchange shall occur not later than 10 days after the date of receipt of the first relevant notice by the Registrar.

### **Transfer of Interests**

Interests in a Registered Global Bond may, subject to compliance with all applicable restrictions, be transferred to a person who wishes to hold such interest in another Registered Global Bond and Definitive IAI Registered Bonds may, subject to compliance with all applicable restrictions, be transferred to a person who wishes to hold such Bonds in the form of an interest in a Registered Global Bond. No beneficial owner of an interest in a Registered Global Bond will be able to transfer such interest, except in accordance with the applicable procedures of DTC, Euroclear and Clearstream, Luxembourg, in each case to the extent applicable. **Registered Bonds are also subject to the restrictions on transfer set forth therein and will bear a legend regarding such restrictions, see Chapter 16, “Subscription and Sale and Transfer and Selling Restrictions”.**

### **General**

Pursuant to the Agency Agreement (as defined in Chapter 9, “*Terms and Conditions of the Bonds*”), the Principal Paying Agent shall arrange that, where a further Tranche of Bonds is issued which is intended to form a single Series with an existing Tranche of Bonds, the Bonds of such further Tranche shall be assigned a common code and ISIN and, where applicable, a CUSIP and CINS number which are different from the common code, ISIN, CUSIP and CINS assigned to Bonds of any other Tranche of the same Series until at least the expiry of the distribution compliance period applicable to the Bonds of such Tranche.

For so long as any of the Bonds is represented by a Global Bond held on behalf of Euroclear and/or Clearstream, Luxembourg each person (other than Euroclear or Clearstream, Luxembourg) who is for the time being shown in the records of Euroclear or of Clearstream, Luxembourg as the holder of a particular nominal amount of such Bonds (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the nominal amount of such Bonds standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated by the Obligors and their agents as the holder of such nominal amount of such Bonds for all purposes other than with respect to the payment of principal or interest on such nominal amount of such Bonds, for which purpose the bearer of the relevant Bearer Global Bond or the registered holder of the relevant Registered Global Bond shall be treated by the Obligors and their agents as the holder of such nominal amount of such Bonds in accordance with and subject to the terms of the relevant Global Bond and the expressions “**Bondholder**” and “**holder of Bonds**” and related expressions shall be construed accordingly.

So long as DTC or its nominee is the registered owner or holder of a Registered Global Bond, DTC or such nominee, as the case may be, will be considered the sole owner or holder of the Bonds represented by such Registered Global Bond for all purposes under the Bond Trust Deed, the Agency Agreement and such Bonds except to the extent that in accordance with DTC’s published rules and procedures any ownership rights may be exercised by its participants or beneficial owners through participants.

Any reference herein to Euroclear and/or Clearstream, Luxembourg and/or DTC shall, whenever the context so permits, be deemed to include a reference to any additional or alternative clearing system specified in the applicable Pricing Supplement.

## Applicable Pricing Supplement

Set out below is the form of Pricing Supplement which will be completed for each Tranche of Bonds issued under the Programme.

[Date]

### ANGLIAN WATER SERVICES FINANCING PLC

**Issue of [Aggregate Nominal Amount of Tranche] [Title of Bonds] unconditionally and irrevocably guaranteed by, inter alia, ANGLIAN WATER SERVICES LIMITED [and unconditionally and irrevocably guaranteed as to scheduled payment of principal and interest pursuant to a financial guarantee insurance policy issued by [MBIA Assurance S.A.]/[other]] under the €10,000,000,000 Global Secured Medium Term Note Programme**

This document constitutes the Pricing Supplement relating to the issue of Bonds described herein. Terms used herein shall be deemed to be defined as such for the purposes of the conditions set forth in the Offering Circular dated 23 July 2002. This Pricing Supplement is supplemental to and must be read in conjunction with such Offering Circular.

[Repayment of the principal and payment of any interest or premium in connection with the Bonds has not been guaranteed by MBIA Assurance S.A. or by any other financial institution.]

[Note: include above paragraph if not Wrapped Bonds being described in the Pricing Supplement.]

[Include whichever of the following apply or specify as "Not Applicable" (N/A). Note that the numbering should remain as set out below, even if "Not Applicable" is indicated for individual paragraphs or sub-paragraphs.]

[If the Bonds must be redeemed before the first anniversary of their date of issue, the minimum denomination must be £100,000 or its equivalent in any other currency.]

1. (i) Issuer: Anglian Water Services Financing Plc
- (ii) Obligors: Anglian Water Services Limited, Anglian Water Services Holdings Limited and Anglian Water Services Overseas Holdings Limited
- (iii) Financial Guarantor: [MBIA/Specify Other]  
(Delete if not Wrapped Bonds)
2. (i) Series Number: [ ]
- (ii) Tranche Number: [ ]  
(If fungible with an existing Series, details of that Series, including the date on which the Bonds become fungible)
- [(iii) Nature of Bonds: USPP Bonds]
3. Specified Currency or Currencies: [ ]
4. Aggregate Nominal Amount:
  - (i) Series: [ ]
  - (ii) Tranche: [ ]
5. (i) Issue Price of Tranche: [ ] per cent of the Aggregate Nominal Amount [plus accrued interest from [insert date] (in the case of fungible issues only, if applicable)].
- (ii) Net Proceeds:  
(Required only for listed issues) [ ]

6. Specified Denominations: [ ]  
*(in the case of Registered Bonds, this means the minimum integral amount in which transfers can be made)*
7. (i) Issue Date: [ ]  
(ii) Interest Commencement Date: [ ]  
*(if different from Issue Date)*
8. Maturity Date: [Fixed rate – specify date/Floating rate — Interest Payment Date falling in or nearest to [specify month and year]]
9. Interest Basis: [[ ] per cent. Fixed Rate]  
[[LIBOR/EURIBOR] +/- [ ] per cent. Floating Rate]  
[Zero Coupon]  
[Index Linked Interest]  
[Dual Currency Interest]  
[specify other]  
(further particulars specified below)
10. Redemption/Payment Basis: [Redemption at par]  
[Index Linked Redemption]  
[Dual Currency Redemption]  
[Partly Paid]  
[Instalment]  
[US Change of Control Redemption Event]  
[specify other]
11. Change of Interest Basis or Redemption/Payment Basis: [Specify details of any provision for change of Bonds into another interest basis or redemption/ payment basis]
12. Call Options: [Issuer Call]  
[(further particulars specified below)]
13. (i) Status of the Bonds: [If Class A Wrapped Bonds or Class A Unwrapped Bonds:]  
The Class A Wrapped Bonds and the Class A Unwrapped Bonds will rank *pari passu* among each other in terms of interest and principal payments and rank in priority to the Class B Wrapped Bonds and the Class B Unwrapped Bonds.  
[If Class B Wrapped Bonds or Class B Unwrapped Bonds:]  
The Class B Wrapped Bonds and the Class B Unwrapped Bonds will rank *pari passu* among each other and are subordinated in terms of interest and principal payments to the Class A Wrapped Bonds and the Class A Unwrapped Bonds.
- (ii) Status of the Guarantees: Senior

- [(iii) Status of the Bond Policy: *(Only required if Wrapped Bonds)*  
The Bond Policy will rank *pari passu* with all other unsecured obligations of the Financial Guarantor]
- [(iv) Financial Guarantor Event of Default (if not MBIA): *(Only required if Wrapped Bonds)*  
*[Specify for Financial Guarantor]*]
14. Listing: [London/specify other/None]
15. Method of distribution: [Syndicated/Non-syndicated]

**PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE**

16. **Fixed Rate Bond Provisions** [Applicable/Not Applicable]  
*(If not applicable, delete the remaining sub paragraphs of this paragraph)*
- (i) Rate(s) of Interest: [ ] per cent. per annum [payable [annually/semi-annually/quarterly] in arrear] *(If payable other than annually, consider amending Condition 6)*
- (ii) Interest Payment Date(s): [[ ] in each year up to and including the Maturity Date]/[specify other]  
*(NB: This will need to be amended in the case of long or short coupons)*
- (iii) Fixed Coupon Amount(s): [ ] per [ ] in nominal amount
- (iv) Broken Amount(s): *[Insert particulars of any initial or final broken interest amounts which do not correspond with the Fixed Coupon Amount]*
- (v) Day Count Fraction: [30/360 or Actual/Actual (ISMA) or specify other]
- (vi) Determination Date[s]: [ ] in each year  
*[Insert regular interest payment dates, ignoring issue date of maturity date in the case of a long or short first or last coupon.*  
*NB: This will need to be amended in the case of regular interest payment dates which are not of equal duration*  
*NB: Only relevant where Day Count Fraction is Actual/Actual (ISMA)]*
- (vii) Other terms relating to the method of calculating interest for Fixed Rate Bonds: [None/Give details]
17. **Floating Rate Bond Provisions** [Applicable/Not Applicable]  
*(If not applicable, delete the remaining subparagraphs of this paragraph)*
- (i) Specified Period(s)/Specified Interest Payment Dates: [ ]
- (ii) Business Day Convention: [Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/[specify other]]
- (iii) Additional Business Centre(s): [ ]

- (iv) Manner in which the Rate of Interest and Interest Amount is to be determined: [Screen Rate Determination/ISDA Determination/specify other]
- (v) Party responsible for calculating the Rate of Interest and Interest Amount (if not the Principal Paying Agent): [ ]
- (vi) Screen Rate Determination:
- Reference Rate: [ ]  
(Either LIBOR, EURIBOR or other, although additional information is required if other – including fallback provisions)
  - Interest Determination Date(s): [ ]  
(Second London business day prior to the start of each Interest Period if LIBOR (other than Sterling or euro LIBOR), first day of each Interest Period if Sterling LIBOR and the second day on which the TARGET System is open prior to the start of each Interest Period if EURIBOR or euro LIBOR)
  - Relevant Screen Page: [ ]  
(In the case of EURIBOR, if not Telerate Page 248 ensure it is a page which shows a composite rate or amend the fallback provisions appropriately)
- (vii) ISDA Determination:
- Floating Rate Option: [ ]
  - Designated Maturity: [ ]
  - Reset Date: [ ]
- (viii) Margin(s): [+/-] [ ] per cent. per annum
- (ix) Minimum Rate of Interest: [ ] per cent. per annum
- (x) Maximum Rate of Interest: [ ] per cent. per annum
- (xi) Day Count Fraction: [Actual/365  
Actual/365 (Fixed)  
Actual/365 (Sterling)  
Actual/360  
30/360  
30E/360  
Other]  
(See Condition 7 for alternatives)
- (xii) Fall back provisions (including, if applicable, details of Reference Banks), rounding provisions and any other terms relating to the method of calculating interest on Floating Rate Bonds, if different from those set out in the Conditions: [ ]
18. **Zero Coupon Bond Provisions** [Applicable/Not Applicable]  
(If not applicable, delete the remaining subparagraphs of this paragraph)
- (i) Accrual Yield: [ ] per cent. per annum
  - (ii) Reference Price: [ ]

- (iii) Any other formula/basis of determining amount payable: [ ]  
*(Consider applicable day count fraction if not U.S. dollar denominated)*
- (iv) Day Count Fraction in relation to Early Redemption Amounts and late payment: [Conditions 10(e)(ii) and 10(k) apply/specify other]  
*(Consider applicable day count fraction if not U.S. dollar denominated)*
19. **Index Linked Interest/Redemption Bond Provisions** [Applicable/Not Applicable]  
*(If applicable, specify which or both of Index Linked Interest Bond or Index Linked Redemption Bond provisions applicable or if not applicable, delete the remaining subparagraphs of this paragraph)*
- (i) Index/Formula: [give or annex details]
- (ii) Calculation Agent responsible for calculating the principal and/or interest due: [ ]
- (iii) Provisions for determining coupon where calculation by reference to Index and/or Formula is impossible or impracticable: [ ]
- (iv) Specified Period(s)/Specified Interest Payment Dates: [ ]
- (v) Business Day Convention: [Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/specify other]
- (vi) Additional Business Centre(s): [ ]
- (vii) Minimum Rate of Interest: [ ] per cent. per annum
- (viii) Maximum Rate of Interest: [ ] per cent. per annum
- (ix) Day Count Fraction: [ ]
20. **Indexation Bond Provisions** [Applicable/Not Applicable]  
*(If not applicable, delete the remaining subparagraphs of this paragraph)*
- (i) Base Index Figure: [ ]
- (ii) Any other terms relating to indexation, if different from those set out in the Conditions: [ ]
- (iii) Reference Gilt: [ ]

21. **Dual Currency Bond Provisions** [Applicable/Not Applicable]  
*(If not applicable, delete the remaining subparagraphs of this paragraph)*
- (i) Rate of Exchange/method of calculating Rate of Exchange: [give details]
- (ii) Calculation Agent, if any, responsible for calculating the principal and/or interest payable: [ ]
- (iii) Provisions applicable where calculation by reference to Rate of Exchange impossible or impracticable: [ ]
- (iv) Person at whose option Specified Currency(ies) is/are payable: [ ]

**PROVISIONS RELATING TO REDEMPTION**

22. **Issuer Call:** [Applicable/Not Applicable]  
*(If not applicable, delete the remaining subparagraphs of this paragraph)*
- (i) Optional Redemption Date(s): [ ]
- (ii) Optional Redemption Amount of each Bond and method, if any, of calculation of such amount(s): [Spens Price/Par/specify other]  
*(if Spens Price, specify Reference Gilt)*
- (iii) If redeemable in part:
- (a) Minimum Redemption Amount: [ ]
- (b) Maximum Redemption Amount: [ ]
- (iv) Notice period (if other than as set out in the Conditions): [ ]
23. Final Redemption Amount of each Bond: [Par/specify other/see Appendix]
24. Early Redemption Amount of each Bond payable on redemption for taxation reasons or on event of default and/or the method of calculating the same (if required or if different from that set out in Condition 10(e)): [Par/specify other]

**GENERAL PROVISIONS APPLICABLE TO THE BONDS**

25. Form of Bonds: [Bearer Bonds:
- [Temporary Bearer Global Bond exchangeable for a Permanent Bearer Global Bond which is exchangeable for Definitive Bonds [on 60 days' notice given at any time/only upon an Exchange Event].]
- [Temporary Bearer Global Bond exchangeable for Definitive Bonds on and after the Exchange Date.]
- [Permanent Bearer Global Bond exchangeable for Definitive Bonds [on 60 days' notice given at any time/only upon an Exchange Event].]



	[Registered Bonds:
	[Regulation S Global Bond (U.S.\$[ ] nominal amount) registered in the name of a nominee for [DTC/ a common depository for Euroclear and Clearstream, Luxembourg].]
	[Rule 144A Global Bond (U.S.\$[ ] nominal amount registered in the name of a nominee for [DTC/ a common depository for Euroclear and Clearstream, Luxembourg].]
	[Definitive IAI Registered Bonds ( <i>specify nominal amounts</i> ).]
26. Additional Financial Centre(s) or other special provisions relating to Payment Dates:	[Not Applicable/ <i>give details</i> ] ( <i>Note that this item relates to the place of payment and not Interest Period end dates to which items 17(iii) and 19(vi) relate</i> )
27. Talons for future Coupons or Receipts to be attached to Definitive Bearer Bonds (and dates on which such Talons mature):	[Yes/No. <i>If yes, give details</i> ]
28. Details relating to Partly Paid Bonds: amount of each payment comprising the Issue Price and date on which each payment is to be made and consequences of failure to pay, including any right of the Issuer to forfeit the Bonds and interest due on late payment:	[Not applicable/ <i>give details. NB: new forms of Global Bond may be required for Partly Paid issues.</i> ]
29. Details relating to Instalment Bonds:	
(i) Instalment Amount(s):	[Not applicable/ <i>give details</i> ]
(ii) Instalment Date(s):	[Not applicable/ <i>give details</i> ]
30. Redenomination applicable:	Redenomination [not] applicable ( <i>If Redenomination is applicable, specify the terms of Redenomination in an Annex to the Pricing Supplement</i> )
31. Other terms or special conditions:	[Not Applicable/ <i>give details</i> ]
<b>DISTRIBUTION</b>	
32. (i) If syndicated, names of Managers:	[Not Applicable/ <i>give names</i> ]
(ii) Stabilising Manager (if any):	[Not Applicable/ <i>give names</i> ]
33. If non-syndicated, name of relevant Dealer:	[ ]
34. Whether TEFRA D or TEFRA C rules applicable or TEFRA rules not applicable:	[TEFRA D/ TEFRA C/ TEFRA not applicable]
35. Additional selling restrictions:	[Not Applicable/ <i>give details</i> ]
<b>OPERATIONAL INFORMATION</b>	
36. Any clearing system(s) other than DTC, Euroclear and Clearstream, Luxembourg and the relevant identification number(s):	[Not Applicable/ <i>give name(s) and number(s)</i> ]
37. Delivery:	Delivery [against/free of] payment
38. Additional Paying Agent(s) (if any):	[ ]

---

ISIN: [    ]

Common Code: [    ]

*(insert here any other relevant codes such as CUSIP and CINS codes)*

**[LISTING APPLICATION**

This Pricing Supplement comprises the details required to list the issue of Bonds described herein pursuant to the listing of the €10,000,000,000 Global Secured Medium Term Note Programme of Anglian Water Services Financing Plc.]

**RESPONSIBILITY**

Each of the Obligors accepts responsibility for the information contained in this Pricing Supplement [save for the [Financial Guarantor] Information]\*.

[The Financial Guarantor accepts responsibility for the [Financial Guarantor] Information contained in this Pricing Supplement.]\*

Signed on behalf of the Issuer:

By: .....  
*Duly authorised*

Signed on behalf of Anglian Water Services Limited:

By: .....  
*Duly authorised*

Signed on behalf of Anglian Water Services Holdings Limited:

By: .....  
*Duly authorised*

Signed on behalf of Anglian Water Services Overseas Holdings Limited:

By: .....  
*Duly authorised*

[Signed on behalf of [Financial Guarantor]:

By: .....  
*Duly authorised]\**

If the applicable Pricing Supplement specifies any modification to the Terms and Conditions of the Bonds as described herein, it is envisaged that, to the extent that such modification relates only to Conditions 1, 6, 7, 8, 9, 10 (except Condition 10(c)), 15, 16, 17, 18 (insofar as such Bonds are not listed or admitted to trade on any stock exchange) or 22, they will not necessitate the preparation of supplementary Listing Particulars. If the Terms and Conditions of the Bonds of any Series are to be modified in any other respect, supplementary Listing Particulars will be prepared, if appropriate.

\* Delete if not applicable.

## CHAPTER 9

### TERMS AND CONDITIONS OF THE BONDS

*The following (other than the italicised portions) are the Terms and Conditions of the Bonds which will be incorporated by reference into each Global Bond (as defined below) and each definitive Bond, in the latter case only if permitted by the relevant stock exchange (if any) and agreed by the Issuer and the relevant Dealer at the time of issue but, if not so permitted and agreed, such definitive Bond will have endorsed thereon or attached thereto such Terms and Conditions. The applicable Pricing Supplement in relation to any Tranche of Bonds may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with the following Terms and Conditions, replace or modify the following Terms and Conditions for the purpose of such Bonds. The applicable Pricing Supplement (or the relevant provisions thereof) will be endorsed upon, or attached to, each Global Bond and definitive Bond. Reference should be made to "Form of the Bonds" for a description of the content of Pricing Supplements which will specify which of such terms are to apply in relation to the relevant Bonds.*

This Bond is one of a Series (as defined below) of Bonds issued by Anglian Water Services Financing Plc (the "**Issuer**") constituted by a trust deed (such trust deed as modified and/or supplemented and/or restated from time to time, the "**Bond Trust Deed**") dated 30 July 2002 and made between the Issuer, Anglian Water Services Limited ("**AWS**"), Anglian Water Services Holdings Limited ("**AWS Holdings**"), Anglian Water Services Overseas Holdings Limited ("**AWS Overseas Holdings**"), MBIA Assurance S.A. ("**MBIA**") and Deutsche Trustee Company Limited as trustee (the "**Bond Trustee**", which expression includes the trustee or trustees for the time being of the Bond Trust Deed).

The payment of all amounts in respect of the Bonds has been secured by the Issuer and guaranteed and secured by each of AWS, AWS Holdings and AWS Overseas Holdings (each, together with the Issuer, an "**Obligor**" and together, the "**AWS Financing Group**") in the Security Agreement (as defined below).

In addition, the Class A Wrapped Bonds and the Class B Wrapped Bonds (each as defined in Condition 1(a) below) only shall be unconditionally and irrevocably guaranteed as to scheduled payments of principal and interest (as adjusted for indexation but excluding certain amounts including any additional amounts relating to prepayment or any accelerated amounts or amounts by which the Rate of Interest exceeds the initial Rate of Interest applicable to such Series as at the relevant Issue Date (together, the "**FG Excepted Amounts**") in respect of such Class A Wrapped Bonds and Class B Wrapped Bonds pursuant to a financial guarantee insurance policy (each a "**Bond Policy**") to be issued by MBIA or another financial guarantor (each a "**Financial Guarantor**") in conjunction with the issue of Class A Wrapped Bonds and Class B Wrapped Bonds.

None of the Class A Unwrapped Bonds or Class B Unwrapped Bonds (each as defined in Condition 1(a) below) will have the benefit of any such Bond Policy.

References herein to the "**Bonds**" shall be references to the Bonds of this Series and of each Class and shall mean:

- (i) in relation to any Bonds represented by a global Bond (a "**Global Bond**"), units of the lowest Specified Denomination in the Specified Currency;
- (ii) any Global Bond;
- (iii) any definitive Bonds in bearer form ("**Bearer Bonds**") issued in exchange for a Global Bond in bearer form; and
- (iv) definitive Bonds in registered form ("**Registered Bonds**") (whether or not issued in exchange for a Global Bond in registered form).

The Bonds, the Receipts (as defined below) and the Coupons (as defined below) have the benefit of an agency agreement (such agency agreement as amended and/or supplemented and/or restated from time to time, the "**Agency Agreement**") dated 30 July 2002 and made between the Issuer and the other Obligors, the Bond Trustee, Deutsche Bank AG London as issuing and principal paying agent and agent bank (the "**Principal Paying Agent**", which expression shall include any successor principal paying agent and agent bank) and any other paying agents appointed from time to time under the Agency Agreement (together with the Principal Paying Agent, the "**Paying Agents**", which expression shall include any successor paying agents), Deutsche Bank Trust Company Americas as exchange agent (the "**Exchange Agent**" which expression shall include any successor

exchange agent) and as registrar (the “**Registrar**”, which expression shall include any successor registrar) and Deutsche Bank AG London as a transfer agent (together with the Registrar, the “**Transfer Agents**”, which expression shall include any additional or successor transfer agents).

Interest bearing definitive Bearer Bonds have interest coupons (“**Coupons**”) and, if indicated in the applicable Pricing Supplement, talons for further Coupons (“**Talons**”) attached on issue. Any reference herein to Coupons or coupons shall, unless the context otherwise requires, be deemed to include a reference to Talons or talons. Definitive Bearer Bonds repayable in instalments have receipts (“**Receipts**”) for the payment of the instalments of principal (other than the final instalment) attached on issue. Registered Bonds and Global Bonds do not have Receipts, Coupons or Talons attached on issue.

The Pricing Supplement for this Bond (or the relevant provisions thereof) is attached to or endorsed on this Bond and supplements these Terms and Conditions and may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with these Terms and Conditions, replace or modify these Terms and Conditions for the purposes of this Bond. References to the “**applicable Pricing Supplement**” are to the Pricing Supplement (or the relevant provisions thereof) attached to or endorsed on this Bond.

Any reference to “**Bondholders**” or “**holders**” in relation to any Bonds shall mean (in the case of Bearer Bonds) the holders of the Bonds and (in the case of Registered Bonds) the persons in whose name the Bonds are registered and shall, in relation to any Bonds represented by a global Bond, be construed as provided below. Any reference herein to “**Receiptholders**” shall mean the holders of the Receipts and any reference herein to “**Couponholders**” shall mean the holders of the Coupons and shall, unless the context otherwise requires, include the holders of the Talons.

As used herein, “**Tranche**” means Bonds which are identical in all respects (including as to listing) and “**Series**” means a Tranche of Bonds together with any further Tranche or Tranches of Bonds which are (i) expressed to be consolidated and form a single series and (ii) identical in all respects (including as to listing) except for their respective Issue Dates, Interest Commencement Dates and/or Issue Prices.

Each Obligor has, on 30 July 2002, entered into the security agreement (the “**Security Agreement**”) with Deutsche Trustee Company Limited as security trustee (the “**Security Trustee**”), pursuant to which each Obligor guarantees the obligations of each other Obligor under the Finance Documents (as defined below) to the Security Trustee as security trustee for the Secured Creditors (as defined below) and grants certain fixed and floating charge security (the “**Security**”) to the Security Trustee for itself and on behalf of the Bond Trustee (for itself and on behalf of the Bondholders), the Bondholders, the USPP 2001 Bondholders, the Initial Financial Guarantor, the Existing Finance Lessors, the Existing Hedge Counterparties, the Issuer, the Initial Authorised Credit Facility Agent, the Initial Authorised Credit Facility Arrangers, the Original Lenders, the O&M Facility Reserve Provider, the Debt Service Reserve Liquidity Providers, the Account Bank, the Cash Manager, the Agent Bank, the Principal Paying Agent, the Registrar, the Exchange Agent and the Transfer Agents (each as defined in the Master Definitions Agreement (as defined below)) together with any receiver and any additional creditor of the AWS Financing Group which accedes to the STID (as defined below) and the Common Terms Agreement (as defined below) (together, the “**Secured Creditors**”).

The Obligors have also entered into a security and trust intercreditor deed dated 30 July 2002 (the “**STID**”) with, inter alia, the Security Trustee and the other Secured Creditors pursuant to which the Security Trustee holds the Security on trust for the Secured Creditors and the Secured Creditors agree to certain intercreditor arrangements.

The Issuer has entered or may enter into liquidity facility agreements (together, the “**Liquidity Facility Agreements**”) with certain liquidity facility providers (together, “**Liquidity Facility Providers**”), pursuant to which the Liquidity Facility Providers agree to make certain facilities available to meet debt service liquidity shortfalls and shortfalls in projected operating and maintenance expenditure of the AWS Financing Group.

The Issuer has entered or may enter into bank lending facilities being the Bridging Facility dated 18 April 2002 (the “**Bridging Facility Agreement**”) and the Initial Authorised Loan Agreement dated 30 July 2002 (the “**Initial Authorised Loan Agreement**”) with, inter alia, certain lenders who agree to make certain facilities available to the Issuer for the purposes of funding the corporate restructuring detailed in the Offering Circular dated 23 July 2002 and issued by the Issuer and certain working capital, capital expenditure and other expenses.

The Issuer has entered or may enter into certain currency and interest-rate hedging agreements and other derivative transactions (together, the “**Hedging Agreements**”) with certain hedge counterparties (together, the

“**Hedge Counterparties**”), pursuant to which the Issuer hedges certain of its currency and interest-rate obligations.

The Obligors have entered into a common terms agreement dated 30 July 2002 (the “**Common Terms Agreement**”) with, inter alios, the Security Trustee and the other Secured Creditors, which contains certain representations and covenants of the Issuer and the other Obligors and events of default relating to, inter alia, the Bonds.

The Issuer has entered into intercompany loan arrangements (the “**Intercompany Loan Arrangements**”) under which the Issuer agreed to make available loan facilities and other financial accommodation to AWS.

The Bond Trust Deed, the Bonds, the Bond Policy, the Common Terms Agreement, the Security Agreement, the STID, the Agency Agreement, the Liquidity Facility Agreements, the Hedging Agreements, the Issuer/AWS Loan Agreement, the AWS Loan Notes, the Bridging Facility Agreement, the Initial Authorised Loan Agreement, the I&I Agreements and the Master Definitions Agreement dated 30 July 2002 (the “**Master Definitions Agreement**”) and, together with the other documents referred to in the Master Definitions Agreement, the “**Finance Documents**”.

Copies of, inter alia, the Bond Trust Deed, the Common Terms Agreement, the Security Agreement, the STID, the Agency Agreement, the Liquidity Facility Agreements, the Hedging Agreements, the Bridging Facility Agreement, the Initial Authorised Loan Agreement, the I&I Agreements and the Master Definitions Agreement are available for inspection during normal business hours at the specified office of each of the Principal Paying Agent, the Registrar and any other Paying Agents and Transfer Agents (such Paying Agents and the Transfer Agents being together referred to as the “**Agents**”). Copies of the applicable Pricing Supplement are obtainable during normal business hours at the specified office of each of the Agents save that, if this Bond is an unlisted Bond of any Series, the applicable Pricing Supplement will only be obtainable by a Bondholder holding one or more unlisted Bonds of that Series and such Bondholder must produce evidence satisfactory to the Issuer and the relevant Agent as to its holding of such Bonds and identity.

The Bondholders, the Receiptholders and the Couponholders are deemed to have notice of, and are entitled to the benefit of, all the provisions of the Bond Trust Deed, the Common Terms Agreement, the Security Agreement, the STID and the applicable Pricing Supplement and to have notice of those provisions of the Agency Agreement and the other Finance Documents which are applicable to them. The statements in these Terms and Conditions include summaries of, and are subject to, the detailed provisions of the Agency Agreement, the Bond Trust Deed, the Security Agreement, the Common Terms Agreement and the STID.

Words and expressions defined in the Bond Trust Deed and/or the Agency Agreement and/or the Master Definitions Agreement or used in the applicable Pricing Supplement shall have the same meanings where used in these Terms and Conditions unless the context otherwise requires or unless otherwise stated and provided that, in the event of inconsistency between the Master Definitions Agreement and the applicable Pricing Supplement, the applicable Pricing Supplement will prevail.

Any reference in these Conditions to a matter being “specified” means as the same may be specified in the applicable Pricing Supplement.

## **1. CLASSES, FORM, DENOMINATION AND TITLE**

### **(a) Classes of Bonds**

Each Series of Bonds belongs to one of four classes of Bonds (each a “**Class**”). The available Classes of Bonds will be “**Class A Wrapped Bonds**”, “**Class A Unwrapped Bonds**”, “**Class B Wrapped Bonds**” and “**Class B Unwrapped Bonds**”.

### **(b) Form and Denomination**

The Bonds are in bearer form or in registered form as specified in the applicable Pricing Supplement and, in the case of definitive Bonds, serially numbered, in the Specified Currency and the Specified Denomination(s). Bonds of one Specified Denomination may not be exchanged for Bonds of another Specified Denomination and Bearer Bonds may not be exchanged for Registered Bonds and vice versa.

This Bond may be a Fixed Rate Bond, an Indexation Bond, a Floating Rate Bond, a Zero Coupon Bond, an Index Linked Interest Bond, a Dual Currency Interest Bond or a combination of any of the foregoing, depending upon the Interest Basis shown in the applicable Pricing Supplement.

This Bond may be an Index Linked Redemption Bond, an Instalment Bond, a Dual Currency Redemption Bond, a Partly Paid Bond or a combination of any of the foregoing, depending upon the Redemption/Payment Basis shown in the applicable Pricing Supplement.

Definitive Bearer Bonds are issued with Coupons attached, unless they are Zero Coupon Bonds in which case references to Coupons and Couponholders in these Terms and Conditions are not applicable.

**(c) Title**

Subject as set out below, title to the Bearer Bonds, Receipts and Coupons will pass by delivery and title to the Registered Bonds will pass upon registration of transfers in accordance with the provisions of the Agency Agreement. The Issuer and each of the other Obligors, the Bond Trustee and any Agent will (except as otherwise required by law) deem and treat the bearer of any Bearer Bond, Receipt or Coupon and the registered holder of any Registered Bond as the absolute owner thereof (whether or not overdue and notwithstanding any notice of ownership or writing thereon or notice of any previous loss or theft thereof) for all purposes but, in the case of any Global Bond, without prejudice to the provisions set out in the next succeeding paragraph and no person will be liable for treating such holder.

For so long as any of the Bonds are represented by a Global Bond held on behalf of Euroclear Bank S.A./N.V. as operator of the Euroclear System (“**Euroclear**”) and/or Clearstream Banking, société anonyme (“**Clearstream, Luxembourg**”), each person (other than Euroclear or Clearstream, Luxembourg) who is for the time being shown in the records of Euroclear or of Clearstream, Luxembourg as the holder of a particular nominal amount of such Bonds (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the nominal amount of such Bonds standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated by the Issuer, the Obligors, the Security Trustee, the Bond Trustee and the Agents as the holder of such nominal amount of such Bonds for all purposes other than with respect to the payment of principal or interest on such nominal amount of such Bonds, for which purpose the bearer of the relevant Bearer Global Bond or the registered holder of the relevant Registered Global Bond shall be treated by the Issuer, the Obligors, the Security Trustee, the Bond Trustee and any Agent as the holder of such nominal amount of such Bonds in accordance with and subject to the terms of the relevant Global Bond and the expressions “**Bondholder**” and “**holder of Bonds**” and related expressions shall be construed accordingly.

For so long as The Depository Trust Company (“**DTC**”) or its nominee is the registered owner or holder of a Registered Global Bond, DTC or such nominee, as the case may be, will be considered the sole owner or holder of the Bonds represented by such Registered Global Bond for all purposes under the STID, the Bond Trust Deed, the Agency Agreement and the Bonds except to the extent that in accordance with DTC’s published rules and procedures any ownership rights may be exercised by its participants or beneficial owners through participants.

Bonds which are represented by a Global Bond will be transferable only in accordance with the rules and procedures for the time being of DTC, Euroclear and Clearstream, Luxembourg, as the case may be. References to DTC, Euroclear and/or Clearstream, Luxembourg shall, whenever the context so permits, be deemed to include a reference to any additional or alternative clearing system specified in the applicable Pricing Supplement or as may otherwise be approved by the Issuer, the Principal Paying Agent and the Bond Trustee.

**2. TRANSFERS OF REGISTERED BONDS**

**(a) Transfers of interests in Registered Global Bonds**

Transfers of beneficial interests in Registered Global Bonds will be effected by DTC, Euroclear or Clearstream, Luxembourg, as the case may be, and, in turn, by other participants and, if appropriate, indirect participants in such clearing systems acting on behalf of beneficial transferors and transferees of such interests. A beneficial interest in a Registered Global Bond will, subject to compliance with all applicable legal and regulatory restrictions, be transferable for Bonds in definitive form or for a beneficial interest in another Registered Global Bond only in the authorised denominations set out in the applicable Pricing Supplement and only in accordance with the rules and operating procedures for the time being of DTC, Euroclear or Clearstream, Luxembourg, as the case may be, and in accordance with the terms and conditions specified in the Agency Agreement. Transfers of a Registered Global Bond registered in the

name of a nominee for DTC shall be limited to transfers of such Registered Global Bond, in whole but not in part, to another nominee of DTC or to a successor of DTC or such successor's nominee.

**(b) Transfers of Registered Bonds in definitive form**

Subject as provided in paragraph (g) below, upon the terms and subject to the conditions set forth in the Agency Agreement, a Registered Bond in definitive form may be transferred in whole or in part (in the authorised denominations set out in the applicable Pricing Supplement). In order to effect any such transfer (i) the holder or holders must (A) surrender the Registered Bond for registration of the transfer of the Registered Bond (or the relevant part of the Registered Bond) at the specified office of the Registrar or any Transfer Agent, with the form of transfer thereon duly executed by the holder or holders thereof or his or their attorney or attorneys duly authorised in writing and (B) complete and deposit such other certifications as may be required by the Registrar or, as the case may be, the relevant Transfer Agent and (ii) the Registrar or, as the case may be, the relevant Transfer Agent must, after due and careful enquiry, be satisfied with the documents of title and the identity of the person making the request. Any such transfer will be subject to such reasonable regulations as the Issuer and the Registrar may from time to time prescribe (the initial such regulations being set out in Schedule 5 to the Agency Agreement). Subject as provided above, the Registrar or, as the case may be, the relevant Transfer Agent will, within three business days (being for this purpose a day on which banks are open for business in the city where the specified office of the Registrar or, as the case may be, the relevant Transfer Agent is located) of the request (or such longer period as may be required to comply with any applicable fiscal or other laws or regulations), authenticate and deliver, or procure the authentication and delivery of, at its specified office to the transferee or (at the risk of the transferee) send by uninsured mail, to such address as the transferee may request, a new Registered Bond in definitive form of a like aggregate nominal amount to the Registered Bond (or the relevant part of the Registered Bond) transferred. In the case of the transfer of part only of a Registered Bond in definitive form, a new Registered Bond in definitive form in respect of the balance of the Registered Bond not transferred will be so authenticated and delivered or (at the risk of the transferor) sent to the transferor.

Transfers of Registered Bonds in definitive form may also be made:

- (i) to a transferee who takes delivery also through an interest in a Regulation S Global Bond, upon receipt by the Registrar of a written confirmation substantially in the form set out in the Agency Agreement, amended as appropriate (a “**Transfer Certificate**”) from the transferor to the effect that such transfer is being made in accordance with Regulation S and that, if such transfer is being made prior to expiry of the applicable Distribution Compliance Period, the interests in the Bonds being transferred will be held immediately thereafter through Euroclear and/or Clearstream, Luxembourg; or
- (ii) to a transferee who takes delivery of such interest through a Legended Bond:
  - (A) where the transferee is a person whom the transferor reasonably believes is a QIB in a transaction meeting the requirements of Rule 144A, without certification; or
  - (B) where the transferee is an Institutional Accredited Investor, subject to delivery to the Registrar of a Transfer Certificate from the transferor to the effect that such transfer is being made to an Institutional Accredited Investor, together with a duly executed IAI Investment Letter from the relevant transferee; or
- (iii) otherwise pursuant to the Securities Act or an exemption therefrom, subject to receipt by the Issuer of such satisfactory evidence as the Issuer may reasonably require, which may include an opinion of U.S. counsel, that such transfer is in compliance with any applicable securities laws of any State of the United States,

and, in each case, in accordance with any applicable securities laws of any State of the United States or any other jurisdiction.

Registered Bonds in definitive form transferred by Institutional Accredited Investors to QIBs pursuant to Rule 144A or outside the United States pursuant to Regulation S will be eligible to be held by such QIBs or non-U.S. investors through DTC, Euroclear or Clearstream, Luxembourg, as appropriate, and the Registrar will arrange for any Bonds which are the subject of such a transfer to be represented by the appropriate Registered Global Bond, where applicable.



Upon the transfer, exchange or replacement of Registered Bonds in definitive form, or upon specific request for removal of the Legend on such Bond, the Registrar shall deliver only Registered Bonds in definitive form or refuse to remove the Legend, as the case may be, unless there is delivered to the Issuer such satisfactory evidence as may reasonably be required by the Issuer, which may include an opinion of U.S. counsel, that neither the Legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act.

**(c) Registration of transfer upon partial redemption**

In the event of a partial redemption of Bonds under Condition 10, the Issuer shall not be required to register the transfer of any Registered Bond, or part of a Registered Bond, called for partial redemption.

**(d) Costs of registration**

Bondholders will not be required to bear the costs and expenses of effecting any registration of transfer as provided above, except for any costs or expenses of delivery other than by regular uninsured mail and except that the Issuer may require the payment of a sum sufficient to cover any stamp duty, tax or other governmental charge that may be imposed in relation to the registration.

**(e) Transfers of interests in Regulation S Global Bonds**

Prior to expiry of the applicable Distribution Compliance Period, transfers by the holder of, or of a beneficial interest in, a Regulation S Global Bond to a transferee in the United States or who is a U.S. person will only be made (i) upon receipt by the Registrar of a Transfer Certificate, copies of which are available from the specified office of the Registrar or any Transfer Agent, from the transferor of the Bond or beneficial interest therein to the effect that such transfer is being made to a person whom the transferor reasonably believes is a QIB in a transaction meeting the requirements of Rule 144A; or (ii) otherwise pursuant to the Securities Act or an exemption therefrom, subject to receipt by the Issuer of such satisfactory evidence as the Issuer may reasonably require, which may include an opinion of U.S. counsel, that such transfer is in compliance with any applicable securities laws of any State of the United States, and, in each case, in accordance with any applicable securities laws of any State of the United States or any other jurisdiction.

In the case of (i) above, such transferee may take delivery through a Legended Bond in global or definitive form. After expiry of the applicable Distribution Compliance Period (i) beneficial interests in Regulation S Global Bonds registered in the name of a nominee for DTC may be held through DTC directly, by a participant in DTC, or indirectly through a participant in DTC and (ii) such certification requirements will no longer apply to such transfers.

**(f) Transfers of interests in Rule 144A Global Bonds**

Transfers of Rule 144A Global Bonds or beneficial interests therein may be made:

- (i) to a transferee who takes delivery of such interest through a Regulation S Global Bond, upon receipt by the Registrar of a duly completed Transfer Certificate from the transferor to the effect that such transfer is being made in accordance with Regulation S and that, in the case of a Regulation S Global Bond registered in the name of a nominee for DTC, if such transfer is being made prior to expiry of the applicable Distribution Compliance Period, the interests in the Bonds being transferred will be held immediately thereafter through Euroclear and/or Clearstream, Luxembourg; or
- (ii) to a transferee who takes delivery of such interest through a Rule 144A Global Bond where the transferee is a person whom the transferor reasonably believes is a QIB in a transaction meeting the requirements of Rule 144A, without certification; or
- (iii) otherwise pursuant to the Securities Act or an exemption therefrom, subject to receipt by the Issuer of such satisfactory evidence as the Issuer may reasonably require, which may include an opinion of U.S. counsel, that such transfer is in compliance with any applicable securities laws of any State of the United States,

and, in each case, in accordance with any applicable securities laws of any State of the United States or any other jurisdiction.

Upon the transfer, exchange or replacement of Rule 144A Global Bonds, or upon specific request for removal of the Legend on such Bond, the Registrar shall deliver only Rule 144A Global Bonds or refuse to remove the Legend, as the case may be, unless there is delivered to the Issuer such satisfactory evidence as may reasonably be required by the Issuer, which may include an opinion of U.S. counsel, that neither the Legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act.

**(g) Exchanges and transfers of Registered Bonds generally**

Holders of Registered Bonds in definitive form, other than Institutional Accredited Investors, may exchange such Bonds for interests in a Registered Global Bond of the same type at any time.

**(h) Definitions**

In this Condition, the following expressions shall have the following meanings:

“**Distribution Compliance Period**” means the period that ends 40 days after the completion of the distribution of each Tranche of Bonds, as certified by the relevant Dealer (in the case of a non-syndicated issue) or the relevant Lead Manager (in the case of a syndicated issue);

“**IAI Investment Letter**” means a letter from an Institutional Accredited Investor in or substantially in the form set out in the Agency Agreement;

“**Institutional Accredited Investor**” means “accredited investors” (as defined in Rule 501(a)(1), (2), (3) or (7) under the Securities Act) that are institutions;

“**Legended Bond**” means Registered Bonds in definitive form that are issued to Institutional Accredited Investors and Registered Bonds (whether in definitive form or represented by a Registered Global Bond) sold in transactions to QIBs in accordance with the requirements of Rule 144A;

“**QIB**” means a “**qualified institutional buyer**” within the meaning of Rule 144A;

“**Regulation S**” means Regulation S under the Securities Act;

“**Regulation S Global Bond**” means a Registered Global Bond representing Bonds sold outside the United States in reliance on Regulation S;

“**Rule 144A**” means Rule 144A under the Securities Act;

“**Rule 144A Global Bond**” means a Registered Global Bond representing Bonds sold in the United States or to QIBs; and

“**Securities Act**” means the United States Securities Act of 1933, as amended.

**3. STATUS OF THE BONDS, GUARANTEES AND BOND POLICY**

**(a) Status of Class A Wrapped Bonds and Class A Unwrapped Bonds**

*This Condition 3(a) is applicable only in relation to Bonds which are specified as being Class A Wrapped Bonds or Class A Unwrapped Bonds.*

The Bonds and any relative Receipts and Coupons are direct and unconditional, obligations of the Issuer, are secured in the manner described in Condition 4 and rank *pari passu* without any preference among themselves. However, the Class A Unwrapped Bonds will not have the benefit of any Bond Policy.

**(b) Status of Class B Wrapped Bonds and Class B Unwrapped Bonds**

*This Condition 3(b) is applicable only in relation to Bonds which are specified as being Class B Wrapped Bonds or Class B Unwrapped Bonds.*

The Bonds and any relative Receipts and Coupons are direct and unconditional obligations of the Issuer, are secured in the manner described in Condition 4, are subordinated to the Class A Wrapped Bonds and the Class A Unwrapped Bonds and rank *pari passu* without any preference among themselves. However, the Class B Unwrapped Bonds will not have the benefit of any Bond Policy.

(c) **Guarantees by the Obligors**

The obligations of the Obligors under the Finance Documents are unconditionally and irrevocably guaranteed by each other Obligor pursuant to the Security Agreement. Each such guarantee constitutes a direct and unconditional obligation of such Obligor secured in the manner described in Condition 4.

(d) **Bond Policy issued by Financial Guarantor**

*This Condition 3(d) is applicable only in relation to Bonds which are specified as being Class A Wrapped Bonds or Class B Wrapped Bonds.*

Class A Wrapped Bonds and Class B Wrapped Bonds will each have the benefit of a Bond Policy issued by a Financial Guarantor specified in the applicable Pricing Supplement, issued pursuant to an insurance and indemnity agreement between the Issuer, AWS and the relevant Financial Guarantor dated on or before the Issue Date (each an “**I&I Agreement**”) of such Bonds. Under the relevant Bond Policy, the relevant Financial Guarantor unconditionally and irrevocably agrees to pay to the Bond Trustee all sums due and repayable but unpaid by the Issuer in respect of scheduled interest and payment of principal (adjusted for indexation in accordance with these Terms and Conditions but excluding always the FG Excepted Amounts) on such Class A Wrapped Bonds or Class B Wrapped Bonds, all as more particularly described in the relevant Bond Policy. However, the Issuer is required to draw upon certain liquidity facilities available to it before the relevant Financial Guarantor is required to pay under the relevant Bond Policy.

The terms of the relevant Bond Policy provide that amounts of principal on any such Bonds which have become immediately due and payable (whether by virtue of acceleration, prepayment or otherwise) other than on a relevant Payment Day (as defined under such Bond Policy) will not be treated as Insured Amounts (as defined in such Bond Policy) which are Due for Payment (as defined in such Bond Policy) under such Bond Policy unless the relevant Financial Guarantor in its sole discretion elects to do so by notice in writing to the Bond Trustee. If no such election is made, the relevant Financial Guarantor will continue to be liable to make payments in respect of the Bonds pursuant to the relevant Bond Policy on the dates on which such payments would have been required to be made if such amounts had not become immediately due and repayable.

**To the extent that the Early Redemption Amount (as referred to in Condition 10(e)) or the Optional Redemption Amount (as referred to in Condition 10(d)), of any Bonds exceeds the aggregate of the outstanding nominal amount of and any accrued interest outstanding on any such Bonds to be redeemed, payment of such Early Redemption Amount or, as the case may be, such Optional Redemption Amount, will not be guaranteed by the relevant Financial Guarantor under the relevant Bond Policy.**

(e) **Status of Bond Policy**

*This Condition 3(e) is applicable only in relation to Bonds which are specified as being Class A Wrapped Bonds or Class B Wrapped Bonds.*

The relevant Bond Policy provided by the relevant Financial Guarantor in respect of the Bonds will constitute a direct and unconditional obligation of the relevant Financial Guarantor which will rank *pari passu* with all other unsecured obligations of such Financial Guarantor, save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.

#### **4. SECURITY, PRIORITY AND RELATIONSHIP WITH SECURED CREDITORS**

(a) **Security**

Under the Security Agreement, each Obligor guarantees the obligations of each other Obligor under the Finance Documents to the Security Trustee for itself and on behalf of the Secured Creditors (including, without limitation, Bondholders) and secures such obligations upon the whole of its property, undertaking and assets, subject to certain specified exceptions and, in the case of AWS, to the terms of the Instrument of Appointment (as defined below) and any requirements thereunder or the Act (as defined below). There is no intention to create further security for the benefit of the holders of Bonds issued after the first Series. Each further Series of Bonds issued by the Issuer and any additional creditor of the Issuer acceding to the STID will share in the Security.

In these Conditions:

the “**Act**” means the United Kingdom Water Industry Act 1991 (as amended); and

“**Instrument of Appointment**” means the instrument of appointment dated 1989 under which the Secretary of State for the Environment appointed AWS as a water and sewerage undertaker under the Act for the areas described in the Instrument of Appointment, as modified or amended from time to time.

**(b) Relationship among Bondholders and with other Secured Creditors**

The Bond Trust Deed contains provisions detailing the Bond Trustee’s obligations to consider the interests of the Bondholders as regards all powers, trusts and authorities, duties and discretions of the Bond Trustee (except where expressly provided or otherwise referred to in Condition 20).

The STID provides that the Security Trustee (except in relation to its Reserved Matters and Entrenched Rights and subject to certain exceptions) will act on instructions of the Majority Creditors (as defined in the Master Definitions Agreement) (including the Bond Trustee as trustee for and representative of the holders of each Series of Wrapped Bonds (following the occurrence of an FG Event of Default in respect of the Financial Guarantor of those Wrapped Bonds which is continuing) and the Unwrapped Bondholders) (other than the USPP Bondholders) and, when so doing, the Security Trustee is not required to have regard to the interests of any Secured Creditor (including the Bond Trustee as trustee for and representative of the Bondholders or any individual Bondholder) in relation to the exercise of such rights and, consequently, has no liability to the Bondholders as a consequence of so acting.

**(c) Enforceable Security**

In the event of the Security becoming enforceable as provided in the STID, the Security Trustee shall, if instructed by the Majority Creditors, enforce its rights with respect to the Security, but without any liability as to the consequence of such action and without having regard to the effect thereof on, or being required to account for such action to, any particular Secured Creditor (including the Bond Trustee as trustee for the Bondholders or any individual Bondholder), provided that the Security Trustee shall not be obliged to take any action unless it is indemnified and/or secured to its satisfaction.

**(d) Application After Enforcement**

After enforcement of the Security, the Security Trustee shall (to the extent that such funds are available) use funds standing to the credit of the Accounts to make payments in accordance with the Payment Priorities (as set out in the Common Terms Agreement).

**(e) Bond Trustee and Security Trustee not liable for security**

The Bond Trustee and the Security Trustee will not be liable for any failure to make the usual investigations or any investigations which might be made by a security holder in relation to the property which is the subject of the Security, and shall not be bound to enquire into or be liable for any defect or failure in the right or title of the relevant Obligor to the Security, whether such defect or failure was known to the Bond Trustee or the Security Trustee or might have been discovered upon examination or enquiry or whether capable of remedy or not, nor will it have any liability for the enforceability of the Security created under the Security Documents whether as a result of any failure, omission or defect in registering or filing or otherwise protecting or perfecting such Security. The Bond Trustee and the Security Trustee have no responsibility for the value of any such Security.

**5. ISSUER COVENANTS**

So long as any of the Bonds remain outstanding, the Obligors have agreed to comply with the covenants as set out in Schedule 5 of the Common Terms Agreement.

The Bond Trustee is entitled to rely absolutely on a certificate of any two directors of the Issuer or any other Obligor in relation to any matter relating to the Covenants and to accept without liability any such certificate as sufficient evidence of the relevant fact or matter stated in such certificate.

The Covenants include, subject, in some cases, to certain materiality qualifications, exceptions and reservations as to matters of law, covenants as to how AWS will carry on its business, including restrictions upon each Obligor’s ability to dispose of its assets, create security, grant guarantees, incur further financial indebtedness and amend any Material Agreement. *Details of the covenants to be given by*

*the Obligors, and those to be given by AWS and the Issuer are summarised in Chapter 7, “Financing Structure – Common Terms Agreement, Information – Covenants, Covenants – General, Financial Covenants”.*

The Common Terms Agreement also prescribes the manner in which AWS must manage its cash resources and the order in which it must pay its liabilities. See Chapter 7, “Financing Structure – Common Terms Agreement” and “Cash Management”.

## **6. REDENOMINATION**

### **(a) Redenomination**

Where redenomination is specified in the applicable Pricing Supplement as being applicable, the Issuer may, without the consent of the Bondholders, the Receiptholders and the Couponholders, on giving prior notice to the Agent, Euroclear and Clearstream, Luxembourg and at least 30 days’ prior notice to the Bondholders in accordance with Condition 18, elect that, with effect from the Redenomination Date specified in the notice, the Bonds shall be redenominated in euro.

The election will have effect as follows:

- (i) the Bonds and the Receipts shall be deemed to be redenominated in euro in the denomination of euro 0.01 with a nominal amount for each Bond and Receipt equal to the nominal amount of that Bond or Receipt in the Specified Currency, converted into euro at the Established Rate, provided that, if the Issuer determines, with the agreement of the Principal Paying Agent, that the then market practice in respect of the redenomination in euro of internationally offered securities is different from the provisions specified above, such provisions shall be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Bondholders, the stock exchange (if any) on which the Bonds may be listed and the Paying Agents of such deemed amendments;
- (ii) save to the extent that an Exchange Notice has been given in accordance with paragraph (iv) below, the amount of interest due in respect of the Bonds will be calculated by reference to the aggregate nominal amount of Bonds presented (or, as the case may be, in respect of which Coupons are presented) for payment by the relevant holder and the amount of such payment shall be rounded down to the nearest euro 0.01;
- (iii) if definitive Bonds are required to be issued after the Redenomination Date, they shall be issued at the expense of the Issuer in the denominations of euro 1,000, euro 10,000, euro 100,000 and (but only to the extent of any remaining amounts less than euro 1,000 or such smaller denominations as the Principal Paying Agent may approve) euro 0.01 and such other denominations as the Principal Paying Agent shall determine and notify to the Bondholders;
- (iv) if issued prior to the Redenomination Date, all unmatured Coupons denominated in the Specified Currency (whether or not attached to the Bonds) will become void with effect from the date on which the Issuer gives notice (the “**Exchange Notice**”) that replacement euro-denominated Bonds, Receipts and Coupons are available for exchange (provided that such securities are so available) and no payments will be made in respect of them. The payment obligations contained in any Bonds and Receipts so issued will also become void on that date although those Bonds and Receipts will continue to constitute valid exchange obligations of the Issuer. New euro-denominated Bonds, Receipts and Coupons will be issued in exchange for Bonds, Receipts and Coupons denominated in the Specified Currency in such manner as the Agent may specify and as shall be notified to the Bondholders in the Exchange Notice. No Exchange Notice may be given less than 15 days prior to any date for payment of principal or interest on the Bonds;
- (v) after the Redenomination Date, all payments in respect of the Bonds, the Receipts and the Coupons, other than payments of interest in respect of periods commencing before the Redenomination Date, will be made solely in euro as though references in the Bonds to the Specified Currency were to euro. Payments will be made in euro by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee or, at the option of the payee, by a euro cheque;
- (vi) if the Bonds are Fixed Rate Bonds and interest for any period ending on or after the Redenomination Date is required to be calculated for a period ending other than on an Interest

Payment Date, it will be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention; and

- (vii) if the Bonds are Floating Rate Bonds or Index-Linked Bonds, the applicable Pricing Supplement will specify any relevant changes to the provisions relating to interest.

**(b) Definitions**

In the Conditions, the following expressions have the following meanings:

“**Established Rate**” means the rate for the conversion of the Specified Currency (including compliance with rules relating to roundings in accordance with applicable European Community regulations) into euro established by the Council of the European Union pursuant to Article 123 of the Treaty;

“**euro**” means the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty;

“**Redenomination Date**” means (in the case of interest bearing Bonds) any date for payment of interest under the Bonds or (in the case of Zero Coupon Bonds) any date, in each case specified by the Issuer in the notice given to the Noteholders pursuant to paragraph (a) above and which falls on or after the date on which the country of the Specified Currency first participates in the third stage of European economic and monetary union; and

“**Treaty**” means the Treaty establishing the European Community, as amended.

**7. INTEREST**

**(a) Interest on Fixed Rate Bonds and Indexation Bonds**

Each Fixed Rate Bond and Indexation Bond bears interest on its outstanding nominal amount (or, if it is a Partly Paid Bond, the amount paid up) and, if it is an Indexation Bond, adjusted for indexation in accordance with Condition 9) from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest. Interest will be payable in arrear on the Interest Payment Date(s) in each year up to (and including) the Maturity Date.

Except as provided in the applicable Pricing Supplement, the amount of interest payable on each Interest Payment Date in respect of the Fixed Interest Period ending on (but excluding) such date will amount to the Fixed Coupon Amount. Payments of interest on any Interest Payment Date will, if so specified in the applicable Pricing Supplement, amount to the Broken Amount so specified.

As used in these Terms and Conditions, “**Fixed Interest Period**” means the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date.

If interest is required to be calculated for a period other than a Fixed Interest Period, such interest shall be calculated (i) in the case of Bonds other than Indexation Bonds, by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention and (ii) in the case of Indexation Bonds, on an actual/actual basis in line with the method used by the Debt Management Office for the United Kingdom Index-Linked Gilt Edged Market.

“**Day Count Fraction**” means, in respect of the calculation of an amount of interest, in accordance with this Condition 7(a):

- (i) if “**Actual/Actual (ISMA)**” is specified in the applicable Pricing Supplement:
  - (A) in the case of Bonds where the number of days in the relevant period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (the “**Accrual Period**”) is equal to or shorter than the Determination Period during which the Accrual Period ends, the number of days in such Accrual Period divided by the product of (1) the number of days in such

Determination Period and (2) the number of Determination Dates (as specified in the applicable Pricing Supplement) that would occur in one calendar year; or

- (B) in the case of Bonds where the Accrual Period is longer than the Determination Period, during which the Accrual Periods ends, the sum of:
- (1) the number of days in such Accrual Period falling in the Determination Period in which the Accrual Period begins divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates (as specified in the applicable Pricing Supplement) that would occur in one calendar year; and
  - (2) the number of days in such Accrual Period falling in the next Determination Period divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and
- (ii) if “30/360” is specified in the applicable Pricing Supplement, the number of days in the period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (such number of days being calculated on the basis of a year of 360 days with 12 30-day months) divided by 360.

In these Terms and Conditions:

“**Determination Period**” means each period from (and including) a Determination Date to (but excluding) the next Determination Date (including, where either the Interest Commencement Date or the final Interest Payment Date is not a Determination Date, the period commencing on the first Determination Date prior to, and ending on the first Determination Date falling after, such date); and

“**sub-unit**” means with respect to any currency other than euro, the lowest amount of such currency that is available as legal tender in the country of such currency and, with respect to euro, means one cent.

**(b) Interest on Floating Rate Bonds and Index Linked Interest Bonds**

**(i) Interest Payment Dates**

Each Floating Rate Bond and Index Linked Interest Bond bears interest on its outstanding nominal amount (or, if it is a Partly Paid Bond, the amount paid up) from (and including) the Interest Commencement Date and such interest will be payable in arrear on either:

- (A) the Specified Interest Payment Date(s) in each year specified in the applicable Pricing Supplement; or
- (B) if no express Specified Interest Payment Date(s) is/are specified in the applicable Pricing Supplement, each date (each such date, together with each Specified Interest Payment Date, an “**Interest Payment Date**”) which falls the number of months or other period specified as the Specified Period in the applicable Pricing Supplement after the preceding Interest Payment Date or, in the case of the first Interest Payment Date, after the Interest Commencement Date.

Such interest will be payable in respect of each Interest Period (which expression shall, in these Conditions, mean the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date).

If a Business Day Convention is specified in the applicable Pricing Supplement and (x) if there is no numerically corresponding day on the calendar month in which an Interest Payment Date should occur or (y) if any Interest Payment Date would otherwise fall on a day which is not a Business Day, then, if the Business Day Convention specified is:

- (1) in any case where Specified Periods are specified in accordance with Condition 7(b)(i)(B) above, the Floating Rate Convention, such Interest Payment Date (i) in the case of (x) above, shall be the last day that is a Business Day in the relevant month and the provisions of (B) below shall apply, *mutatis mutandis*, or (ii) in the case of (y) above, shall be postponed to the next day which is a Business Day unless it would thereby fall into the next

calendar month, in which event (A) such Interest Payment Date shall be brought forward to the immediately preceding Business Day and (B) each subsequent Interest Payment Date shall be the last Business Day in the month which falls in the Specified Period after the preceding applicable Interest Payment Date occurred; or

- (2) the Following Business Day Convention, such Interest Payment Date shall be postponed to the next day which is a Business Day; or
- (3) the Modified Following Business Day Convention, such Interest Payment Date shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event such Interest Payment Date shall be brought forward to the immediately preceding Business Day; or
- (4) the Preceding Business Day Convention, such Interest Payment Date shall be brought forward to the immediately preceding Business Day.

In these Conditions, “**Business Day**” means a day which is both:

- (A) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in London and any Additional Business Centre specified in the applicable Pricing Supplement; and
  - (B) either (1) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than London and any Additional Business Centre and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney and Auckland, respectively) or (2) in relation to any sum payable in euro, a day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) System (the “**TARGET System**”) is open.
- (ii) Rate of Interest

The Rate of Interest payable from time to time in respect of Floating Rate Bonds and Index Linked Interest Bonds will be determined in the manner specified in the applicable Pricing Supplement.

(A) ISDA Determination for Floating Rate Bonds

Where ISDA Determination is specified in the applicable Pricing Supplement as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will be the relevant ISDA Rate plus or minus (as indicated in the applicable Pricing Supplement) the Margin (if any). For the purposes of this sub-paragraph (A), “**ISDA Rate**” for an Interest Period means a rate equal to the Floating Rate that would be determined by the Principal Paying Agent under an interest rate swap transaction if the Principal Paying Agent were acting as Calculation Agent for that swap transaction under the terms of an agreement incorporating the 2000 ISDA Definitions, as published by the International Swaps and Derivatives Associations, Inc. and as amended and updated as at the Issue Date of the first Tranche of the Bonds, published by the International Swaps and Derivatives Association, Inc. (the “**ISDA Definitions**”) and under which:

- (1) the Floating Rate Option is as specified in the applicable Pricing Supplement;
- (2) the Designated Maturity is a period specified in the applicable Pricing Supplement; and
- (3) the relevant Reset Date is either (i) if the applicable Floating Rate Option is based on the London inter-bank offered rate (“**LIBOR**”) or on the Euro-zone inter-bank offered rate (“**EURIBOR**”), the first day of that Interest Period or (ii) in any other case, as specified in the applicable Pricing Supplement.



For the purposes of this sub-paragraph (A), “**Floating Rate**”, “**Calculation Agent**”, “**Floating Rate Option**”, “**Designated Maturity**” and “**Reset Date**” have the meanings given to those terms in the ISDA Definitions.

(B) Screen Rate Determination for Floating Rate Bonds

Where Screen Rate Determination is specified in the applicable Pricing Supplement as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will, subject as provided below, be either:

- (1) the offered quotation; or
- (2) the arithmetic mean (rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards) of the offered quotations,

(expressed as a percentage rate per annum) for the Reference Rate which appears or appear, as the case may be, on the Relevant Screen Page as at 11.00 a.m. (London time, in the case of LIBOR, or Brussels time, in the case of EURIBOR) (the “**Specified Time**”) on the Interest Determination Date in question plus or minus (as indicated in the applicable Pricing Supplement) the Margin (if any), all as determined by the Principal Paying Agent. If five or more of such offered quotations are available on the Relevant Screen Page, the highest (or, if there is more than one such highest quotation, one only of such quotations) and the lowest (or, if there is more than one such lowest quotation, one only of such quotations) shall be disregarded by the Principal Paying Agent for the purpose of determining the arithmetic mean (rounded as provided above) of such offered quotations.

If the Relevant Screen Page is not available or if, in the case of (1) above, no offered quotation appears or, in the case of (2) above, fewer than three offered quotations appear, in each case as at the Specified Time on the Interest Determination Date in question, the Principal Paying Agent shall request each of the Reference Banks to provide the Principal Paying Agent with its offered quotation (expressed as a percentage rate per annum) for the Reference Rate at approximately the Specified Time on the Interest Determination Date in question. If two or more of the Reference Banks provide the Principal Paying Agent with offered quotations, the Rate of Interest for the Interest Period shall be the arithmetic mean (rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards) of the offered quotations plus or minus (as appropriate) the Margin (if any), all as determined by the Principal Paying Agent.

If on any Interest Determination Date one only or none of the Reference Banks provides the Principal Paying Agent with an offered quotation as provided in the preceding paragraph, the Rate of Interest for the relevant Interest Period shall be the rate per annum which the Principal Paying Agent determines as being the arithmetic mean (rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards) of the rates, as communicated to (and at the request of) the Principal Paying Agent by the Reference Banks or any two or more of them, at which such banks were offered, at approximately the Specified Time on the relevant Interest Determination Date, deposits in the Specified Currency for a period equal to that which would have been used for the Reference Rate by leading banks in the London inter-bank market (if the Reference Rate is LIBOR) or the Euro-zone inter-bank market (if the Reference Rate is EURIBOR) plus or minus (as appropriate) the Margin (if any) or, if fewer than two of the Reference Banks provide the Principal Paying Agent with offered rates, the offered rate for deposits in the Specified Currency for a period equal to that which would have been used for the Reference Rate, or the arithmetic mean (rounded as provided above) of the offered rates for deposits in the Specified Currency for a period equal to that which would have been used for the Reference Rate, at which, at approximately the Specified Time on the relevant Interest Determination Date, any one or more banks (which bank or banks is or are in the opinion of the Issuer suitable for the purpose) informs the Principal Paying Agent it is quoting to leading banks in the London inter-bank market (if the Reference Rate is LIBOR) or the Euro-zone inter-bank market (if the Reference Rate is EURIBOR) plus or minus (as appropriate) the Margin (if any), provided that, if the Rate of Interest cannot be determined in accordance with the foregoing provisions of this paragraph, the Rate of Interest shall be

determined as at the last preceding Interest Determination Date (though substituting, where a different Margin is to be applied to the relevant Interest Period from that which applied to the last preceding Interest Period, the Margin relating to the relevant Interest Period in place of the Margin relating to that last preceding Interest Period).

If the Reference Rate from time to time in respect of Floating Rate Bonds is specified in the applicable Pricing Supplement as being other than LIBOR or EURIBOR, the Rate of Interest in respect of such Bonds will be determined as provided in the applicable Pricing Supplement.

(iii) Minimum Rate of Interest and/or Maximum Rate of Interest

If the applicable Pricing Supplement specifies a Minimum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (ii) above is less than such Minimum Rate of Interest, the Rate of Interest for such Interest Period shall be such Minimum Rate of Interest.

If the applicable Pricing Supplement specifies a Maximum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (ii) above is greater than such Maximum Rate of Interest, the Rate of Interest for such Interest Period shall be such Maximum Rate of Interest.

(iv) Determination of Rate of Interest and calculation of Interest Amounts

The Principal Paying Agent, in the case of Floating Rate Bonds, and the Calculation Agent, in the case of Index Linked Interest Bonds, will at or as soon as practicable after each time at which the Rate of Interest is to be determined, determine the Rate of Interest for the relevant Interest Period. In the case of Index Linked Interest Bonds, the Calculation Agent will notify the Principal Paying Agent of the Rate of Interest for the relevant Interest Period as soon as practicable after calculating the same.

The Principal Paying Agent will calculate the amount of interest (the “**Interest Amount**”) payable on the Floating Rate Bonds or Index Linked Interest Bonds in respect of each Specified Denomination for the relevant Interest Period. Each Interest Amount shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention.

“**Day Count Fraction**” means, in respect of the calculation of an amount of interest in accordance with this Condition 7(b):

- (A) if “Actual/365” or “Actual/Actual-ISDA” is specified in the applicable Pricing Supplement, the actual number of days in the Interest Period divided by 365 (or, if any portion of that Interest Period falls in a leap year, the sum of (A) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (B) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365);
- (B) if “Actual/365 (Fixed)” is specified in the applicable Pricing Supplement, the actual number of days in the Interest Period divided by 365;
- (C) if “Actual/365 (Sterling)” is specified in the applicable Pricing Supplement, the actual number of days in the Interest Period divided by 365 or, in the case of an Interest Payment Date falling in a leap year, 366;
- (D) if “Actual/360” is specified in the applicable Pricing Supplement, the actual number of days in the Interest Period divided by 360;
- (E) if “30/360”, “360/360” or “Bond Basis” is specified in the applicable Pricing Supplement, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months (unless (x) the last day of the Interest Period is the 31st day of a month but the first day of the Interest Period is a

day other than the 30th or 31st day of a month, in which case the month that includes that last day shall not be considered to be shortened to a 30-day month, or (y) the last day of the Interest Period is the last day of the month of February in which case the month of February shall not be considered to be lengthened to a 30-day month)); and

- (F) if “30E/360” or “Eurobond Basis” is specified in the applicable Pricing Supplement, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months, without regard to the date of the first day or last day of the Interest Period unless, in the case of the final Interest Period, the Maturity Date is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month).

(v) **Notification of Rate of Interest and Interest Amounts**

The Principal Paying Agent will cause the Rate of Interest and each Interest Amount for each Interest Period and the relevant Interest Payment Date to be notified to the Issuer and the other Obligors, the Bond Trustee and any stock exchange or other relevant authority on which the relevant Floating Rate Bonds or Index Linked Interest Bonds are for the time being listed or by which they have been admitted to listing and notice thereof to be published in accordance with Condition 18 as soon as possible after their determination but in no event later than the fourth London Business Day thereafter. Each Interest Amount and Interest Payment Date so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without prior notice in the event of an extension or shortening of the Interest Period. Any such amendment will be promptly notified to each stock exchange or other relevant authority on which the relevant Floating Rate Bonds or Index Linked Interest Bonds are for the time being listed or by which they have been admitted to listing and to the Bondholders in accordance with Condition 18. For the purposes of this paragraph, the expression “**London Business Day**” means a day (other than a Saturday or a Sunday) on which banks and foreign exchange markets are open for general business in London.

(vi) **Determination or calculation by the Bond Trustee**

If for any reason at any time the Principal Paying Agent or, as the case may be, the Calculation Agent defaults in its obligations to determine the Rate of Interest or the Principal Paying Agent defaults in its obligation to calculate any Interest Amount in accordance with sub-paragraph (ii) (A) or (B) above, as the case may be, and in each case, (iv) above, the Bond Trustee shall determine the Rate of Interest at such rate as, in its absolute discretion (having regard as it shall think fit to the foregoing provisions of this Condition, but subject always to any Minimum or Maximum Rate of Interest specified in the applicable Pricing Supplement), it shall deem fair and reasonable in all the circumstances or, as the case may be, the Bond Trustee shall calculate the Interest Amount(s) in such manner as it shall deem fair and reasonable in all the circumstances and each such determination or calculation shall be deemed to have been made by the Principal Paying Agent or the Calculation Agent, as applicable.

(vii) **Certificates to be final**

All certificates, communications, opinions, determinations, calculations, quotations and decisions given, expressed, made or obtained for the purposes of the provisions of this Condition 7(b), whether by the Principal Paying Agent or, if applicable, the Calculation Agent or the Bond Trustee, shall (in the absence of wilful default, bad faith or manifest error) be binding on the Issuer, the Obligors, the Bond Trustee, the Principal Paying Agent, the Calculation Agent (if applicable), the other Agents and all Bondholders, Receiptholders and Couponholders and (in the absence as aforesaid) no liability to the Issuer, the Obligors, the Bond Trustee, the Bondholders, the Receiptholders or the Couponholders shall attach to the Principal Paying Agent or, if applicable, the Calculation Agent or the Bond Trustee in connection with the exercise or non-exercise by it of its powers, duties and discretions pursuant to such provisions.

(c) **Interest on Dual Currency Interest Bonds**

The rate or amount of interest payable in respect of Dual Currency Interest Bonds shall be determined in the manner specified in the applicable Pricing Supplement.

**(d) Interest on Partly Paid Bonds**

In the case of Partly Paid Bonds (other than Partly Paid Bonds which are Zero Coupon Bonds), interest will accrue as aforesaid on the paid-up nominal amount of such Bonds and otherwise as specified in the applicable Pricing Supplement.

**(e) Accrual of interest**

Each Bond (or in the case of the redemption of part only of a Bond, that part only of such Bond) will cease to bear interest (if any) from the date for its redemption unless, upon due presentation thereof, payment of principal is improperly withheld or refused. In such event, interest will continue to accrue as provided in the Bond Trust Deed.

**(f) Deferral of interest on Class B Bonds**

*This Condition 7(f) is applicable only in relation to Bonds which are specified as being Class B Bonds.*

In the case of Class B Bonds only, if, on any Interest Payment Date, prior to delivery of an enforcement notice under Condition 13, there are insufficient funds available to pay any accrued interest on such Class B Bonds, such accrued interest will be treated as not having fallen due and will be deferred in accordance with the cash management provisions contained in Schedule 12 of the Common Terms Agreement (“**Deferred Interest**”) until the earlier of (i) the next succeeding Interest Payment Date for those Class B Bonds on which the Issuer has, in accordance with the cash management provisions contained in Schedule 12 of the Common Terms Agreement, sufficient funds available to pay such Deferred Interest (including any interest accrued thereon); and (ii) the date on which all the Class A Debt (as defined in the Master Definitions Agreement) is repaid in full. Interest will continue to accrue on such Deferred Interest at the Rate of Interest otherwise payable on unpaid principal of such Class B Bonds.

**8. PAYMENTS**

**(a) Method of payment**

Subject as provided below:

- (i) payments in a Specified Currency other than euro will be made by credit or transfer to an account in the relevant Specified Currency (which, in the case of a payment in Japanese yen to a non-resident of Japan, shall be a non-resident account) maintained by the payee with, or, at the option of the payee, by a cheque in such Specified Currency drawn on, a bank in the principal financial centre of the country of such Specified Currency (which, if the Specified Currency is Australian dollars or New Zealand dollars, shall be Sydney and Auckland, respectively); and
- (ii) payments in euro will be made by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee or, at the option of the payee, by a euro cheque.

Payments will be subject in all cases to any fiscal or other laws and regulations applicable thereto in the place of payment, but without prejudice to the provisions of Condition 11.

**(b) Presentation of definitive Bearer Bonds, Receipts and Coupons**

Payments of principal in respect of definitive Bearer Bonds will (subject as provided below) be made in the manner provided in paragraph (a) above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of definitive Bearer Bonds, and payments of interest in respect of definitive Bearer Bonds will (subject as provided below) be made as aforesaid only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of Coupons, in each case at the specified office of any Paying Agent outside the United States (which expression, as used herein, means the United States of America (including the States and the District of Columbia, its territories, its possessions and other areas subject to its jurisdiction)).

Payments of instalments of principal (if any) in respect of definitive Bearer Bonds, other than the final instalment, will (subject as provided below) be made in the manner provided in paragraph (a) above against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Receipt in accordance with the preceding paragraph. Payment of the final instalment will be made in the manner provided in paragraph (a) above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Bearer Bond in accordance with the

preceding paragraph. Each Receipt must be presented for payment of the relevant instalment together with the definitive Bearer Bond to which it appertains. Receipts presented without the definitive Bearer Bond to which they appertain do not constitute valid obligations of the Issuer. Upon the date on which any definitive Bearer Bond becomes due and repayable, unmatured Receipts (if any) relating thereto (whether or not attached) shall become void and no payment shall be made in respect thereof.

Fixed Rate Bonds in definitive bearer form (other than Dual Currency Bonds, Index Linked Interest Bonds, Indexation Bonds or Long Maturity Bonds (as defined below)) should be presented for payment together with all unmatured Coupons appertaining thereto (which expression shall for this purpose include Coupons falling to be issued on exchange of matured Talons), failing which the amount of any missing unmatured Coupon (or, in the case of payment not being made in full, the same proportion of the amount of such missing unmatured Coupon as the sum so paid bears to the sum due) will be deducted from the sum due for payment. Each amount of principal so deducted will be paid in the manner mentioned above against surrender of the relative missing Coupon at any time before the expiry of 10 years after the Relevant Date (as defined in Condition 12) in respect of such principal (whether or not such Coupon would otherwise have become void under Condition 12) or, if later, five years from the date on which such Coupon would otherwise have become due, but in no event thereafter.

Upon any Fixed Rate Bond in definitive bearer form becoming due and repayable prior to its Maturity Date, all unmatured Talons (if any) appertaining thereto will become void and no further Coupons will be issued in respect thereof.

Upon the date on which any Floating Rate Bond, Dual Currency Bond, Index Linked Interest Bond, Indexation Bond or Long Maturity Bond in definitive bearer form becomes due and repayable, unmatured Coupons and Talons (if any) relating thereto (whether or not attached) shall become void and no payment or, as the case may be, exchange for further Coupons shall be made in respect thereof. A “**Long Maturity Bond**” is a Fixed Rate Bond (other than a Fixed Rate Bond which on issue had a Talon attached) whose nominal amount on issue is less than the aggregate interest payable thereon provided that such Bond shall cease to be a Long Maturity Bond on the Interest Payment Date on which the aggregate amount of interest remaining to be paid after that date is less than the nominal amount of such Bond.

If the due date for redemption of any definitive Bearer Bond is not an Interest Payment Date, interest (if any) accrued in respect of such Bond from (and including) the preceding Interest Payment Date or, as the case may be, the Interest Commencement Date shall be payable only against surrender of the relevant definitive Bearer Bond.

**(c) Payments in respect of Bearer Global Bonds**

Payments of principal and interest (if any) in respect of Bonds represented by any Global Bond in bearer form will (subject as provided below) be made in the manner specified above in relation to definitive Bearer Bonds and otherwise in the manner specified in the relevant Global Bond against presentation or surrender, as the case may be, of such Global Bond at the specified office of any Paying Agent outside the United States. A record of each payment made against presentation or surrender of any Global Bond in bearer form, distinguishing between any payment of principal and any payment of interest, will be made on such Global Bond by the Paying Agent to which it was presented and such record shall be *prima facie* evidence that the payment in question has been made.

**(d) Payments in respect of Registered Bonds**

Payments of principal (other than instalments of principal prior to the final instalment) in respect of each Registered Bond (whether or not in global form) will be made against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the Registered Bond at the specified office of the Registrar or any of the Paying Agents. Such payments will be made by transfer to the Designated Account (as defined below) of the holder (or the first named of joint holders) of the Registered Bond appearing in the register of holders of the Registered Bonds maintained by the Registrar (the “**Register**”) at the close of business on the third business day (being for this purpose a day on which banks are open for business in the city where the specified office of the Registrar is located) before the relevant due date. Notwithstanding the previous sentence, if (i) a holder does not have a Designated Account or (ii) the principal amount of the Bonds held by a holder is less than U.S.\$250,000 (or its approximate equivalent in any other Specified Currency), payment will instead be made by a cheque in the Specified Currency drawn on a Designated Bank (as defined below). For these purposes, “**Designated Account**” means the account (which, in the case of a payment in Japanese yen to a non-resident of Japan, shall be a non-

resident account) maintained by a holder with a Designated Bank and identified as such in the Register and “**Designated Bank**” means (in the case of payment in a Specified Currency other than euro) a bank in the principal financial centre of the country of such Specified Currency (which, if the Specified Currency is Australian dollars or New Zealand dollars, shall be Sydney and Auckland, respectively) and (in the case of a payment in euro) any bank which processes payments in euro.

Payments of interest and payments of instalments of principal (other than the final instalment) in respect of each Registered Bond (whether or not in global form) will be made by a cheque in the Specified Currency drawn on a Designated Bank and mailed by uninsured mail on the business day in the city where the specified office of the Registrar is located immediately preceding the relevant due date to the holder (or the first named of joint holders) of the Registered Bond appearing in the Register at the close of business on the fifteenth day (whether or not such fifteenth day is a business day) before the relevant due date (the “**Record Date**”) at his address shown in the Register on the Record Date and at his risk. Upon application of the holder to the specified office of the Registrar not less than three business days in the city where the specified office of the Registrar is located before the due date for any payment of interest in respect of a Registered Bond, the payment may be made by transfer on the due date in the manner provided in the preceding paragraph. Any such application for transfer shall be deemed to relate to all future payments of interest (other than interest due on redemption) and instalments of principal (other than the final instalment) in respect of the Registered Bonds which become payable to the holder who has made the initial application until such time as the Registrar is notified in writing to the contrary by such holder. Payment of the interest due in respect of each Registered Bond on redemption and the final instalment of principal will be made in the same manner as payment of the principal amount of such Registered Bond.

Holders of Registered Bonds will not be entitled to any interest or other payment for any delay in receiving any amount due in respect of any Registered Bond as a result of a cheque posted in accordance with this Condition arriving after the due date for payment or being lost in the post. No commissions or expenses shall be charged to such holders by the Registrar in respect of any payments of principal or interest in respect of the Registered Bonds.

All amounts payable to DTC or its nominee as registered holder of a Registered Global Bond in registered form in respect of Bonds denominated in a Specified Currency other than U.S. dollars shall be paid by transfer by the Registrar to an account in the relevant Specified Currency of the Exchange Agent on behalf of DTC or its nominee for conversion into and payment in U.S. dollars in accordance with the provisions of the Agency Agreement.

None of the Issuer or the other Obligors, the Bond Trustee or the Agents will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the Registered Global Bonds or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

**(e) General provisions applicable to payments**

The holder of a Global Bond shall be the only person entitled to receive payments in respect of Bonds represented by such Global Bond and the Issuer will be discharged by payment to, or to the order of, the holder of such Global Bond in respect of each amount so paid. Each of the persons shown in the records of Euroclear, Clearstream, Luxembourg or DTC as the beneficial holder of a particular nominal amount of Bonds represented by such Global Bond must look solely to Euroclear, Clearstream, Luxembourg or DTC, as the case may be, for his share of each payment so made by the Issuer to, or to the order of, the holder of such Global Bond.

Notwithstanding the foregoing provisions of this Condition, if any amount of principal and/or interest in respect of Bearer Bonds is payable in U.S. dollars, such U.S. dollar payments of principal and/or interest in respect of such Bond will be made at the specified office of a Paying Agent in New York City if:

- (i) the Issuer has appointed Paying Agents with specified offices outside the United States with the reasonable expectation that such Paying Agents would be able to make payment in U.S. dollars in the manner provided above when due;
- (ii) payment of the full amount of such principal and interest at all such specified offices outside the United States is illegal or effectively precluded by exchange controls or other similar restrictions on the full payment or receipt of principal and interest in U.S. dollars; and

- (iii) such payment is then permitted under United States law without involving, in the opinion of the Issuer, adverse tax consequences to the Issuer.

**(f) Payment Day**

If the date for payment of any amount in respect of any Bond, Receipt or Coupon is not a Payment Day, the holder thereof shall not be entitled to payment until the next following Payment Day and shall not be entitled to further interest or other payment in respect of such delay. For these purposes, “**Payment Day**” means any day which (subject to Condition 12) is:

- (i) either (A) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than the place of presentation, London and any Additional Financial Centre and which, if the Specified Currency is Australian dollars or New Zealand dollars, shall be Sydney and Auckland, respectively) or (B) in relation to any sum payable in euro, a day on which the TARGET System is open; and
- (ii) in the case of any payment in respect of a Registered Global Bond denominated in a Specified Currency other than U.S. dollars and registered in the name of DTC or its nominee and in respect of which an accountholder of DTC (with an interest in such Registered Global Bond) has elected to receive any part of such payment in U.S. dollars, a day on which commercial banks are not authorised or required by law or regulation to be closed in New York City.

**(g) Interpretation of principal and interest**

Any reference in these Conditions to principal in respect of the Bonds shall be deemed to include, as applicable:

- (i) any additional amounts which may be payable with respect to principal under Condition 11 or under any undertaking or covenant given in addition thereto or in substitution therefor pursuant to the Bond Trust Deed or the applicable Pricing Supplement;
- (ii) the Final Redemption Amount of the Bonds;
- (iii) the Early Redemption Amount of the Bonds;
- (iv) the Optional Redemption Amount(s) (if any) of the Bonds;
- (v) in relation to Bonds redeemable in instalments, the Instalment Amounts;
- (vi) in relation to Zero Coupon Bonds, the Amortised Face Amount (as defined in Condition 10(e)); and
- (vii) any premium and any other amounts (other than interest) which may be payable by the Issuer under or in respect of the Bonds.

Any reference in these Conditions to interest in respect of the Bonds shall be deemed to include, as applicable, any additional amounts which may be payable with respect to interest under Condition 11 or under any undertaking or covenant given in addition thereto or in substitution therefor pursuant to the Bond Trust Deed or the applicable Pricing Supplement.

**9. INDEXATION**

*The provisions of this Condition 9 apply only to Indexation Bonds.*

**(a) Definitions**

In these Terms and Conditions:

“**Base Index Figure**” means, subject as provided in paragraph (c) below, the base index figure as specified in the applicable Pricing Supplement;

“**Index**” or “**Index Figure**” means, subject as provided in paragraph (c) below, RPI (for all items) published by the Office for National Statistics (January 1987 = 100) or any comparable index

which may replace such index for the purpose of calculating the amount payable on repayment of the Reference Gilt. Any reference to the Index Figure applicable to a particular month shall, subject as provided in paragraph (c) below, be construed as a reference to the Index Figure published in the seventh month prior to that particular month and relating to the month before that of publication;

“**Index Ratio**” applicable to any month means the Index Figure applicable to such month divided by the Base Index Figure; and

“**Reference Gilt**” means the reference gilt specified in the applicable Pricing Supplement.

**(b) Application of the Index Ratio**

Each payment of interest and principal in respect of the Bonds shall be the amount provided in or determined in accordance with these Conditions, multiplied by the Index Ratio applicable to the month in which such payment falls to be made and rounded to four decimal places (0.00005 being rounded upwards).

**(c) Changes in circumstances affecting the Index**

(i) If at any time and from time to time the Index shall be changed by the substitution of a new base therefor, then with effect from, and including, the calendar month in which such substitution takes effect:

(A) the definition of “**Index**” and “**Index Figure**” shall be deemed to refer to the new date or month in substitution for January 1987 (or, as the case may be, such other date or month as may have been substituted therefor under this sub-paragraph (i)); and

(B) the new Base Index Figure shall be the product of the then existing Base Index Figure and the Index Figure immediately following such substitution, divided by the Index Figure immediately prior to such substitution.

(ii) If the Index Figure normally published in the seventh month, and relating to the eighth month (the “**relevant month**”), before the month in which a payment is due to be made is not published on or before the fourteenth Business Day before the date (the “**date for payment**”) on which such payment is due otherwise than because the Index has ceased to be published, the Index Figure applicable to the month in which the date for payment falls shall be:

(A) such substitute index figure (if any) as the Bond Trustee shall agree to have been published by the Bank of England for the purposes of indexation of payments on the Reference Gilt or, failing such publication, on any one or more issues of index-linked Treasury stock selected by the Bond Trustee on the advice of a gilt-edged market maker or other adviser selected by it in its sole discretion having consulted with the Issuer (but without responsibility or liability to the Issuer) (the “**Indexation Adviser**”); or

(B) if no such determination is made by the Indexation Adviser within seven days, the Index Figure last published (or, if later, the substitute index figure last determined pursuant to sub-paragraph (A) above before the date for payment).

Where the provisions of sub-paragraph (ii) above apply, the determination of the Indexation Adviser as to the Index Figure applicable to the month in which the date for payment falls shall be conclusive and binding. If, an Index Figure having been applied pursuant to sub-paragraph (B) above, the Index Figure relating to the relevant month is subsequently published while a Bond is still outstanding, then:

(x) in relation to a payment of principal or interest in respect of such Bond other than upon redemption in full of such Bond, the principal or interest (as the case may be) next payable after the date of such subsequent publication shall be increased or reduced by an amount equal to (respectively) the shortfall or excess of the amount of the relevant payment made on the basis



of the Index Figure applicable by virtue of sub-paragraph (B) above either below or above the amount of the relevant payment that would have been due if the Index Figure subsequently published had been published on or before the fourteenth Business Day before the date for payment;

(y) in relation to a payment of principal or interest upon redemption in full of a Bond, no subsequent adjustment to amounts paid will be made.

(iii) (A) If:

(x) the Bond Trustee has been notified by the Principal Paying Agent that the Index has ceased to be published; or

(y) any change is made to the coverage or the basic calculation of the Index which constitutes a fundamental change which would, in the opinion of the Bond Trustee, acting solely on the advice of the Indexation Adviser, be materially prejudicial to the interests of the Bondholders,

the Bond Trustee will give written notice of such occurrence to the Issuer, and the Issuer and the Bond Trustee together shall seek to agree for the purpose of the Bonds one or more adjustments to the Index or a substitute index (with or without adjustments) with the intention that the same should leave the Issuer and the Bondholders in no better and no worse position than they would have been had the Index not ceased to be published or the relevant fundamental change not been made.

(B) If the Issuer and the Bond Trustee fail to reach such agreement within 20 Business Days following the giving of such notice by the Bond Trustee, a bank or other person in London shall be appointed by the Issuer and the Bond Trustee, or, failing agreement on such appointment within 20 Business Days following the expiry of the 20 day period referred to above, by the Bond Trustee (in each case, such bank or other person so appointed being referred to as the “**Expert**”), to determine for the purpose of the Bonds one or more adjustments to the Index or a substitute index (with or without adjustments) with the intention that the same should leave the Issuer and the Bondholders in no better and no worse position than they would have been had the Index not ceased to be published or the relevant fundamental change not been made. Any Expert so appointed shall act as an expert and not as an arbitrator and all fees, costs and expenses of the Expert, the Issuer and the Bond Trustee in connection with such appointment shall be borne by the Issuer.

(C) The Index shall be adjusted or replaced by a substitute index as agreed by the Issuer and the Bond Trustee or as determined by the Expert pursuant to the foregoing paragraphs, as the case may be, and references in these Conditions to the Index and to any Index Figure shall be deemed amended in such manner as the Bond Trustee may determine, and notify to the Issuer, as appropriate to give effect to such adjustment or replacement. Such amendments shall be effective from the date of such notification and binding upon the Issuer and the other Obligors, the Bond Trustee, the Financial Guarantors, the other Secured Creditors and the Bondholders and the Issuer shall give notice to the Bondholders in accordance with Condition 18 of such amendments as promptly as practicable following such notification.

## **10. REDEMPTION AND PURCHASE**

### **(a) Redemption at maturity**

Unless previously redeemed or purchased and cancelled as specified below, each Bond (including each Index Linked Redemption Bond and Dual Currency Redemption Bond) will be redeemed by the Issuer at its Final Redemption Amount (subject, in the case of Indexation Bonds, to adjustments for indexation in accordance with Condition 9) specified in, or determined in the manner specified in, the applicable Pricing Supplement in the relevant Specified Currency on the Maturity Date.

**(b) Early Redemption for Index Reasons**

If, in the case of Indexation Bonds, either:

- (i) the Index Figure fails to be determined for three consecutive months other than on the basis provided in Condition 9(c)(ii) and the Bond Trustee has been notified by the Principal Paying Agent that publication of the Index has ceased; or
- (ii) notice is published by Her Majesty's Treasury or on its behalf following a change in relation to the Index, offering a right of redemption to holders of the Reference Gilt,

and (in either case) no amendment or substitution of the Index shall have been advised by the Indexation Adviser to the Issuer, the Issuer may, on any Interest Payment Date upon which such circumstances are continuing, having given not more than 60 nor less than 30 days' notice to the Bond Trustee, the Security Trustee, the Majority Creditors and the holders of Indexation Bonds in accordance with Condition 18 (which notice shall be irrevocable) redeem all, but not some only, of the Indexation Bonds at their Early Redemption Amount, together with interest accrued up to and including the date of redemption.

**(c) Redemption for tax reasons**

In addition, if the Issuer satisfies the Bond Trustee that the Issuer would, on the next Interest Payment Date, become obliged to deduct or withhold from any payment of interest or principal in respect of the Bonds (other than in respect of default interest), any amount for or on account of any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by the United Kingdom or any political subdivision thereof, or any other authority thereof or any change in the application or official interpretation of such laws or regulations, then the Issuer may in order to avoid the relevant deduction or withholding, use its reasonable endeavours to arrange substitution of a company incorporated in another jurisdiction approved by the Bond Trustee as principal debtor under the Bonds and as lender or creditor under the Intercompany Loan Arrangements upon satisfying the conditions for substitution of the Issuer as set out in the STID (and referred to in Condition 19). If the Issuer is unable to arrange a substitution as described above and, as a result, the relevant deduction or withholding is continuing then the Issuer may, except as otherwise provided in the applicable Pricing Supplement, upon giving not more than 60 nor less than 30 days' notice to the Bond Trustee, the Security Trustee, the Majority Creditors and the Bondholders by the publication of a notice of redemption, in accordance with Condition 18, redeem all (but not some only) of the Bonds on any Interest Payment Date at their Early Redemption Amount plus accrued but unpaid interest thereon.

Prior to the publication of any notice of redemption pursuant to this Condition, the Issuer shall deliver to the Bond Trustee a certificate signed by two Directors of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred. The Bond Trustee shall be entitled to accept such certificate as sufficient evidence of the satisfaction of such conditions precedent in which event they shall be conclusive and binding on the Bondholders, the Receiptholders and the Couponholders.

Bonds redeemed pursuant to this Condition 10(c) will be redeemed at their Early Redemption Amount referred to in paragraph (e) below together (if appropriate) with interest accrued to (but excluding) the date of redemption (adjusted, in the case of Indexation Bonds, for indexation in accordance with Condition 9 (the Index Ratio for this purpose being that applicable pursuant to Condition 9(c)(ii)(B) up to and including the date of redemption)).

**(d) Redemption at the option of the Issuer (Issuer Call)**

If Issuer Call is specified in the applicable Pricing Supplement, the Issuer may, having given:

- (i) not less than 15 nor more than 30 days' notice to the Bondholders in accordance with Condition 18; and
- (ii) not less than 15 days before the giving of the notice referred to in (i), notice to the Principal Paying Agent and the Bond Trustee and, in the case of a redemption of Registered Bonds, the Registrar,

(which notices shall be irrevocable and shall specify the date fixed for redemption and, in the case of the USPP Bonds (as defined in Condition 10(k) below), such notice shall be accompanied by a certificate of a Director of the Issuer as to the estimated Make-Whole Amount due in connection with such redemption (calculated as if the date of such notice were the date of redemption) together with details of such

computation), redeem all or some only of the Bonds then outstanding on any Optional Redemption Date and at the Optional Redemption Amount(s) specified in, or determined in the manner specified in, the applicable Pricing Supplement together, if appropriate, with interest accrued to (but excluding) the relevant Optional Redemption Date. Any such redemption must be of a nominal amount not less than the Minimum Redemption Amount and not more than the Maximum Redemption Amount in each case as may be specified in the applicable Pricing Supplement. In the case of the USPP Bonds, the Optional Redemption Amount shall be the outstanding nominal amount of the USPP Bond plus the Make-Whole Amount, if any.

In the case of a partial redemption of Bonds, the Bonds to be redeemed (“**Redeemed Bonds**”) will be selected individually by lot, in the case of Redeemed Bonds represented by definitive Bonds, and in accordance with the rules of Euroclear and/or Clearstream, Luxembourg and/or DTC, in the case of Redeemed Bonds represented by a Global Bond, not more than 30 days prior to the date fixed for redemption (such date of selection being hereinafter called the “**Selection Date**”). In the case of Redeemed Bonds represented by definitive Bonds, a list of the serial numbers of such Redeemed Bonds will be published in accordance with Condition 18 not less than 15 days prior to the date fixed for redemption. The aggregate nominal amount of Redeemed Bonds represented by definitive Bonds or represented by a Global Bond shall in each case bear the same proportion to the aggregate nominal amount of all Redeemed Bonds as the aggregate nominal amount of definitive Bonds outstanding and Bonds outstanding represented by such Global Bond, respectively, bears to the aggregate nominal amount of the Bonds outstanding, in each case on the Selection Date, provided that, such first mentioned amount shall, if necessary, be rounded downwards to the nearest integral multiple of the Specified Denomination and the aggregate nominal amount of Redeemed Bonds represented by a Global Bond shall be equal to the balance of the Redeemed Bonds. No exchange of the relevant Global Bond will be permitted during the period from (and including) the Selection Date to (and including) the date fixed for redemption pursuant to this paragraph (d) and notice to that effect shall be given by the Issuer to the Bondholders in accordance with Condition 18 at least five days prior to the Selection Date.

Where Spens Price is specified in the applicable Pricing Supplement as being the Optional Redemption Amount, the Optional Redemption Amount in respect of each Bond shall be the higher of the following:

- (i) its outstanding nominal amount (adjusted, in the case of Indexation Bonds, for indexation in accordance with Condition 9 (the Index Ratio for this purpose being that applicable pursuant to Condition 9(c)(ii)(B) up to and including the date of redemption); and
- (ii) the price determined to be appropriate by a financial adviser in London (selected by the Issuer and approved by the Bond Trustee) as being the price at which the Gross Redemption Yield (as defined below) on the Bonds on the Reference Date (as defined below) is equal to the Gross Redemption Yield at 3.00 p.m. (London time) on the Reference Date on the Reference Gilt (as defined below) while that stock is in issue, and thereafter such United Kingdom government stock as the Issuer may, with the advice of three persons operating in the gilt-edged market (selected by the Issuer and approved by the Bond Trustee) determine to be appropriate.

For the purposes of sub-paragraph (ii) above, “**Gross Redemption Yield**” means a yield expressed as a percentage and calculated on a basis consistent with the basis indicated by the United Kingdom Debt Management Office publication “*Formulae for Calculating Gilt Prices from Yields*” page 4, Section One, Price/Yield Formulae: “*Conventional Gilts; Double-dated and Undated Gilts with Assumed (or Actual) Redemption on a Quasi-Coupon Date*” (published 8 June 1998); “**Reference Date**” means the date which is two Business Days prior to the despatch of the notice of redemption under this paragraph (d), as the case may be; and “**Reference Gilt**” means the reference gilt specified in the applicable Pricing Supplement.

**(e) Early Redemption Amounts**

For the purpose of paragraphs (b) and (c) above and following an Event of Default (save as may otherwise be provided in these Conditions or the relevant Pricing Supplement), each Bond will be redeemed at its Early Redemption Amount calculated as follows:

- (i) in the case of a Bond (other than a Zero Coupon Bond but including an Instalment Bond and a Partly Paid Bond) with a Final Redemption Amount which is or may be less or greater than the Issue Price or which is payable in a Specified Currency other than that in which the Bond is denominated, at the amount specified in, or determined in the manner specified in, the applicable Pricing Supplement or, if no such amount or manner is so specified in the applicable Pricing

Supplement, at its nominal amount (adjusted, in the case of Indexation Bonds, for indexation in accordance with Condition 9 (the Index Ratio for this purpose being that applicable pursuant to Condition 9(c)(ii)(B) up to and including the date of redemption)); or

- (ii) in the case of a Zero Coupon Bond, at an amount (the “**Amortised Face Amount**”) calculated in accordance with the following formula:

$$\text{Early Redemption Amount} = \text{RP} \times (1 + \text{AY})^y$$

where:

“**RP**” means the Reference Price; and

“**AY**” means the Accrual Yield expressed as a decimal; and

“**y**” is a fraction the numerator of which is equal to the number of days (calculated on the basis of a 360-day year consisting of 12 months of 30 days each) from (and including) the Issue Date of the first Tranche of the Bonds to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Bond becomes due and repayable and the denominator of which is 360,

or on such other calculation basis as may be specified in the applicable Pricing Supplement.

**(f) Instalments**

Instalment Bonds will be redeemed in the Instalment Amounts and on the Instalment Dates. In the case of early redemption, the Early Redemption Amount will be determined pursuant to paragraph (e) above.

**(g) Partly Paid Bonds**

Partly Paid Bonds will be redeemed, whether at maturity, early redemption or otherwise, in accordance with the provisions of this Condition and the applicable Pricing Supplement.

**(h) Purchases**

The Obligors may at any time purchase Bonds (provided that, in the case of definitive Bearer Bonds, all unmatured Receipts, Coupons and Talons appertaining thereto are purchased therewith) at any price in the open market or otherwise provided that the Obligors will not and will not permit any Affiliate to purchase or otherwise acquire, directly or indirectly, any of the outstanding USPP Bonds except pursuant to an offer to purchase made by such Obligor or an Affiliate pro rata to the holders of the USPP Bonds at the time outstanding upon the same terms and conditions to each such holder of the USPP Bonds. Any such offer to the holders of the USPP Bonds shall provide each holder with sufficient information to enable it to make an informed decision with respect to such offer, and shall remain open for at least 30 Business Days. If the holders of more than 25 per cent. of the nominal amount of the USPP Bonds then outstanding accept such offer, the Issuer shall promptly notify the remaining holders of such fact and the expiration date for the acceptance by holders of USPP Bonds of such offer shall be extended by the number of days necessary to give each such remaining holder at least 10 Business Days from its receipt of such notice to accept such offer. If purchases are made by tender, tenders must be available to all Bondholders alike.

**(i) Cancellation**

All Bonds which are redeemed will forthwith be cancelled (together with all unmatured Receipts, Coupons and Talons attached thereto or surrendered therewith at the time of redemption). All Bonds so cancelled and any Bonds purchased and cancelled pursuant to paragraph (h) above (together with all unmatured Receipts, Coupons and Talons cancelled therewith) shall be forwarded to the Principal Paying Agent and cannot be reissued or resold.

**(j) Late payment on Zero Coupon Bonds**

If the amount payable in respect of any Zero Coupon Bond upon redemption of such Zero Coupon Bond pursuant to paragraph (a), (b), (c) or (d) above or upon its becoming due and repayable following an Event of Default is improperly withheld or refused, the amount due and repayable in respect of such Zero Coupon Bond shall be the amount calculated as provided in paragraph (e)(ii) above as though the references therein to the date fixed for the redemption or the date upon which such Zero Coupon Bond becomes due and payable were replaced by references to the date which is the earlier of:

- (i) the date on which all amounts due in respect of such Zero Coupon Bond have been paid; and

- (ii) five days after the date on which the full amount of the moneys payable in respect of such Zero Coupon Bond has been received by the Principal Paying Agent or the Registrar and notice to that effect has been given to the Bondholders in accordance with Condition 18.

**(k) US Private Placement Holders**

*This Condition 10(k) is applicable only in relation to Bonds which are specified as being USPP Bonds in the applicable Pricing Supplement.*

*(i) Make-Whole Amount Calculation*

The Computing Adviser shall determine the estimated aggregate amount of any Make-Whole Amount required to be paid under the Conditions on the fifth Business Day prior to the relevant Optional Redemption Date or such other date on which any Make-Whole Amount is required to be paid, as the case may be, and shall give written notice thereof to the Issuer on such fifth Business Day, which notice shall set forth in reasonable detail the computation thereof; provided, that the failure of the Computing Adviser to make such determination shall not affect the obligation of the Issuer to pay such Make-Whole Amount when due, and the Computing Adviser shall have no liability to the Issuer or any other holder of USPP Bonds for its failure to make such determination. The Make-Whole Amount calculation formula set forth in such notice shall be binding on the Issuer and all of the holders of USPP Bonds, in the absence of manifest error. Four Business Days prior to the relevant Optional Redemption Date or such other date on which any Make-Whole Amount is required to be paid, as the case may be, the Issuer will furnish to each holder of any USPP Bond being so redeemed a certificate signed by a Director of the Issuer setting forth the estimated Make-Whole Amount in respect of the principal amount of USPP Bonds held by such holder to be redeemed, accompanied by a copy of the written notice by the Computing Adviser described in this Condition 10(k). Two Business Days prior to such redemption, the Issuer shall deliver to each holder of USPP Bonds a certificate of a Director of the Issuer specifying the calculation of such Make-Whole Amount as of the Optional Redemption Date or such other date on which any Make-Whole Amount is required to be paid, as the case may be.

*(ii) Definitions:*

In these Conditions:

“**Called Principal**” means, with respect to any USPP Bond, the nominal amount of such USPP Bond that is to be redeemed pursuant to these Conditions;

“**Computing Adviser**” means, with respect to a redemption of USPP Bonds where the Make-Whole Amount is required to be calculated, a financial adviser in London (selected by the Issuer and approved by the Bond Trustee);

“**Discounted Value**” means, with respect to the Called Principal of any USPP Bond, the amount obtained by discounting all Remaining Scheduled Payments with respect to such Called Principal from their respective scheduled due dates to the Settlement Date with respect to such Called Principal, in accordance with accepted financial practice and at a discount factor (applied on the same periodic basis as that on which interest on the USPP Bonds is payable) equal to the Reinvestment Yield with respect to such Called Principal;

“**Make-Whole Amount**” means, with respect to any USPP Bond, an amount equal to the excess, if any, of the Discounted Value of the Remaining Scheduled Payments with respect to the Called Principal of such USPP Bond over the amount of such Called Principal, provided that the Make-Whole Amount may in no event be less than zero;

“**Person**” means an individual, partnership, corporation, limited liability company, association, trust, unincorporated organisation, or a government or agency or political subdivision thereof;

“**Reinvestment Yield**” means, with respect to the Called Principal of any USPP Bond, the Specified Margin (as specified in the applicable Pricing Supplement) over the yield to maturity implied by (i) the yields reported, as of 10:00 a.m. (New York City time) on the second Business Day preceding the Settlement Date with respect to such Called Principal, on the display designated as “Page 678” on the Dow Jones Market Service (or such other display as may replace Page 678 on the Dow Jones Market Service) for actively traded U.S. Treasury securities having a maturity equal to the Remaining Average Life of such Called Principal as of such Settlement Date, or (ii) if

such yields are not reported as of such time or the yields reported as of such time are not ascertainable, the Treasury Constant Maturity Series Yields reported, for the latest day for which such yields have been so reported as of the second Business Day preceding the Settlement Date with respect to such Called Principal, in Federal Reserve Statistical Release H.15 (519) (or any comparable successor publication) for actively traded U.S. Treasury securities having a constant maturity equal to the Remaining Average Life of such Called Principal as of such Settlement Date. Such implied yield will be determined, if necessary, by (a) converting U.S. Treasury bill quotations to bond-equivalent yields in accordance with accepted financial practice and (b) interpolating linearly between (1) the actively traded U.S. Treasury security with the maturity closest to and greater than the Remaining Average Life and (2) the actively traded U.S. Treasury security with the maturity closest to and less than the Remaining Average Life;

“**Remaining Average Life**” means, with respect to any Called Principal, the number of years (calculated to the nearest one-twelfth year) obtained by dividing such Called Principal into the sum of the products obtained by multiplying (a) the principal component of each Remaining Scheduled Payment with respect to such Called Principal by (b) the number of years (calculated to the nearest one-twelfth year) that will elapse between the Settlement Date with respect to such Called Principal and the scheduled due date of such Remaining Scheduled Payment;

“**Remaining Scheduled Payments**” means, with respect to the Called Principal of any USPP Bond, all payments of such Called Principal and interest thereon that would be due after the Settlement Date with respect to such Called Principal if no payment of such Called Principal were made prior to its scheduled due date, provided that if such Settlement Date is not a date on which interest payments are due to be made under the terms of the USPP Bonds, then the amount of the next succeeding scheduled interest payment will be reduced by the amount of interest accrued to such Settlement Date and required to be paid on such Settlement Date pursuant to Condition 10(d) or (k);

“**Settlement Date**” means, with respect to the Called Principal of any USPP Bond, the Optional Redemption Date or any other date on which any Make-Whole Amount is required to be paid, as the case may be; and

“**USPP Bonds**” means those Bonds identified as such in the applicable Pricing Supplement relating to any Class A Bonds or Class B Bonds issued by the Issuer after the Effective Date.

## 11. TAXATION

All payments of principal and interest in respect of the Bonds, Receipts and Coupons by the Issuer and the other Obligors or by any Paying Agent, the Registrar, the Bond Trustee, the Security Trustee or any Financial Guarantor will be made without withholding or deduction for or on account of any present or future taxes or duties of whatever nature imposed or levied by or on behalf of any Tax Jurisdiction unless such withholding or deduction is required by law. In such event, the Issuer or, as the case may be, the other Obligors, or else any Paying Agent, the Registrar, the Bond Trustee, the Security Trustee or the Financial Guarantor shall make such payment after such withholding or deduction has been made and shall account to the relevant authorities for the amount so required to be withheld or deducted. None of the Issuer or the other Obligors, any Paying Agent, the Registrar, the Bond Trustee, the Security Trustee or the relevant Financial Guarantor will be obliged to make any additional payments to the Bondholders, Receiptholders or the Couponholders in respect of such withholding or deduction. Except as otherwise provided in the applicable Pricing Supplement, the Issuer or the other Obligors, any Paying Agent, the Registrar, the Bond Trustee, the Security Trustee or the relevant Financial Guarantor may require holders to provide such certifications and other documents as required by applicable law in order to qualify for exemptions from applicable tax laws.

As used herein:

“**Tax Jurisdiction**” means the United Kingdom or any political subdivision or any authority thereof or therein having power to tax or (in the case of payment by AWS Overseas Holdings) the Cayman Islands or any political subdivision or any authority thereof or therein having power to tax.

## 12. PRESCRIPTION

The Bonds (whether in bearer or registered form), Receipts and Coupons will become void unless presented for payment within a period of 10 years (in the case of principal) and five years (in the case of interest) after the Relevant Date (as defined below) therefor.

There shall not be included in any Coupon sheet issued on exchange of a Talon any Coupon the claim for payment in respect of which would be void pursuant to this Condition or Condition 8(b) or any Talon which would be void pursuant to Condition 8(b).

As used herein, the “**Relevant Date**” means the date on which such payment first becomes due, except that, if the full amount of the moneys payable has not been duly received by the Bond Trustee or the Principal Paying Agent or the Registrar, as the case may be, on or prior to such due date, it means the date on which, the full amount of such moneys having been so received, notice to that effect is duly given to the Bondholders in accordance with Condition 18.

### **13. EVENTS OF DEFAULT**

The Events of Default relating to the Bonds are set out in Schedule 7 of the Common Terms Agreement.

Following the notification of an Event of Default, the STID provides for a Standstill Period to commence and for restrictions to apply to all Secured Creditors. (*See Chapter 7, “Financing Structure – Intercreditor Arrangements” for details of the extension and termination of the Standstill and for details of the relevant Instructing Groups permitted to instruct the Security Trustee during a Standstill*). The Common Terms Agreement also contains various Trigger Events that will, if they occur, (amongst other things) permit the Majority Creditors to commission an Independent Review, require AWS to discuss its plans for appropriate remedial action and prevent the AWS Financing Group from making further Restricted Payments.

#### **(a) Events of Default**

If any Event of Default (as defined in the Master Definitions Agreement) occurs and is continuing, subject always to the terms of the STID, the Bond Trustee may at any time (in accordance with the provisions of the Bond Trust Deed and the STID), having certified in writing that in its opinion the happening of such event is materially prejudicial to the interests of the Bondholders and shall upon the Bond Trustee being so directed or requested, (i) by an Extraordinary Resolution (as defined in the Bond Trust Deed) of holders of the relevant Series of Class A Bonds or, if there are no Class A Bonds outstanding, the Class B Bonds or (ii) in writing by holders of at least one quarter in outstanding nominal amount of the relevant Series of Class A Bonds, or if there are no Class A Bonds outstanding, the Class B Bonds and subject, in each case, to being indemnified and/or secured to its satisfaction, give notice to the Issuer and the Security Trustee that the Bonds of the relevant Series are, and they shall immediately become, due and repayable, at their respective Early Redemption Amounts plus accrued and unpaid interest thereon.

#### **(b) Confirmation of no Event of Default**

The Issuer shall provide written confirmation to the Bond Trustee, on an annual basis, that no Event of Default or other matter which is required to be brought to the Bond Trustee’s attention pursuant to the terms of the Finance Documents has occurred.

#### **(c) Enforcement of Security**

If the Bond Trustee gives written notice to the Issuer and the Security Trustee that an Event of Default has occurred under the Bonds of any Series, a Standstill Period shall commence. The Security Trustee may only enforce the Security acting on the instructions of the Majority Creditors.

#### **(d) Automatic Acceleration**

In the event of the acceleration of the Secured Liabilities (other than a Permitted Acceleration as set out in the STID), the Bonds of each Series shall automatically become due and repayable at their respective Early Redemption Amounts plus accrued and unpaid interest thereon or as specified in the applicable Pricing Supplement.

### **14. RECOURSE AGAINST ISSUER**

No Bondholder, Receiptholder or Couponholder is entitled to take any action against the Issuer or, in the case of holders of Class A Wrapped Bonds, against any Financial Guarantor or against any assets of the Issuer or any Financial Guarantor to enforce its rights in respect of the Bonds or to enforce any of the Security or to enforce any Bond Policy unless the Bond Trustee or the Security Trustee (as applicable), having become bound so to proceed, fails or neglects to do so within a reasonable period and such failure or neglect is continuing.

## 15. REPLACEMENT OF BONDS, RECEIPTS, COUPONS AND TALONS

Should any Bond, Receipt, Coupon or Talon be lost, stolen, mutilated, defaced or destroyed, it may be replaced subject to applicable terms and stock exchange requirements at the specified office of the Principal Paying Agent (in the case of Bearer Bonds, Receipts or Coupons) or the Registrar (in the case of Registered Bonds) upon payment by the claimant of such costs and expenses as may be incurred in connection therewith and on such terms as to evidence and indemnity as the Issuer may require. Mutilated or defaced Bonds, Receipts, Coupons or Talons must be surrendered before replacements will be issued.

## 16. AGENTS

The names of the initial Agents and their initial specified offices are set out below.

The Issuer is entitled (with the prior written approval of the Bond Trustee) to vary or terminate the appointment of any Agent and/or appoint additional or other Agents and/or approve any change in the specified office through which any Agent acts, provided that:

- (a) there will at all times be a Principal Paying Agent and a Registrar;
- (b) so long as the Bonds are listed on any stock exchange or admitted to listing by any other relevant authority, there will at all times be a Paying Agent (in the case of Bearer Bonds) and a Transfer Agent (in the case of Registered Bonds) with a specified office in such place as may be required by the rules and regulations of the relevant stock exchange or, as the case may be, other relevant authority;
- (c) so long as any of the Registered Global Bonds payable in a Specified Currency other than U.S. dollars are held through DTC or its nominee, there will at all times be an Exchange Agent with a specified office in New York City; and
- (d) if the proposal for a Directive on the taxation of savings presented by the European Union Commission on 18 July 2001 or on 13 December 2001 is implemented, the Issuer will ensure that it maintains a Paying Agent in a Member State of the European Union that will not be obliged to withhold or deduct tax from payments made under the Notes pursuant to any such Directive or law implementing or complying with, or introduced in order to conform to, such Directive.

In addition, the Issuer shall forthwith appoint a Paying Agent having a specified office in New York City in the circumstances described in Condition 8(e). Any variation, termination, appointment or change shall only take effect (other than in the case of insolvency, when it shall be of immediate effect) after not less than 30 nor more than 45 days' prior notice thereof shall have been given to the Bondholders in accordance with Condition 18.

In acting under the Agency Agreement, the Agents act solely as agents of the Issuer and the other Obligors and, in certain circumstances specified therein, of the Bond Trustee and do not assume any obligation to, or relationship of agency or trust with, any Bondholders, Receiptholders or Couponholders. The Agency Agreement contains provisions permitting any entity into which any Agent is merged or converted or with which it is consolidated or to which it transfers all or substantially all of its assets to become the successor agent.

## 17. EXCHANGE OF TALONS

On and after the Interest Payment Date on which the final Coupon comprised in any Coupon sheet matures, the Talon (if any) forming part of such Coupon sheet may be surrendered at the specified office of the Principal Paying Agent or any other Paying Agent in exchange for a further Coupon sheet including (if such further Coupon sheet does not include Coupons to (and including) the final date for the payment of interest due in respect of the Bond to which it appertains) a further Talon, subject to the provisions of Condition 12.

## 18. NOTICES

All notices regarding the Bearer Bonds will be deemed to be validly given if published in a leading English language daily newspaper of general circulation in London. It is expected that such publication will be made in the *Financial Times* in London. The Issuer shall also ensure that notices are duly published in a manner which complies with the rules and regulations of any stock exchange or any other relevant authority on which the Bearer Bonds are for the time being listed or by which they have been



admitted to listing. Any such notice will be deemed to have been given on the date of the first publication or, where required to be published in more than one newspaper, on the date of the first publication in all required newspapers. If publication as provided above is not practicable, a notice will be given in such other manner, and will be deemed to have been given on such date, as the Bond Trustee shall approve.

All notices regarding the Registered Bonds will be deemed to be validly given if sent by first class mail or (if posted to an address overseas) by airmail to the holders (or the first named of joint holders) at their respective addresses recorded in the Register and will be deemed to have been given on the fifth day after mailing (or as specified in the applicable Pricing Supplement) and, in addition, for so long as any Registered Bonds are listed on a stock exchange or admitted to listing by any other relevant authority and the rules of that stock exchange or relevant authority so require, such notice will be published in a daily newspaper of general circulation in the place or places required by those rules.

Until such time as any definitive Bonds are issued, there may, so long as any Global Bonds representing the Bonds are held in their entirety on behalf of Euroclear and/or Clearstream, Luxembourg and/or DTC, be substituted for such publication in such newspaper(s) the delivery of the relevant notice to Euroclear and/or Clearstream, Luxembourg and/or DTC for communication by them to the holders of the Bonds and, in addition, for so long as any Bonds are listed on a stock exchange or are admitted to listing by another relevant authority and the rules of that stock exchange or relevant authority so require, such notice will be published in a daily newspaper of general circulation in the place or places required by those rules. Any such notice shall be deemed to have been given to the holders of the Bonds on the seventh day after the day on which the said notice was given to Euroclear and/or Clearstream, Luxembourg and/or DTC.

Notices to be given by any Bondholder shall be in writing and given by lodging the same, together (in the case of any Bond in definitive form) with the relative Bond or Bonds, with the Principal Paying Agent (in the case of Bearer Bonds) or the Registrar (in the case of Registered Bonds). Whilst any of the Bonds are represented by a Global Bond, such notice may be given by any holder of a Bond to the Principal Paying Agent or the Registrar through Euroclear and/or Clearstream, Luxembourg and/or DTC, as the case may be, in such manner as the Principal Paying Agent, the Registrar and Euroclear and/or Clearstream, Luxembourg and/or DTC, as the case may be, may approve for this purpose.

## **19. MEETINGS OF BONDHOLDERS, MODIFICATION, WAIVER AND SUBSTITUTION**

### **(a) Decisions of Majority Creditors**

The STID contains provisions dealing with the manner in which matters affecting the interests of the Secured Creditors (including the Bond Trustee and the Bondholders) will be dealt with. Bondholders will (subject to various Reserved Matters and Entrenched Rights) be bound by the decisions of the Majority Creditors (and additionally in a Default Situation decisions made pursuant to the Emergency Instructions Procedures). *(For details see Chapter 7, “Financing Structure” – “Intercreditor Arrangements”, “Voting and Control”, “Class A Debt Instructing Group”, “Class B Debt Instructing Group”, “Entrenched Rights”, “Reserved Matters” and “Emergency Instruction Procedures”).*

In the circumstances which do not relate to Entrenched Rights or Reserved Matters of the Bondholders (as set out in the STID), prior to a Default Situation, the Bond Trustee shall be entitled to vote as the DIG Representative of holders of each Series of Wrapped Bonds (following the occurrence of an FG Event of Default in respect of the Financial Guarantor of those Wrapped Bonds which is continuing) and the Unwrapped Bonds (other than the USPP Bonds) on intercreditor issues (“**Intercreditor Issues**”) but shall not be entitled to convene a meeting of any one or more Series of Bondholders to consider the relevant matter. To the extent that a Default Situation has occurred and is subsisting, the Bond Trustee may vote on Intercreditor Issues in its absolute discretion or shall vote in accordance with a direction by those holders of such outstanding Class A Bonds (other than USPP Bonds) or, if there are no Class A Bonds outstanding, Class B Bonds (i) by means of an Extraordinary Resolution of the relevant Series of Bonds or (ii) (in respect of a DIG Proposal to terminate Standstill) as requested in writing by the holders of at least one quarter of the Outstanding Principal Amount of the relevant Series of Class A Bonds, or if there are no Class A Bonds outstanding, Class B Bonds. In any case, the Bond Trustee shall not be obliged to vote unless it has been indemnified and/or secured to its satisfaction.

Whilst a Default Situation is subsisting, certain decisions and instructions may be required in a timeframe which does not allow the Bond Trustee to convene Bondholder meetings. To cater for such circumstances, the Intercreditor Arrangements provide for an emergency instruction procedure. The Security Trustee will be required to act upon instructions contained in an emergency notice (an “**Emergency Instruction**”).

**Notice**”). An Emergency Instruction Notice must be signed by DIG Representatives (the “**EIN Signatories**”) representing 66⅔ per cent. or more of the aggregate Outstanding Principal Amount of the Qualifying Class A Debt or following repayment in full of the Class A Debt, the Qualifying Class B Debt after, inter alia, excluding the proportion of Qualifying Debt in respect of which the Bond Trustee is the DIG Representative and in respect of which the Bond Trustee has not voted. The Emergency Instruction Notice must specify the emergency action which the Security Trustee is being instructed to take and must certify that, unless such action is taken within the time frame specified in the Emergency Instruction Notice, the interests of the EIN Signatories will be materially prejudiced.

**(b) Meetings of Bondholders, Modification and Waiver**

The Bond Trust Deed contains provisions for convening meetings of the Bondholders to consider any matter affecting their interests, including the modification of the Bonds, the Receipts, the Coupons or any of the provisions of the Bond Trust Deed, (in the case of Class A Wrapped Bonds and Class B Wrapped Bonds) the Bond Policies and any other Finance Document to which the Bond Trustee is a party (subject to the terms of the STID). Any modification may (except in relation to any Entrenched Right or Reserved Matter of the Bond Trustee (as set out in the STID), subject to the terms of the STID, including, in the case of any of the Class A Wrapped Bonds or Class B Wrapped Bonds, to Entrenched Rights or Reserved Matters of any Financial Guarantor (as set out in the STID) and subject to the provisions concerning ratification and/or meetings of particular combinations of Series of Bonds as set out in Condition 20(b) and the Bond Trust Deed), be made if sanctioned by a resolution passed at a meeting of such Bondholders duly convened and held in accordance with the Bond Trust Deed by a majority of not less than three-quarters of the votes cast (an “**Extraordinary Resolution**”) at such meeting. Such a meeting may be convened by the Bond Trustee or the Issuer, and shall be convened by the Issuer upon the request in writing of the relevant Bondholders holding not less than one-tenth in nominal amount of the relevant Bonds for the time being outstanding.

The quorum at any meeting convened to vote on an Extraordinary Resolution will be one or more persons holding or representing not less than 50 per cent. in nominal amount of the relevant Bonds for the time being outstanding or, at any adjourned meeting, one or more persons being or representing Bondholders, whatever the nominal amount of the relevant Bonds held or represented, provided however, that certain matters as set out in paragraph 5 of the Third Schedule to the Bond Trust Deed (the “**Basic Terms Modifications**”) in respect of the holders of any particular Series of Bonds may be sanctioned only by an Extraordinary Resolution passed at a meeting of Bondholders of the relevant Series of Bonds at which one or more persons holding or representing not less than three-quarters or, at any adjourned meeting, one-quarter in nominal amount of the outstanding Bonds form a quorum. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the relevant Bondholders, Receiptholders and Couponholders whether present or not.

In addition, a resolution in writing signed by or on behalf of all Bondholders who for the time being are entitled to receive notice of a meeting of Bondholders under the Bond Trust Deed will take effect as if it were an Extraordinary Resolution. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Bondholders.

**(c) Modification, consent and waiver**

As more fully set out in the Bond Trust Deed (and subject to the conditions and qualifications therein), the Bond Trustee may, without the consent of the Bondholders of any Series, concur with the Issuer or any other relevant parties in making (i) any modification of these Conditions, the Bond Trust Deed, any Bond Policy or any Finance Document which is of a formal, minor or technical nature or is made to correct a manifest error; and (ii) (except as mentioned in the Bond Trust Deed and subject to the terms of the STID) any other modification and granting any consent under or waiver or authorisation of any breach or proposed breach of these Conditions, the Bond Trust Deed, such Bond Policy or any such Finance Document or other document which is, in the opinion of the Bond Trustee, not materially prejudicial to the interests of the Bondholders of that Series. Any such modification, consent, waiver or authorisation shall be binding on the Bondholders of that Series, and the holders of all relevant Receipts and Coupons and, if the Bond Trustee so requires, notice thereof shall be given by the Issuer to the Bondholders of that Series as soon as practicable thereafter.

The Bond Trustee shall be entitled to assume that any such modification, consent, waiver or authorisation is not materially prejudicial to the Bondholders if the Rating Agencies confirm that there will not be any adverse effect thereof on the original issue ratings of the Bonds.

**(d) Substitution of the Issuer**

As more fully set forth in the STID (and subject to the conditions and qualifications therein), the Bond Trustee may also agree with the Issuer, without reference to the Bondholders, to the substitution of another corporation in place of the Issuer as principal debtor in respect of the Bond Trust Deed and the Bonds of all Series and subject to the Class A Wrapped Bonds continuing to carry the unconditional guarantee of the relevant Financial Guarantor.

**20. BOND TRUSTEE PROTECTIONS**

**(a) Trustee considerations**

Subject to the terms of the STID and Condition 20(b), in connection with the exercise, under these Conditions, the Bond Trust Deed, any Bond Policy or any Finance Document, of its rights, powers, trusts, authorities and discretions (including any modification, consent, waiver or authorisation), the Bond Trustee shall have regard to the interests of the holders of the relevant Series of Class A Bonds, or if there are no Class A Bonds outstanding, the Class B Bonds then outstanding provided that, if the Bond Trustee considers, in its sole opinion, that there is a conflict of interest between the holders of one or more Series of Bonds, it shall consider the interests of the holders of the Class A Bonds, or if there are no Class A Bonds outstanding, the Class B Bonds outstanding with the shortest dated maturity and will not have regard to the consequences of such exercise for the holders of other Series of Bonds or for individual Bondholders, resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory. The Bond Trustee shall not be entitled to require from the Issuer or any Financial Guarantor, nor shall any Bondholders be entitled to claim from the Issuer, any Financial Guarantor or the Bond Trustee, any indemnification or other payment in respect of any consequence (including any tax consequence) for individual Bondholders of any such exercise.

**(b) Exercise of rights by Bond Trustee**

Except as otherwise provided in these Conditions and the Bond Trust Deed, when exercising any rights, powers, trusts, authorities and discretions relating to or contained in these Conditions or the Bond Trust Deed (other than in determining or in respect of any Entrenched Right or Reserved Matter relating to the Bonds or any other Basic Terms Modification), which affects or relates to any Class A Wrapped Bonds and/or Class B Wrapped Bonds, the Bond Trustee shall only act with the consent of the relevant Financial Guarantor(s) (provided no FG Event of Default has occurred and is continuing) in accordance with the provisions of the Bond Trust Deed and the Bond Trustee shall not be required to have regard to the interests of the Bondholders in relation to the exercise of such rights, powers, trusts, authorities and discretions and shall have no liability to any Bondholders as a consequence of so acting. As a consequence of being required to act only with the consent of the relevant Financial Guarantor(s) in the circumstances referred to in the previous sentence, the Bond Trustee may not, notwithstanding the provisions of these Conditions, be entitled to act on behalf of the holders of any Series of Bonds. Subject as provided in these Conditions and the Bond Trust Deed, the Bond Trustee will exercise its rights under, or in relation to, the Bond Trust Deed, the Conditions or any Bond Policy in accordance with the directions of the relevant Bondholders, but the Bond Trustee shall not be bound as against the Bondholders to take any such action unless it has (i) (a) (in respect of the matters set out in Condition 13 and Condition 19(a) only) been so requested in writing by the holders of at least 25 per cent. in nominal amount of the relevant Series of Bonds outstanding or (b) been so directed by an Extraordinary Resolution and (ii) been indemnified and/or furnished with security to its satisfaction.

**(c) Decisions under STID binding on all Bondholders**

Subject to the provisions of the STID and the Entrenched Rights and Reserved Matters of the Bond Trustee and the Bondholders, decisions of the Majority Creditors and (in a Default Situation) decisions made pursuant to the Emergency Instructions Procedures will bind the Bond Trustee and the Bondholders in all circumstances.

## **21. INDEMNIFICATION OF THE BOND TRUSTEE AND SECURITY TRUSTEE**

### **(a) Indemnification of the Bond Trustee**

The Bond Trust Deed contains provisions for indemnification of the Bond Trustee, and for its relief from responsibility, including provisions relieving it from taking any action including taking proceedings against the Issuer, any Financial Guarantor and/or any other person unless indemnified and/or secured to its satisfaction. The Bond Trustee or any of its affiliates are entitled to enter into business transactions with the Issuer, any Financial Guarantor, the other Secured Creditors or any of their respective subsidiaries or associated companies without accounting for any profit resulting therefrom.

### **(b) Indemnification of the Security Trustee**

Subject to the Entrenched Rights and Reserved Matters of the Security Trustee, the Security Trustee will only be required to take any action under or in relation to, or to enforce or protect the Security, or any other security interest created by a Finance Document, or a document referred to therein, if instructed to act by the Majority Creditors or Secured Creditors (or their representatives) (as appropriate) and if indemnified to its satisfaction.

### **(c) Directions, Duties and Liabilities**

Neither the Security Trustee nor the Bond Trustee, in the absence of its own wilful misconduct, gross negligence or fraud, and in all cases when acting as directed by or subject to the agreement of the Majority Creditors or Secured Creditors (or their representatives) (as appropriate), shall in any way be responsible for any loss, costs, damages or expenses or other liability, which may result from the exercise or non-exercise of any consent, waiver, power, trust, authority or discretion vested in the Security Trustee or the Bond Trustee pursuant to the STID, any Finance Document or any Ancillary Document.

## **22. FURTHER ISSUES**

The Issuer shall be at liberty from time to time without the consent of the Bondholders, the Receiptholders or the Couponholders to create and issue further bonds having terms and conditions the same as the Bonds or the same in all respects save for the amount and date of the first payment of interest thereon and so that the same shall be consolidated and form a single Series with the outstanding Bonds.

## **23. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999**

No rights are conferred on any person under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Bond, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

## **24. GOVERNING LAW**

The Bond Trust Deed, the Security Agreement, the Common Terms Agreement, the STID, the Agency Agreement, the relevant Bond Policy (if any), the Bonds, the Receipts and the Coupons and any other Finance Documents are governed by, and shall be construed in accordance with, English law.

## CHAPTER 10

### USE OF PROCEEDS

The net proceeds from each issue of Bonds will be on-lent to AWS under the terms of an Issuer/AWS Loan Agreement as part of the Intercompany Loan Arrangements to be applied by AWS for its corporate restructuring, and thereafter for its general corporate purposes. See Section 7.1, “*Financing Structure – The AWS Financing Group*”.

## CHAPTER 11

### REGULATION OF THE WATER AND SEWERAGE INDUSTRY IN ENGLAND AND WALES

#### 11.1 Water and Sewerage Regulation Generally

##### 11.1.1 Background

The current structure of the water and sewerage industry in England and Wales dates from 1989, when the United Kingdom Water Act 1989 was enacted. Before this, there were ten regional public sector Water Authorities supplying water and sewerage services and 29 privately owned statutory water companies, supplying water only. Under the Water Act 1989, the functions of the Water Authorities relating to water supply (except in areas where those functions were carried out through statutory water companies) and sewerage services, together with the majority of the Water Authorities' property, rights and liabilities, were transferred to ten companies appointed as water and sewerage undertakers in England and Wales. The industry is now made up of the 10 water and sewerage companies and 14 water only companies which are all subject to the same regulatory regime (together, the “**Regulated Companies**”, but so that, unless otherwise expressly stated, references to a “Regulated Company” in this Chapter 11 are references to that company in its capacity as a water and sewerage undertaker or, as the case may be, a water undertaker). The provisions of the Water Act 1989 are now contained mainly in the consolidating WIA. References in this section to statutes are to the WIA unless otherwise stated.

##### 11.1.2 Regulatory Framework

The activities of Regulated Companies are principally regulated by the provisions of the WIA and the WRA, regulations made under the WIA and the conditions of their licences. Under the WIA, the Secretary of State has a duty to ensure that at all times there is an appointee for every area of England and Wales. Appointments may be made by the Secretary of State or, in accordance with a general authorisation given by him, the DGWS.

The economic regulator for water and sewerage is the DGWS who is aided in his duties by Ofwat, a non-ministerial government department, of which he is the head. The DGWS is responsible for, inter alia, setting limits on charges and monitoring and enforcing licence obligations. Regulated Companies are required by their licences to make an annual return to Ofwat (including accounts and financial information) to enable Ofwat to assess their activities and affairs. The two principal quality regulators are the DWI, which is part of DEFRA, and the EA. There are different structures and different regulatory frameworks for water and sewerage services in the remainder of the United Kingdom (Scotland and Northern Ireland).

#### 11.2 The DGWS and the Secretary of State

The DGWS is appointed for a fixed term by the Secretary of State. He is independent of government ministers and may only be removed for incapacity or misbehaviour. The present DGWS is Philip Fletcher who was appointed in the summer of 2000 for an initial (but renewable) term of five years. He replaced Sir Ian Byatt, who had been the DGWS for the previous 11 years.

Each of the Secretary of State and the DGWS has a primary duty under the WIA to exercise and perform his powers and duties under the WIA in the manner he considers best calculated to secure that:

- the functions of Regulated Companies are properly carried out throughout England and Wales; and
- Regulated Companies are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of those functions.

Subject to this primary duty, each of the Secretary of State and the DGWS is required to exercise and perform his powers and duties in the manner he considers best calculated to:

- protect the interests of customers (in particular rural customers) in connection with the fixing and recovery of water and drainage charges, and so that there is no undue preference or discrimination in the fixing of those charges;

- protect the interests of customers in connection with the other terms on which services are provided and the quality of those services;
- protect the interest of customers as respects non-regulated activities of Regulated Companies (and companies connected with them) in particular by ensuring that (i) transactions are carried out at arm's length; and (ii) in relation to their regulated business, Regulated Companies maintain and present accounts in a suitable form and manner;
- protect the interests of customers in connection with the benefits that could be secured for them by the application of the proceeds of disposal by Regulated Companies of Protected Land;
- promote economy and efficiency on the part of Regulated Companies; and
- facilitate effective competition between Regulated Companies and those seeking appointments as Regulated Companies.

## 11.3 Licences

### 11.3.1 General

Under the WIA, each Regulated Company holds a licence and is regulated through the conditions of such licence as well as the WIA. Each licence specifies the geographic area served by the company and imposes a number of conditions on the licence holder which relate to limits on charges, information reporting requirements, various codes of practice, and other matters. The main provisions of AWS's Licence before the proposed modifications are typical of those of other licences. In addition to the conditions regulating price limits (see 11.8, "*Economic Regulation*", below), AWS's Licence also contains conditions regulating infrastructure charges and the making of charges schemes, and imposes prohibitions on undue discrimination and undue preference in charging. Other matters covered by conditions in the Licence include: accounts and the provision of accounting information; codes of practice for customers on disconnection and on leakage; levels of service and service targets; "ring-fencing" of assets and restrictions on disposal of land; asset management plans; the provision of information to the DGWS; and payments to customers for supply interruptions because of drought. The DGWS is responsible for monitoring compliance with licence conditions and, where necessary, enforcing compliance through procedures laid down in the WIA. See 11.4, "*Enforcement Orders*" below.

### 11.3.2 Termination of a Licence

There are certain circumstances provided for in the WIA under which a Regulated Company could cease to hold a licence for all or part of its area:

- (1) a Regulated Company could consent to the making of a replacement appointment or variation, which changes its appointed area, in which case the DGWS has the authority to appoint a new licence holder;
- (2) under Condition O of the licence, where the first date at which the Secretary of State may terminate a licence is 2014 (provided at least 10 years' notice has been given);
- (3) under the provisions of the Special Administration regime the Special Administrator may transfer the business and licence to a successor (see 11.5, "*Enforcement Orders*" below);  
or
- (4) by the granting of an "inset" appointment over part of a Regulated Company's existing appointed area to another Regulated Company (see below).

Before making an appointment or variation replacing a Regulated Company, the DGWS or the Secretary of State must consider any representations or objections made. In making an appointment or variation replacing a Regulated Company and, where he makes such an appointment or variation, in determining what provision should be made for the fixing by the new Regulated Company of charges, it is the duty of the Secretary of State or the DGWS to ensure, so far as may be consistent with their duties under the WIA, that the interests of the members and creditors of the existing Regulated Company are not unfairly prejudiced as respects the terms on which the new Regulated Company could accept transfers of property, rights and liabilities from the existing Regulated Company.

An “inset” appointment can be granted to a company seeking to provide water and/or sewerage services on a greenfield site, or to a large user of water and/or sewerage services within an existing Regulated Company’s area, or where the incumbent Regulated Company consents to the variation. The threshold for large user insets has been reduced, from 250 to 100 megalitres of water supplied or likely to be supplied to particular premises in any 12 month period, which has increased the number of large users that are able to qualify for inset appointments. Ofwat has expressed the view that an incumbent undertaker might be required to give consent to an inset appointment in order to facilitate common carriage and not be regarded as abusing a dominant position.

### **11.3.3 Modification of a Licence**

Conditions of a licence may be modified in accordance with the procedures laid down in the WIA. Subject to a power of veto of certain proposed modifications by the Secretary of State, the DGWS may modify the conditions in the licence with the consent of the Regulated Company concerned. Before making the modifications, the DGWS must publish the proposed modifications as part of a consultation process, giving third parties the opportunity to make representations and objections which the DGWS must consider.

In the absence of consent, the only means by which the DGWS can secure a modification is following a modification reference to the Competition Commission. A modification reference may also be required in the event of a direction from the Secretary of State to the effect that, inter alia, in his view, the modifications should only be made, if at all, following a reference to the Competition Commission.

A modification reference requires the Competition Commission to investigate and report on whether matters specified in the reference operate, or may be expected to operate, against the public interest and, if so, whether the adverse public interest effect of those matters could be remedied or prevented by modification of the conditions of the licence. In determining whether any particular matter operates or may be expected to operate against the public interest, the Competition Commission is to have regard to the matters in relation to which duties are imposed on the Secretary of State and the DGWS.

If there is an adverse finding, the Competition Commission’s report will state whether any adverse effects on the public interest could be remedied or prevented by modification of the licence. If the Competition Commission so concludes, the DGWS must then make such modifications to the licence as appear to him necessary to remedy or prevent the adverse effects specified in the report whilst having regard to the modifications specified therein and after giving due notice and consideration to any representations and objections.

The Secretary of State would also have the power, among others, to modify the conditions of the licence after an investigation under the United Kingdom Fair Trading Act 1973 into a monopoly or merger situation, if the Competition Commission concludes that matters investigated by it in relation to water or sewerage services amount to the existence of a monopoly or merger situation and operate, or may be expected to operate, against the public interest.

### **11.3.4 Water Supply**

Each Regulated Company has a general duty as a water undertaker to develop and maintain an efficient and economical system of water supply and to make arrangements in relation to the provision of water supplies within its appointed area. It also has specific supply duties, including duties to supply water for domestic purposes to premises within the appointed area which are connected to a water main and to connect new premises to a water main. In addition, it may be required in certain circumstances to connect premises outside its appointed area to one of its water mains and to supply water for domestic purposes to those premises.

Water supplied for domestic purposes must be wholesome at the time of supply, which entails compliance with the Water Quality Regulations. In certain circumstances, the standards set in those regulations may be relaxed. Where standards or relaxed standards are not being met, the Secretary of State is under a duty to take enforcement action against the supplier. However, Regulated Companies may submit undertakings to the Secretary of State detailing steps designed to secure or facilitate compliance with those standards. The Drinking Water (Undertakings) (England and Wales) Regulations 2000 regulate the way in which such undertakings can be



accepted by the Secretary of State. The Secretary of State is not required to take enforcement action for breaches of the Water Quality Regulations while he is satisfied with the undertakings, or if he is satisfied that the breaches are of a trivial nature, or if his general duties preclude him from taking enforcement action. The Secretary of State has stated that, except in certain circumstances, he is unlikely to take enforcement action against Regulated Companies which are complying with the terms of their undertakings. Under the WIA, it is a criminal offence for a water undertaker to supply water which is unfit for human consumption. In the financial year 2001, AWS was fined £21,000 in respect of the supply of water which was deemed unfit for human consumption.

Of the tests carried out on samples from customers' taps in AWS's water supply area in the calendar year 2001 99.6 per cent. complied with the Water Quality Regulations. Undertakings given by it to the Secretary of State or relaxations under the Water Quality Regulations are in place to cover any significant instances, other than occasional breaches, in which water quality standards are not met. Since 1988, AWS has implemented an extensive investment programme to ensure compliance with respect to water leaving treatment works. This work has been largely completed and AWS intends to continue work on distribution mains for 15 to 20 years. Each Regulated Company is under a duty to promote the efficient use of water by its customers.

### **11.3.5 Sewerage Services**

Each Regulated Company has a general duty as a sewerage undertaker to provide, improve, extend and maintain a system of public sewers capable of draining its region effectively, and to make provision for the emptying of sewers and for dealing effectively with their contents. It also has specific sewerage duties, including a duty to comply with a sewer requisition, a duty to provide sewers otherwise than by requisition, and a duty to permit private drains and sewers to be connected to its public sewers.

It is a criminal offence for a person to cause or knowingly permit any poisonous, noxious or polluting matter to enter controlled waters (including most rivers and other inland and coastal waters) other than in accordance with the terms of a discharge consent or with some other lawful authority. The principal prosecuting body is the EA, although third parties also have a right of prosecution. In the calendar year 2001, AWS was fined a total of £59,000 in respect of four pollution incidents.

The terms of discharge consents and the assessment of compliance with those terms vary, depending largely on the type of discharge and when the consents were granted. Within the scope of its powers and duties under the WRA, the EA has discretion as to the terms on which discharge consents are granted or existing consents are altered. The disposal of sewage sludge from sewage treatment works is also controlled.

As regards sewerage, consents are in place in respect of substantially all known discharges by AWS of polluting matter. Substantially all of AWS's sewage treatment works are capable of complying with the conditions of their consents.

In the light of two recent judgments of the Court of Appeal, in March 2001 and February 2002, Regulated Companies may in future incur greater costs in respect of discharges of surface water to certain watercourses and have a greater exposure to claims for compensation in respect of sewage flooding.

### **11.3.6 Service Standards**

Ofwat makes annual assessments of the serviceability of Regulated Companies' sewerage assets on the basis of data submitted in companies' annual returns. For 2000/01 Ofwat initially assessed AWS's sewerage serviceability to be "marginal". This assessment was quoted in Table 26 of Ofwat's Financial Performance and Expenditure report for 2000/01. AWS subsequently provided further information to Ofwat to demonstrate that the frequency of sewer collapses and flooding incidents for 2000/01 was within historical norms. Ofwat accepted this information, together with data on the improvements to river water quality in AWS's region, and revised AWS assessment to "stable". This assessment was confirmed in Ofwat's RD 01/02 letter of 10 January 2002.

Regulated Companies are required to report to the DGWS on their performance against certain service standards, particularly service to customers, in respect of their obligations as water

undertakers and sewerage undertakers. If they do not meet certain standards under the DGWS' guaranteed standards scheme, they may be required to pay compensation to customers.

#### 11.4 Enforcement Orders

The general duties of Regulated Companies as water or sewerage undertakers are enforceable by the Secretary of State or the DGWS or both. The conditions of the licence (and other duties) are enforceable by the DGWS alone whilst other duties, including those relating to water quality, are enforceable by the Secretary of State.

Where the Secretary of State or the DGWS is satisfied that a Regulated Company is contravening, or has contravened and is likely to do so again, its licence or a relevant statutory or other requirement, either the Secretary of State or the DGWS must (subject to exemptions mentioned below) make a final enforcement order to secure compliance with that condition or requirement, save that, where it appears to the Secretary of State or the DGWS more appropriate to make a provisional enforcement order, he may do so. In determining whether a provisional enforcement order should be made, the Secretary of State or DGWS shall have regard to the extent to which any person is likely to sustain loss or damage as a consequence of such breach before a final enforcement order is made. The Secretary of State or the DGWS will confirm a provisional enforcement order if satisfied that the provision made by the order is needed to ensure compliance with the condition or requirement which is in breach.

There are exemptions from the Secretary of State's and the DGWS's duty to make an enforcement order or to confirm a provisional enforcement order:

- where the contraventions were, or the apprehended contraventions are, of a trivial nature;
- where the company has given, and is complying with, an undertaking to secure or facilitate compliance with the condition or requirement in question; or
- where duties in the WIA preclude the making or confirmation of the order.

#### 11.5 Special Administration Orders

The WIA contains provisions enabling the Secretary of State, or the DGWS with the consent of the Secretary of State, to secure the general continuity of water supply and sewerage services. In certain specified circumstances, the Court may, on the application of the Secretary of State or, with his consent, the DGWS, make a Special Administration Order in relation to a Regulated Company and appoint a Special Administrator. These circumstances include:

- where there has been, or is likely to be, a breach by a Regulated Company of its principal duties to supply water or provide sewerage services or of a final or confirmed provisional enforcement order and, in either case, the breach is serious enough to make it inappropriate for the Regulated Company to continue to hold its licence;
- where the Regulated Company is, or is likely to be, unable to pay its debts;
- where, in a case in which the Secretary of State has certified that it would be appropriate, but for Section 25 of the WIA, for him to petition for the winding up of the Regulated Company under Section 440 of the Companies Act, it would be just and equitable, as mentioned in that section, for the Regulated Company to be wound up if it did not hold a licence; and
- where the Regulated Company is unable or unwilling adequately to participate in arrangements certified by the Secretary of State or the DGWS to be necessary by reason of, or in connection with, the appointment of a new Regulated Company upon termination of the existing Regulated Company's licence.

In addition, on an application being made to Court, whether by the Regulated Company itself or by its directors, creditors or contributories, for the compulsory winding up of the Regulated Company, the Court would not be entitled to make a winding up order; however, if satisfied that it would be appropriate to make such an order if the Regulated Company were not a company holding a licence, the Court shall instead make a Special Administration Order.

During the period beginning with the presentation of the petition for Special Administration and ending with the making of a Special Administration Order or the dismissal of the petition (the "**Special**

**Administration Petition Period”**), the Regulated Company may not be wound up, no steps may be taken to enforce any security except with the leave of the Court, and subject to such terms as the Court may impose, and no other proceedings or other legal process may be commenced or continued against the Regulated Company or its property except with the leave of the Court.

Once a Special Administration Order has been made, any petition presented for the winding up of the company will be dismissed and any receiver appointed, removed. Whilst a Special Administration Order is in force, those restrictions imposed during the Special Administration Petition Period continue with some modification: an administrative receiver can no longer be appointed (with or without the leave of the Court) and, in the case of certain actions which require the Court’s leave, the consent of the Special Administrator is acceptable in its place. See 11.7.2, “*Restrictions on the enforcement of security*” below.

A Special Administrator has extensive powers under the WIA similar to those of an administrator under the Insolvency Act, but with certain important differences. A Special Administrator would, if appointed, be charged with managing the affairs, business and property of the Regulated Company: (i) for the achievement of the purposes of the Special Administration Order; and (ii) in such a manner as protects the respective interests of the members and creditors of the Regulated Company. The purposes of the Special Administration Order consist of (i) transferring to one or more different Regulated Companies, as a going concern, as much of the business of the Regulated Company as is necessary in order to ensure that the functions which have been vested in the Regulated Company by virtue of its licence are properly carried out; and (ii) pending the transfer, the carrying out of those functions. It would therefore not be open to him to accept an offer to purchase the assets on a break-up basis in circumstances where the purchaser would be unable properly to carry out the relevant functions of a Regulated Company.

The transfer would be effected by a transfer scheme which the Special Administrator would put in place on behalf of the existing Regulated Company. The transfer scheme may provide for the transfer of the property, rights and liabilities of the existing Regulated Company to the new Regulated Company(ies) and may also provide for the transfer of the existing Regulated Company’s licence (with modifications as set out in the transfer scheme) to the new Regulated Company(ies). The powers of a Special Administrator include, as part of a transfer scheme, the ability to make modifications to the licence of the existing Regulated Company, subject to the approval of the Secretary of State or the DGWS. The Special Administrator would agree the terms of the transfer of the existing Regulated Company’s business to the new Regulated Company(ies), on behalf of the existing Regulated Company. The powers of a Special Administrator include power to exercise any right the Regulated Company may have to seek a review by the DGWS of the Regulated Company’s charges pursuant to an Interim Determination. To take effect, the transfer scheme must be approved by the Secretary of State or the DGWS. In addition, the Secretary of State and the DGWS may modify a transfer scheme before approving it or at any time afterwards with the consent of the Special Administrator and each new Regulated Company.

The WIA also grants the Secretary of State, with the approval of the Treasury the power: (i) to make appropriate grants or loans to achieve the purposes of the Special Administration Order and to indemnify the Special Administrator against losses or damages sustained in connection with the carrying out of his functions; and (ii) to guarantee the payment of principal or interest and the discharge of any other financial obligations in connection with any borrowings of the Regulated Company subject to a Special Administration Order.

## **11.6 Protected Land**

Under the WIA, there is a prohibition on Regulated Companies disposing of any of their Protected Land except with the specific consent of, or in accordance with a general authorisation given by, the Secretary of State. A consent or authorisation may be given on such conditions as the Secretary of State considers appropriate. For the purpose of these provisions, disposal includes the creation of any interest (including leases, licences, mortgages, easements and wayleaves) in or any right over land, and includes the creation of a charge. All land disposals are reported to Ofwat in the annual return.

Protected Land comprises any land, or any interest or right in or over any land, which:

- was transferred to a water and sewerage company (under the provisions of the Water Act 1989) on 1 September 1989, or was held by a water only company at any time during the financial year 1989/90;
- is, or has at any time on or after 1 September 1989, been held by a company for purposes connected with the carrying out of its regulated water or sewerage functions; or

- has been transferred to a company in accordance with a scheme under Schedule 2 to the WIA from another company, in relation to which the land was Protected Land when the transferring company held an appointment as a water or sewerage undertaker.

Unless a specific consent is obtained from the Secretary of State, all disposals of Protected Land must comply with Condition K of the licence. This condition seeks to ensure (i) that, in disposing of Protected Land, the Regulated Company retains sufficient rights and assets to enable a Special Administrator to manage the business, affairs and property of the Regulated Company so that the purposes of the Special Administration Order can be achieved and (ii) that the best price is received from such disposals so as to secure benefits to customers (where such proceeds were not taken into account when price limits were set, they are shared as between customers and shareholders). To this end there are certain procedures for and restrictions on the disposal of Protected Land and special rules apply to disposals by auction or formal tender and to disposals to certain associated companies. These include a restriction on the disposal (except with the consent of the DGWS) of Protected Land required for carrying out the Regulated Business. In addition, Ofwat can impose conditions on disposals of Protected Land including those relating to the manner in which the proceeds of a sale are to be used.

Given the purposes of the WIA (in particular of the Special Administration regime under it) and of Condition K of its Licence, AWS would not expect to obtain, and has not obtained, the consent of the Secretary of State or of the DGWS to the creation of any security (including the Security) over its Protected Land.

## 11.7 Security

### 11.7.1 Restrictions on the Granting of Security

A Regulated Company's ability to grant security over its assets and the enforcement of such security are restricted by the provisions of the WIA and its licence. For example, all licences (including AWS's Licence) restrict a Regulated Company's ability to dispose of Protected Land in this way (as explained in 11.6, "*Protected Land*" above). Accordingly, a licence restricts a Regulated Company's ability to create a charge or mortgage over Protected Land.

In addition, provisions in a Regulated Company's licence require the Regulated Company at all times:

- (1) to ensure, so far as is reasonably practicable, that if a Special Administration Order were made in respect of it, it would have sufficient rights and assets (other than financial resources) to enable the Special Administrator to manage its affairs, business and property so that the purpose of such order could be achieved; and
- (2) to act in the manner best calculated to ensure that it has adequate: (i) financial resources and facilities; and (ii) management resources, to enable it to carry out its regulated activities.

These provisions further limit the ability of AWS to grant security over its assets, in particular assets required for carrying out the Regulated Business, and limit in practice the ability to enforce such security.

In the case of AWS, the substantial majority of AWS's assets by value is tangible property which is either Protected Land and/or assets which are required for carrying out AWS's Regulated Business and cannot therefore be effectively secured. This necessarily affects the ability of AWS to create a floating charge over the whole or substantially the whole of its business. However, in any event, there is no right under the WIA to block the appointment of a Special Administrator equivalent to the right of a holder of a floating charge over the whole or substantially the whole of the business of a non-Regulated Company to block the appointment of a conventional Insolvency Act administrator.

### 11.7.2 Restrictions on the Enforcement of Security

Under the WIA, the enforcement of security given by a Regulated Company in respect of its assets is prohibited unless the person enforcing the security has first given 14 days' notice to both the Secretary of State and the DGWS. If a petition for Special Administration has been presented leave of the Court is required before such security is enforceable or any administrative receiver

can be appointed (or, if an administrative receiver has been appointed between the expiry of the required notice period and presentation of the petition, before the administrative receiver can continue to carry out his functions). These restrictions continue once a Special Administration Order is in force with some modification (see 11.5, “*Special Administration Orders*” above).

Once a Special Administrator has been appointed, he would have the power, without requiring the Court’s consent, to deal with property charged pursuant to a floating charge as if it were not so charged. When such property is disposed of under this power, the proceeds of the disposal would, however, be treated as if subject to a floating charge which had the same priority as that afforded by the original floating charge.

A disposal by the Special Administrator of any property secured by a fixed charge given by the Regulated Company could be made only under an order of the Court unless the creditor in respect of whom such security is granted otherwise agreed to such disposal. Such an order could be made if, following an application by the Special Administrator, the Court was satisfied that the disposal would be likely to promote one or more of the purposes for which the order was made (although the Special Administrator is subject to the general duty to manage the company in a manner which protects the respective interests of the creditors and members of the Regulated Company). Upon such disposal, the proceeds to which that creditor would be entitled would be determined by reference to the “best price which is reasonably available on a sale which is consistent with the purposes of the Special Administration Order” as opposed to an amount not less than “open market value” which would apply in a conventional administration for a non-Regulated Company under the Insolvency Act.

Within three months of the making of a Special Administration Order or such longer period as the Court may allow, the Special Administrator must send a copy of his proposals for achieving the purposes of the order to, inter alia, the Secretary of State, the DGWS and the creditors of the company. The creditors’ approval to the Special Administrator’s proposal is not required at any specially convened meeting (unlike in the conduct of a conventional administration under the Insolvency Act). The interests of creditors and members in a Special Administration are still capable of being protected since they have the right to apply to the Court if they consider that their interests are being prejudiced. Such an application may be made by the creditors or members by petition for an order on a number of grounds, including either: (i) that the Regulated Company’s affairs, business and property are being or have been managed by the Special Administrator in a manner which is unfairly prejudicial to the interests of its creditors or members; or (ii) that any actual or proposed act of the Special Administrator is/or would be so prejudicial. Except as mentioned below, the Court may make such order as it thinks fit, and any order made by the Court may include an order to require the Special Administrator to refrain from doing or continuing an act about which there has been a complaint. The exception referred to above is that the Court may not make an order which would prejudice or prevent the achievement of the purposes of the Special Administration order.

### **11.7.3 Enforcement of Security over Shares in AWS**

Under the WIA, the enforcement of security over, and the subsequent sale of, directly or indirectly, the shares in a Regulated Company such as AWS would not be subject to the restrictions described above in relation to the security over AWS’s business and assets. Notwithstanding this, given the DGWS’s general duties under the WIA to exercise and perform his powers and duties, inter alia, to ensure that the functions of a Regulated Company are properly carried out, the Issuer anticipates that any intended enforcement either directly or indirectly of the Security or the Security over, and subsequently any planned disposal of, the shares in AWS to a third party purchaser, would require consultation with the DGWS. In addition, depending on the circumstances, the merger control provisions referred to in 11.10.3, “*Competition in the Water Industry – Merger Regime*” below could apply in respect of any such disposal.

## **11.8 Economic Regulation**

### **11.8.1 General**

Economic regulation of the water industry in England and Wales is based on a system of five year price caps imposed on the amounts Regulated Companies can charge to their customers. This is intended to reward companies for efficiency and quality of service to customers. The system was

intended generally to allow companies to retain for a period any savings attributable to efficiency, thus creating incentives to make such gains.

#### **11.8.2 K Price Limitation Formula**

The main instrument of economic regulation are the price limits set out in the conditions of the licences. These limit increases in a basket of standard charges made by Regulated Companies for water supply and sewerage services. The weighted average charges increase is limited to the sum of the percentage movement in the RPI plus K, an adjustment factor which may be positive, negative or zero. K is a number set by the DGWS for each Regulated Company individually and may be a different number in different years. Certain charges are not included in the price limitation formula but are determined on an individual basis.

#### **11.8.3 Price Control**

A small number of mainly large consumption non-domestic customers are charged in accordance either with individual “special” arrangements, or with standard charges which do not fall within the scope of the tariff basket. These include charges for bulk supplies and charges in respect of infrastructure provision and, where these are not in accordance with standard charges, charges for non-domestic supplies of water and the reception, treatment and disposal of trade effluent. Charges for bulk supplies of water are usually determined on an individual basis, as are charges for some larger non-domestic water supplies and some trade effluent. The charging basis for bulk supplies in some cases provides for annual recalculation by reference to the expenditure associated with the supply. In May 2002 Ofwat published its Tariff Structure and Charges Report for 2002 – 2003, in which it set out its policy on tariff issues and the approach to be taken in assessing and approving Regulated Companies’ charge schemes, including its expectation that customers’ bills should broadly reflect the cost of the service provided.

#### **11.8.4 Periodic Reviews of K**

K factors are currently redetermined every five years. Following the last Periodic Review, new price limits took effect from 1 April 2000 and are set for the five year period from 1 April 2000 to 31 March 2005. The DGWS will next determine price limits in 2004 and these will come into effect on 1 April 2005. The DGWS made a statement on 31 January 2001 in which he indicated his general approach to the carrying out of Periodic Reviews (see Appendix 1, “*Ofwat Letter*”). The DGWS published a paper in February 2002 which indicated that, and the basis on which, price limits are to be linked to service levels (see “*Linking Service Levels to Prices*”). In March 2002 Ofwat published its Forward Programme for 2002/3 to 2004/5 in preparation for the next Periodic Review.

#### **11.8.5 Interim Determinations of K**

The conditions of the licences provide for the DGWS to determine in certain circumstances whether, and if so how, K should be changed between Periodic Reviews. The procedure for Interim Determinations of K can be initiated either by the Regulated Company or by the DGWS. In AWS’s Licence an application for an Interim Determination of K may be made in respect of a Notified Item, a Relevant Change of Circumstance or where there has been a substantial adverse or favourable effect.

A Notified Item is any item formally notified by the DGWS to the Regulated Company as not having been allowed for in K, provided that there has been no Periodic Review subsequent to that notification. Notified Items put forward by the DGWS in the determination of price limits for AWS for the period 2000 to 2005 were: (a) the costs and revenues associated with any difference in the number of domestic customers who opt to switch to measured charges from that assumed by the DGWS; (b) any net increase in bad debt and debt collection costs arising from the loss of power to disconnect residential customers for non-payment from 1 April 2000; and (c) any additional administrative costs arising out of statutory obligations to offer protection from high metered bills to vulnerable groups of customers.

Relevant Changes of Circumstance are defined in the licences. Such changes include: (a) the application to the Regulated Company of any new or changed legal requirement including any legal requirement ceasing to apply, being withdrawn or not being renewed (to the extent that the legal requirement applies to the Regulated Company in its capacity as a water or sewerage

undertaker); (b) any difference in value between actual or anticipated proceeds of disposals of Protected Land and those allowed for at the last Periodic Review or Interim Determination; (c) where on a determination of K allowance has been made for taking steps to secure compliance or facilitate compliance with a legal requirement or achieve a service standard and the Regulated Company has failed to take those steps and (i) as a result, failed to spend the full amount which it was assumed would be spent taking into account savings which may have been achieved by prudent management and (ii) the stated purpose has not otherwise been achieved; and (in some licences, including AWS's) (d) movements in construction prices so as to differ from those assumed in the determination.

An Interim Determination takes account of the costs, receipts and savings to be included in the computation of K which are reasonably attributable to the Notified Items or the Relevant Changes of Circumstance in question and are not recoverable by charges outside the K price limitation formula. The amount and timing of the costs, receipts and savings must be appropriate and reasonable for the Regulated Company in all the circumstances and they must exclude: trivial amounts, any costs which would have been avoided by prudent management action, any savings achieved by management action over and above those which would have been achieved by prudent management action, and any amounts previously allowed for in determining K. These costs are then netted off against the receipts and savings to determine the annual cash flows thereof for each year included in the period over which the costs are to be measured ("**Base Cash Flows**").

The conditions of the licences also specify a materiality threshold which must be reached before any adjustment can be made. In relation to certain licences (including that of AWS) this materiality threshold is reached where the sum of the net present values of (i) Base Cash Flows consisting of operating expenditure and/or loss of revenue calculated over 15 years and (ii) other Base Cash Flows calculated over the period to the next Periodic Review, is equal to at least 10 per cent. of the latest reported turnover attributable to the Regulated Company's water and sewerage business. An adjustment to K (which may be up or down) is then calculated on the basis of a formula broadly designed to enable the Regulated Company to recover the additional allowable costs incurred or to be incurred during the period until the start of the first charging year to which the next Periodic Review applies and attributable to the identified Base Cash Flows. The change is then made for the remainder of the period up to the start of that first charging year. Condition B of the licence sets out in detail the step-by-step methodology which the DGWS is required to apply.

In addition, under the Shipwreck Clause, AWS's Licence permits it or the DGWS to request price limits to be reset if its regulated business either: (i) suffers a substantial adverse effect which could not have been avoided by prudent management action; or (ii) enjoys a substantial favourable effect which is fortuitous and not attributable to prudent management action. For this purpose, the financial impact is calculated in the same way as for the materiality threshold above and "substantial" is defined by reference to 20 per cent. or more of the latest reported turnover attributable to the Regulated Company's water and sewerage business. Since the DGWS' open letter of 31 January 2001 to the Managing Directors of Regulated Companies offering to reinsert the clause in their licences, several other Regulated Companies have accepted the proposed inclusion of a shipwreck clause in their licences and the DGWS is proceeding with the modification to their licences.

#### **11.8.6 References to the Competition Commission**

If the DGWS fails within specified periods to make a determination at a Periodic Review or in respect of an Interim Determination or if the Regulated Company disputes his determination, the Regulated Company may require the DGWS to refer the matter to the Competition Commission for determination by it (after making such investigation as the Commission considers necessary). The Competition Commission must make its determination in accordance with any regulations made by the Secretary of State and with the principles which apply, by virtue of the WIA, in relation to determinations made by the DGWS. The decisions of the Competition Commission are binding on the DGWS.

### **11.8.7 Other Restrictions on Charging**

Under the WIA Regulated Companies must charge for water supplied, or sewerage services provided, to dwellings in accordance with a charges scheme which cannot take effect unless approved by the DGWS and must comply with any requirements prescribed by the Secretary of State by regulations. Regulated Companies are prohibited from disconnecting dwellings and certain other premises for non-payment of charges for water supply.

## **11.9 Drinking Water and Environmental Regulation**

### **Principal United Kingdom Law**

The water industry is subject to numerous regulatory requirements concerning human health and safety and the protection of the environment.

Under the WRA abstractions must be in accordance with a licence granted by the EA. It is a criminal offence to breach the conditions of an abstraction licence. The draft Water Bill published in November 2000 contained proposals for amendment of the abstraction licensing system in England and Wales to ensure the sustainable use of water. Included in these proposals is the power to amend or revoke abstraction licences in the interests of environmental protection. As drafted, no compensation would be available for any loss suffered as a consequence of any such amendment or revocation and the Government has said that it would expect all abstractors to work with the EA to ensure that any environmentally damaging abstractions are replaced with sustainable alternatives before this provision comes into effect. Also included in the proposals is a provision requiring all new abstraction licences to be time-limited (and the Government has indicated that it expects most existing licences to be converted to a time-limited basis over time) and a provision creating a new right to claim damages against the holder of an abstraction licence for loss or damage due to water abstraction. DEFRA has confirmed that it intends to take these proposals forward. Although the draft Water Bill was removed from the Government's agenda for the current session of Parliament, DEFRA has recently confirmed in its response to the consultation on the draft Water Bill that it remains committed to introducing the Water Bill as soon as Parliamentary time allows.

In April 2001 the EA finalised plans for Catchment Abstraction Management Strategies ("CAMS") which are a part of the Government's plans to reform water resources licensing. The EA has divided England and Wales into catchment areas and intends to work through the CAMS process in each catchment area by 2008. This will involve identifying local water resource issues and consulting with stakeholders such as abstractors, conservation organisations and water users. The EA will then formulate a local strategy for each catchment area based upon sustainable use of water resources. The strategy will give details of the water resource availability in the catchment area and will inform the EA's abstraction licensing policies for that area. CAMS will also be a vehicle for reviewing time-limited abstraction licences and determining whether and on what terms they should be renewed.

If an abstraction licence affects a site designated under the Habitats Regulations it must be reviewed in accordance with those Regulations. AWS has appealed against the decision of the EA made pursuant to the Habitats Regulations not to renew two of its abstraction licences. One appeal was withdrawn following the issue of a two-year time-limited licence. In the other, the Secretary of State's decision is still awaited but a two-year time-limited licence for a reduced quantity has been granted on the grounds of overriding public importance. The EA has said that it intends to review at least another six of AWS's abstraction licences under the Habitats Regulations before the end of the AMP3 period in March 2005. The capital cost of replacing any deployable output lost as a result of the non-renewal of any abstraction licences is likely to be material.

As a result of CAMS and the Habitats Regulations, the EA has indicated that a reduction of up to 40 MI/d for the Anglian region will be required by 2010 and up to 210 MI/d by 2025. The average deployable output of all AWS sourceworks is 1485 MI/d. AWS anticipates that these reductions will be fully allowed for by the DGWS in future asset management plans.

The DWI's principal task is to ensure that water undertakers in England and Wales are fulfilling their statutory requirements under the WIA and the Water Quality Regulations for the supply of wholesome drinking water. The DWI is part of DEFRA and acts as a technical assessor on behalf of the Secretary of State in respect of the quality of drinking water supplies. It carries out annual technical audits of each water company; this includes an assessment (based on information supplied by the company) of the quality of water in each supply zone, arrangements for sampling and analysis, and progress made on



achieving compliance with United Kingdom and EU requirements. It can also take enforcement action in the event that a water undertaker is in contravention of regulatory requirements concerning the “wholesomeness” of water supplies. Court proceedings can be brought by the DWI in the name of the Secretary of State or the Director of Public Prosecutions for the offence of supplying water “unfit for human consumption”, for example if discoloured or foul tasting water is supplied to customers. During 2000 and 2001, 99.6 per cent. of the tests carried out on samples from customers’ taps in AWS’s water supply area complied with the Water Quality Regulations.

The EA was established under the Environment Act 1995 and is responsible, in England and Wales, for the protection and improvement of the water environment. Its duties include the regulation of abstractions from, and discharges to, controlled waters. Controlled waters include coastal waters, territorial waters extending three miles from shore, inland freshwaters and groundwater.

A consent under the WRA is required from the EA for any discharge of trade or sewage effluent or other poisonous, noxious or polluting matter into controlled waters. It is a criminal offence under the WRA to cause or knowingly permit such a discharge, although there is a defence if it is carried out in compliance with a consent. The principal prosecuting body is the EA. The EA is considering bringing prosecutions against AWS in respect of a number of incidents relating to polluting discharges. Under the WRA, the EA is empowered to take remedial action to deal with actual or potential pollution of controlled waters and may recover the reasonable costs of any works undertaken from any person who caused or knowingly permitted the pollution (and can also require that person to take the remedial action itself). AWS was subject to four prosecutions in 2001 in respect of pollution incidents. There have been two prosecutions in 2002, each of which has led to significant fines. AWS was fined a total of £190,000 for eight offences over an eight month period in respect of the first prosecution. The second prosecution, involving pollution of an Essex river, was heard in the Crown Court on 8 March 2002 and 15 March 2002. AWS pleaded guilty and a fine of £200,000 was subsequently imposed.

Sewerage undertakers are responsible under the WIA for regulating discharges of industrial effluent into their sewers. In addition, discharges by sewerage undertakers from sewage treatment works require consents issued by the EA. Pollution of controlled waters by unconsented discharges of non-compliant effluent may subject the sewerage undertaker to liability, including prosecution, imprisonment, fines and/or clean-up costs. The EA publicises prosecutions and incidents. As a result of a decision of the Court of Appeal in March 2001, sewerage undertakers may in future have to negotiate contracts with the owners of certain watercourses in order to be able to discharge water into such watercourses. Following a recent decision in February 2002 by the Court of Appeal, water companies may be at risk of greater exposure to claims for compensation after sewage flooding. The additional costs involved may be material.

There are separate legislative controls over discharges to water courses from certain environmentally hazardous processes under the Integrated Pollution Control Regime introduced by the Environmental Protection Act 1990. This regime is being replaced by a new Integrated Pollution Prevention and Control (IPPC) regime which was introduced by the Pollution Prevention and Control Act 1999 and is being phased in on an industry sector basis. The aim of the IPPC regime is to protect the environment from the potentially harmful effects of industrial installations and operators will be required to use the best available techniques to reduce environmental damage both during the life of an installation and following its closure. Depending on the type and volume of waste processed, sewage treatment works that employ biological treatment processes or deal with non-domestic hazardous wastes of over 10 tonnes per day will be subject to IPPC. The application of IPPC to AWS’s installations may give rise to material expenditure.

AWS currently disposes of around three-quarters of its sewage sludge by spreading it on agricultural land and is investigating alternative methods of disposal, such as gasification. The Government has announced that it intends to introduce new sludge to agriculture regulations and is expected to do so during 2002. The draft regulations contain stringent requirements for the performance of sludge treatment processes, the introduction of which may cause AWS to incur material expenditure. Pending the implementation of the regulations, the industry has entered into a voluntary agreement with stakeholders including members of the British Retail Consortium to comply with a safe sludge matrix from 1 January 2002. The matrix requires certain levels of pre-treatment and prescribed disposal rules to be observed.

Energy use in water and sewage treatment processes is one of AWS’s biggest environmental impacts as it results in emissions of greenhouse gases. As part of its sustainable development strategy, AWS aims to reduce emissions of greenhouse gases and to obtain more energy from renewable sources. AWS is subject to the Climate Change Levy introduced in April 2001 as part of the Government’s strategy for tackling

climate change. According to its own estimate, AWS will incur an annual cost of around £2.6 million under the Climate Change Levy.

Under Section 101A of the WIA, sewerage undertakers are under a duty to provide a public sewer if certain conditions are met and, having regard to guidance issued by DEFRA, it is considered appropriate to provide a public sewer. There is a right of appeal to the EA. A recent case concerning the provision of public sewers to villages in accordance with the WIA is referred to in Chapter 4, “*AWS Business Description – Litigation*”.

Part IIA of the Environmental Protection Act 1990, together with certain implementing regulations and statutory guidance, establishes a legal regime to address the remediation of historically contaminated land. Current and future impacts are dealt with under other pollution control laws. Under the regime the original polluter or any person who is a “knowing permitter” can be required to clean up contamination of land if it is causing, or there is a significant possibility of it causing, significant harm to the environment or to human health or if pollution of controlled waters is being or is likely to be caused. If the polluter or a knowing permitter cannot be found, the owner or occupier of the land may be held liable whether or not it caused the contamination. AWS has a large landholding and recognises that some of its sites are or may have been contaminated due to historic practices. At present insufficient information is available to enable AWS to quantify any existing exposure, or the likelihood, size or extent of any future exposure that it may have under Part IIA of the Environmental Protection Act 1990. Given the extent of AWS’s landholdings and historic site activities, the costs of remediating any contamination of land or water may be material, although the timeframe during which any such costs might be incurred is difficult to predict. Civil liability may also arise (under such heads of claim as nuisance or negligence) where contamination migrates into or on to third party land and/or impacts upon human health, flora or fauna.

The Government is planning to introduce new regulations concerning the management of risks from asbestos in premises at the end of August 2002. These are expected to be in force in March 2004 and are likely to include a new duty to manage that will require surveys to be carried out to determine the location, extent and condition of any existing or suspected asbestos containing materials. An appropriate management plan will need to be put in place to address any asbestos detected. Asbestos is present at a number of AWS’s properties and there is a risk that AWS may incur material expenditure in managing or removing asbestos located at these properties to comply with the new regulations.

### **Principal EU Law**

The activities of Regulated Companies are affected by the requirements of EU Directives. Principal EU Directives relating to such activities which are currently in force or are proposed are detailed below.

The Water Framework Directive was adopted in 2000. It is intended to rationalise existing EU water legislation in order to provide a framework for the protection of inland and coastal waters from hazardous substances and to promote sustainable water consumption. The Directive must be transposed into United Kingdom law by 2003 and is expected to have a significant impact on Regulated Companies in the longer term. For example, it may result in increased limitations on abstraction licences and discharge consents, which could cause AWS to incur material expenditure. To comply with the Directive, Member States will have to achieve “good” status for surface water and groundwater within the next 15 years.

The purpose of the Urban Waste Water Treatment Directive (“UWWTD”) is the reduction of pollution caused by urban sewage. The UWWTD lays down minimum requirements for the treatment of municipal waste water and for the disposal of sludge and aims to control the discharge of industrial waste waters. Receiving waters are classified according to their “sensitivity” to harm from pollution, with “sensitive” waters being subject to more stringent treatment requirements. The European Commission has commenced infraction proceedings against the United Kingdom, alleging that it has failed to implement the UWWTD correctly by inaccurately designating “sensitive” waters. Included amongst these is the Wash. Depending on the outcome of the infraction proceedings, AWS may be required to make material investment in further treatment processes. On 27 June 2002 the Government announced an increase in the number of sensitive areas, some of which are in the Anglian region.

The EU’s Directive on the Quality of Water intended for Human Consumption sets standards for water intended for drinking, food preparation or other domestic purposes. In 1998, the EU passed a new Directive which will be fully in force by the end of 2003 and will set tighter standards for quality control and will introduce a detailed new regime for rectifying breaches of those standards.

The European Commission will be proposing a new Bathing Water Directive to take account of advances in water quality science since the original Bathing Water Directive was introduced in 1975. The proposals are expected to involve a shift of emphasis from bathing water quality monitoring to bathing water quality management and will introduce a more risk-based approach. The level of investment required to ensure compliance with the Directive will depend on the microbiological parameters ultimately adopted.

There are 23 designated shellfish areas in the Anglian region and the Shellfish Waters Directive identifies specific standards applicable to such waters. Whilst there is some overlap with the investment required by the UWWTD and the Bathing Water Directive, additional treatment may be required in some areas to meet the more stringent requirements. It is anticipated that any required investment will be made during AMP4, although there is a possibility that the EA could force earlier investment. Such investment would not be covered by funding allocated by the regulator and could be material.

The Habitats Directive and the Birds Directive establish a network of areas protected by designation across Europe called “Natura 2000” to conserve endangered habitats. AWS owns or has an interest in sites which are directly affected by such designations and also conducts operations from sites adjacent to areas which are protected. Once a site is designated, Member States must take steps to avoid the deterioration of habitats and disturbance of species. As outlined above, this will involve a review of any existing authorisations likely to impact upon a protected area.

The European Commission has adopted a proposal for a Directive on environmental liability which aims both to prevent and restore environmental damage including water pollution, damage to biodiversity and land contamination which causes serious harm to human health. Under the proposal, operators responsible for certain prescribed activities (for example, those which are subject to IPPC) and which cause environmental damage, would, subject to certain defences, be held strictly liable for restoring the damage caused or made to pay for the restoration. All other operators who cause damage to biodiversity by fault or negligence will be under an obligation to restore the damage. The proposal will follow the co-decision procedure through the European Parliament and is expected to be finally adopted in two to three years’ time, after which Member States will have two years to implement the Directive into national law. Although liability under the Directive will not be retrospective, the Directive may well have a significant impact on Regulated Companies whose operations cause damage to the environment and biodiversity.

## **11.10 Competition in the Water Industry**

### **11.10.1 General**

Each Regulated Company effectively holds a geographic monopoly within its appointed area for the provision of water and sewerage services. There is certain limited competition, however, for the provision of water and sewerage services and the United Kingdom Government has indicated that it hopes to increase the scope for competition. Furthermore, the DGWS has stated that he will use his powers under the Competition Act to investigate and prohibit anti-competitive practices and abuses of a dominant position to ensure a level playing field in the industry.

The current main methods for introducing competition are:

- inset appointments which allow one Regulated Company to replace another as the statutory undertaker for a specified geographical area within the other Regulated Company’s appointed territory;
- common carriage – when a company supplies water or sewerage services to its customers using a Regulated Company’s network. All Regulated Companies prepared draft network access codes during the course of 2000;
- cross border supplies where a customer in an area adjacent to a neighbouring Regulated Company’s territory can connect to another Regulated Company’s network and receive a supply; and
- private suppliers or private sewers including on-site water and effluent treatment.

In April 2000, the DETR published the Competition Consultation Paper (“Competition in the Water Industry in England and Wales”) on ways to extend the scope for competition both through the methods set out above and by introducing further mechanisms as set out below:

- further lowering the threshold for inset appointments, time limiting inset appointments and allowing premises to be combined to meet the consumption limit for a large user inset;
- extending the obligation on Regulated Companies to allow connections to their water mains from outside their areas in response to requests by non-domestic customers as well as domestic customers (currently, Regulated Companies are only obliged to make such supplies outside their areas when requested by domestic customers);
- time limiting abstraction licences and liberalising trade in abstraction licences so that new entrants can enter the market for the provision of water (the provisions for which were contained in the draft Water Bill published in November 2000);
- consideration of legislation to provide a sector specific framework to encourage the development of common carriage; and
- removing water companies’ monopolies in making connections to water mains.

In addition, the Competition Consultation Paper put forward three more radical amendments to the existing regulatory regime:

- licensing – whereby potential new entrants could be licensed to supply water or sewerage services to any customer over a given size, rather than being restricted by the existing limitation of inset appointments;
- restructuring – where the key monopoly elements of the industry are separated out and competition is promoted in each stage of the delivery of the rest of the service; and
- franchising – where statutory undertakers are required to seek bids for a franchise to operate the whole of their main operational functions.

On 17 April 2001, the Government announced that it planned to issue a further consultation paper in the summer of 2001 (now expected summer 2002), inviting views on more detailed proposals for increased competition in the industry. Requisite legal provision for these proposals is expected to be incorporated in the draft Water Bill before it is introduced to Parliament.

The aim of the proposals is to provide a framework for competitors to enter the market in production (water abstraction and treatment) and retail activities (including billing and customer services). New entrants to the market would apply to the DGWS for licences for production and/or retail activities and only licensees would be able to make common carriage arrangements with incumbent network operators.

Regulated companies would remain monopoly network operators with responsibility for resource planning and as “suppliers of last resort” (a duty to supply water for domestic purposes to any customer and to provide alternative sources of supply when mains supplies fail). The cost to the Regulated Companies of undertaking these activities would be taken into account in the charges they set new entrants for using their pipes and facilities.

On 19 March 2002, DEFRA announced that it proposed to extend competition for non-household customers that use large quantities of water. Under these proposals new entrants to the industry would be able to use the existing statutory undertakers’ pipework to supply premises which use more than a specified threshold of water per year. The proposals would initially set this threshold at 50 megalitres, with provision for review and revision. The proposals would not apply to domestic households and would be brought into effect by means of such a Water Bill as is mentioned above (and in 11.11, “*The Draft Water Bill*” below). DEFRA has also indicated that consideration will be given to whether the threshold for inset appointments should be reduced in line with the 50 megalitre threshold proposed for these new competition arrangements.

On 25 March 2002, Ofwat issued a letter to Regulatory Directors that set out changes designed to improve incentives for companies which seek to generate new revenues through new bulk supplies or competitive initiatives.

At present the price-setting methodology at periodic reviews dampens the incentive for such initiatives by effectively giving companies back the revenue lost through losing a customer and taking away the revenue gained through winning a new customer.

To remedy this, Ofwat proposes that companies retain the net revenue gains (or losses) relating to new bulk supplies or competitive non-tariff basket activity (i.e. the larger industrial and commercial customers) for five years.

Ofwat has recently issued guidance to Regulated Companies on competition in pipe laying (with particular reference to the policies they should adopt for allowing developers to lay water mains and service pipes) and on the contents of access codes for common carriage. As regards the latter Ofwat has stated its view that, although it is in the public interest for all entrants to be subject to a licensing regime, it is not justifiable for a Regulated Company to refuse access to a new entrant on the ground that the latter is not licensed as a water undertaker.

#### **11.10.2 The Competition Act**

The Competition Act came into force in March 2000 and introduces two prohibitions concerning anti-competitive agreements and conduct and powers of investigation and enforcement.

The Chapter I Prohibition prohibits agreements, decisions by associations of undertakings or concerted practices between undertakings which may affect trade within the UK and which have as their object or effect the prevention, restriction or distortion of competition within the UK. The Chapter II Prohibition prohibits the abuse of a dominant position which may affect trade within the UK. The Chapter II prohibition is the basis for the DGWS's attempt to introduce common carriage in the absence of primary legislation.

The DGWS has concurrent powers with the Director General of Fair Trading to apply and enforce the Competition Act 1998 to deal with anti-competitive agreements or abuses of dominance relating to the water and sewerage sector, including the power to enforce directions to bring an infringement to an end and to impose fines of up to 10 per cent. of AWG's UK group-wide turnover for each year of infringement up to a maximum of three years. Also any arrangement which infringes the Competition Act may be void and unenforceable and may give rise to claims for damages from third parties. A party to an anti-competitive agreement may also be able to seek relief from the other party if it was in a markedly weaker bargaining position than the other party when the contract was made or where the party seeking relief cannot bear significant responsibility for infringement of the Chapter I Prohibition.

On 17 August 2001, AWS received a formal notice from Ofwat regarding a complaint made to it under the Competition Act 1998, alleging that AWS or one of its subsidiaries had breached the Competition Act 1998 by concluding agreements for the supply of water at excessively low prices. Ofwat required certain information to be provided to it in this regard. AWS provided information to Ofwat in November 2001. On 26 February 2002, Ofwat requested additional information, clarification of the relationship between AWS and H<sub>2</sub>GO (an AWG Group company which was involved in pursuing inset appointments), and specified that transactions be accounted for separately to identify relevant costs.

#### **11.10.3 Merger Regime**

The Secretary of State has a duty to refer to the Competition Commission mergers or proposed mergers between two or more Regulated Companies where the value of the gross assets of each of the Regulated Companies to be merged exceeds £30 million. In determining whether such a matter operates or may be expected to operate against the public interest, the Competition Commission must have regard to the desirability of giving effect to the principle that the DGWS's ability to make comparisons between different water companies should not be prejudiced. Depending on the size of the parties involved, such mergers may require notification to the European Commission under the EU merger regime.

In cases of an acquisition of a Regulated Company by a company which is not already a Regulated Company or where the special merger water regime does not otherwise apply, general merger control rules apply. These may call for discussion with the OFT as well as Ofwat. The Director General of Fair Trading has the power to investigate any merger within the jurisdiction of the United Kingdom merger regime. He advises the Secretary of State on whether the transaction should be referred to the Competition Commission for further investigation to determine if the arrangement will or may be expected to operate against the public interest. In giving his advice to the Secretary of State, he will consult with Ofwat. Depending on the size of the parties involved, such mergers may require notification to the European Commission under the EU's merger regime.

#### **11.10.4 Monopoly Regime**

Where it appears to the DGWS or the Director General of Fair Trading, the Secretary of State alone or together with another Minister, that a monopoly situation exists or may exist in relation to commercial activities connected with the supply of water or the provision of sewerage services, he may refer the matter to the Competition Commission. These powers relate to both scale, or structural, monopolies as well as complex, or behavioural, monopolies. The Competition Commission will investigate the matter and, if a monopoly situation exists and there are effects adverse to the public interest, the Competition Commission must consider what, if any, action should be taken to remedy or prevent them and may, if it thinks fit, recommend remedial action. The remedy (which may include structural break up) may be implemented either by virtue of the monopolist giving appropriate undertakings or by an order from the Secretary of State.

#### **11.10.5 Reform of UK Competition Regime**

On 26 March 2002, the UK Government introduced into Parliament the Enterprise Bill which includes a number of measures to reform the UK competition regime. In particular, measures include the ability of consumer groups to bring actions on behalf of a group of consumers (including for damages) in relation to the Chapter I and II prohibitions contained in the Competition Act 1998. The Government also proposes to expand the role currently performed by the Competition Commission Appeal Tribunals enabling them to hear claims for damages in competition cases brought by harmed parties. Criminal sanctions are also proposed to be imposed on individuals who have been involved in certain cartels, and directors involved in breach of competition law may be disqualified.

The Enterprise Bill also includes reform of the Fair Trading Act 1973. In particular, rather than relying on a general public interest test to decide whether action should be taken against mergers and monopolies, the test for mergers will be whether there is a substantial lessening of competition and in relation to monopolies there will be a general power to investigate markets and assess them by way of a competition-based test. Remedies may include behavioural orders, structural “break-ups” and modification of the licences/conditions of appointment. Ministerial intervention will be limited and the majority of decisions made by independent competition authorities. There will also be reforms to the special water merger regime referred to above, including replacement of the jurisdictional test with one based on turnover rather than asset value, but the substantive test against which water mergers are assessed will continue to operate in the way that attaches particular weight to the preservation of comparator enterprises.

#### **11.11 The Draft Water Bill**

On 6 November 2000, the United Kingdom Government published the consultation document “Water Bill – Consultation on draft legislation” (the “**Water Bill Consultation Paper**”). The consultation ran until 31 January 2001. This document and the draft Water Bill published with it draw together the results of a number of previous consultation exercises including the DTI July 1998 white paper, “A Fair Deal for Consumers – Modernising the Framework for Utility Regulation” (the “**White Paper**”) and the DETR April 2000 Competition Consultation Paper. The White Paper set out proposals relating to the water sector which were originally reflected in the Utilities Bill but which were withdrawn and are now reflected in the draft Water Bill. The draft Water Bill has three main elements:

- reform of abstraction licensing and promotion of greater water conservation by water companies;

- the re-introduction of the provisions of new regulatory arrangements for water aiming to put the consumer at the heart of the regulatory process and to make regulation more open and accountable, which were removed from the Utilities Bill; and
- other changes to the regulatory system for water.

The Water Bill Consultation Paper contains both firm proposals, which are provided for in the draft Water Bill, and a discussion of “work in progress” which may be included in the future draft legislation if the Bill is introduced.

Firm proposals made in the Bill include:

- Financial Penalties for Breaches of Statutory and other Requirements

A power for the DGWS and the Secretary of State to impose financial penalties on a Regulated Company for contraventions of its licence, statutory or other requirements including performance standards. The penalty must be reasonable in all the circumstances and be not more than 10 per cent. of a Regulated Company’s turnover. A financial penalty may not be imposed under this provision for an infringement if it is more appropriate to proceed under the Competition Act. It is also proposed to extend the duty and powers of the DGWS and Secretary of State to make an enforcement order for contravention of licence, statutory and other requirements, so that an order can be made where a contravention is likely (whether or not one has previously occurred) as well as where it is occurring.

- Consumer Objective

An amendment to the primary duty of the Secretary of State and the DGWS is proposed to introduce a new consumer objective to protect the interests of consumers of regulated water and sewerage services, wherever appropriate, by promoting effective competition. At present, the primary duty of the Secretary of State and the DGWS is to ensure that the functions of Regulated Companies are properly carried out and that the Regulated Companies are able to finance the proper carrying out of those functions takes priority over the regulators’ duties to protect the interests of customers. The amendments would remove that priority. In addition, a modification to the regulators’ duty to secure that Regulated Companies are able to finance the proper carrying out of their functions was proposed by removing the words “in particular, by securing reasonable returns on their capital”. The Government has recently indicated that this proposed additional modification should not be made.

The Government has also recently indicated that it intends to amend the draft Water Bill (a) to include proposals for Ofwat to be governed by a Regulatory Board instead of an individual Director General, with the DGWS continuing as the Chief Executive and Chairman of that Board; and (b) to oblige the DGWS to be mindful of social and environmental concerns when exercising his functions.

It was intended that the results of the Competition Consultation Paper were to have been included in the draft Water Bill. However, in the light of responses to it and to industry developments, the United Kingdom Government concluded that further work on options for extending competition in the water industry needed to be undertaken. In its statement of 17 April 2001, the United Kingdom Government announced that a further consultation paper, setting out detailed proposals for increased competition in the industry, was to be issued in the summer of 2001 (now delayed) as further described above. It is proposed that the legal provisions underpinning such proposals will be included in the draft Water Bill.

The proposals to extend competition for non-household customers announced by DEFRA on 19 March 2002 (see 11.10.1 above) are intended to be dealt with in a Water Bill which DEFRA has indicated will be introduced as soon as Parliamentary time is available.

On 31 January 2001, Ofwat published its response to the Water Bill Consultation Paper. In its response, Ofwat welcomed the proposals in the draft Water Bill and stated that in particular it shared the objective of placing customers at the heart of regulation. However, Ofwat stated competition also has potential benefits for consumers and that the proposals in the consultation paper are incomplete without the United Kingdom Government’s proposals to promote further competition. More recently, the DGWS, in a speech in March 2001, suggested that it would be easier to make significant progress in introducing competition in the industry by introducing a licence recognising the different roles within the public water supply system: supply, distribution and retail.

Other subjects which are currently being considered, and which could lead to legislative provisions relevant to Regulated Companies, include:

- measures to improve the availability to customers of information on company performance; and
- the application of “economic instruments” to water abstraction (e.g. “incentive” pricing, tradable water rights).

At present there is no published timetable for the draft Water Bill to be finalised and implemented although it is possible that certain proposals in it may be included in a Water Bill introduced during the next or a subsequent session of Parliament. See Section 6.1.2, “*Investment Considerations – Draft Water Bill*”. On 2 May 2002, the Government published its response to consultation on the draft Water Bill, in which it stated that it remains committed to introducing the Water Bill and that it will do so as soon as Parliamentary time allows.

## **11.12 Customers’ Interests**

### **11.12.1 General**

The DGWS is responsible for protecting the interests of customers. He monitors the performance and level of service of Regulated Companies and the implementation of a “guaranteed standards” scheme in respect of customer care.

### **11.12.2 Customer Service Committees**

Under the WIA, the DGWS is required to establish regional Customer Service Committees (the “CSCs”). Each of the 10 CSCs has a Chairman and between 10 and 20 members appointed by the DGWS, who are usually from the local area. Meetings of the full CSCs are held in public and take place at least four times a year. CSCs are funded by Ofwat and each has a full-time Secretariat; expert advice is provided by Ofwat staff. CSCs are independent of both the Regulated Companies and the DGWS and have their own statutory duties. The CSCs review all matters relating to the interests of customers and investigate complaints made by customers against companies. CSCs report back to Ofwat with their views and the DGWS aims to meet each CSC annually.

### **11.12.3 The Ofwat National Customer Council**

The Ofwat National Customer Council (the “**Council**”), established by the then DGWS in March 1993, represents all water customers at national and European levels and is made up of the 10 chairs of the CSCs. The Council advises the DGWS on the development of policy and represents the interests of customers in Europe. The Council meets at least five times a year and the DGWS attends part of every meeting. On 24 April 2002, “WaterVoice” was adopted as the new name for the Council and the 10 regional CSCs.

### **11.12.4 Guaranteed Standards**

The guaranteed standards scheme is underpinned by regulations made under Sections 38(2) and 95(2) of the WIA, which prescribe standards of performance in connection with water supply and sewerage services in relation to matters such as the keeping of appointments with customers, dealing with enquiries and complaints from customers, giving notice of interruption of supply, installation of meters and flooding from sewers.

If a Regulated Company does not meet any of the prescribed standards, under the guaranteed standards scheme, the customer is entitled to compensation, normally in the region of £20 for domestic customers and £50 for business customers (although, in the case of sewer flooding, it can be up to £1,000) within 10 working days of the incident. The availability of such compensation is in addition to the availability of any other remedy the customer may have.



## CHAPTER 12

### PROPOSED MODIFICATIONS TO AWS'S LICENCE

#### 12.1 Ofwat and the Consultation Process

On 9 January 2002, in accordance with the procedure for modifying a Regulated Company's licence with its consent (see Section 11.3.3, "*Regulation of the Water and Sewerage Industry in England and Wales – Modification of a licence*"), Ofwat published the consultation paper "Proposals for the modification of the Conditions of Appointment of Anglian Water Services Ltd". The paper described the proposals for financial restructuring of AWS; explained the process for consideration of those proposals by Ofwat; set out the regulatory issues and requested comments on Ofwat's assessment of those issues; and described the Licence modifications proposed by the DGWS and invited comments on these.

The closing date for submission of representations to Ofwat was 8 February 2002. In the consultation paper Ofwat stated that responses to the consultation paper would inform its final view on the proposals, but indicated its preliminary assessment that the proposals do not, on balance, give rise to any insurmountable issues, provided that the package of proposed Licence modifications is fully implemented, and that the appropriate corporate investment grade credit rating for AWS's borrowings is achieved and maintained.

The consultation paper sought views on whether the proposed Licence modifications are appropriate and sufficient to protect customers. It also raised two additional issues for consideration. First, the financing of functions and, second, incentives for ongoing efficiency. The paper stated that these issues are similar to those raised in previous Ofwat consultations concerning Dwr Cymru, Mid Kent Water, Portsmouth Water and Southern Water.

As regards financing of functions, Ofwat requested views on whether a highly geared, thin equity structure would be sufficiently robust to withstand cost shocks and to enable AWS to carry out and finance its functions as a water and sewerage undertaker. As regards incentives for ongoing efficiency, Ofwat requested views on whether AWG's reduced equity investment would result in significantly weaker incentives for continuing efficiency improvements.

Following the closure of the public consultation period, Ofwat has indicated to AWS that, having reviewed the responses received, Ofwat is not intending to seek Licence modifications additional to or different from those already proposed, and that Ofwat maintains its preliminary assessment, as mentioned above.

In April 2002, Ofwat produced a position paper on the restructuring proposals put forward by AWS. Ofwat concluded that it would not object to the proposals on condition that:

- AWS implements the proposed licence modifications as discussed between AWS and Ofwat;
- AWS confirms that the rights proposed for bondholders do not impede the Directors' duties under the Water Industry Act 1991;
- AWS obtains an investment-grade issuer credit rating before the transaction is complete; and
- AWS links its management's remuneration to the performance of AWS.

AWS is in the process of satisfying these conditions (as to the first of which see Section 12.2 below).

#### 12.2 Proposed Licence Modifications

Section 6 of the consultation paper "Proposals for the modification of the Conditions of Appointment of Anglian Water Services Ltd" described the Licence modifications proposed by Ofwat. Under the procedure for modification adopted by Ofwat, the making of the proposed modifications requires the consent of AWS.

The drafting of the Licence modifications as proposed by Ofwat has raised a number of issues of interpretation which have led AWS to request clarification of, or changes to, the text of the proposed modifications.

In some cases Ofwat has agreed to make changes; in other cases it has declined to do so, but has provided clarification as to how it intends to interpret and apply particular modifications. AWS has agreed to give its consent to the proposed modifications subject to the changes agreed with Ofwat being made and in reliance on and subject to Ofwat interpreting and applying the modifications in accordance with the clarification provided by it.

### 12.2.1 Ring-fencing of the Regulated Business

The DGWS wishes to ensure that AWS's regulated business is ring-fenced and protected from the risks arising from other activities which may be carried out by the AWG Group so that AWS does not, whether through its involvement in those other activities or by its dividend policy, put at risk its ability either to carry out its functions as a water and sewerage undertaker or to finance them. The DGWS has therefore proposed Licence modifications to:

- (i) prohibit the transfer of rights or assets from AWS to any associated company, except with the consent of the DGWS (being such rights or assets as a Special Administrator would require, if a Special Administration Order were made, to enable him so to manage the affairs, business and property of AWS that the purposes of the order could be achieved);
- (ii) prohibit AWS from giving a guarantee of any liability to any associated company or making loans to any such company, except with the consent of the DGWS;
- (iii) prohibit AWS from continuing (except in limited circumstances involving a subsidiary of AWS) or incurring any commitment which includes a 'cross-default obligation' (whereby its financial liabilities are increased or accelerated because of the default of an AWG Group company other than AWS), except with the consent of the DGWS; and
- (iv) require AWS, or any associated company issuing debt, to maintain an investment-grade corporate credit rating.

It should be noted that the DGWS has confirmed that he would not regard the cross-default obligations and guarantees described in Section 7.8, "*Financing Structure – Security Agreement*" as being in breach of the prohibitions mentioned in paragraphs (ii) and (iii) above and he has confirmed that he would not regard the loans described in Section 7.5, "*Financing Structure – Intercompany Loan Arrangements*" as being in breach of the prohibition mentioned in paragraph (ii) above.

AWS is already required to certify annually to the DGWS that it has adequate financial and management resources. Further modifications relating to such certification will require:

- (v) AWS to submit a statement of the main factors taken into account in giving a certificate, to inform the DGWS if the Board of AWS believes that any circumstances might mean that its most recent certificate could not be repeated, and to provide a supporting auditor's report.

Further modifications will require:

- (vi) that AWS shall declare or pay dividends only in accordance with a dividend policy which has been approved by the Board of AWS and which complies with the principles: (1) that dividends will not impair the ability of AWS to finance its regulated business, and (2) that under a system of incentive regulation dividends would be expected to reward efficiency and the management of economic risk.

The modifications proposed by Ofwat also include modifications relating to transfer pricing and the terms of contracts between AWS and associated companies, and to the interest cover test for Interim Determination purposes, which are not mentioned in the consultation paper.

### 12.2.2 Management and Control of AWS

Although AWS will remain a subsidiary of AWG, it has its own duties as a water and sewerage undertaker. The DGWS considers it important that AWS should, in carrying out those functions, behave as if they were substantially its sole business and AWS were a separate public limited company. The DGWS has therefore proposed modifications requiring AWS at all times to conduct

the Regulated Business as if it were substantially its sole business and AWS were a separate public limited company, and further modifications obliging AWS to have particular regard to the following in the application of this requirement:

- (i) the composition of the Board of AWS should be such that the directors can act independently of the parent company or controlling shareholder and exclusively in the interests of AWS;
- (ii) AWS is to ensure that each of its directors discloses, both to AWS and to the DGWS, any conflicts of interest between duties as directors of AWS and other duties;
- (iii) where potential conflicts exist between the interests of AWS as a water and sewerage undertaker and those of other companies in the AWG Group, AWS and its directors must ensure that, in acting as directors of AWS, they should have regard exclusively to the interests of AWS as a water and sewerage undertaker;
- (iv) no director of AWS should vote on any contract or arrangement or any other proposal in which he has an interest by virtue of other directorships (this should be reflected in AWS's articles of association);
- (v) AWS should inform the DGWS without delay when a new director is appointed or leaves the Board of AWS or any important change in the functions or executive responsibilities of a director occurs; and
- (vi) AWS should have regard, in particular, to the dividend policy adopted by AWS and the implications of the proposed Licence conditions on the dividend policy (see paragraph 12.2.1(vi)), and to the Principles of Good Governance and Code of Best Practice recognised by the Listing Rules of the Financial Services Authority.

AWS has expressed concern to Ofwat that the modifications as proposed:

- could effectively mean that the directors of AWS could be required to act in what the DGWS considers – rather than what they consider – to be the interests of AWS;
- could provide the DGWS with a basis for questioning and intervening in commercial decisions of the directors of AWS;
- could be construed as precluding the directors of AWS from having due regard to the interests of its shareholders (and hence, indirectly, AWG's shareholders); and
- could be construed as prohibiting executive directors of AWS who are also directors of other AWG Group companies from voting on dividend payments by AWS and a wide range of other proposals.

In response to the concern expressed by AWS, Ofwat has provided the following clarification and has agreed to make the following changes.

Ofwat has stated that the modification referred to in 12.2.2(i) above “is concerned with whether or not the constitution of the board [of AWS] is such that it would allow the directors to act exclusively in the interests of [AWS], not whether directors, either individually or collectively, are in fact doing so”. To underline this point, Ofwat has agreed to insert the words “are able to” before the word “act” in that paragraph.

Ofwat has also stated that, in assessing compliance with the requirement to conduct the Regulated Business as if it were the sole business of AWS and AWS were a separate public limited company: “we may take account, inter alia, of the constitution of the board, but we would not need nor wish to try and second guess whether or not the directors were acting in, or in what they thought were, the interests of” AWS. Ofwat has further stated that it does not see this requirement “in any way as the regulator re-interpreting the duties of a director under either the Companies Act or common law..... nor in [Ofwat's] view should it be construed as precluding a director from having due regard to the interests of an Appointee's shareholders”.

In relation to the modification referred to in paragraph 12.2.2(iv) above, Ofwat has stated that: “We are quite clear . . . that directors should be allowed to vote on dividends and our concern is principally with contracts or similar arrangements.” In addition, Ofwat has agreed to delete from the modifications as proposed the words “or any other proposal”.

### **12.2.3 Maintenance of Comparisons with other Water and Sewerage Undertakers**

The DGWS considers that the performance of AWS’s regulated business should be transparent to regulators, customers and other water companies. Ofwat has stated that it will assess AWS’s performance in terms of efficiency and customer service in exactly the same way as for other water and sewerage companies. Accordingly, the DGWS has proposed modifications to require AWS to publish such information about its interim and annual financial results as if AWS’s shares were listed on the London Stock Exchange.

### **12.2.4 The Role of AWG as the Owner of AWS**

Ofwat has stated that AWS should have the active co-operation of its owner AWG (or any successor) in complying with its Licence and in the proper discharge of its functions as a water and sewerage undertaker. The DGWS has proposed modifications to require a legally enforceable undertaking from AWG in favour of AWS, in a form specified by the DGWS, to be given within one month of the modifications becoming effective, that AWG (and each of its subsidiaries (other than AWS and its subsidiaries)) will:

- (i) give AWS all such information as it requires to comply with its Licence;
- (ii) refrain from any action which would or may cause AWS to breach any of its obligations under the Water Industry Act 1991 or its Licence; and
- (iii) ensure that the Board of AWS 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 AWS provides water and sewerage services and an understanding of the interests of customers and how these can be respected and protected.

AWS must inform the DGWS, immediately in writing, if it becomes aware that the undertaking has ceased to be legally enforceable, or that there has been any breach of its terms.

AWS must not, except with the written consent of the DGWS, enter (directly or indirectly) into any contract or arrangement with AWG or any associated company (other than subsidiaries of AWS) at a time when no such undertaking exists or there is an unremedied breach of such undertaking.

### **12.2.5 Procurement of Services**

Whilst outsourcing of some operational work is commonplace in the water industry, AWS proposes, over time, to contract out a substantial proportion of its activities. The only other company that has so far outsourced such a significant proportion of its activities is Dwr Cymru (Welsh Water). The DGWS has proposed that similar Licence modifications to those accepted by Dwr Cymru (Welsh Water) are required for AWS.

All water and sewerage undertakers have the same statutory responsibilities for the proper discharge of their functions. The DGWS considers that any contracting-out of the day-to-day operations of AWS’s regulated business must not interfere with its continuing responsibilities as a water and a sewerage undertaker.

The DGWS has proposed that the requirements relating to certification of adequacy of financial and management resources (see 12.2.1 above) be extended to cover certification of the sufficiency of AWS’s methods of planning and internal control to enable it to discharge its functions for the ensuing year. For these purposes, AWS will be required to ensure that those systems for planning and internal control comply with requirements specified by the DGWS in written guidance. The DGWS has stated that the guidance on internal planning and control is based on the Combined Code of the Committee on Corporate Governance and of the Turnbull Report: Internal Control – Guidance for Directors on the Combined Code (September 1999).

The DGWS has stated that such guidance will require the Board of AWS to pay additional attention to the assessment and handling of hazard and risk, when the services in question are being provided by any contractor.

AWS will be required to co-operate with its Reporter (an independent consultant, appointed by AWS with the DGWS' approval). The Reporter will review, audit and challenge AWS's systems for planning and internal control and report to Ofwat, the DWI and the EA upon their effectiveness.

The DGWS also considers it important that AWS pursues proper market-testing of whatever services it chooses to outsource. The DGWS has proposed a new Licence Condition (initially designated as R and subsequently as F1) concerning procurement of services requiring:

- (i) AWS to submit a Procurement Plan to the DGWS by not later than 31 December 2002;
- (ii) the Procurement Plan to cover at least the three following years, to be subject to an annual audit by AWS's Reporter and to be resubmitted (that is, rolled forward over the following three years) at least every 18 months and revised if required by the DGWS;
- (iii) AWS's procurement of services to ensure, so far as possible, that no existing contractor has any competitive advantage over prospective contractors;
- (iv) AWS to facilitate the development of a fully competitive market for the provision of outsourced services necessary for the discharge of its functions as a water and sewerage undertaker;
- (v) AWS to demonstrate that it retains full control of its assets and its ability to discharge its functions as a water and sewerage undertaker, including on those occasions where a contractor's performance is in breach of its obligations or a change of contractor is required for any reason, and that AWS is able to obtain all such information from its contractors as is necessary to comply with its Licence;
- (vi) the Procurement Plan to include an explanation of the activities to which it relates;
- (vii) the Procurement Plan to include an assessment of the current contestability of the markets to which the plan relates associated with each of AWS's regulated activities;
- (viii) the Procurement Plan to include details of the number, mix and type of contracts currently let or proposed to be let under the Procurement Plan;
- (ix) the Procurement Plan to include details of the procurement processes, terms and conditions of contract; and
- (x) AWS to submit to the DGWS annually (and at such other times as the DGWS may require) a written report on its procurement activities, including an explanation for any non-compliance with the Procurement Plan and a statement of the measures taken or proposed to remedy any deficiency.

AWS has requested changes to make it clear that the proposed modifications do not apply to existing contracts before expiry or renewal. Although not agreeing to AWS's request, Ofwat has stated that: "we agree that the conditions should not in principle apply to existing contracts" and that, subject to Ofwat reviewing existing contracts which have not been subject to competitive tender, it "would not consider [AWS] to be in breach of the licence if these contracts remained in place".

AWS has also requested changes to the effect that in procuring services it should not be obliged to put out to tender those minor and other excepted contracts which, under existing laws, are exempt from competitive tendering requirements. The administration and cost implications of having to competitively tender all such contracts could well be disproportionate to any benefits for competition. Although not agreeing to AWS's request, Ofwat has stated that: "This does not mean that a full procurement process must be gone through for every contract regardless of size".

Paragraph (v) above could, in practice, constrain the ability of the Security Trustee to take action in respect of contracts over which a Security Interest is purported to be given under the Security Documents.

### 12.2.6 Control of Operations

The DGWS has also proposed modifications (1) to prohibit the delegation or transfer of responsibility for the proper performance of AWS's functions as a water and sewerage undertaker to any other person; (2) requiring that the obligations on the part of AWS to ensure that it has adequate systems of planning and internal control, financial resources and facilities and management resources are not dependent on the discharge by any other person of any contractual obligation; and (3) requiring AWS in its procurement of services to demonstrate that it retains full control of all its assets and its ability at all times to discharge its functions as a water and sewerage undertaker.

The first of these proposed modifications does not make it clear whether contracting out of services is within the prohibition. Ofwat has agreed to change the wording so as to delete the words "the proper performance of". Ofwat has also stated: "We are quite clear that the issue at stake is that whilst responsibility for performance of particular activities can be delegated under contract, responsibility for meeting [AWS's] statutory functions as a relevant undertaker cannot and must not be." The DGWS has also reiterated that: "Responsibility for performance of particular activities can be delegated under contract. Responsibility for meeting [AWS's] statutory functions as a Relevant Undertaker cannot and must not be so delegated".

AWS has expressed concern as to whether it can in practice comply with the strict letter of the second and third of these proposed modifications, since – like a number of other utility undertakers – it is in fact dependent on certain services provided by external contractors. Ofwat, whilst emphasising that AWS as the licence holder must be able to demonstrate that it has the capacity at all times to meet its statutory functions, and that it retains sufficient control over its operations to enable it to deliver uninterrupted service to customers, has stated that the modifications "simply require that AWS be able to demonstrate that they have in place proper systems of planning and control to ensure proper oversight of their outsourced functions."

The DGWS has also proposed a modification to the effect that if AWS is prosecuted for any offence under the Water Industry Act 1991 or the Water Resources Act 1991 or any regulations made under either Act, which is alleged to have been committed in relation to a function the performance of which has been contracted out, AWS must not raise any defence of due diligence on the grounds that responsibility for compliance rested with any other person. In response to concerns expressed by AWS, Ofwat has agreed to insert the word "solely" before the words "on the grounds that". In addition, Ofwat has stated, in relation to this modification, that: "We would not consider [AWS] to be in breach of this [modification] unless it sought to rely on a defence which consisted wholly in it having exercised due diligence in the appointment of its contractors".

### 12.3 Ofwat's Review of Consistency of Licence Conditions

In its letter to all managing directors of regulated companies dated 20 December 2001 ("MD174") Ofwat launched consultation on greater alignment between licences.

Although not part of that consultation, Ofwat also stated that it considered there was a good case for Ofwat to be given similar powers to those of the energy regulator, Ofgem, under the Utilities Act 2000 to make licence modifications on the basis of majority consent. Ofwat stated that it raised this issue in its formal response to the Government's consultation on the Water Bill and Ofwat is awaiting the Government's reply.

The key proposals on which Ofwat has invited responses by 20 March 2002 are summarised below.

- (i) All companies will be offered the reciprocal version of RCC(4) (the defined Relevant Change of Circumstance which relates to changes in the Construction Output Price Index) at the next Periodic Review. Currently only a few companies (including AWS) have this condition.
- (ii) Ofwat invites views on whether the cost of capital for Interim Determinations of K (IDoKs) should be the same for all companies (for twelve companies (including AWS) it is currently the cost of

debt only and for all others it is the weighted average cost of capital (WACC)), and if so which. Ofwat is not expressing a preference for one or the other but believes a standard form would improve transparency.

- (iii) Ofwat invites views on whether Condition B should be changed for all companies (AWS does not have this provision) to allow increases in revenues to be taken into account when calculating the materiality of an IDoK, or whether this change should be made only for companies that apply for an IDoK on the basis of the Notified Item for metering.
- (iv) Following mergers and restructuring Ofwat has modified Condition F of certain licences to strengthen the ring-fencing of the regulated business of a number of companies from other activities of their groups. Ofwat invites views on whether a number of elements of the higher financial ring-fence should be included for all companies' licences. This modification is included in the modifications proposed to AWS's Licence.
- (v) Ofwat proposes that all companies should be prohibited from entering into any agreements incorporating cross-default obligations. This modification is included in the modifications proposed to AWS's Licence.
- (vi) Ofwat invites views on whether it would be appropriate to formalise in the licence the requirements for all companies to comply with the Code of Best Practice of the Financial Services Authority. This modification is included in the modifications proposed to AWS's Licence.
- (vii) Ofwat invites views on whether all companies should be required to publish results for the appointee as if it were a separate listed company, or whether this requirement should be limited to those companies where the regulated water business represents only a minority of the group's activities. This modification is included in the modifications proposed to AWS's Licence.
- (viii) Ofwat proposes that all companies except the small water-only companies should be required to maintain an investment-grade credit rating. This modification is included in the modifications proposed to AWS's Licence.
- (ix) Ofwat invites views on whether it would be appropriate for all companies to have a condition which restricts (with de minimis exceptions) the activities of the company to activities required of or connected with a water and sewerage undertaker. Ofwat has indicated that it is considering whether this modification would be appropriate for AWS.
- (x) Ofwat invites views on whether Condition P (The Role of the Appointee's Owners) should be introduced into all companies' licences with a requirement for there to be at least three independent non-executive directors on the appointee's board. This modification is included in the modifications proposed to AWS's Licence.
- (xi) Ofwat invites views on whether Condition R (dealing with internal controls and the procurement of services) which currently applies only to Dwr Cymru (Welsh Water) should apply to all companies, but activated only when a significant proportion of operational activities is outsourced. This modification is included in the modifications proposed to AWS's Licence.
- (xii) Ofwat also invites views on the appropriate threshold for activation of Condition R, and how this threshold should be defined.

It is unclear from the text of MD174 whether certain of the modifications contemplated by it, particularly with regard to ring-fencing and management, are as extensive as those proposed for AWS in the consultation paper. In any event, it remains to be seen whether, and if so to what extent, the consistency review will result in other Regulated Companies agreeing to modifications of their licences in the same terms as those proposed for AWS.

## CHAPTER 13

### FINANCIAL GUARANTOR

#### 13.1 MBIA Assurance S.A.

##### 13.1.1 General

MBIA Assurance S.A. (“**MBIA**”) is a *société anonyme* that was created and incorporated under French law on 3 May 1990. MBIA’s corporate charter expires on 3 May 2089. MBIA’s principal activity is the guarantee of financial obligations. MBIA has been set up in the form of a joint stock corporation and is subject to the provisions of the French Code of Commerce (“**Code de Commerce**”) as the law of 24 July 1966 has been replaced by the Code de Commerce. Furthermore, MBIA is licensed in the French Republic, under the terms of Article L-321-1 of the French Insurance Code (“**Code des Assurances**”), to carry out operations of the type corresponding to Branch 15 Guarantee listed in Article R-321-1 of the aforementioned Code (Journal Officiel dated 28 March 1991). MBIA is under the supervision of the Commission de Contrôle des Assurances. Its registration number is the Commercial Register (Paris Register of Trade and Companies) No. B377883293 (98 B 05130). MBIA has its head office in Paris at 112, Avenue Kléber, 75116 Paris, France.

MBIA has used the provisions of the Third Non-life Insurance Directive No. 92/49/EEC to operate in the United Kingdom both on a services and a branch basis. It was established as an overseas company under number FC020116 and as a branch under number BR003789 in England and Wales under Schedule 21A to the Companies Act 1985 on 10 February 1997. MBIA’s business in the United Kingdom is to a limited extent subject to supervision by the Financial Services Authority. Its branch office is located at 1 Great St Helen’s, 2nd Floor, London EC3A 6HX, United Kingdom.

##### 13.1.2 Business and Financial Structure

MBIA is licensed to do business in, and is subject to regulations under the laws of the French Republic. MBIA is a 99.99 per cent. owned subsidiary of MBIA Insurance Corp. MBIA Insurance Corp. is the principal operating subsidiary of MBIA Inc., a New York Stock Exchange listed company. MBIA Inc. is not obliged to pay the debts of, or claims against, MBIA Insurance Corp. or MBIA.

MBIA is engaged primarily in carrying out insurance and reinsurance transactions of any kind authorised by the Commission de Contrôle des Assurances, except for insurance transactions involving commitments, the performance of which depends on human life, but including particularly guarantee transactions, and notably, insuring the repayment of financial or other contractual obligations entered into by local governments, other public entities, companies, trusts and other commercial entities as well as any ancillary activities. MBIA may, to this purpose, make any investment and acquire any stake, in France and/or abroad, through the acquisition of a participating interest or securities, contributions in cash or in kind, subscription to any issue of shares or bonds, loans or credits; and may, to this end, borrow and make use of any means of financing it may choose and pledge such investments or interests as it sees fit. MBIA may carry out in France and/or abroad any industrial, commercial, financial or real estate operations that may be linked, directly or indirectly, to the above activities or are likely to facilitate the development thereof within the scope of the legislation specific to insurance companies.

##### 13.1.3 Claims-paying Ability Ratings

Moody’s rates the financial strength of MBIA Insurance Corp. and MBIA “*Aaa*”. S&P rates the financial strength of MBIA Insurance Corp. and MBIA “*AAA*”. Fitch rates the financial strength of MBIA Insurance Corp. and MBIA “*AAA*”.

Each rating of MBIA Insurance Corp. and MBIA should be evaluated independently. The ratings reflect the respective rating agency’s current assessment of the financial strength of MBIA Insurance Corp. and MBIA and their ability to pay claims on their policies of insurance. Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency.



The above ratings are not recommendations to buy, sell or hold the Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the Bonds. MBIA Insurance Corp. and MBIA do not guarantee the market price of the Bonds nor do they guarantee that the ratings on the Bonds will not be revised or withdrawn.

### 13.1.4 Capitalisation and Indebtedness Table

As at 31 December 2001 and 31 December 2000, the capitalisation and indebtedness of MBIA was as follows:

	<i>31 December 2001</i>	<i>31 December 2000</i>
	<i>(euro thousands)<sup>1</sup></i>	
<b>Indebtedness</b>		
Funds Held <sup>2</sup> .....	499	3,887
<b>Stockholders' Equity</b>		
Common stock, par value 15 euros per share: 1,750,000		
authorised and issued shares (fully paid) .....	26,250	26,679
Retained Earnings, Other Reserves, Net Loss .....	4,752	5,678
<b>Total Stockholders Equity</b> .....	31,002	32,357
<b>Total Capitalisation and Indebtedness<sup>3</sup></b> .....	<b>31,501</b>	<b>36,244</b>

1 This Capitalisation and Indebtedness Table has been prepared in accordance with generally accepted accounting principles in France. Save as set out in the Table, MBIA Assurance S.A. did not at the relevant dates have any loan capital outstanding or created but unissued, term loans or any other borrowings in the nature of borrowing, including bank overdrafts and liabilities under acceptances or acceptance credits, mortgages, charges, finance lease commitments, hire purchase obligations or guarantees, or contingent liabilities.

2 Represents security deposits held by MBIA Assurance S.A. in respect of insured transactions relating to a past securitisation. There is a corresponding asset of equal value on the MBIA Assurance S.A. balance sheet. These funds constitute a short-term security deposit and were entirely released on 12 April 2002. There is no medium or long-term indebtedness.

3 There has been no material change in the authorised and issued share capital, and in the capitalisation and indebtedness of MBIA Assurance S.A., since 31 December 2001, and MBIA has no material contingent liabilities or guarantees.

### 13.1.5 Risk Diversification

MBIA Insurance Corp. and MBIA seek to maintain a diversified insured portfolio designed to spread risk based on a variety of criteria, including revenue source, issue size, type of bond and geographic area. As at 31 December 2001, MBIA Insurance Corp. had 34,315 policies outstanding. These policies are diversified among 10,524 “credits”, which MBIA Insurance Corp. defines as any group of issues supported by the same revenue source. MBIA seeks similar diversification. The breakdown of risks insured by MBIA (before reinsurance) and in force as at 31 December 2001 is presented in the following table (*source: MBIA's books and records*):

	<i>2001</i>	<i>2000</i>	<i>1999</i>
	<i>(euro thousands)</i>		
Sovereign and Sub-Sovereign .....	1,202,950	1,320,690	1,193,032
Public Utilities .....	3,406,744	1,121,994	850,075
Structured Finance .....	903,246	1,178,424	1,311,997
Financial Institutions <sup>4</sup> .....	173,591	251,185	320,164
Investor Owned Utilities .....	268,731	255,546	159,836
<b>Total</b> .....	<b>5,955,262</b>	<b>4,127,839</b>	<b>3,835,104</b>

4 Consists in large part of risks involving smaller banks and insurance companies

### 13.1.6 Relationship between MBIA and MBIA Insurance Corp.

MBIA Insurance Corp. and MBIA have entered into (i) a reinsurance agreement dated 1 January 1993 providing for MBIA Insurance Corp.'s reinsurance of the risks of MBIA (the "**Reinsurance Agreement**") and (ii) an agreement dated 1 November 1991 whereby MBIA Insurance Corp. agrees to maintain the net worth of MBIA, to remain its sole shareholder and not to pledge its shares of MBIA (as amended, the "**Net Worth Maintenance Agreement**"). Under the Reinsurance Agreement, MBIA Insurance Corp. agrees to reimburse MBIA, on an excess of loss basis, for losses incurred in each calendar year for net retained insurance liability. MBIA Insurance Corp. shall reimburse MBIA for the amount of MBIA's losses paid in each calendar year which amount is in the aggregate in excess of an amount equal to the greater of (1) \$500,000 or (2) 40 per cent. of MBIA's net earned premium income for that same calendar year. The liability of MBIA Insurance Corp. shall not exceed \$100,000,000 in any one calendar year.

Under the Net Worth Maintenance Agreement, MBIA Insurance Corp. agrees to maintain a minimum capital and surplus position of 4,573,471 euros, or such greater amount as shall be required now or in the future by French law or French regulatory authorities, provided however, (i) any contributions to MBIA for such purpose shall not exceed 35 per cent. of MBIA Insurance Corp.'s policyholders' surplus on an accumulated basis as determined by the laws of the State of New York (ii) no contribution will be made that would jeopardise MBIA Insurance Corp.'s ratings from Standard & Poor's or Moody's and (iii) any contribution shall be made in compliance with section 150 of the New York Insurance Law.

MBIA has no subsidiaries.

**Bondholders should note that the Net Worth Maintenance Agreement between MBIA and MBIA Insurance Corp. and the Reinsurance Agreement (together, the "MBIA Assurance Agreements") are entered into for the benefit of MBIA and are not, and should not be regarded as, guarantees by MBIA Insurance Corp. of the payment of any indebtedness, liability or obligations of the Issuer, the Bonds or any Bond Policies.**

**Information in this Offering Circular concerning MBIA Insurance Corp. is provided for background purposes only in view of the importance of MBIA and the MBIA Assurance Agreements. It does not imply that the MBIA Assurance Agreements are guarantees for the benefit of Bondholders. Payments of principal and of interest on the Bonds will be guaranteed by MBIA pursuant to the Bond Policy and will not be additionally guaranteed by MBIA Insurance Corp.**

The MBIA Assurance Agreements are agreements solely between MBIA and MBIA Insurance Corp. and do not confer rights on third parties; however, these arrangements, together with the ownership of MBIA by MBIA Insurance Corp. and the underwriting support supplied to MBIA by MBIA Insurance Corp., may make information about MBIA Insurance Corp. of interest to holders of policies and guarantees issued by MBIA. Additionally, the MBIA Assurance Agreements were relevant to the rating agencies in justification of the triple-A ratings granted to MBIA. Any modifications to the Net Worth Maintenance Agreement may not occur without confirmation from each of S&P and Moody's that such modifications will not result in the reduction or withdrawal of the claims-paying ratings then assigned to MBIA Insurance Corp.

Pursuant to procedures initially developed by MBIA Insurance Corp., MBIA is selective in the risks it chooses to underwrite. Logistic and underwriting support are supplied to MBIA from MBIA Insurance Corp. A logistic review of a credit and the proposed structure is undertaken by an analyst. Both the credit and the structure are then presented to a separate underwriting committee composed of persons not involved in the analysis. Only following approval of both the credit and the structure may a policy or guarantee be issued by MBIA.

### 13.1.7 Management

At 23 July 2002, the members of the Board of Directors of MBIA, their ages and positions within MBIA and their other principal activities were as follows:

<i>Name</i>	<i>Age</i>	<i>Title</i>	<i>Other Activities</i>
John B. Caouette .....	57	Member of the Board of Directors	Vice Chairman of MBIA Insurance Corp.
Karen E. Decter.....	35	Member of the Board of Directors	Analyst of MBIA Insurance Corp.
David H. Dubin.....	40	Member of the Board of Directors	Managing Director of MBIA Insurance Corp.
Gary C. Dunton.....	47	Member of the Board of Directors	President and Chief Operating Officer of MBIA Insurance Corp.
Philip C. Sullivan.....	46	Member of the Board of Directors	Managing Director of MBIA Insurance Corp.
Richard L. Weill.....	59	Member of the Board of Directors	Vice Chairman of MBIA Insurance Corp.
Ram D. Wertheim.....	48	Member of the Board of Directors	General Counsel and Assistant Secretary of MBIA Inc.
Deborah M. Zurkow.....	45	President of the Board of Directors	Director of MBIA Insurance Corp.

The board members do not perform any activities which are significant in the context of the issue of the Bonds save as indicated above.

The business address of Ms. Decter and Ms. Zurkow is 112, Avenue Kléber, 75116 Paris, France. The business address of Messrs. Caouette, Dubin and Sullivan is 1 Great St. Helen's, London EC3A 6HX, United Kingdom. The business address of Messrs. Dunton, Weill and Wertheim is 113 King Street, Armonk, New York 10504, United States.

## 13.2 MBIA Insurance Corporation

### 13.2.1 General

MBIA Inc. (“**MBIA Inc.**”) is engaged in providing financial guarantee insurance and investment management and financial services to public finance clients and financial institutions on a global basis. Financial guarantees for municipal bonds, asset-backed and mortgage-backed securities, investor-owned utility bonds, and collateralised obligations of sovereigns, corporations and financial institutions, both in the new issue and secondary markets, are provided through MBIA Inc.’s wholly-owned subsidiary, MBIA Insurance Corp. (“**MBIA Insurance Corp.**”). MBIA Insurance Corp. is the successor to the business of the Municipal Bond Insurance Association (the “**Association**”) which began writing financial guarantees for municipal bonds in 1974. MBIA Insurance Corp. is the parent of MBIA Insurance Corp. of Illinois (“**MBIA Illinois**”) and Capital Markets Assurance Corporation (“**CapMAC**”), both financial guarantee companies. In 1990, MBIA Inc. formed a French insurance company, MBIA Assurance S.A. (“**MBIA Assurance**”), to write financial guarantee insurance in the countries of the European Community. MBIA Assurance, which is also a 99.99 per cent. subsidiary of MBIA Insurance Corp., writes policies insuring sovereign risk, public infrastructure financings, asset-backed transactions and certain collateralised obligations of corporations and financial institutions. MBIA has used the provisions of the Third Non-life Insurance Directive No. 92-49-EEC to operate in the United Kingdom both on a services and a branch basis. Generally, throughout the text, references to MBIA Insurance Corp. include the activities of its subsidiaries, MBIA Illinois, MBIA Assurance and CapMAC.

### 13.2.2 Business and Financial Structure

Financial guarantee insurance provides an unconditional and irrevocable guarantee of the payment of the principal of, and interest or other amounts owing on, insured obligations when due. MBIA Insurance Corp. primarily insures obligations which are sold in the new issue and secondary markets, or which are held in unit investment trusts (“**UIT**”) and by mutual funds. It also provides surety bonds for debt service reserve funds. The principal economic value of financial guarantee insurance to the entity offering the obligations is the savings in interest costs resulting from the difference in the market yield between an insured obligation and the same obligation on an

uninsured basis. In addition, for complex financings and for obligations of issuers that are not well-known by investors, insured obligations receive greater market acceptance than uninsured obligations. The municipal obligations that MBIA Insurance Corp. insures include tax-exempt and taxable indebtedness of states, counties, cities, utility districts and other political subdivisions, as well as airports, higher education and health care facilities and similar authorities. The asset-backed or structured finance obligations insured by MBIA Insurance Corp. typically consist of securities that are payable from, or which are tied to the performance of, a specified pool of assets that have a defined cash flow. These include residential and commercial mortgages, a variety of consumer loans, corporate loans and bonds and equipment and real property leases.

MBIA Inc. also provides investment management products and financial services through a group of subsidiary companies. These services include cash management, municipal investment agreements, discretionary asset management, purchase and administrative services, and municipal revenue enhancement services. MBIA Municipal Investors Service Corporation (“**MBIA-MISC**”) provides cash management services and investment placement services to local governments and school districts, and provides those clients with fund administration services. American Money Management Associates, Inc. (“**AMMA**”) offers customised asset management and treasury management consulting services to municipal and quasi-municipal clients. MBIA Investment Management Corp. (“**IMC**”) offers guaranteed investment agreements primarily for bond proceeds to states and municipalities. MBIA Capital Management Corp. (“**CMC**”) performs investment management services for the Company, MBIA-MISC, IMC and selected external clients. In 1998, the company acquired 1838 Investment Advisors, Inc. (“**1838**”), an investment advisor to equity mutual funds and to third party clients. In 1999, MBIA Inc. formed a holding company, MBIA Asset Management Corporation, to consolidate the resources and capabilities of these four entities.

### 13.2.3 Financial Strength Ratings

MBIA Insurance Corp. has a Triple-A claims-paying rating from S&P, which it received in 1974; from Moody’s which it received in 1984; from Fitch which it received in 1995; and from Japan Rating and Investment Information, Inc. (“**JRII**”), which it received in 1998. Obligations which are guaranteed by MBIA Insurance Corp. are rated Triple-A primarily based on these claims-paying ratings of MBIA Insurance Corp. Both S&P and Moody’s have also continued the Triple-A rating on MBIA Illinois and CapMAC guaranteed bond issues. The Triple-A ratings are important to the operation of MBIA Inc.’s business and any reduction in these ratings could have a material adverse impact on MBIA Insurance Corp.’s ability to compete and could have a material adverse impact on the business, operations and financial results of MBIA Inc.

### 13.2.4 Capitalisation and Indebtedness Table

The following table sets forth the capitalisation and indebtedness of MBIA Insurance Corp. as at 31 December 2001 and 31 December 2000 (source: audited accounts of MBIA Insurance Corp. for the financial year 31 December 2001).

	<i>31 December 2001</i>	<i>31 December 2000</i>
	<i>(U.S.\$ in thousands)</i>	
Long-term Debt.....	Nil	Nil
<b>Investor’s Equity:</b>		
Common stock, par value \$150 per share; authorised issued and outstanding – 100,000 shares.....	15,000	15,000
Additional paid-in capital <sup>1</sup> .....	1,567,478	1,540,071
Retained earnings.....	3,572,397	3,191,536
Accumulated other comprehensive income.....	71,014	60,999
<b>Total Investors’ Equity.....</b>	<b>U.S.\$5,225,889</b>	<b>U.S.\$4,807,606</b>
<b>Total Capitalisation and Indebtedness<sup>2</sup>.....</b>	<b>U.S.\$5,225,889</b>	<b>U.S.\$4,807,606</b>

1 Represents the additional contribution from MBIA Inc. above the par value of the common stock.

2 There has been no material change in the capitalisation and indebtedness of MBIA Insurance Corp. since 31 December 2001, and MBIA Insurance Corp. has no material contingent liabilities or guarantees.

### **13.2.5 Risk Diversification**

At 31 December 2001, the net par amount outstanding on MBIA Insurance Corp.'s insured obligations (including insured obligations of MBIA Illinois, MBIA and CapMAC) was U.S. \$452.4 billion. Net insurance in force was U.S.\$722.4 billion, (excluding U.S.\$6.7 billion relating to municipal investment agreements of IMC guaranteed by MBIA Insurance Corp.).

MBIA Insurance Corp. guarantees to the holder of the underlying obligation the scheduled payment of the principal of and interest on such obligation. Accordingly, in the case of a default on an insured obligation, payments under the insurance policy cannot be accelerated by the holder. MBIA Insurance Corp. will be required to pay principal and interest only as originally scheduled payments come due.

MBIA Insurance Corp. underwrites financial guarantee insurance on the assumption that the insurance will remain in force until maturity of the insured obligations. MBIA Insurance Corp. estimates that the average life (as opposed to the stated maturity) of its insurance policies in force at 31 December 2001 was 10.5 years. The average life was determined by applying a weighted average calculation, using the remaining years to maturity of each insured obligation, and weighing them on the basis of the remaining debt service insured. No assumptions were made for any future refundings of insured issues. Average annual debt service on the portfolio at 31 December 2001 was U.S.\$58.3 billion.

### **13.2.6 Reinsurance**

State insurance laws and regulations, as well as Moody's and S&P, impose minimum capital requirements on financial guarantee companies, limiting the aggregate amount of insurance which may be written and the maximum size of any single risk exposure which may be assumed. MBIA Insurance Corp. increases its capacity to write new business by using treaty and facultative reinsurance to reduce its gross liabilities on an aggregate and single risk basis.

As a primary insurer, MBIA Insurance Corp. is required to honour its obligations to its policyholders whether or not its reinsurers perform their obligations to MBIA Insurance Corp. The financial position of all reinsurers is monitored by MBIA Insurance Corp. on a regular basis.

### **13.2.7 Regulation**

MBIA Insurance Corp. is licensed to do insurance business in, and is subject to insurance regulation and supervision by, the State of New York (its state of incorporation), the 49 other US states, the District of Columbia, Guam, the Northern Mariana Islands, the U.S. Virgin Islands, the Commonwealth of Puerto Rico, the Kingdom of Spain, the Republic of France and the Republic of Singapore. MBIA Assurance is licensed to do insurance business in France and is subject to regulations under the corporation and insurance laws of the French Republic. MBIA has used the provisions of the Third Non-life Insurance Directive to operate in the United Kingdom both on a services and a branch basis and is to a limited extent subject to supervision by the Financial Services Authority. The extent of state insurance regulation and supervision varies by jurisdiction, but New York, Illinois and most other jurisdictions have laws and regulations prescribing minimum standards of solvency, including minimum capital requirements and business conduct which must be maintained by insurance companies. These laws prescribe permitted classes and concentrations of investments. In addition, some state laws and regulations require the approval or filing of policy forms and rates. MBIA Insurance Corp. is required to file detailed annual financial statements with the New York Insurance Department and similar supervisory agencies in each of the other jurisdictions in which it is licensed. The operations and accounts of MBIA Insurance Corp. are subject to examination by these regulatory agencies at regular intervals. MBIA Inc. is subject to the direct and indirect effects of governmental regulation, including changes in tax laws affecting the municipals and asset-backed debt markets. No assurance can be given that future legislative or regulatory changes might not adversely affect the results of operations and financial conditions of MBIA Inc.

MBIA Insurance Corp. is licensed to provide financial guarantee insurance under Article 69 of the New York Insurance Law. Article 69 defines financial guarantee insurance to include any guarantee under which loss is payable upon proof of occurrence of financial loss to an insured as a result of certain events. These events include the failure of any obligor on or any issuer of any debt

instrument or other monetary obligation to pay principal, interest, premium, dividend or purchase price of or on such instrument or obligation, when due. Under Article 69, MBIA Insurance Corp. is licensed to transact financial guarantee insurance, surety insurance and credit insurance and such other kinds of business to the extent necessarily or properly incidental to the kinds of insurance which MBIA Insurance Corp. is authorised to transact. In addition, MBIA Insurance Corp. is empowered to assume or reinsure the kinds of insurance described above.

As a financial guarantee insurer, MBIA Insurance Corp. is required by the laws of New York, California, Connecticut, Florida, Illinois, Iowa, New Jersey and Wisconsin to maintain contingency reserves on its municipal bond and other financial guarantee liabilities. Under New Jersey, Illinois and Wisconsin regulations, contributions by such an insurer to its contingency reserves are required to equal 50 per cent. of earned premiums on its municipal bond business. Under New York law, such an insurer is required to contribute to contingency reserves 50 per cent. of premiums as they are earned on policies written prior to 1 July 1989 (net of reinsurance) and, with respect to policies written on and after 1 July 1989, must make contributions over a period of 15 or 20 years (based on issue type), or until the contingency reserve for such insured issues equals the greater of 50 per cent. of premiums written for the relevant category of insurance or a percentage of the principal guaranteed, varying from 0.55 per cent. to 2.5 per cent., depending upon the type of obligation guaranteed (net of reinsurance, refunding, refinancings and certain insured securities). California, Connecticut, Iowa and Florida law impose a generally similar requirement. In each of these states, MBIA Insurance Corp. may apply for release of portions of the contingency reserves in certain circumstances.

The laws and regulations of these states also limit both the aggregate and individual municipal bond risks that MBIA Insurance Corp. may insure on a net basis. California, Connecticut, Florida, Illinois and New York, among other things, limit insured average annual debt services on insured municipal bonds with respect to a single entity and backed by a single revenue source (net of qualifying collateral and reinsurance) to 10 per cent. of policyholders' surplus and contingency reserves. In New Jersey, Virginia and Wisconsin, the average annual debt service on any single issue of municipal bonds (net of reinsurance) is limited to 10 per cent. of policyholders' surplus. Other states that do not explicitly regulate financial guarantee or municipal bond insurance do impose single risk limits which are similar in effect to the foregoing. California, Connecticut, Florida, Illinois and New York also limit the net insured unpaid principal issued by a single entity and backed by a single revenue source to 75 per cent. of policyholders' surplus and contingency reserves.

Under New York, California, Connecticut, Florida, Illinois, New Jersey and Wisconsin law, aggregate insured unpaid principal and interest under policies insuring municipal bonds (in the case of New York, Connecticut, Florida and Illinois, net of reinsurance) are limited to certain multiples of policyholders' surplus and contingency reserves. New York, California, Connecticut, Florida, Illinois and other states impose a 300:1 limit for insured municipal bonds, although more restrictive limits on bonds of other types do exist. For example, New York, California and Florida impose a 100:1 limit for certain types of non-municipal bonds.

MBIA Inc., MBIA Insurance Corp., MBIA Illinois and CapMAC are subject to regulation under the insurance holding company statutes of New York, Illinois and other jurisdictions in which MBIA Insurance Corp., MBIA Illinois and CapMAC are licensed to write insurance. The requirements of holding company statutes vary from jurisdiction to jurisdiction but generally require insurance holding companies, such as MBIA Inc., and their insurance subsidiaries, to register and file certain reports describing, among other information, their capital structure, ownership and financial condition. The holding company statutes also require prior approval of changes in control, of certain dividends and other intercorporate transfers of assets, and of transactions between insurance companies, their parents and affiliates. The holding company statutes impose standards on certain transactions with related companies, which include, among other requirements, that all transactions be fair and reasonable and that those exceeding specified limits receive prior regulatory approval.

Prior approval by the New York Insurance Department is required for any entity seeking to acquire "control" of MBIA Inc., MBIA Insurance Corp., or CapMAC. Prior approval by the Illinois Department of Insurance is required for any entity seeking to acquire "control" of MBIA

Inc., MBIA Insurance Corp. or MBIA Illinois. In many states, including New York and Illinois, “control” is presumed to exist if 10 per cent. or more of the voting securities of the insurer are owned or controlled by an entity, although the supervisory agency may find that “control” in fact does or does not exist when an entity owns or controls either a lesser or greater amount of securities.

The laws of New York regulate the payment of dividends by MBIA Insurance Corp. and provide that a New York domestic stock property/casualty insurance company (such as MBIA Insurance Corp.) may not declare or distribute dividends except out of statutory earned surplus. New York law provides that the sum of (i) the amount of dividends declared or distributed during the preceding 12-month period and (ii) the dividend to be declared may not exceed the lesser of (a) 10 per cent. of policyholders’ surplus, as shown by the most recent statutory financial statement on file with the New York Insurance Department, and (b) 100 per cent. of adjusted net investment income for such 12-month period (the net investment income for such 12-month period plus the excess, if any, of net investment income over dividends declared or distributed during the two-year period preceding such 12-month period), unless the New York Superintendent of Insurance approves a greater dividend distribution based upon a finding that the insurer will retain sufficient surplus to support its obligations and writings.

The foregoing dividend limitations are determined in accordance with Statutory Accounting Practices (“**SAP**”), which generally produce statutory earnings in amounts less than earnings computed in accordance with Generally Accepted Accounting Principles (“**GAAP**”). Similarly, policyholders’ surplus, computed on a SAP basis, will normally be less than net worth computed on a GAAP basis.

MBIA Insurance Corp., MBIA Illinois and CapMAC are exempt from assessments by the insurance guarantee funds in the majority of the states in which they do business. Guarantee fund laws in most states require insurers transacting business in the state to participate in guarantee associations which pay claims of policyholders and third-party claimants against impaired or insolvent insurance companies doing business in the state. In most cases, insurers licensed to write only municipal bond insurance, financial guarantee insurance and other forms of surety insurance are exempt from assessment by these funds and their policyholders are prohibited from making claims on these funds.

### **13.2.8 Management**

At 23 July 2002, the executive officers and their present ages and positions within MBIA Insurance Corp. are set forth below:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Joseph W. Brown	53	Chairman and Chief Executive Officer
Gary C. Dunton	47	President and Chief Operating Officer
Richard L. Weill	59	Vice Chairman and Secretary
John B. Caouette	57	Vice Chairman
Neil G. Budnick	48	Vice Chairman and Chief Financial Officer
Ram D. Wertheim	48	General Counsel and Assistant Secretary

### 13.2.9 Recent Developments<sup>1</sup>

For the quarter ended 31 March 2002, MBIA Insurance Corp. had net income of U.S.\$162.2 million as compared to U.S.\$130.5 million for the quarter ended 31 March 2001. At 31 March 2002, MBIA Insurance Corp.'s investor's equity was U.S.\$5.3 billion.

MBIA Insurance Corp. guaranteed U.S.\$17.5 billion of net par value in the first quarter of 2002, a decrease of 35 per cent. over the U.S.\$27.0 billion of net par insured in the same 2001 period. In the first quarter 2002, MBIA Insurance Corp. insured U.S.\$8.1 billion of net par value of municipal bonds, a 33 per cent. increase from U.S.\$6.1 billion insured in the same 2001 period. In the domestic structured finance market, which includes mortgage-backed and asset-backed transactions, MBIA Insurance Corp. insured U.S.\$7.0 billion of net par value, a decrease of 59 per cent. from the U.S.\$17.1 billion insured in the same period last year. In addition, MBIA Insurance Corp. insured U.S.\$2.3 billion of net securities internationally compared with U.S.\$3.9 billion net in 2001.

Gross premiums written in the first quarter 2002 increased to U.S.\$186.8 million from U.S.\$184.9 million a year ago. Premiums earned in the first quarter 2002 were U.S.\$139.0 million, up from U.S.\$120.1 million in the comparable 2001 period. Net investment income, excluding net realised capital gains, increased in 2002 to U.S.\$106.1 million from U.S.\$102.4 million in 2001. Revenues of MBIA Insurance Corp. in the quarter ended 31 March 2002 increased to U.S.\$263.4 million compared with U.S.\$229.5 million for the quarter ended 31 March 2001. Total expenses for the quarter ended 31 March 2002 were U.S.\$43.5 million compared to U.S.\$41.9 million for the quarter ended 31 March 2001.

Computed on a statutory basis, as of 31 March 2002, MBIA Insurance Corp.'s unearned premium reserve was U.S.\$2.6 billion, and its capital base, consisting of capital and surplus and contingency reserve, was U.S.\$5.0 billion. Aggregate policyholders' reserves at 31 March 2002, rose to U.S.\$7.9 billion, compared with U.S.\$7.3 billion at 31 March 2001.

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<sup>1</sup> The source of the financial information appearing in the section entitled "Recent Developments" is MBIA Insurance Corp.'s books and records.



## MBIA'S BOND POLICY

MBIA Assurance S.A.  
London Branch  
1 Great St Helen's  
2nd Floor  
London EC3A 6HX  
United Kingdom

Telephone: 00 44 20 7920 6363

Fax: 00 44 20 7588 3393

### Financial Guarantee Insurance Policy in respect of Class A Wrapped Bonds

Policy Number: [ ]

Insured Obligations: the payment obligations of Anglian Water Services Financing Plc (the "Issuer") in respect of each amount of Principal and Interest owing by the Issuer and outstanding pursuant to the Issuer's [Series [ ], Tranche [ ]] Guaranteed Class A Wrapped Bonds due [ ] (the "Class A Wrapped Bonds")

Beneficiary: Deutsche Trustee Company Limited or any additional or successor trustee appointed pursuant to the Bond Trust Deed as trustee for the Holders of the Insured Obligations (the "Bond Trustee")

MBIA Assurance S.A. ("MBIA"), a *société anonyme* incorporated under the laws of the French Republic (registered with the Paris Register of Trade and Companies under No. B377883293 (98 B 05130)) and acting through its registered branch office in England and Wales (registration number BR003789) in consideration of the payment of the premium and subject to the terms of the Policy (including the Endorsement attached hereto), hereby agrees unconditionally and irrevocably to pay to the Bond Trustee for the benefit of the Holders of the Insured Obligations an amount equal to that portion of the Insured Amounts which shall become Due for Payment but shall have remained unpaid by reason of Nonpayment.

MBIA will make any such payments to the Bond Trustee from its own funds by 11.00 a.m. (London time) on the later of (a) the day which is four (4) Business Days following notification to MBIA of Nonpayment or (b) the day on which the Insured Amounts are Due for Payment or, if that is not a Business Day, on the next succeeding Business Day. Such payments of Principal or Interest shall be made only upon presentation to MBIA of (i) a validly completed Notice of Claim signed by the Bond Trustee and in the form hereto attached; and (ii) an instrument of assignment in form and substance satisfactory to MBIA, transferring to MBIA all rights under such Insured Obligations, including the right to receive Principal and Interest in respect of the Insured Obligations free of any adverse claim. MBIA shall be subrogated to the Holders' rights to payment on the Insured Obligations to the extent of any payments made by or on behalf of MBIA under the Policy. Once payments of any Insured Amounts have been made to the Bond Trustee or as the Bond Trustee shall have directed, MBIA shall have no further obligation hereunder in respect of such Insured Amounts.

In the event that the Bond Trustee has notice that any payment of Insured Amounts in respect of the Insured Obligations which has become Due for Payment and which was made to the Bond Trustee or a Holder by or on behalf of the Issuer has been deemed an unfair preference and recovered from the Bond Trustee or such Holder pursuant to sections 239 to 244 of the Insolvency Act 1986 or otherwise pursuant to applicable bankruptcy or insolvency law in accordance with a final, non-appealable order of a court of competent jurisdiction, the Bond Trustee or such Holder will be entitled to payment from MBIA to the extent of such recovery if sufficient funds are not otherwise available.

The Policy is non-cancellable by MBIA for any reason, including failure by MBIA to receive payment of any premium due hereunder. The premium on the Policy is not refundable by MBIA for any reason. The Policy does not insure against loss of any prepayment or other acceleration payment which at any time may become due in respect of any Insured Obligation, other than at the sole option of MBIA as specified below, nor against any risk other than Nonpayment, including failure of the Bond Trustee or any Agent to make any payment due to Holders of Insured Obligations.

To the fullest extent permitted by applicable law, MBIA hereby waives for the benefit of the Bond Trustee and each Holder and agrees not to assert any and all rights (whether by counterclaim, set-off or otherwise) and

defences (including, without limitation, any defence of fraud (including fraud on the part of any agent for the Bond Trustee but excluding fraud by the Bond Trustee itself) or any defence based on misrepresentation, breach of warranty, or non-disclosure of information by any person) whether acquired by subrogation, assignment or otherwise to the extent such rights and defence may be available to MBIA to avoid payment of its obligations under the Policy in accordance with the express provisions of the Policy. MBIA agrees that nothing in the Policy (including the Endorsement attached hereto) constitutes a warranty or a condition precedent to the Policy.

All payments of Insured Amounts by or on behalf of MBIA shall be made without withholding or deduction for, or on account of, any present or future tax, duties, assessment or other governmental charges of whatever nature, unless the withholding or deduction of such tax, assessment or other governmental charge is required by law or regulation or administrative practice of any jurisdiction. If any such withholding or deduction is required, MBIA shall pay the Insured Amounts net of such withholding or deduction and shall account to the appropriate tax authority for the amount required to be withheld or deducted. **MBIA shall not be obliged to pay any amount to the Bond Trustee or any Holder in respect of the amount of such withholding or deduction.**

The Policy (including the Endorsement attached hereto) constitutes the entire agreement between MBIA and the Bond Trustee in relation to MBIA’s obligation to make payments to the Bond Trustee for the benefit of the Holders of the Insured Obligations in respect of Insured Amounts which shall become Due for Payment but shall have remained unpaid by reason of Nonpayment and supersedes any previous agreement between MBIA and the Bond Policy in relation thereto.

Any capitalised terms not defined herein shall have the meaning given to such terms in the endorsement attached hereto, which forms an integral part of the Policy.

**Unless prior to such date the Issuer has become subject to any insolvency or analogous proceedings in respect of its insolvency, winding-up or administration under any applicable insolvency law, the Policy shall terminate on the date falling two years and one day after the last Payment Day and MBIA shall cease upon such date to be liable for any claim made in respect hereof after such date.**

The Policy shall be governed by and construed in accordance with the laws of England and Wales.

IN WITNESS WHEREOF MBIA has caused the Policy to be signed by its duly authorised representative.

**MBIA ASSURANCE S.A.**

.....

Authorised Representative  
Effective Date: [Effective Date] 2002

MBIA Assurance S.A.  
London Branch  
1 Great St Helen's  
2nd Floor  
London EC3A 6HX  
United Kingdom

Telephone: 00 44 20 7920 6363  
Fax: 00 44 20 7588 3393

### **Financial Guarantee Insurance Policy Endorsement (the "Endorsement")**

Effective Date of Endorsement: [Effective Date] 2002

Attached to and forming a part of Policy No. [ ] (the "**Policy**") issued in respect of:

Insured Obligations: the payment obligations of the Issuer in respect of each amount of Principal and Interest owing by the Issuer and outstanding pursuant to the Issuer's [Series [ ], Tranche [ ]] Guaranteed Class A Wrapped Bonds due [ ] (the "**Class A Wrapped Bonds**").

For all purposes of the Policy, the following terms shall have the following meanings:

"**Affiliate**" shall mean, as to any person which directly or indirectly through one or more intermediaries controls, or is controlled by, or is under common control with, the first person where "**control**" means the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of a person, whether through the ownership of voting stock, by contract or otherwise.

"**Agency Agreement**" shall have the meaning given to it pursuant to the Conditions.

"**Agent**" shall have the meaning given to it pursuant to the Conditions.

"**Bond Trust Deed**" shall have the meaning given to it pursuant to the Conditions.

"**Bond Trustee**" shall mean Deutsche Trustee Company Limited or any additional or successor trustee appointed pursuant to the terms of the Bond Trust Deed, which expression includes any modification or supplement thereto.

"**Business Day**" shall have the same meaning as given to it pursuant to Condition 7 of the Conditions.

"**Conditions**" shall mean the terms and conditions of the Class A Wrapped Bonds as may from time to time be amended, varied or supplemented.

"**Due for Payment**" shall mean due and payable on a Payment Day.

"**Holder**" shall mean the holder or holders of one or more Class A Wrapped Bonds being the holder(s) of Insured Obligations.

"**Insurance and Indemnity Agreement**" shall mean the agreement, dated on or around the date of the Policy, governed by the laws of England and Wales, between the Issuer, Anglian Water Services Limited and MBIA pursuant to which, inter alia, MBIA has agreed to issue the Policy subject to satisfaction (or waiver by MBIA) of certain conditions precedent, in particular the payment to MBIA of the premium, and the Issuer has agreed, inter alia, to indemnify MBIA for, and to MBIA being subrogated to the rights of the Holders in respect of any payments made by or on behalf of MBIA under the Policy.

"**Insured Amounts**" shall mean, with respect to any Payment Day, the sum of (i) an amount equal to the amount of Interest due on the Insured Obligations as of such Payment Day and (ii) an amount equal to the Principal due on the Insured Obligations on such Payment Day.

"**Insured Obligations**" shall mean the payment obligations of the Issuer in respect of each amount of Principal and Interest owing by the Issuer and outstanding and Due for Payment under the Class A Wrapped Bonds.

"**Interest**" shall mean any amount in respect of regularly scheduled interest (as adjusted for indexation in accordance with the Conditions, if applicable) owing by the Issuer under the Class A Wrapped Bonds when issued excluding any amount relating to prepayment, early redemption, broken funding indemnities, penalties, default interest or any amounts by which the coupon on such Class A Wrapped Bonds exceeds their initial coupon as at the date on which such Class A Wrapped Bonds were issued.

“**Issuer**” shall mean Anglian Water Services Financing Plc, a company incorporated in England and Wales with registered number 4330322.

“**Master Definitions Agreement**” shall have the meaning given to it pursuant to the Conditions.

“**Nonpayment**” shall mean, as of any Payment Day, the failure by the Issuer to pay all or any part of any Insured Amount.

“**Notice of Claim**” shall mean the notice of claim and certificate attached in the form hereto.

“**Payment Day**” shall mean:

- (a) in respect of Interest, a Payment Day (as defined in Condition 8(f));
- (b) in respect of Principal, the scheduled dates for repayment specified in the Conditions; and
- (c) any earlier date for the payment of Interest or repayment of Principal to which MBIA shall have consented at its sole discretion.

“**Principal**” shall mean the outstanding nominal amount of the relevant Class A Wrapped Bonds as adjusted for indexation in accordance with the Conditions (if applicable), excluding (if MBIA elects in its sole discretion to accelerate payments due under the Policy) any additional amount relating to prepayment, early redemption, broken funding indemnities or penalties.

“**Principal Paying Agent**” shall have the meaning given to it pursuant to the Conditions.

“**Receipt**” shall mean (a) actual delivery of the Notice of Claim to MBIA at its address above (or such other office as shall have been notified by MBIA to the Bond Trustee from time to time by at least seven Business Days’ notice) prior to 12.00 noon, London time, on a Business Day or (b) if actual delivery either is on a day that is not a Business Day or, after 12.00 noon, London time, be deemed to have occurred on the next succeeding Business Day.

“**Registrar**” shall have the meaning given to it pursuant to the Conditions.

“**Transaction Documents**” shall have the meaning given to it pursuant to the Master Definitions Agreement.

The Policy is hereby amended to provide that:

- (i) There shall be no acceleration payment due under the Policy unless any such acceleration is, at the sole option of MBIA, communicated in writing by MBIA to the Bond Trustee without the need for Receipt of a further Notice of Claim. In the event that MBIA decides in its absolute discretion to accelerate any payments due under the Policy, nothing in the Policy shall oblige MBIA to make payments in respect of any part of the Insured Obligations which would be greater than the Principal of such part of the Insured Obligations (plus accrued but unpaid interest and amounts in respect of indexation if applicable) and MBIA’s obligations under the Policy shall be satisfied in full by the payment of such Principal in accordance with the terms of the Policy. MBIA may elect to accelerate payments due under the Policy in full or partially.
- (ii) All notices including the Notice of Claim shall be delivered by registered mail or personally delivered to MBIA at the address set out in the Notice of Claim or such other different address or addresses as MBIA may notify in writing to the Bond Trustee. If any Notice of Claim given hereunder by the Bond Trustee is not in proper form or is not properly completed, executed or delivered, it shall be deemed not to have been received and MBIA shall promptly so advise the Bond Trustee and the Bond Trustee may submit to MBIA an amended Notice of Claim.
- (iii) MBIA hereby agrees that the Bond Trust Deed shall be treated as if it were an instrument of assignment in form and substance satisfactory to it for the purposes of the Policy and acknowledges that the Bond Trust Deed has been presented to it by the Bond Trustee as required by the Policy.
- (iv) At any time during the term of the Policy, MBIA may appoint a fiscal agent (the “**Fiscal Agent**”) for the purposes of the Policy by written notice to the Bond Trustee at the notice address specified in the Bond Trust Deed specifying the name and notice address of the Fiscal Agent, which Fiscal Agent shall be situated in the City of New York or London. From and after the date of receipt of such notice by the Bond Trustee, (i) copies of all notices including the Notice of Claim and other

documents required to be delivered to MBIA pursuant to the Policy shall be simultaneously delivered to the Fiscal Agent and to MBIA and shall not be deemed to be received until they are received by both the Fiscal Agent and MBIA, and (ii) all payments required to be made by MBIA under the Policy shall be made directly by MBIA or by the Fiscal Agent on behalf of MBIA, provided, however, that payment by MBIA to the Fiscal Agent shall not discharge MBIA's obligations hereunder in respect of Insured Amounts. The Fiscal Agent is the agent of MBIA only and the Fiscal Agent shall in no event be liable to the Bond Trustee nor to any Holder for any acts of the Fiscal Agent or any failure of MBIA to deposit, or cause to be deposited, sufficient funds to make payments under the Policy.

In the event that any term or provision on the face of the Policy is inconsistent with the provision of this Endorsement, the provisions of this Endorsement shall take precedence and shall be binding.

The obligations of MBIA hereunder may be assigned or transferred to any Affiliate of MBIA provided that:

- (a) no FG Event of Default (as defined in the Master Definitions Agreement) has occurred and is continuing at the time of such assignment or transfer;
- (b) MBIA or such assignee or transferee delivers to the Bond Trustee written confirmation from all three of the Rating Agencies (as defined in the Master Definitions Agreement) that, at the time of such assignment or transfer, the claims-paying ability of such Affiliate was rated at least equal to the claims-paying ability of MBIA at that time and there is no downgrade to the then current rating of the Class A Wrapped Bonds by reason only of such assignment or transfer; and
- (c) MBIA or such assignee or transferee thereafter delivers to the Bond Trustee written notice of any such assignment or transfer and such assignee or transferee assumes the obligations of MBIA hereunder and accedes to the relevant Transaction Documents,

whereupon, without further action, MBIA shall be released from its obligations hereunder.

The Policy shall be governed by and construed in accordance with the laws of England and Wales.

MBIA irrevocably waives any objection which it might now or hereafter have to the courts of England and Wales being nominated as the forum to hear and determine any suit, action or proceedings, and to settle any disputes, which arises out of or in connection with the Policy, and agrees not to claim that any such court is not a convenient or appropriate forum.

The obligations of MBIA under the Policy shall not be affected by any redenomination of the Insured Obligations into euro pursuant to the Condition 6 save that, following any such redenomination, payments of Insured Amounts hereunder shall be made in euro.

Nothing herein contained shall be held to vary, alter, waive or extend any of the terms, conditions, provisions, agreements or limitations of the Policy other than as above stated.

Any right under the United Kingdom Contracts (Rights of Third Parties) Act 1999 which any person (other than MBIA as issuer of the Policy and the Bond Trustee as beneficiary of the Policy) may otherwise have to enforce any term or condition of the Policy and this Endorsement is expressly excluded.

**Unless prior to such date the Issuer has become subject to any insolvency or analogous proceedings in respect of its insolvency, winding-up or administration under any applicable insolvency law, the Policy shall terminate on the date falling two years and one day after the last Payment Day and MBIA shall cease on such date to be liable for any claim made in respect hereof after such date.**

IN WITNESS WHEREOF MBIA has caused this Endorsement to the Policy to be signed by its duly authorised representative.

**MBIA ASSURANCE S.A.**

.....

Authorised Representative  
Effective Date: [Effective Date] 2002

## Notice of Claim and Certificate

MBIA Assurance S.A.  
London Branch  
1 Great St. Helen's  
2nd Floor  
London EC3A 6HX  
United Kingdom

Telephone: 00 44 20 7920 6363

Fax: 00 44 20 7588 3393

Attention: Insured Portfolio Management/Global Public Finance

*[and the Fiscal Agent as the case may be]*

The undersigned, a duly authorised officer of Deutsche Trustee Company Limited or any additional or successor trustee appointed pursuant to the terms of the Bond Trust Deed (the “**Bond Trustee**”), hereby certifies to MBIA Assurance S.A. (“**MBIA**”), with reference to Financial Guarantee Insurance Policy No. [ ] and the endorsement thereto dated [ ] (together, the “**Policy**”) issued by MBIA in respect of the payment obligations of Anglian Water Services Financing Plc (the “**Issuer**”) in respect of each amount of Principal and Interest owing by the Issuer and outstanding pursuant to the Issuer's [Series [ ] Tranche [ ]] Guaranteed Class A Wrapped Bonds] (the “**Insured Obligations**”), that:

- (i) the Bond Trustee is the trustee for the Holders under the Bond Trust Deed;
- (ii) the Bond Trustee has been notified by the Principal Paying Agent or, as the case may be, the Registrar that the deficiency in respect of Insured Amounts which are Due for Payment on *[insert Payment Day]* will be £/€//\$ *[insert applicable amount]* (the “**Shortfall**”);
- (iii) the Bond Trustee is making a claim under the Policy for the Shortfall to be applied to the payment of Insured Amounts which are Due for Payment;
- (iv) the Bond Trustee agrees that, following payment of funds by or on behalf of MBIA to the Bond Trustee (if applicable), it shall procure that (a) it shall hold such amounts in trust and procure that such amounts are applied directly to the payment of Insured Amounts which are Due for Payment; (b) such funds are not applied for any other purpose; (c) such funds are not commingled with other funds held by the Bond Trustee; and (d) a record of such payments with respect to each Insured Obligation and the corresponding claim on the Policy and the proceeds thereof is maintained by the Principal Paying Agent or, in the case of Registered Bonds, the Registrar in accordance with the terms of the Agency Agreement;
- (v) the Bond Trustee acknowledges that under the Bond Trust Deed it has assigned to MBIA its rights to receive any payments from the Issuer in respect of the Insured Obligations to the extent of any payments which have been made under the Policy. The foregoing assignment is in addition to, and not in limitation of, rights of subrogation otherwise available to MBIA in respect of such payments. The Bond Trustee shall take such action and deliver such instruments as may be reasonably requested or required by MBIA to effectuate the purpose or provisions of this clause (v); and
- (vi) payment should be made [in £/€//\$] by [credit] to a designated [pounds Sterling/euro/United States Dollar] account of the *[insert payee]* at *[insert account details]* with *[insert bank details]*.

Unless the context otherwise requires, capitalised terms used in this Notice of Claim and not defined herein shall have the meanings provided in the Policy.

This Notice of Claim may be revoked by written notice by the Bond Trustee to MBIA at any time prior to 10.00 a.m. (London time) on the second Business Day prior to the date specified above on which Insured Amounts are Due for Payment if and only to the extent that moneys are actually received in respect of the Insured Obligations prior to such time from a source other than MBIA.

This Notice of Claim shall be governed by and construed in accordance with the laws of England and Wales.

IN WITNESS WHEREOF the Bond Trustee has executed and delivered this Notice of Claim on the [insert date] day of [insert date].

Deutsche Trustee Company Limited

By: .....

Title: .....

For MBIA Assurance S.A. or Fiscal Agent Use Only

Wire transfer sent on \_\_\_\_\_ By \_\_\_\_\_

Confirmation Number

## CHAPTER 14

### BOOK-ENTRY CLEARANCE SYSTEMS

The information set out below is subject to any change in or reinterpretation of the rules, regulations and procedures of DTC, Euroclear or Clearstream, Luxembourg (together, the “**Clearing Systems**”) currently in effect. The information in this section concerning the Clearing Systems has been obtained from sources that the Issuer believes to be reliable, but none of the Issuer, the Bond Trustee or any Dealer takes any responsibility for the accuracy thereof. Investors wishing to use the facilities of any of the Clearing Systems are advised to confirm the continued applicability of the rules, regulations and procedures of the relevant Clearing System. None of the Issuer, the Bond Trustee or any Dealer nor any other party to the Agency Agreement will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the Bonds held through the facilities of any Clearing System or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

#### **Book-entry Systems**

##### *DTC*

DTC has advised the Issuer that it is a limited purpose trust company organised under the New York Banking Law, a “banking organisation” within the meaning of the New York Banking Law, a “clearing corporation” within the meaning of the New York Uniform Commercial Code and a “clearing agency” registered pursuant to Section 17A of the Exchange Act. DTC holds securities that its participants (“**Participants**”) deposit with DTC. DTC also facilitates the settlement among Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerised book-entry changes in Participants’ accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organisations. DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc. and the National Association of Securities Dealers, Inc. Access to the DTC System is also available to others such as securities brokers and dealers, banks and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“**Indirect Participants**”).

Under the rules, regulations and procedures creating and affecting DTC and its operations (the “**Rules**”), DTC makes book-entry transfers of Registered Bonds among Direct Participants on whose behalf it acts with respect to Bonds accepted into DTC’s book-entry settlement system (“**DTC Bonds**”) as described below and receives and transmits distributions of principal and interest on DTC Bonds. The Rules are on file with the Securities and Exchange Commission. Direct Participants and Indirect Participants with which beneficial owners of DTC Bonds (“**Owners**”) have accounts with respect to the DTC Bonds similarly are required to make book-entry transfers and receive and transmit such payments on behalf of their respective Owners. Accordingly, although Owners who hold DTC Bonds through Direct Participants or Indirect Participants will not possess Registered Bonds, the Rules, by virtue of the requirements described above, provide a mechanism by which Direct Participants will receive payments and will be able to transfer their interest in respect of the DTC Bonds.

Purchases of DTC Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the DTC Bonds on DTC’s records. The ownership interest of each actual purchaser of each DTC Bond (“**Beneficial Owner**”) is in turn to be recorded on the Direct and Indirect Participant’s records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the DTC Bonds are to be accomplished by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in DTC Bonds, except in the event that use of the book-entry system for the DTC Bonds is discontinued.

To facilitate subsequent transfers, all DTC Bonds deposited by Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co. The deposit of DTC Bonds with DTC and their registration in the name of Cede & Co. effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the DTC Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such DTC Bonds are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed



by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to Cede & Co. If less than all of the DTC Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. will consent or vote with respect to DTC Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the Issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the DTC Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the DTC Bonds will be made to DTC. DTC's practice is to credit Direct Participants' accounts on the due date for payment in accordance with their respective holdings shown on DTC's records unless DTC has reason to believe that it will not receive payment on the due date. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC or the Issuer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to DTC is the responsibility of the Issuer, disbursement of such payments to Direct Participants is the responsibility of DTC, and disbursement of such payments to the Beneficial Owners is the responsibility of Direct and Indirect Participants.

Under certain circumstances, including if there is an Event of Default under the Bonds, DTC will exchange the DTC Bonds for definitive Registered Bonds, which it will distribute to its Participants in accordance with their proportionate entitlements and which, if representing interests in a Rule 144A Global Bond, will be legended as set forth in Chapter 16, "*Subscription and Sale and Transfer and Selling Restrictions*".

Since DTC may only act on behalf of Direct Participants, who in turn act on behalf of Indirect Participants, any Owner desiring to pledge DTC Bonds to persons or entities that do not participate in DTC, or otherwise take actions with respect to such DTC Bonds, will be required to withdraw its Registered Bonds from DTC as described below.

#### *Euroclear and Clearstream, Luxembourg*

Euroclear and Clearstream, Luxembourg each holds securities for its customers and facilitates the clearance and settlement of securities transactions by electronic book-entry transfer between their respective accountholders. Euroclear and Clearstream, Luxembourg provide various services including safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg also deal with domestic securities markets in several countries through established depository and custodial relationships. Euroclear and Clearstream, Luxembourg have established an electronic bridge between their two systems across which their respective participants may settle trades with each other.

Euroclear and Clearstream, Luxembourg customers are worldwide financial institutions, including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations. Indirect access to Euroclear and Clearstream, Luxembourg is available to other institutions that clear through or maintain a custodial relationship with an accountholder of either system.

#### **Book-entry Ownership of and Payments in Respect of DTC Bonds**

The Issuer may apply to DTC in order to have any Tranche of Bonds represented by a Registered Global Bond accepted in its book-entry settlement system. Upon the issue of any such Registered Global Bond, DTC or its custodian will credit, on its internal book-entry system, the respective nominal amounts of the individual beneficial interests represented by such Registered Global Bond to the accounts of persons who have accounts with DTC. Such accounts initially will be designated by or on behalf of the relevant Dealer. Ownership of beneficial interests in such a Registered Global Bond will be limited to Direct Participants or Indirect Participants, including, in the case of any Regulation S Global Bond, the respective depositories of Euroclear and Clearstream, Luxembourg. Ownership of beneficial interests in a Registered Global Bond accepted by DTC will be shown on, and the transfer of such ownership will be effected only through, records maintained by DTC or its nominee (with respect to the interests of Direct Participants) and the records of Direct Participants (with respect to interests of Indirect Participants).

Payments in U.S. dollars of principal and interest in respect of a Registered Global Bond accepted by DTC will be made to the order of DTC or its nominee as the registered holder of such Bond. In the case of any

payment in a currency other than U.S. dollars, payment will be made to the Exchange Agent on behalf of DTC or its nominee and the Exchange Agent will (in accordance with instructions received by it) remit all or a portion of such payment for credit directly to the beneficial holders of interests in the Registered Global Bond in the currency in which such payment was made and/or cause all or a portion of such payment to be converted into U.S. dollars and credited to the applicable Participants' account.

The Issuer expects DTC to credit accounts of Direct Participants on the applicable payment date in accordance with their respective holdings as shown in the records of DTC unless DTC has reason to believe that it will not receive payment on such payment date. The Issuer also expects that payments by Participants to beneficial owners of Bonds will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers, and will be the responsibility of such Participant and not the responsibility of DTC, the Principal Paying Agent, the Registrar or the Issuer. Payment of principal, premium, if any, and interest, if any, on Bonds to DTC is the responsibility of the Issuer.

### **Transfers of Bonds Represented by Registered Global Bonds**

Transfers of any interests in Bonds represented by a Registered Global Bond within DTC, Euroclear and Clearstream, Luxembourg will be effected in accordance with the customary rules and operating procedures of the relevant clearing system. The laws in some states within the United States require that certain persons take physical delivery of securities in definitive form. Consequently, the ability to transfer Bonds represented by a Registered Global Bond to such persons may depend upon the ability to exchange such Bonds for Bonds in definitive form. Similarly, because DTC can only act on behalf of Direct Participants in the DTC system who in turn act on behalf of Indirect Participants, the ability of a person having an interest in Bonds represented by a Registered Global Bond accepted by DTC to pledge such Bonds to persons or entities that do not participate in the DTC system or otherwise to take action in respect of such Bonds may depend upon the ability to exchange such Bonds for Bonds in definitive form. The ability of any holder of Bonds represented by a Registered Global Bond accepted by DTC to resell, pledge or otherwise transfer such Bonds may be impaired if the proposed transferee of such Bonds is not eligible to hold such Bonds through a Direct or Indirect Participant in the DTC system.

Subject to compliance with the transfer restrictions applicable to the Registered Bonds described in Chapter 16 under "*Subscription and Sale and Transfer and Selling Restrictions*", cross-market transfers between DTC, on the one hand, and directly or indirectly through Clearstream, Luxembourg or Euroclear accountholders, on the other, will be effected by the relevant clearing system in accordance with its rules and through action taken by the Registrar, the Fiscal Agent and any custodian ("**Custodian**") with whom the relevant Registered Global Bonds have been deposited.

On or after the Issue Date for any Series, transfers of Bonds of such Series between accountholders in Clearstream, Luxembourg and Euroclear and transfers of Bonds of such Series between participants in DTC will generally have a settlement date three business days after the trade date (T+3). The customary arrangements for delivery versus payment will apply to such transfers.

Cross-market transfers between accountholders in Clearstream, Luxembourg or Euroclear and DTC participants will need to have an agreed settlement date between the parties to such transfer. Because there is no direct link between DTC, on the one hand, and Clearstream, Luxembourg and Euroclear, on the other, transfers of interests in the relevant Registered Global Bonds will be effected through the Registrar, the Fiscal Agent and the Custodian receiving instructions (and, where appropriate, certification) from the transferor and arranging for delivery of the interests being transferred to the credit of the designated account for the transferee. In the case of cross-market transfers, settlement between Euroclear or Clearstream, Luxembourg accountholders and DTC participants cannot be made on a delivery versus payment basis. The securities will be delivered on a free delivery basis and arrangements for payment must be made separately.

DTC, Clearstream, Luxembourg and Euroclear have each published rules and operating procedures designed to facilitate transfers of beneficial interests in Registered Global Bonds among participants and accountholders of DTC, Clearstream, Luxembourg and Euroclear. However, they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued or changed at any time. None of the Obligors, the Bond Trustee, the Agents or any Dealer will be responsible for any performance by DTC, Clearstream, Luxembourg or Euroclear or their respective direct or indirect participants or accountholders of their respective obligations under the rules and procedures governing their operations and none of them will have any liability for any aspect of the records relating to or payments made on account of beneficial interests in the Bonds represented by Registered Global Bonds or for maintaining, supervising or reviewing any records relating to such beneficial interests.

## CHAPTER 15

### TAXATION

#### 15.1 United Kingdom

The following is a summary of the United Kingdom withholding taxation treatment at the date of this document in relation to payments of principal and interest in respect of the Bonds. These comments do not deal with other United Kingdom tax aspects of acquiring, holding or disposing of Bonds. They relate only to the position of persons who are absolute beneficial owners of the Bonds. Prospective purchasers of Bonds should be aware that the particular terms of issue of any Series of Bonds as specified in the relevant Pricing Supplement may affect the tax treatment of that and other Series of Bonds. This summary as it applies to United Kingdom taxation is based upon United Kingdom law and Inland Revenue practice in effect on the date of this Offering Circular and is subject to any change in law or practice that may take effect after such date.

Bondholders who may be liable to taxation in jurisdictions other than the United Kingdom in respect of their acquisition, holding or disposal of Bonds are particularly advised to consult their professional advisers as to whether they are so liable (and if so under the laws of which jurisdictions), since the following comments relate only to certain United Kingdom taxation aspects of payments in respect of the Bonds. In particular, Bondholders should be aware that they may be liable to taxation under the laws of other jurisdictions in relation to payments in respect of the Bonds even if such payments may be made without withholding or deduction for or on account of taxation under the laws of the United Kingdom.

Prospective purchasers who are in any doubt as to their tax position should consult their professional advisers.

##### 15.1.1 Payment of Interest by the Issuer

Interest on Bonds which are listed on a recognised stock exchange within the meaning of section 841 of the United Kingdom Income and Corporation Taxes Act 1988 may be paid without withholding or deduction for or on account of income tax (“**United Kingdom withholding tax**”). The London Stock Exchange is such a recognised stock exchange. Under the current Inland Revenue practice, securities will be listed on the London Stock Exchange if they are admitted to the Official List by the UK Listing Authority and admitted to trading by the London Stock Exchange. United Kingdom withholding tax at the lower rate (currently 20 per cent.) is generally imposed on interest payments on Bonds that are not listed on a recognised stock exchange subject to any available exemptions or reliefs e.g.:-

- (i) where the Issuer reasonably believes that the beneficial owner of such interest is a United Kingdom resident company or a non-United Kingdom resident company within the charge to United Kingdom corporation tax as regards the payment of interest at the time the payment is made, provided that the Inland Revenue has not given a direction (in circumstances where it has reasonable grounds to believe that it is likely that the beneficial owner does not qualify for gross payment) that the interest should be paid under deduction of United Kingdom withholding tax; or
- (ii) where the Inland Revenue direct the Issuer to pay without withholding pursuant to a claim under the provisions of any applicable double taxation treaty.

Bonds may be issued at an issue price of less than 100 per cent. of their principal amount. Any discount element on any such Bond will not be subject to any United Kingdom withholding tax.

Where Bonds are issued with a redemption premium, as opposed to being issued at a discount, then any such element of premium may constitute a payment of interest. Payments of interest are subject to United Kingdom withholding tax as outlined above, subject to any available exemptions or reliefs (for example the exemptions outlined above).

Except as described herein with respect to holders of the USPP Bonds, if United Kingdom withholding tax is imposed, then the Issuer will not pay any additional amounts. See Section 6.9.6, “*Withholding Tax under the Bonds*”.

### **15.1.2 Provision of Information by United Kingdom Paying and Collecting Agents**

Persons in the United Kingdom paying interest to or receiving interest on behalf of another person may be required to provide certain information (including the name and address of the beneficial owner of the interest) to the United Kingdom Inland Revenue regarding the identity of the persons beneficially entitled to the interest and, in certain circumstances, such information may be exchanged with the tax authorities of other jurisdictions.

### **15.1.3 Proposed EU Directive on the Taxation of Savings Income**

The EU is currently considering proposals for a new directive regarding the taxation of savings income. Subject to a number of important conditions being met, it is proposed that Member States will be required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to an individual resident in that other Member State, subject to the right of certain Member States to opt instead for a withholding system for a transitional period in relation to such payments. The proposals are not yet final, and they may be subject to further amendment and/or clarification.

### **15.1.4 Payments by Financial Guarantor under the Bond Policies**

If the relevant Financial Guarantor makes any payments in respect of scheduled payments of principal and interest on the Class A Wrapped Bonds and/or the Class B Wrapped Bonds (or other amounts due under the Class A Wrapped Bonds and/or the Class B Wrapped Bonds other than the repayment of amounts subscribed for the Class A Wrapped Bonds and/or the Class B Wrapped Bonds) such payments may be subject to United Kingdom withholding tax subject to any available exemptions or reliefs (for example, the exemptions outlined in 15.1.1 above). If United Kingdom withholding tax is imposed, then the relevant Financial Guarantor will not pay any additional amounts under the Bond Policies.

## **15.2 United States Taxation**

*The following is a summary of certain material U.S. federal income tax consequences of the acquisition, ownership and disposition of Bonds by a U.S. Holder (as defined below). This summary does not address the material U.S. federal income tax consequences of every type of Bond which may be issued under the Programme, and the relevant Pricing Supplement will contain additional or modified disclosure concerning the material U.S. federal income tax consequences relevant to such type of Bond as appropriate. This summary deals only with purchasers of Bonds that are U.S. Holders and that will hold the Bonds as capital assets. The discussion does not cover all aspects of U.S. federal income taxation that may be relevant to, or the actual tax effect that any of the matters described herein will have on, the acquisition, ownership or disposition of Bonds by particular investors, and does not address state, local, foreign or other tax laws. In particular, this summary does not address tax considerations applicable to investors that own (directly or indirectly) 10 per cent. or more of the voting stock of the Issuer, nor does this summary discuss all of the tax considerations that may be relevant to certain types of investors subject to special treatment under the U.S. federal income tax laws (such as banks, insurance companies, investors liable for the alternative minimum tax, individual retirement accounts and other tax-deferred accounts, tax-exempt organisations, dealers in securities or currencies, investors that will hold the Bonds as part of straddles, hedging transactions or conversion transactions for U.S. federal income tax purposes or investors whose functional currency is not the U.S. Dollar). Moreover, the summary deals only with Bonds with a term of 30 years or less. The U.S. federal income tax consequences of owning Bonds with a longer term will be discussed in the applicable Pricing Supplement.*

*As used herein, the term “U.S. Holder” means a beneficial owner of Bonds that is (i) a citizen or resident of the United States for U.S. federal income tax purposes, (ii) a corporation, or other entity treated as a corporation, created or organised under the laws of the United States or any state thereof (including the District of Columbia), (iii) an estate the income of which is subject to U.S. federal income tax without regard to its source or (iv) a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust.*

*The summary is based on the tax laws of the United States including the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations thereunder, published rulings and court decisions, as well as on the income tax treaty between the United States and the United Kingdom*

(the “*Treaty*”) all as currently in effect and all subject to change at any time, possibly with retroactive effect.

**THE SUMMARY OF U.S. FEDERAL INCOME TAX CONSEQUENCES SET OUT BELOW IS FOR GENERAL INFORMATION ONLY. PROSPECTIVE PURCHASERS SHOULD CONSULT THEIR OWN TAX ADVISERS AS TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF OWNING THE BONDS, INCLUDING THEIR ELIGIBILITY FOR THE BENEFITS OF THE TREATY, THE APPLICABILITY AND EFFECT OF STATE, LOCAL, FOREIGN AND OTHER TAX LAWS AND POSSIBLE CHANGES IN TAX LAW.**

## **Payments of Interest**

### *General*

Interest on a Bond, whether payable in U.S. Dollars or a currency, composite currency or basket of currencies other than U.S. Dollars (a “**foreign currency**”), other than interest on a “Discount Bond” that is not “qualified stated interest” (each as defined below under “*Original Issue Discount – General*”), will be taxable to a U.S. Holder as ordinary income at the time it is received or accrued, depending on the holder’s method of accounting for tax purposes. Interest paid by the Issuer on the Bonds and OID, if any, accrued with respect to the Bonds (as described below under “*Original Issue Discount*”) generally will constitute income from sources outside the United States. A U.S. Holder of a Bond that is not listed on a recognised stock exchange, and is therefore not eligible for exemption from United Kingdom withholding tax, will nonetheless not be subject to United Kingdom withholding tax if the U.S. Holder is eligible for benefits under the treaty. A new treaty, which has been signed but not ratified, may, when effective, restrict the availability of treaty benefits for some U.S. Holders. Prospective purchasers should consult their tax advisers concerning the applicability of the current and proposed treaties and the source of income rules to income attributable to the Bonds.

### *Foreign Currency Denominated Interest*

If an interest payment is denominated in, or determined by reference to, a foreign currency, the amount of income recognised by a cash basis U.S. Holder will be the U.S. Dollar value of the interest payment, based on the exchange rate in effect on the date of receipt, regardless of whether the payment is in fact converted into U.S. Dollars.

An accrual basis U.S. Holder may determine the amount of income recognised with respect to an interest payment denominated in, or determined by reference to, a foreign currency in accordance with either of two methods. Under the first method, the amount of income accrued will be based on the average exchange rate in effect during the interest accrual period (or, with respect to an accrual period that spans two taxable years of a U.S. Holder, the part of the period within the taxable year).

Under the second method, the U.S. Holder may elect to determine the amount of income accrued on the basis of the exchange rate in effect on the last day of the accrual period or, in the case of an accrual period that spans two taxable years, the exchange rate in effect on the last day of the part of the period within the taxable year. Additionally, if a payment of interest is actually received within five business days of the last day of the accrual period or taxable year, an electing accrual basis U.S. Holder may instead translate the accrued interest into U.S. Dollars at the exchange rate in effect on the day of actual receipt. Any such election will apply to all debt instruments held by the U.S. Holder at the beginning of the first taxable year to which the election applies or thereafter acquired by the U.S. Holder, and will be irrevocable without the consent of the Internal Revenue Service (the “**IRS**”).

Upon receipt of the interest payment (including a payment attributable to accrued but unpaid interest upon the sale or retirement of a Bond) denominated in, or determined by reference to, a foreign currency, the U.S. Holder will recognise ordinary income or loss measured by the difference between the exchange rate used to accrue interest income pursuant to one of the two above methods and the exchange rate in effect on the date of receipt, regardless of whether the payment is in fact converted into U.S. Dollars.

## **Original Issue Discount**

### *General*

The following is a summary of the principal U.S. federal income tax consequences of the ownership of Bonds issued with original issue discount (“**OID**”). The following summary does not discuss the U.S. federal income tax consequences of an investment in contingent payment debt instruments. In the event

the Issuer issues contingent payment debt instruments the applicable Pricing Supplement will describe the material U.S. federal income tax consequences thereof.

A Bond, other than a Bond with a term of one year or less (a “**Short-Term Bond**”), will be treated as issued with OID (a “**Discount Bond**”) if the excess of the Bond’s “stated redemption price at maturity” over its issue price is more than a de minimis amount (0.25 per cent. of the Bond’s stated redemption price at maturity multiplied by the number of complete years to its maturity). An obligation that provides for the payment of amounts other than qualified stated interest before maturity (an “**installment obligation**”) will be treated as a Discount Bond if the excess of the Bond’s stated redemption price at maturity over its issue price is greater than 0.25 per cent. of the Bond’s stated redemption price at maturity multiplied by the weighted average maturity of the Bond. A Bond’s weighted average maturity is the sum of the following amounts determined for each payment on a Bond (other than a payment of qualified stated interest): (i) the number of complete years from the issue date until the payment is made multiplied by (ii) a fraction, the numerator of which is the amount of the payment and the denominator of which is the Bond’s stated redemption price at maturity. Generally, the issue price of a Bond will be the first price at which a substantial amount of Bonds included in the issue of which the Bond is a part is sold to persons other than bond houses, brokers, or similar persons or organisations acting in the capacity of underwriters, placement agents, or wholesalers. The stated redemption price at maturity of a Bond is the total of all payments provided by the Bond that are not payments of “qualified stated interest.” A qualified stated interest payment is generally any one of a series of stated interest payments on a Bond that are unconditionally payable at least annually at a single fixed rate (with certain exceptions for lower rates paid during some periods), or a variable rate (in the circumstances described below under “*Variable Interest Rate Bonds*”), applied to the outstanding principal amount of the Bond.

U.S. Holders of Discount Bonds must include OID in income calculated on a constant-yield method before the receipt of cash attributable to the income, and generally will have to include in income increasingly greater amounts of OID over the life of the Discount Bonds. The amount of OID includible in income by a U.S. Holder of a Discount Bond is the sum of the daily portions of OID with respect to the Discount Bond for each day during the taxable year or portion of the taxable year on which the U.S. Holder holds the Discount Bond (“**accrued OID**”). The daily portion is determined by allocating to each day in any “accrual period” a pro rata portion of the OID allocable to that accrual period. Accrual periods with respect to a Bond may be of any length selected by the U.S. Holder and may vary in length over the term of the Bond as long as (i) no accrual period is longer than one year and (ii) each scheduled payment of interest or principal on the Bond occurs on either the final or first day of an accrual period. The amount of OID allocable to an accrual period equals the excess of (a) the product of the Discount Bond’s adjusted issue price at the beginning of the accrual period and the Discount Bond’s yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period) over (b) the sum of the payments of qualified stated interest on the Bond allocable to the accrual period. The “adjusted issue price” of a Discount Bond at the beginning of any accrual period is the issue price of the Bond increased by (x) the amount of accrued OID for each prior accrual period and decreased by (y) the amount of any payments previously made on the Bond that were not qualified stated interest payments.

#### *Acquisition Premium*

A U.S. Holder that purchases a Discount Bond for an amount less than or equal to the sum of all amounts payable on the Bond after the purchase date, other than payments of qualified stated interest, but in excess of its adjusted issue price (any such excess being “**acquisition premium**”) and that does not make the election described below under “*Election to Treat All Interest as Original Issue Discount*”, is permitted to reduce the daily portions of OID by a fraction, the numerator of which is the excess of the U.S. Holder’s adjusted basis in the Bond immediately after its purchase over the Bond’s adjusted issue price, and the denominator of which is the excess of the sum of all amounts payable on the Bond after the purchase date, other than payments of qualified stated interest, over the Bond’s adjusted issue price.

#### *Market Discount*

A Bond, other than a Short-Term Bond, generally will be treated as purchased at a market discount (a “**Market Discount Bond**”) if the Bond’s stated redemption price at maturity or, in the case of a Discount Bond, the Bond’s “revised issue price”, exceeds the amount for which the U.S. Holder purchased the Bond by at least 0.25 per cent. of the Bond’s stated redemption price at maturity or revised issue price, respectively, multiplied by the number of complete years to the Bond’s maturity (or, in the case of a Bond

that is an installment obligation, the Bond's weighted average maturity). If this excess is not sufficient to cause the Bond to be a Market Discount Bond, then the excess constitutes "de minimis market discount". For this purpose, the "revised issue price" of a Bond generally equals its issue price, increased by the amount of any OID that has accrued on the Bond and decreased by the amount of any payments previously made on the Bond that were not qualified stated interest payments.

Under current law, any gain recognized on the maturity or disposition of a Market Discount Bond (including any payment on a Bond that is not qualified stated interest) will be treated as ordinary income to the extent that the gain does not exceed the accrued market discount on the Bond. Alternatively, a U.S. Holder of a Market Discount Bond may elect to include market discount in income currently over the life of the Bond. This election shall apply to all debt instruments with market discount acquired by the electing U.S. Holder on or after the first day of the first taxable year to which the election applies. This election may not be revoked without the consent of the IRS. A U.S. Holder of a Market Discount Bond that does not elect to include market discount in income currently will generally be required to defer deductions for interest on borrowings incurred to purchase or carry a Market Discount Bond that is in excess of the interest and OID on the Bond includible in the U.S. Holder's income, to the extent that this excess interest expense does not exceed the portion of the market discount allocable to the days on which the Market Discount Bond was held by the U.S. Holder.

Under current law, market discount will accrue on a straight-line basis unless the U.S. Holder elects to accrue the market discount on a constant-yield method. This election applies only to the Bond with respect to which it is made and is irrevocable.

#### *Election to Treat All Interest as Original Issue Discount*

A U.S. Holder may elect to include in gross income all interest that accrues on a Bond using the constant-yield method described above under "*Original Issue Discount – General*," with certain modifications. For purposes of this election, interest includes stated interest, OID, de minimis OID, market discount, de minimis market discount and unstated interest, as adjusted by any amortisable bond premium (described below under "*Bonds Purchased at a Premium*") or acquisition premium. This election will generally apply only to the Bond with respect to which it is made and may not be revoked without the consent of the IRS. If the election to apply the constant-yield method to all interest on a Bond is made with respect to a Market Discount Bond, the electing U.S. Holder will be treated as having made the election discussed above under "*Market Discount*" to include market discount in income currently over the life of all debt instruments with market discount held or thereafter acquired by the U.S. Holder. U.S. Holders should consult their tax advisers concerning the propriety and consequences of this election.

#### *Variable Interest Rate Bonds*

Bonds that provide for interest at variable rates ("**Variable Interest Rate Bonds**") generally will bear interest at a "qualified floating rate" and thus will be treated as "variable rate debt instruments" under Treasury regulations governing accrual of OID. A Variable Interest Rate Bond will qualify as a "variable rate debt instrument" if (a) its issue price does not exceed the total noncontingent principal payments due under the Variable Interest Rate Bond by more than a specified de minimis amount and (b) it provides for stated interest, paid or compounded at least annually, at (i) one or more qualified floating rates, (ii) a single fixed rate and one or more qualified floating rates, (iii) a single objective rate, or (iv) a single fixed rate and a single objective rate that is a qualified inverse floating rate.

A "**qualified floating rate**" is any variable rate where variations in the value of the rate can reasonably be expected to measure contemporaneous variations in the cost of newly borrowed funds in the currency in which the Variable Interest Rate Bond is denominated. A fixed multiple of a qualified floating rate will constitute a qualified floating rate only if the multiple is greater than 0.65 but not more than 1.35. A variable rate equal to the product of a qualified floating rate and a fixed multiple that is greater than 0.65 but not more than 1.35, increased or decreased by a fixed rate, will also constitute a qualified floating rate. In addition, two or more qualified floating rates that can reasonably be expected to have approximately the same values throughout the term of the Variable Interest Rate Bond (e.g. two or more qualified floating rates with values within 25 basis points of each other as determined on the Variable Interest Rate Bond's issue date) will be treated as a single qualified floating rate. Notwithstanding the foregoing, a variable rate that would otherwise constitute a qualified floating rate but which is subject to one or more restrictions such as a maximum numerical limitation (i.e. a cap) or a minimum numerical limitation (i.e. a floor) may,

under certain circumstances, fail to be treated as a qualified floating rate unless the cap or floor is fixed throughout the term of the Bond.

An “**objective rate**” is a rate that is not itself a qualified floating rate but which is determined using a single fixed formula and which is based on objective financial or economic information (e.g. one or more qualified floating rates or the yield of actively traded personal property). Other variable interest rates may be treated as objective rates if so designated by the IRS in the future. Despite the foregoing, a variable rate of interest on a Variable Interest Rate Bond will not constitute an objective rate if it is reasonably expected that the average value of the rate during the first half of the Variable Interest Rate Bond’s term will be either significantly less than or significantly greater than the average value of the rate during the final half of the Variable Interest Rate Bond’s term. A “**qualified inverse floating rate**” is any objective rate where the rate is equal to a fixed rate minus a qualified floating rate, as long as variations in the rate can reasonably be expected to inversely reflect contemporaneous variations in the qualified floating rate. If a Variable Interest Rate Bond provides for stated interest at a fixed rate for an initial period of one year or less followed by a variable rate that is either a qualified floating rate or an objective rate for a subsequent period and if the variable rate on the Variable Interest Rate Bond’s issue date is intended to approximate the fixed rate (e.g., the value of the variable rate on the issue date does not differ from the value of the fixed rate by more than 25 basis points), then the fixed rate and the variable rate together will constitute either a single qualified floating rate or objective rate, as the case may be.

A qualified floating rate or objective rate in effect at any time during the term of the instrument must be set at a “current value” of that rate. A “**current value**” of a rate is the value of the rate on any day that is no earlier than three months prior to the first day on which that value is in effect and no later than one year following that first day.

If a Variable Interest Rate Bond that provides for stated interest at either a single qualified floating rate or a single objective rate throughout the term thereof qualifies as a “variable rate debt instrument”, then any stated interest on the Bond which is unconditionally payable in cash or property (other than debt instruments of the Issuer) at least annually will constitute qualified stated interest and will be taxed accordingly. Thus, a Variable Interest Rate Bond that provides for stated interest at either a single qualified floating rate or a single objective rate throughout the term thereof and that qualifies as a “variable rate debt instrument” will generally not be treated as having been issued with OID unless the Variable Interest Rate Bond is issued at a “true” discount (i.e. at a price below the Bond’s stated principal amount) in excess of a specified de minimis amount. OID on a Variable Interest Rate Bond arising from “true” discount is allocated to an accrual period using the constant yield method described above by assuming that the variable rate is a fixed rate equal to (i) in the case of a qualified floating rate or qualified inverse floating rate, the value, as of the issue date, of the qualified floating rate or qualified inverse floating rate, or (ii) in the case of an objective rate (other than a qualified inverse floating rate), a fixed rate that reflects the yield that is reasonably expected for the Variable Interest Rate Bond.

In general, any other Variable Interest Rate Bond that qualifies as a “variable rate debt instrument” will be converted into an “equivalent” fixed rate debt instrument for purposes of determining the amount and accrual of OID and qualified stated interest on the Variable Interest Rate Bond. Such a Variable Interest Rate Bond must be converted into an “equivalent” fixed rate debt instrument by substituting any qualified floating rate or qualified inverse floating rate provided for under the terms of the Variable Interest Rate Bond with a fixed rate equal to the value of the qualified floating rate or qualified inverse floating rate, as the case may be, as of the Variable Interest Rate Bond’s issue date. Any objective rate (other than a qualified inverse floating rate) provided for under the terms of the Variable Interest Rate Bond is converted into a fixed rate that reflects the yield that is reasonably expected for the Variable Interest Rate Bond. In the case of a Variable Interest Rate Bond that qualifies as a “variable rate debt instrument” and provides for stated interest at a fixed rate in addition to either one or more qualified floating rates or a qualified inverse floating rate, the fixed rate is initially converted into a qualified floating rate (or a qualified inverse floating rate, if the Variable Interest Rate Bond provides for a qualified inverse floating rate). Under these circumstances, the qualified floating rate or qualified inverse floating rate that replaces the fixed rate must be such that the fair market value of the Variable Interest Rate Bond as of the Variable Interest Rate Bond’s issue date is approximately the same as the fair market value of an otherwise identical debt instrument that provides for either the qualified floating rate or qualified inverse floating rate rather than the fixed rate. Subsequent to converting the fixed rate into either a qualified floating rate or a qualified inverse floating rate, the Variable Interest Rate Bond is converted into an “equivalent” fixed rate debt instrument in the manner described above.



Once the Variable Interest Rate Bond is converted into an “equivalent” fixed rate debt instrument pursuant to the foregoing rules, the amount of OID and qualified stated interest, if any, are determined for the “equivalent” fixed rate debt instrument by applying the general OID rules to the “equivalent” fixed rate debt instrument and a U.S. Holder of the Variable Interest Rate Bond will account for the OID and qualified stated interest as if the U.S. Holder held the “equivalent” fixed rate debt instrument. In each accrual period, appropriate adjustments will be made to the amount of qualified stated interest or OID assumed to have been accrued or paid with respect to the “equivalent” fixed rate debt instrument in the event that these amounts differ from the actual amount of interest accrued or paid on the Variable Interest Rate Bond during the accrual period.

If a Variable Interest Rate Bond, such as a Bond the payments on which are determined by reference to an index, does not qualify as a “variable rate debt instrument”, then the Variable Interest Rate Bond will be treated as a contingent payment debt obligation. The proper U.S. federal income tax treatment of Variable Interest Rate Bonds that are treated as contingent payment debt obligations will be more fully described in the applicable Pricing Supplement.

#### *Short-Term Bonds*

In general, an individual or other cash basis U.S. Holder of a short-term Bond is not required to accrue OID (as specially defined below for the purposes of this paragraph) for U.S. federal income tax purposes unless it elects to do so (but may be required to include any stated interest in income as the interest is received). Accrual basis U.S. Holders and certain other U.S. Holders are required to accrue OID on Short-Term Bonds on a straight-line basis or, if the U.S. Holder so elects, under the constant-yield method (based on daily compounding). In the case of a U.S. Holder not required and not electing to include OID in income currently, any gain realised on the sale or retirement of the Short-Term Bond will be ordinary income to the extent of the OID accrued on a straight-line basis (unless an election is made to accrue the OID under the constant-yield method) through the date of sale or retirement. U.S. Holders who are not required and do not elect to accrue OID on Short-Term Bonds will be required to defer deductions for interest on borrowings allocable to Short-Term Bonds in an amount not exceeding the deferred income until the deferred income is realised.

For purposes of determining the amount of OID subject to these rules, all interest payments on a Short-Term Bond are included in the Short-Term Bond’s stated redemption price at maturity. A U.S. Holder may elect to determine OID on a Short-Term Bond as if the Short-Term Bond had been originally issued to the U.S. Holder at the U.S. Holder’s purchase price for the Short-Term Bond. This election shall apply to all obligations with a maturity of one year or less acquired by the U.S. Holder on or after the first day of the first taxable year to which the election applies, and may not be revoked without the consent of the IRS.

#### *Foreign Currency Bonds*

OID for any accrual period on a Discount Bond that is denominated in, or determined by reference to, a foreign currency will be determined in the foreign currency and then translated into U.S. Dollars in the same manner as stated interest accrued by an accrual basis U.S. Holder, as described above under “*Payments of Interest*”. Upon receipt of an amount attributable to OID (whether in connection with a payment of interest or the sale or retirement of a Bond), a U.S. Holder may recognise exchange gain or loss, which will be ordinary gain or loss measured by the difference between the amount received (translated into U.S. Dollars at the exchange rate on the date of receipt) and the amount previously accrued.

Market Discount on a Bond that is denominated in, or determined by reference to, a foreign currency will be accrued by a U.S. Holder in the foreign currency. If the U.S. Holder elects to include market discount in income currently, the accrued market discount will be translated into U.S. Dollars at the average exchange rate for the accrual period (or portion thereof within the U.S. Holder’s taxable year). Upon the receipt of an amount attributable to accrued market discount, the U.S. Holder will recognise ordinary gain or loss measured in the same manner as for accrued qualified stated interest or OID. A U.S. Holder that does not make this election will recognise, upon the disposition or maturity of the Bond, the U.S. Dollar value of the amount accrued, calculated at the exchange rate in effect on that date, and no part of this accrued market discount will be treated as exchange gain or loss.

### **Bonds Purchased at a Premium**

A U.S. Holder that purchases a Bond for an amount in excess of its principal amount, or for a Discount Bond, its stated redemption price at maturity, may elect to treat the excess as “amortisable bond premium”, in which case the amount required to be included in the U.S. Holder’s income each year with respect to interest on the Bond will be reduced by the amount of amortisable bond premium allocable (based on the Bond’s yield to maturity) to that year. In the case of a Bond that is denominated in, or determined by reference to, a foreign currency, bond premium will be computed in units of foreign currency, and amortisable bond premium will reduce interest income in units of the foreign currency. At the time amortised bond premium offsets interest income, exchange gain or loss (taxable as ordinary income or loss) is realised measured by the difference between exchange rates at that time and at the time of the acquisition of the Bonds. Any election to amortise bond premium shall apply to all bonds (other than bonds the interest on which is excludable from gross income for U.S. federal income tax purposes) held by the U.S. Holder at the beginning of the first taxable year to which the election applies or thereafter acquired by the U.S. Holder, and is irrevocable without the consent of the IRS. See also “*Original Issue Discount – Election to Treat All Interest as Original Issue Discount*”.

### **Purchase, Sale and Retirement of Bonds**

A U.S. Holder’s tax basis in a Bond will generally be its U.S. Dollar cost (as defined below) increased by the amount of any OID or market discount included in the U.S. Holder’s income with respect to the Bond and the amount, if any, of income attributable to de minimis OID and de minimis market discount included in the U.S. Holder’s income with respect to the Bond, and reduced by (i) the amount of any payments that are not qualified stated interest payments, and (ii) the amount of any amortisable bond premium applied to reduce interest on the Bond. The U.S. Dollar cost of a Bond purchased with a foreign currency will generally be the U.S. Dollar value of the purchase price on the date of purchase or, in the case of Bonds traded on an established securities market, as defined in the applicable Treasury Regulations, that are purchased by a cash basis U.S. Holder (or an accrual basis U.S. Holder that so elects), on the settlement date for the purchase.

A U.S. Holder will generally recognise gain or loss on the sale or retirement of a Bond equal to the difference between the amount realised on the sale or retirement and the tax basis of the Bond. The amount realised on a sale or retirement for an amount in foreign currency will be the U.S. Dollar value of this amount on the date of sale or retirement or, in the case of Bonds traded on an established securities market, as defined in the applicable Treasury Regulations, sold by a cash basis U.S. Holder (or an accrual basis U.S. Holder that so elects), on the settlement date for the sale. Such an election by an accrual basis U.S. Holder must be applied consistently from year to year and cannot be revoked without the consent of the IRS. Except to the extent described above under “*Original Issue Discount – Market Discount*” or “*Original Issue Discount – Short-Term Bonds*” or attributable to accrued but unpaid interest or changes in exchange rates, gain or loss recognised on the sale or retirement of a Bond will be capital gain or loss and will be long-term capital gain or loss if the U.S. Holder’s holding period in the Bonds exceeds one year. For a non-corporate U.S. Holder, the maximum long-term capital gains rate is 20 per cent., which is further reduced to 18 per cent. if the Bonds have been held for more than five years.

Gain or loss recognised by a U.S. Holder on the sale or retirement of a Bond that is attributable to changes in exchange rates will be treated as ordinary income or loss. However, exchange gain or loss is taken into account only to the extent of total gain or loss realised on the transaction.

Gain or loss realised by a U.S. Holder on the sale or retirement of a Bond generally will be U.S. source.

### **Exchange of Amounts in other than U.S. Dollars**

Foreign currency received as interest on a Bond or on the sale or retirement of a Bond will have a tax basis equal to its U.S. Dollar value at the time the interest is received or at the time of the sale or retirement. Foreign currency that is purchased will generally have a tax basis equal to the U.S. Dollar value of the foreign currency on the date of purchase. Any gain or loss recognised on a sale or other disposition of a foreign currency (including its use to purchase Bonds or an exchange for U.S. Dollars) will be ordinary income or loss.

### **Backup Withholding and Information Reporting**

In general, payments of interest and accrued OID on, and the proceeds of a sale, redemption or other disposition of, the Bonds, payable to a U.S. Holder by a U.S. paying agent or other U.S. intermediary will be reported to the IRS and to the U.S. Holder as may be required under applicable regulations. Backup

withholding will apply to these payments and to accruals of OID if the U.S. Holder fails to provide an accurate taxpayer identification number or certification of exempt status or fails to report all interest and dividends required to be shown on its U.S. federal income tax returns. Certain U.S. Holders (including, among others, corporations) are not subject to backup withholding. U.S. Holders should consult their tax advisers as to their qualification for exemption from backup withholding and the procedure for obtaining an exemption.

## CHAPTER 16

### SUBSCRIPTION AND SALE AND TRANSFER AND SELLING RESTRICTIONS

The Dealers have, in a programme agreement (the “**Programme Agreement**”) dated 23 July 2002 agreed with the Obligors a basis upon which they or any of them may from time to time agree to purchase Bonds. Any such agreement will extend to those matters stated under Chapter 8, “*Form of the Bonds*” and Chapter 9, “*Terms and Conditions of the Bonds*”. In the Programme Agreement, each of the Obligors has agreed to reimburse the Dealers for certain of their expenses in connection with the establishment and any future update of the Programme and the issue of Bonds under the Programme and to indemnify the Dealers against certain liabilities incurred by them in connection therewith.

In order to facilitate the offering of any Tranche of the Bonds, certain persons participating in the offering of the Tranche may engage in transactions that stabilise, maintain or otherwise affect the market price of the relevant Bonds during and after the offering of the Tranche. Specifically such persons may over-allot or create a short position in the Bonds for their own account by selling more Bonds than have been sold to them by the Issuer. Such persons may also elect to cover any such short position by purchasing Bonds in the open market. In addition, such persons may stabilise or maintain the price of the Bonds by bidding for or purchasing Bonds in the open market and may impose penalty bids, under which selling concessions allowed to syndicate members or other broker-dealers participating in the offering of the Bonds are reclaimed if Bonds previously distributed in the offering are repurchased in connection with stabilisation transactions or otherwise. The effect of these transactions may be to stabilise or maintain the market price of the Bonds at a level above that which might otherwise prevail in the open market. The imposition of a penalty bid may also affect the price of the Bonds to the extent that it discourages resales thereof. No representation is made as to the magnitude or effect of any such stabilising or other transactions. Such transactions, if commenced, may be discontinued at any time. Under UK laws and regulations stabilising activities may only be carried on by the Stabilising Manager named in the applicable Pricing Supplement and only for a period of 30 days following the Issue Date of the relevant Tranche of Bonds.

#### 16.1 Transfer Restrictions

*As a result of the following restrictions, purchasers of Bonds in the United States are advised to consult legal counsel prior to making any purchase, offer, sale, resale or other transfer of such Bonds.*

Each purchaser of Registered Global Bonds (other than a person purchasing an interest in a Registered Global Bond with a view to holding it in the form of an interest in the same Global Bond) or person wishing to transfer an interest from one Registered Global Bond to another will be required to acknowledge, represent and agree as follows (terms used in this paragraph that are defined in Rule 144A or in Regulation S are used herein as defined therein):

- (i) that either (a) it is a QIB, purchasing (or holding) the Bonds for its own account or for the account of one or more QIBs and it is aware, and each beneficial owner of the Bonds has been advised, that any sale to it is being made in reliance on Rule 144A or (b) it is outside the United States and is not a U.S. person;
- (ii) that the Bonds and the guarantees in respect thereof are being offered and sold in a transaction not involving a public offering in the United States within the meaning of the Securities Act, and that the Bonds and the guarantees in respect thereof have not been and will not be registered under the Securities Act or any other applicable U.S. State securities laws and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except as set forth below;
- (iii) that, unless it holds an interest in a Regulation S Global Bond and either is a person located outside the United States or is not a U.S. person, if in the future it decides to resell, pledge or otherwise transfer the Bonds or any beneficial interests in the Bonds, it will do so, prior to the date which is two years after the later of the last Issue Date for the Series and the last date on which the Issuer or an affiliate of the Issuer was the owner of such Bonds, only (a) to the Issuer or any affiliate thereof, (b) inside the United States to a person whom the seller reasonably believes is a QIB purchasing for its own account or for the account of a QIB in a transaction meeting the requirements of Rule 144A, (c) outside the United States in compliance with Rule 903 or Rule 904 under the Securities Act, (d) pursuant to the exemption from registration provided by Rule 144 under the Securities Act

(if available) or (e) pursuant to an effective registration statement under the Securities Act, in each case in accordance with all applicable U.S. State securities laws;

- (iv) it will, and will require each subsequent holder to, notify any purchaser of the Bonds from it of the resale restrictions referred to in paragraph (iii) above, if then applicable;
- (v) that Bonds initially offered in the United States to QIBs will be represented by one or more Rule 144A Global Bonds and that Bonds offered outside the United States in reliance on Regulation S will be represented by one or more Regulation S Global Bonds;
- (vi) that the Rule 144A Global Bonds, will bear a legend to the following effect unless otherwise agreed to by the Issuer:

“THIS SECURITY AND THE GUARANTEES IN RESPECT HEREOF HAVE NOT BEEN REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), OR ANY OTHER APPLICABLE U.S. STATE SECURITIES LAWS AND, ACCORDINGLY, MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS EXCEPT AS SET FORTH IN THE FOLLOWING SENTENCE. BY ITS ACQUISITION HEREOF, THE HOLDER (A) REPRESENTS THAT IT IS A “QUALIFIED INSTITUTIONAL BUYER” (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) PURCHASING THE SECURITIES FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF ONE OR MORE QUALIFIED INSTITUTIONAL BUYERS; (B) AGREES THAT IT WILL NOT RESELL OR OTHERWISE TRANSFER THE SECURITIES EXCEPT IN ACCORDANCE WITH THE AGENCY AGREEMENT AND, PRIOR TO THE DATE WHICH IS TWO YEARS AFTER THE LATER OF THE LAST ISSUE DATE FOR THE SERIES AND THE LAST DATE ON WHICH THE ISSUER OR AN AFFILIATE OF THE ISSUER WAS THE OWNER OF SUCH SECURITIES OTHER THAN (1) TO THE ISSUER OR ANY AFFILIATE THEREOF, (2) INSIDE THE UNITED STATES TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (3) OUTSIDE THE UNITED STATES IN COMPLIANCE WITH RULE 903 OR RULE 904 UNDER THE SECURITIES ACT, (4) PURSUANT TO THE EXEMPTION FROM REGISTRATION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT (IF AVAILABLE) OR (5) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES AND ANY OTHER JURISDICTION; AND (C) IT AGREES THAT IT WILL DELIVER TO EACH PERSON TO WHOM THIS SECURITY IS TRANSFERRED A NOTICE SUBSTANTIALLY TO THE EFFECT OF THIS LEGEND.

THIS SECURITY AND RELATED DOCUMENTATION (INCLUDING, WITHOUT LIMITATION, THE AGENCY AGREEMENT REFERRED TO HEREIN) MAY BE AMENDED OR SUPPLEMENTED FROM TIME TO TIME, WITHOUT THE CONSENT OF, BUT UPON NOTICE TO, THE HOLDERS OF SUCH SECURITIES SENT TO THEIR REGISTERED ADDRESSES, TO MODIFY THE RESTRICTIONS ON AND PROCEDURES FOR REALES AND OTHER TRANSFERS OF THIS SECURITY TO REFLECT ANY CHANGE IN APPLICABLE LAW OR REGULATION (OR THE INTERPRETATION THEREOF) OR IN PRACTICES RELATING TO REALES OR OTHER TRANSFERS OF RESTRICTED SECURITIES GENERALLY. THE HOLDER OF THIS SECURITY SHALL BE DEEMED, BY ITS ACCEPTANCE OR PURCHASE HEREOF, TO HAVE AGREED TO ANY SUCH AMENDMENT OR SUPPLEMENT (EACH OF WHICH SHALL BE CONCLUSIVE AND BINDING ON THE HOLDER HEREOF AND ALL FUTURE HOLDERS OF THIS SECURITY AND ANY SECURITIES ISSUED IN EXCHANGE OR SUBSTITUTION THEREFOR, WHETHER OR NOT ANY NOTATION THEREOF IS MADE HEREON).”;

- (vii) if it is outside the United States and is not a U.S. person, that if it should resell or otherwise transfer the Bonds prior to the expiration of the distribution compliance period (defined as 40 days after the completion of the distribution of all the Bonds of the tranche of which such Bonds form a part), it will do so only (a)(i) outside the United States in compliance with Rule 903 or 904 under the Securities Act or (ii) to a QIB in compliance with Rule 144A and (b) in accordance with all

applicable U.S. State securities laws; and it acknowledges that the Regulation S Global Bonds will bear a legend to the following effect unless otherwise agreed to by the Issuer:

“THIS SECURITY AND THE GUARANTEES IN RESPECT HEREOF HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), OR ANY OTHER APPLICABLE U.S. STATE SECURITIES LAWS AND, ACCORDINGLY, MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS EXCEPT IN ACCORDANCE WITH THE AGENCY AGREEMENT AND PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT OR PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT. THIS LEGEND SHALL CEASE TO APPLY UPON THE EXPIRY OF THE PERIOD OF 40 DAYS AFTER THE COMPLETION OF THE DISTRIBUTION OF ALL THE BONDS OF THE TRANCHE OF WHICH THIS BOND FORMS PART.”; and

- (viii) that the Issuer and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements and agrees that if any of such acknowledgements, representations or agreements made by it are no longer accurate, it shall promptly notify the Issuer; and if it is acquiring any Bonds as a fiduciary or agent for one or more accounts it represents that it has sole investment discretion with respect to each such account and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such account.

Institutional Accredited Investors who purchase Registered Bonds in definitive form offered and sold in the United States in reliance upon the exemption from registration provided by Regulation D of the Securities Act are required to execute and deliver to the Registrar an IAI Investment Letter, except as otherwise specified in the applicable Pricing Supplement. Upon execution and delivery of an IAI Investment Letter by an Institutional Accredited Investor, Bonds will be issued in definitive registered form, see Chapter 8, “*Form of the Bonds*”.

The IAI Investment Letter will state, among other things, the following:

- (i) that the Institutional Accredited Investor has received a copy of the Offering Circular and such other information as it deems necessary in order to make its investment decision;
- (ii) that the Institutional Accredited Investor is an Institutional Accredited Investor within the meaning of Rule 501(a)(1), (2), (3) or (7) of Regulation D under the Securities Act and has such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of its investment in the Bonds, and it and any accounts for which it is acting are each able to bear the economic risk of its or any such accounts’ investment for an indefinite period of time;
- (iii) that, in the normal course of its business, the Institutional Accredited Investor invests in or purchases securities similar to the Bonds and that the Institutional Accredited Investor is acquiring the Bonds purchased by it for its own account or for one or more accounts (each of which is an Institutional Accredited Investor) as to each of which it exercises sole investment discretion over and not with a view to any distribution of the Bonds, subject, nevertheless, to the understanding that the disposition of its property shall at all times be and remain within its control;
- (iv) that the Bonds and the guarantees in respect thereof are being offered and sold in a transaction not involving a public offering in the United States within the meaning of the Securities Act, and that the Bonds and the guarantees in respect thereof have not been and will not be registered under the Securities Act or any other applicable U.S. State securities laws and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except as set forth below;
- (v) that if in the future it decides to resell, pledge or otherwise transfer the Bonds or any beneficial interests in the Bonds, it will do so, prior to the date which is two years after the later of the last Issue Date for the Series and the last date on which the Issuer or an affiliate of the Issuer was the owner of such Bonds, only (a) to the Issuer or any affiliate thereof, (b) inside the United States to a person whom the seller reasonably believes is a QIB purchasing for its own account or for the account of a QIB in a transaction meeting the requirements of Rule 144A, (c) outside the United States in compliance with Rule 903 or Rule 904 under the Securities Act, (d) to another Institutional Accredited Investor, subject to delivery to the Registrar of a Transfer Certificate to

the effect that such transfer is being made to an Institutional Accredited Investor, together with a duly executed IAI Investment Letter from the relevant transferee, (e) pursuant to the exemption from registration provided by Rule 144 under the Securities Act (if available) or (f) pursuant to an effective registration statement under the Securities Act, in each case in accordance with all applicable U.S. State securities laws;

- (vi) it will, and will require each subsequent holder to, notify any purchaser of the Bonds from it of the resale restrictions referred to in paragraph (v) above, if then applicable;
- (vii) that Bonds offered to Institutional Accredited Investors will be in the form of Definitive IAI Registered Bonds;
- (viii) that the Bonds will bear a legend to the following effect unless otherwise agreed to by the Issuer:

“THIS SECURITY AND THE GUARANTEES IN RESPECT HEREOF HAVE NOT BEEN REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), OR ANY OTHER APPLICABLE U.S. STATE SECURITIES LAWS AND, ACCORDINGLY, MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS EXCEPT AS SET FORTH IN THE FOLLOWING SENTENCE. BY ITS ACQUISITION HEREOF, THE HOLDER (A) REPRESENTS THAT IT IS AN INSTITUTIONAL “ACCREDITED INVESTOR” (AS DEFINED IN RULE 501(A)(1), (2), (3) OR (7) UNDER THE SECURITIES ACT) (AN “INSTITUTIONAL ACCREDITED INVESTOR”); (B) AGREES THAT IT WILL NOT RESELL OR OTHERWISE TRANSFER THE SECURITIES EXCEPT IN ACCORDANCE WITH THE AGENCY AGREEMENT AND, PRIOR TO THE DATE WHICH IS TWO YEARS AFTER THE LATER OF THE LAST ISSUE DATE FOR THE SERIES AND THE LAST DATE ON WHICH THE ISSUER OR AN AFFILIATE OF THE ISSUER WAS THE OWNER OF SUCH SECURITIES OTHER THAN (1) TO THE ISSUER OR ANY AFFILIATE THEREOF, (2) INSIDE THE UNITED STATES TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (3) OUTSIDE THE UNITED STATES IN COMPLIANCE WITH RULE 903 OR RULE 904 UNDER THE SECURITIES ACT, (4) TO ANOTHER INSTITUTIONAL ACCREDITED INVESTOR, SUBJECT TO DELIVERY TO THE REGISTRAR OF A TRANSFER CERTIFICATE TO THE EFFECT THAT SUCH TRANSFER IS BEING MADE TO AN INSTITUTIONAL ACCREDITED INVESTOR, TOGETHER WITH A DULY EXECUTED IAI INVESTMENT LETTER FROM THE RELEVANT TRANSFEREE; (5) PURSUANT TO THE EXEMPTION FROM REGISTRATION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT (IF AVAILABLE) OR (6) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES AND ANY OTHER JURISDICTION; AND (C) IT AGREES THAT IT WILL DELIVER TO EACH PERSON TO WHOM THIS SECURITY IS TRANSFERRED A NOTICE SUBSTANTIALLY TO THE EFFECT OF THIS LEGEND.

THIS SECURITY AND RELATED DOCUMENTATION (INCLUDING, WITHOUT LIMITATION, THE AGENCY AGREEMENT REFERRED TO HEREIN) MAY BE AMENDED OR SUPPLEMENTED FROM TIME TO TIME, WITHOUT THE CONSENT OF, BUT UPON NOTICE TO, THE HOLDERS OF SUCH SECURITIES SENT TO THEIR REGISTERED ADDRESSES, TO MODIFY THE RESTRICTIONS ON AND PROCEDURES FOR REALES AND OTHER TRANSFERS OF THIS SECURITY TO REFLECT ANY CHANGE IN APPLICABLE LAW OR REGULATION (OR THE INTERPRETATION THEREOF) OR IN PRACTICES RELATING TO REALES OR OTHER TRANSFERS OF RESTRICTED SECURITIES GENERALLY. THE HOLDER OF THIS SECURITY SHALL BE DEEMED, BY ITS ACCEPTANCE OR PURCHASE HEREOF, TO HAVE AGREED TO ANY SUCH AMENDMENT OR SUPPLEMENT (EACH OF WHICH SHALL BE CONCLUSIVE AND BINDING ON THE HOLDER HEREOF AND ALL FUTURE HOLDERS OF THIS SECURITY AND ANY SECURITIES ISSUED IN EXCHANGE OR SUBSTITUTION THEREFOR, WHETHER OR NOT ANY NOTATION THEREOF IS MADE HEREON).”; and

- (ix) that, in the event that the Institutional Accredited Investor purchases Bonds, it will acquire Bonds having a minimum purchase price of at least U.S.\$500,000 (or the approximate equivalent in another Specified Currency).

No sale of Legended Bonds in the United States to any one purchaser will be for less than U.S.\$100,000 (or its foreign currency equivalent) principal amount or, in the case of sales to Institutional Accredited Investors, U.S.\$500,000 (or its foreign currency equivalent) principal amount and no Legended Bond will be issued in connection with such a sale in a smaller principal amount. If the purchaser is a non-bank fiduciary acting on behalf of others, each person for whom it is acting must purchase at least U.S.\$100,000 (or its foreign currency equivalent) or, in the case of sales to Institutional Accredited Investors, U.S.\$500,000 (or its foreign currency equivalent) principal amount of Registered Bonds.

## 16.2 Selling Restrictions

### 16.2.1 United States

The Bonds and the guarantees in respect thereof have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act.

The Bonds in bearer form are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code of 1986 and regulations thereunder.

In connection with any Bonds which are offered or sold outside the United States in reliance on an exemption from the registration requirements of the Securities Act provided under Regulation S (“**Regulation S Bonds**”), each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that it will not offer, sell or deliver such Regulation S Bonds (i) as part of their distribution at any time or (ii) otherwise until 40 days after the completion of the distribution, as determined and certified by the relevant Dealer or, in the case of an issue of Bonds on a syndicated basis, the relevant lead manager, of all Bonds of the Tranche of which such Regulation S Bonds are a part, within the United States or to, or for the account or benefit of, U.S. persons. Each Dealer has further agreed, and each further Dealer appointed under the Programme will be required to agree, that it will send to each dealer to which it sells any Regulation S Bonds during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Regulation S Bonds within the United States or to, or for the account or benefit of, U.S. persons.

Until 40 days after the commencement of the offering of any Series of Bonds, an offer or sale of such Bonds within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with an available exemption from registration under the Securities Act.

Dealers may arrange for the resale of Bonds to QIBs pursuant to Rule 144A and each such purchaser of Bonds is hereby notified that the Dealers may be relying on the exemption from the registration requirements of the Securities Act provided by Rule 144A. The minimum aggregate principal amount of Bonds which may be purchased by a QIB pursuant to Rule 144A is U.S.\$100,000 (or the approximate equivalent thereof in any other currency). To the extent that the Issuer is not subject to or does not comply with the reporting requirements of Section 13 or 15(d) of the Exchange Act or the information furnishing requirements of Rule 12g3-2(b) thereunder, the Issuer has agreed to furnish to holders of Bonds and to prospective purchasers designated by such holders, upon request, such information as may be required by Rule 144A(d)(4).

Each issuance of Index Linked Bonds or Dual Currency Bonds shall be subject to such additional U.S. selling restrictions as the Issuer and the relevant Dealer may agree as a term of the issuance and purchase of such Bonds, which additional selling restrictions shall be set out in the applicable Pricing Supplement.



### 16.2.2 United Kingdom

Each Dealer has represented and agreed and each further Dealer appointed under the Programme will be required to represent and agree that:

- (i) in relation to Bonds which have a maturity of one year or more and which are to be admitted to the Official List, it has not offered or sold and will not offer or sell any Bonds to persons in the United Kingdom prior to admission of such Bonds to listing in accordance with Part VI of the Financial Services and Markets Act 2000 (the “FSMA”) except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 (as amended) or the FSMA;
- (ii) in relation to Bonds which have a maturity of one year or more and which are not to be admitted to the Official List, it has not offered or sold and, prior to the expiry of the period of six months from the issue date of such Bonds, will not offer or sell any such Bonds to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 (as amended);
- (iii) in relation to any Bonds having a maturity of less than one year from the date of issue, (a) it is a person whose ordinary activities involve it in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of its business and (b) it has not offered or sold and will not offer or sell any Bonds other than to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses where the issue of the Bonds would otherwise constitute a contravention of Section 19 of the FSMA by the Issuer;
- (iv) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) in connection with the issue or sale of any Bonds in circumstances in which Section 21(1) of the FSMA does not or would not otherwise apply to the Obligors; and
- (v) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Bonds in, from or otherwise involving the United Kingdom.

### 16.2.3 Cayman Islands

No invitation or solicitation will be made to the public in the Cayman Islands to subscribe for the Bonds.

### 16.2.4 Japan

The Bonds have not been and will not be registered under the Securities and Exchange Law of Japan (the “**Securities and Exchange Law**”) and each Dealer has agreed and each further Dealer appointed under the Programme will be required to agree that it will not offer or sell any Bonds, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan), or to others for re-offering or resale, directly or indirectly, in Japan or to a resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Securities and Exchange Law and any other applicable laws and regulations of Japan.

### **16.2.5 Germany**

Each Dealer represents and agrees that Notes have not been and will not be offered, sold or publicly promoted or advertised by it in the Federal Republic of Germany other than in compliance with the German Securities Selling Prospectus Act (Wertpapierverkaufsprospektgesetz) of 13 December 1990, as amended, or any other laws applicable in the Federal Republic of Germany governing the issue, offering and sale of securities.

### **16.2.6 The Netherlands**

Each Dealer has represented and agreed and each further Dealer appointed under the Programme will be required to represent and agree that it has not, directly or indirectly, offered or sold and will not, directly or indirectly, offer or sell in The Netherlands any Bonds with a denomination of less than €50,000 (or its foreign currency equivalent) other than to persons who trade or invest in securities in the conduct of a profession or business (which include banks, stockbrokers, insurance companies, pension funds, other institutional investors and finance companies and treasury departments of large enterprises) unless one of the other exemptions from or exceptions to the prohibition contained in article 3 of the Dutch Securities Transactions Supervisions Act 1995 (“*Wet toezicht effectenverkeer 1995*”) is applicable and the conditions attached to such exemption or exception are complied with.

### **16.2.7 General**

Each Dealer has agreed and each further Dealer appointed under the Programme will be required to agree that it will (to the best of its knowledge and belief) comply with all applicable securities laws and regulations in force in any jurisdiction in which it purchases, offers, sells or delivers Bonds or possesses or distributes this Offering Circular and will obtain any consent, approval or permission required by it for the purchase, offer, sale or delivery by it of Bonds under the laws and regulations in force in any jurisdiction to which it is subject or in which it makes such purchases, offers, sales or deliveries and none of the Obligors, the Bond Trustee nor any of the other Dealers shall have any responsibility therefor.

None of the Obligors, the Bond Trustee nor the Dealers represents that Bonds may at any time lawfully be sold in compliance with any applicable registration or other requirements in any jurisdiction, or pursuant to any exemption available thereunder, or assumes any responsibility for facilitating such sale.

With regard to each Tranche, the relevant Dealer will be required to comply with such other restrictions as the Issuer and the relevant Dealer shall agree and as shall be set out in the applicable Pricing Supplement.

## CHAPTER 17

### GENERAL INFORMATION

#### 17.1 Authorisation

The establishment of the Programme and the issue of Bonds thereunder have been duly authorised by a resolution of the Board of Directors of the Issuer dated 25 June 2002. The Issuer has obtained or will obtain from time to time all necessary consents, approvals and authorisations in connection with the issue and performance of the Bonds.

The giving of the Guarantee by each of AWS, AWS Holdings and AWS Overseas Holdings has been duly authorised by a resolution of the Board of Directors of each of AWS, AWS Holdings and AWS Overseas Holdings, respectively, each of which were dated 25 June 2002.

The issue of the Initial Bond Policy by MBIA in respect of the first Series of Class A Wrapped Bonds to be issued under the Programme has been duly authorised by a resolution of the meeting of the board of directors of MBIA passed on 1 March 2002.

#### 17.2 Listing of Bonds

The admission of the Bonds to the Official List will be expressed as a percentage of their nominal amount (excluding accrued interest). It is expected that each Tranche of Bonds which is to be admitted to the Official List and to trading on the London Stock Exchange will be admitted separately as and when issued, subject only to the issue of a Global Bond or Bonds initially representing the Bonds of such Tranche. In the case of each Tranche of Wrapped Bonds, admission to the Official List and trading on the London Stock Exchange is subject to the issue of the Bond Policy by MBIA or any other Financial Guarantor in respect of such Tranche. The listing of the Programme in respect of Bonds is expected to be granted on or around 23 July 2002.

#### 17.3 Documents Available

So long as Bonds are capable of being issued under the Programme, copies of the following documents will, when published, be available from the AWS headquarters at Henderson House, Ermine Business Park, Huntingdon, Cambridgeshire PE29 6XG, and from the specified offices of the Paying Agents for the time being:

- (i) the Memorandum and Articles of Association of each of the Issuer and the other Obligor;
- (ii) MBIA's Articles of Association and By-Laws;
- (iii) the English translation of MBIA's Articles of Association and By-Laws;
- (iv) the accountants' report from PricewaterhouseCoopers in respect of each of the Issuer, AWS Holdings and AWS Overseas Holdings referred to under "Auditors" below and the audited financial statements of AWS in respect of each of the three financial years ended 31 March 2002;
- (v) the most recently published audited annual financial statements and the most recently published unaudited interim financial statements (if any) of each Obligor;
- (vi) the auditors' report from Coopers & Lybrand Audit included in Chapter 18, "*Financial Information*", in respect of MBIA's financial statements;
- (vii) the audited financial statements of MBIA in respect of each of the two financial years ended 31 December 2001 and the most recently published audited annual financial statements of MBIA;
- (viii) the Programme Agreement, the Agency Agreement, the Bond Trust Deed, the Security Trust Deed and the forms of the Global Bonds, the Bonds in definitive form, the Receipts, the Coupons and the Talons;
- (ix) a copy of this Offering Circular;
- (x) any future offering circulars, prospectuses, information memoranda and supplements including Pricing Supplements (save that a Pricing Supplement relating to an unlisted Bond will only be available for inspection by a holder of such Bond and such holder must produce evidence

satisfactory to the Issuer and the Paying Agent as to its holding of Bonds and identity) to this Offering Circular and any other documents incorporated herein or therein by reference;

- (xi) each Bond Policy and all related Endorsements relating to each Tranche of Wrapped Bonds issued under the Programme;
- (xii) in the case of each issue of listed Bonds subscribed pursuant to a subscription agreement, the subscription agreement (or equivalent document);
- (xiii) the Common Terms Agreement;
- (xiv) the Security Agreement;
- (xv) the STID;
- (xvi) each Liquidity Facility Agreement;
- (xvii) each Hedging Agreement;
- (xviii) the Initial Authorised Credit Agreement;
- (xix) the Bridging Facility Agreement;
- (xx) the Existing Finance Leases;
- (xxi) the I&I Agreements;
- (xxii) the Master Definitions Agreement; and
- (xxiii) the letter from Binnie Black & Veatch Ltd (“**BBV**”) to AWS and MBIA (a copy of which is attached as Appendix 2 to this Offering Circular). In relation to this letter, BBV have given, and not withdrawn their consent to, its inclusion in these Listing Particulars in the form and context in which it is included, and have authorised the contents of the letter for the purposes of Regulation 6(1)(e) of the Financial Services and Markets Act 2000 (Official Listing of Securities) Regulations 2001.

#### **17.4 Clearing Systems**

The Bonds in bearer form have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The appropriate Common Code and ISIN for each Tranche of Bearer Bonds allocated by Euroclear and Clearstream, Luxembourg will be specified in the applicable Pricing Supplement. In addition, the Issuer may make an application for any Bonds in registered form to be accepted for trading in book-entry form by DTC. The CUSIP and/or CINS numbers for each Tranche of Registered Bonds, together with the relevant ISIN and common code, will be specified in the applicable Pricing Supplement. If the Bonds are to clear through an additional or alternative clearing system (including Sicovam) the appropriate information will be specified in the applicable Pricing Supplement.

#### **17.5 Significant or Material Change**

Save as disclosed in this Offering Circular, there has been no significant change in the financial or trading position of AWS, nor any material adverse change in the financial position or prospects of AWS, since 31 March 2002.

Save as disclosed in this Offering Circular, there has been no significant change in the financial or trading position and no material adverse change in the financial position or prospects of each of the Issuer, AWS Holdings or AWS Overseas Holdings since the date of their incorporation, being (in the case of the Issuer and AWS Holdings) 28 November 2001 or (in the case of AWS Overseas Holdings) since 16 January 2002.

Save as disclosed in this Offering Circular, there has been no significant change in the financial or trading position of MBIA, nor any material adverse change in the financial position or prospects of MBIA, since 31 December 2001.

## **17.6 Litigation**

Save as disclosed in this Offering Circular, and in particular on pages 44 and 45 hereof, none of the Obligor is or has been involved in any legal or arbitration proceedings (including any proceedings which are pending or threatened of which any of the Obligor is aware) which may have or have had in the 12 months preceding the date of this document a significant effect on the financial position of any of the Obligor.

MBIA is not involved in any legal or arbitration proceedings (including any proceedings which are pending or threatened of which MBIA is aware) which may have or have had in the 12 months preceding the date of this document a significant effect on the financial position of MBIA.

## **17.7 Auditors**

The auditors of AWS are PricewaterhouseCoopers, chartered accountants, who have audited AWS's accounts, without qualification, in accordance with generally accepted auditing standards in the United Kingdom for each of the three financial years ended on 31 March 2002.

PricewaterhouseCoopers, chartered accountants, have audited, without qualification, the regulatory financial information of AWS in accordance with generally accepted auditing standards in the United Kingdom for the year ended 31 March 2002.

The Issuer has appointed PricewaterhouseCoopers, chartered accountants, as its independent auditors. The Issuer will be preparing audited financial statements for the period ending 31 March 2003 and thereafter.

AWS Holdings has appointed PricewaterhouseCoopers, chartered accountants, as its independent auditors. AWS Holdings will be preparing audited financial statements for the period ending 31 March 2003 and thereafter.

AWS Overseas Holdings, being an exempted company incorporated with limited liability under the laws of the Cayman Islands, is not obliged by statute to prepare audited accounts. However, AWS Overseas Holdings has appointed PricewaterhouseCoopers, chartered accountants, as its independent auditors and will be preparing audited financial statements for the period ending 31 March 2003 and thereafter.

The auditors of MBIA are Coopers & Lybrand Audit, statutory auditors, who have audited MBIA's accounts, without qualification, in accordance with professional standards applied in France for each of the three financial years ended on 31 December 2001.

PricewaterhouseCoopers and, in the case of MBIA, Coopers & Lybrand Audit, have given, and not withdrawn, their consent to the inclusion in these Listing Particulars of their reports in the form and context in which they are included and have authorised the contents of the reports for the purposes of Regulation 6(1)(e) of the Financial Services and Markets Act 2000 (Official Listing of Securities) Regulations 2001.

## **17.8 Bond Trustee's reliance on reports and legal opinions**

Certain of the reports of accountants and other experts to be provided in connection with the Programme and/or the issue of Bonds thereunder may be provided on terms whereby they contain a limit on the liability of such accountants or other experts.

Under the terms of the Programme, the Bond Trustee will not necessarily receive a legal opinion in connection with each issue of Bonds.

The Bond Trustee will be provided with a legal opinion outlining the anticipated tax treatment of AW, the Issuer and other members of the AWG Group in relation to, inter alia, the extinguishment of existing AWG Group borrowings or their assumption by the Issuer, the AWS Loan Notes and the Hedging Agreements. This legal opinion will include certain conclusions on the tax treatment of AW, AWS and the Issuer in relation to these transactions, and these conclusions will have been made in reliance on the conformity with UK GAAP of accounting treatment outlining in an AWG accounting report. This accounting report will be prepared by the accounting department of AWG and will not be reviewed or approved by PricewaterhouseCoopers, auditors of AW and the members of the AWG Group.

**CHAPTER 18**  
**FINANCIAL INFORMATION**  
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**MBIA ASSURANCE S.A.**  
**AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS**

**YEAR ENDED 31 DECEMBER, 2001**

**AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS**  
**Year ended 31 December, 2001**

**To the Shareholders of MBIA Assurance S.A.**  
**112, avenue Kléber**  
**75116 Paris**

In accordance with the terms of our appointment at the Annual Shareholders' Meeting, we hereby submit our report for the year ended 31 December 2001, on:

- our examination of the financial statements of MBIA Assurance, presented in euros, as attached to this report, and
- the specific procedures and information required by law.

These financial statements are the responsibility of the Board of Directors. Our responsibility is to express an opinion on these financial statements based on our audit.

**I. Opinion on the financial statements**

We conducted our audit in accordance with the professional standards applied in France. Those standards require that we plan and perform our audit to obtain reasonable assurance that the financial statements are free from material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made in the preparation of the financial statements, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly in all material respects, the assets and liabilities and financial position of the Company at 31 December 2001 and the results of operations for the year then ended in accordance with generally accepted accounting principles in France.

**II. Specific procedures and information**

We have also performed the specific procedures required by law, in accordance with professional standards applied in France.

We are satisfied that the information given in the report of the Board of Directors and the documents sent to shareholders on the financial position and financial statements is fairly stated and agrees with those financial statements.

We have also verified that details of controlling and other interests acquired during the year and the identity of shareholders are disclosed in the report of the Board of Directors.

30 April 2002

Statutory Auditor  
Coopers & Lybrand Audit  
Member of PricewaterhouseCoopers

**Catherine Thuret**



**MBIA ASSURANCE S.A.**

**FINANCIAL STATEMENTS: BALANCE SHEETS AND PROFIT AND LOSS ACCOUNTS**

	<i>At</i> <i>31 December</i> <i>2001</i>	<i>At</i> <i>31 December</i> <i>2000</i>
<i>(in Euros)</i>		
<b>ASSETS</b>		
<b>Investments</b>		
Other investments .....	73,540,362	62,503,751
	73,540,362	62,503,751
<b>Reinsurers' share in technical reserves</b>		
Unearned premiums and premium deficiency reserves		
Related parties .....	608,959	725,065
Third party reinsurers .....	30,985,587	24,679,375
	31,594,546	25,404,440
<b>Debtors</b>		
Amounts receivable from parent company .....	5,032,519	5,364,335
Other insurance debtors .....	65,601	76,233
Other reinsurance debtors .....	180,824	165,625
Prepaid and recoverable taxes .....	0	663,720
Sundry debtors		
Related parties .....	790,228	580,466
Other .....	479	1,955
Titrimmo guarantee deposit .....	498,707	3,887,277
	6, 568,358	10,739,611
<b>Other assets</b>		
Tangible assets .....	281,210	417,974
Other deposits and guarantees .....	67,769	40,220
Cash and cash equivalents .....	779,736	3,624,765
	1,128,715	4,082,959
<b>Prepayments and accrued income</b>		
Other .....	226,785	239,153
Deferred acquisition costs .....	1,311,965	0
Accrued interest and rental income .....	654,841	507,301
	2,193,591	746,454
<b>Unrealised exchange losses</b> .....	2,104,611	2,469,132
<b>TOTAL ASSETS</b> .....	117,130,183	105,946,347

**MBIA ASSURANCE S.A.**

**FINANCIAL STATEMENTS: BALANCE SHEETS AND PROFIT AND LOSS ACCOUNTS**

	<i>At</i> <i>31 December</i> <i>2001</i>	<i>At</i> <i>31 December</i> <i>2000</i>
<i>(in Euros)</i>		
<b>LIABILITIES</b>		
<b>Shareholders' equity</b>		
Share capital.....	26,250,000	26,678,578
Other reserves .....	457,731	4,603
Retained earnings/(deficit).....	5,684,258	5,829,808
Net income/(loss) for the year .....	(1,389,753)	(155,712)
	<b>31,002,236</b>	<b>32,357,277</b>
<b>Gross technical reserves</b>		
Unearned premiums reserves and outstanding risks .....	64,237,422	53,169,864
	<b>64,237,422</b>	<b>53,169,864</b>
<b>Provisions for liabilities and charges</b>		
Provision for exchange losses .....	2,117,575	2,469,132
	<b>2,117,575</b>	<b>2,469,132</b>
<b>Cash deposits received from reinsurers.....</b>	<b>2,195,266</b>	<b>2,195,266</b>
<b>Other liabilities</b>		
Amounts due to parent company .....	8,957,206	3,183,365
Reinsurance creditors		
Related parties .....	2,150,333	1,989,737
Third party reinsurers .....	81,784	4,786,446
Other liabilities		
Other cash deposits received.....	1,150,350	1,150,350
Other loans.....	11,690	17,806
Accrued personnel costs.....	194,711	43,222
Accrued taxes and social security charges .....	1,677,548	195,336
Sundry creditors.....	602,627	181,379
Titrimmo guarantee deposit .....	498,707	3,887,277
	<b>15,324,956</b>	<b>15,434,918</b>
<b>Accruals and deferred income</b>		
Other accruals .....	2,252,728	319,890
	<b>2,252,728</b>	<b>319,890</b>
<b>TOTAL LIABILITIES.....</b>	<b>117,130,183</b>	<b>105,946,347</b>

**MBIA ASSURANCE S.A.**

**FINANCIAL STATEMENTS: BALANCE SHEETS AND PROFIT AND LOSS ACCOUNTS**

	<i>2001 Gross</i>	<i>Ceded business</i>	<i>2001 Net</i>	<i>2000 Net</i>
	<i>(in Euros)</i>			
<b>NON LIFE INSURANCE TECHNICAL ACCOUNT</b>				
<b>Earned premiums</b>				
Premiums.....	21,080,375	(11,022,589)	10,057,786	9,029,410
Change in unearned premiums reserve ( <i>see note II c</i> ) ...	(10,060,661)	5,677,760	(4,382,901)	(8,276,999)
<b>Allocated investment income</b> .....	1,420,561		1,420,561	2,499,858
<b>Other technical income</b> .....	99,545		99,545	405,920
Acquisition and administration costs				
Acquisition costs.....	(2,914,670)		(2,914,670)	(2,718,308)
Administration costs .....	(4,966,585)		(4,966,585)	(2,922,216)
Reinsurance commissions received.....		682,130	682,130	297,408
<b>Non-life underwritten result</b> .....	<b>4,658,565</b>	<b>(4,662,699)</b>	<b>(4,134)</b>	<b>(1,684,927)</b>
<b>NON-TECHNICAL ACCOUNT OF NON-LIFE INSURANCE</b>				
<b>Investment income</b>				
Investment revenues .....			2,004,540	814,041
Other investment income.....			3,757,391	2,951,895
Gains on sale of investments .....			981,192	5,051,673
<b>Investment expense</b>				
Interest and portfolio expenses.....			(39,684)	(33,761)
Other investment expenses.....			(164,328)	(57,160)
Losses on sale of investments .....			(3,795,836)	(3,397,423)
<b>Investment income transferred to the technical accounts</b> .....			(1,420,561)	(2,499,858)
<b>Other non-underwriting income</b> .....			61,635	1,096
<b>Other non-underwriting expense</b> .....			0	(7,281)
<b>Non-recurring income/expense</b>				
Non-recurring income.....			656	0
<b>Income tax</b> .....			(2,770,624)	(1,294,007)
<b>Non-technical result on non-life insurance</b> .....			(1,385,619)	1,529,215
<b>INCOME FOR THE YEAR</b> .....			<b>(1,389,753)</b>	<b>(155,712)</b>

## NOTES TO THE FINANCIAL STATEMENTS

### I. Business of the Company

MBIA Assurance S.A. “MBIA Assurance” or “the Company” is a *Société Anonyme* with a share capital of 26,250,000 euros. MBIA is a 99.99% owned subsidiary of MBIA Insurance Corporation.

MBIA Assurance carries out operations of the type corresponding to Branch 15 Guarantee listed in Article R 321-1 of the French Insurance Code.

MBIA Assurance’s principal activity is the guarantee of financial obligations, and notably with respect to securitisations, structured finance, and project finance transactions.

Financial guarantee insurance policies issued by MBIA Assurance provide an unconditional and irrevocable guarantee of the payment of the principal and interest, or other amounts owing, on insured obligations when due.

### II. Accounting Policies and Methods

The financial statements for the years ended 31 December 2001 and 2000 have been prepared in accordance with the provisions of the revised French Insurance Code. The company does not own any subsidiaries and therefore does not produce consolidated accounts. During the year 2000, the company established a branch in the United Kingdom and has included its accounts in the financial statements of MBIA Assurance for the years ended 31 December 2001 and 2000. Accounting principles, which are summarised below, remain unchanged from 2000.

#### (a) Investments

*Bonds and other fixed-income securities* are stated at cost, excluding interest accrued at the date of acquisition. Premiums and discounts on bonds and other fixed-income securities (difference between the purchase price and the redemption price) are written off to the profit and loss account over the residual lives of the securities in accordance with article R 332-19 of the French Insurance Code. The accumulated amortisation is recorded under “accrued income” or “deferred income”.

At year-end, the realisable value corresponds to market value. In application of Article R 332-19, no provision is made for unrealised losses corresponding to the difference between the amortised cost of securities and their fair market value. However, a provision for counterparty risks is recorded if the company has reason to believe that the issuer will be unable to fulfil its obligations in terms of the payment of principal or interest.

*Equities and other variable income securities* are stated at cost, excluding accrued interest at the acquisition date. Values are determined by the First In-First Out method “FIFO”.

At year-end, the realisable value corresponds to market value. A provision is recorded separately for each line of securities when a decrease in book value is considered as permanent. In addition, when the market value (excluding fixed-rate securities) is less than the book value, adjusted by the above-mentioned provision, a liquidity risk reserve is set up for the differential amount. The liquidity risk reserve is shown on the balance sheet in the “technical reserves” section of the liabilities.

#### (b) Exchange gains and losses

Foreign currency transactions are converted into euros at year-end exchange rates.

Unrealised exchange gains and losses for all currencies combined are netted and included in the balance sheet in either assets or liabilities. A related allowance is recorded in the case of a net unrealised exchange loss.

#### (c) Technical reserves

— Unearned premium reserve:

The reserve for unearned premiums is calculated on a contract by contract basis, taking into account the risk cycle, in order to better comply with Article R 333-1 of the French Insurance Code and Article 57-2 of the European Directive n°91/674/CEE of 19 December 1991 applicable to statutory and consolidated accounts. This states that: “In classes of insurance where the assumption of a temporal correlation between risk experience and premium is not appropriate, calculation methods shall be applied that take into account the differing pattern of risk over time”.

Since 31 December 2000, at the request of the *Commission de Contrôle des Assurances*, UPR, previously calculated on a pro rata basis through 31 December 1999, is now calculated based upon the risk cycle. When a guarantee is issued upon a loan, the UPR takes into account the repayment schedule of the loan.

The *Commission de Contrôle des Assurances* also required that this new calculation be applied retrospectively to include premiums written prior to 1 January 2000. Adjusting the unearned premium reserve to reflect this change resulted in a reversal of earned premiums in the amount of 3,828,960 euros, which was booked into the profit and loss accounts for the year ended 31 December 2000.

— Claim paying reserves:

Since its formation, MBIA Assurance has never recorded any claims.

(d) *Expense allocation*

Effective from 1 January 1995, a distinction is made between acquisition and administration costs. These costs mainly correspond to personnel expenses which are allocated based on the position occupied by each employee.

Deferred acquisition costs “DAC” linked to UPR are accounted for under DAC in accordance with article R 332-33 of the French Insurance Code. DAC is amortised on a straight-line basis over the period between the balance sheet date and the end of the contract, limited to five years.

The portion of commissions received from reinsurers that is not related to the accounting year is also recorded in the balance sheet. The amount deferred is calculated and then taken to the profit and loss accounts in the same manner as that employed for the calculation of DAC for the same contracts. At 31 December 2001, deferred commissions included in “Other accruals” amounted to 1,948,814 euros.

(e) *Cession in reinsurance*

Reinsurance cessions are calculated in accordance with treaties signed between MBIA Assurance and various reinsurers. Pledged investments received from reinsurers are booked off-balance sheet and calculated at year-end at market value. Cash deposits received from reinsurers are booked under liabilities in the balance sheet.

(f) *Tangible fixed assets used in the business*

Tangible fixed assets are stated at cost. Maintenance charges are charged to the profit and loss account when incurred, except where they serve to increase productivity or extend the useful life of the asset concerned.

Depreciation is calculated using the straight-line method over the estimated useful life of the assets, in accordance with French tax rules. The main estimated useful lives are as follows:

Leasehold improvements, fixtures and fittings .....	8 years
Vehicles .....	5 years
Office and computer equipment .....	4 years
Furniture .....	5 to 8 years

(g) *Taxes*

Taxes are recorded in the profit and loss account and correspond to the tax payable for the period. Tax is related to both transactions concluded by MBIA Assurance and by the UK branch.

(h) *Transfer of investment income*

A percentage of net investment income is transferred from the non-technical account to the technical account on the basis of the following formula: Net technical provision divided by the sum of shareholders’ equity and net technical provision.

### III. NOTES TO THE BALANCE SHEET

#### (a) Investment portfolio

Investments recorded in the balance sheet at 31 December 2001 in accordance with Articles R 332-19 and R 332-20 of the French Insurance Code are as follows:

<i>Description of securities</i>	<i>Units</i>	<i>At cost</i>	<i>Unit market price (rounded)</i>	<i>Market value</i>	<i>Realised/ (unrealised gains)</i>
<b>Long-term investments</b>					
OAT .....		4,177,735		4,383,691	205,956
BTAN.....		12,177,613		12,037,245	(140,368)
Govt. bonds in USD .....		12,402,089		12,472,005	69,916
Govt. bonds in GBP .....		9,042,005		8,943,471	(98,534)
<b>Total .....</b>		<b>37,799,442</b>		<b>37,836,412</b>	<b>36,970</b>
<b>Short-term investments</b>					
Credis EUR.....	874	300,456	373	325,915	25,459
Credis USD .....	801	2,192,836	2,935	2,351,039	158,203
Credis CAD .....	317	334,366	1,290	408,981	74,615
PIM.....	13	221,070	18,544	241,076	20,006
FCP Berri Monet.....	81	1,976,623	24,794	2,008,348	31,725
FCP Berri Tres. ....	3	13,362	4,567	13,700	338
FCP Primerus monet .....	929	2,138,874	2,476	2,299,953	161,079
FCP Fructifonds.....	408	11,228,739	28,753	11,731,159	502,420
Fixed deposit HKD.....		334,677		334,677	
Fixed deposit GBP .....		6,860,075		6,860,075	
Sicav GBP.....	1,644	9,460,006	5,888	9,679,740	219,734
Sicav USD .....	240	679,836	2,935	704,475	24,639
<b>Total .....</b>		<b>35,740,920</b>		<b>36,959,138</b>	<b>1,218,218</b>
<b>TOTAL in euros .....</b>		<b>73,540,362</b>		<b>74,795,550</b>	<b>1,255,188</b>

All the above investments have been valued in accordance with Articles R 332-19 and R 332-20 of the French Insurance Code. The realisable value of the securities corresponds to their market value at 31 December 2001.

#### (b) Debtors and creditors

At 31 December 2001, the maturity of all amounts due from debtors and to creditors was less than one year. Other liabilities include 1,150,350 euros due to CapMAC, an affiliated company.

#### (c) Related party debtors and creditors

<i>Debtors</i>	<i>Reinsurers' share of technical reserves</i>	<i>Insurance receivables</i>	<i>Inter-company account</i>
		(in euros)	
MBIA Insurance Corporation and branches.....	608,959	0	5,032,519
<i>Creditors</i>	<i>Reinsurance debts</i>	<i>Guarantee deposit</i>	<i>Inter-company account</i>
MBIA Insurance Corporation .....	2,150,333	2,195,266	8,957,206

(d) *Share capital and changes in shareholders' equity*

At 31 December 2001, the Company's issued share capital was made up of 1,750,000 ordinary shares with a par value of 15 euros each. MBIA Insurance Corporation held 99.99% of the capital at that date.

Changes in shareholders' equity during 2001 were as follows:

	<i>1 January 2001</i>	<i>Allocation of 2000 earnings</i>	<i>Reduction of capital</i>	<i>Other changes</i>	<i>31 December 2001</i>
					<i>(in thousands of euros)</i>
Share capital .....	26,679		(429)		26,250
Legal reserve.....	4				4
Capitalisation reserve .....	0			25	25
Unavailable reserves.....	0		429		429
(Deficit)/retained earnings .....	5,830	(156)			5,674
Result N-1 .....	(156)	156			0
Result N .....	0			(1,390)	(1,390)
Branch exchange rate difference....	0			10	10
<b>Total .....</b>	<b>32,357</b>	<b>0</b>	<b>0</b>	<b>(1,355)</b>	<b>31,002</b>

#### IV. NOTES TO THE PROFIT AND LOSS ACCOUNTS

(a) *Investment income*

	<i>(in thousands of euros)</i>
Revenues from investments in subsidiaries and affiliates .....	—
Revenues from property holdings .....	—
Other investment revenues .....	2,005
<b>Total.....</b>	<b>2,005</b>

(b) *Breakdown of other investment income*

	<i>(in thousands of euros)</i>
Exchange gain on investments.....	1,110
Amortisation of capital gains .....	178
Reversal of provision for exchange loss on investments.....	2,469
<b>Total.....</b>	<b>3,757</b>

(c) *Breakdown of investment expense*

	<i>(in thousands of euros)</i>
Interest and bank fees.....	40
Amortisation of capital losses .....	164
Charge to provision for exchange loss on investments .....	2,118
Exchange losses on investments .....	1,589
Loss on sale of investments .....	64
Capitalisation reserve .....	25
<b>Total.....</b>	<b>4,000</b>

(d) Additional notes to the profit and loss accounts

Personnel costs

Personnel costs for the period 1999 through 2001 are as follows:

	2001	2000	1999
		<i>(in euros)</i>	
Wages and salaries.....	357,991	350,069	130,344
Pension benefits.....	—	—	—
Social security taxes .....	161,549	126,964	61,282
Other.....	482,391	231,169	2,363
<i>of which, related to UK branch:</i> .....	<i>515,632</i>	<i>179,913</i>	
<b>Total</b> .....	<b>1,001,931</b>	<b>708,202</b>	<b>193,989</b>

Breakdown of gross premiums written

Gross premiums written in the period 1999 through 2001 are as follows:

	2001	2000	1999
		<i>(By product type in euros)</i>	
Local government .....	(22,425)	236,273	1,808,371
Structured finance .....	1,269,941	2,236,684	2,339,240
Concessions and corporates.....	19,832,859	17,346,323	9,996,834
<b>Total</b> .....	<b>21,080,375</b>	<b>19,819,280</b>	<b>14,144,445</b>

	2001	2000	1999
		<i>(By geographic region in euros)</i>	
Europe .....	20,997,027	19,725,553	14,006,021
<i>of which, France:</i> .....	<i>298,647</i>	<i>62,954</i>	<i>2,479,112</i>
The Americas.....	0	0	10,171
Asia.....	83,348	93,727	128,253
<b>Total</b> .....	<b>21,080,375</b>	<b>19,819,280</b>	<b>14,144,445</b>

## V OTHER INFORMATION

(a) Consolidating entity

MBIA Assurance is a 99.99% owned subsidiary of MBIA Insurance Corporation whose head office is located at 113 King Street, Armonk, New York, 10504, USA.

*Relationship between MBIA Assurance and MBIA Insurance Corporation*

The relationship between MBIA Assurance and MBIA Insurance Corporation is based upon the maintenance of the net worth of the French subsidiary (under the conditions of the “Net Worth Maintenance Agreement” described below) and on the reinsurance of MBIA Assurance risk by MBIA Insurance Corporation.

This relationship is the basis upon which the rating agencies have granted a Triple-A rating to MBIA Assurance.

*Agreements between MBIA Assurance and MBIA Insurance Corporation*

*Net Worth Maintenance Agreement*

Under the “Net Worth Maintenance Agreement”, MBIA Insurance Corporation agrees to remain the sole shareholder of MBIA Assurance and not to pledge its shares. It also agrees to maintain for its French subsidiary a



minimum capital and surplus position of 4,573,471 euros, or such greater amount as shall be required now or in the future by French law or French regulatory authorities provided that:

- (i) any contributions to MBIA Assurance for such purpose shall not exceed 35% of MBIA Insurance Corporation's policyholders' surplus on an accumulated basis as determined by the laws of the State of New York;
- (ii) no contribution will be made that would jeopardize MBIA Insurance Corporation's ratings from Standard & Poor's Rating Services or Moody's Investors Service, Inc.; and
- (iii) any contribution shall be made in compliance with Section 150 of the New York State Insurance law.

Any modifications to the "Net Worth Maintenance Agreement" may not occur without confirmation from each Standard's & Poor's Rating Services and Moody's Investors Service, that such modifications will not result in the reduction or the withdrawal of the claims-paying ratings then assigned to MBIA Insurance Corporation.

#### *Reinsurance Agreement*

Under the "Reinsurance Agreement", MBIA Insurance Corporation agrees to reimburse MBIA Assurance on an excess of loss basis for losses incurred in each calendar year for net retained insurance liabilities. MBIA Insurance Corporation shall reimburse MBIA Assurance for the amount of MBIA Assurance's losses paid in each calendar year which amount is in the aggregate in excess of an amount equal to the greater of:

- (i) US\$ 500,000 or
- (ii) 40% of MBIA Assurance's net earned premium income for that same calendar year.

The liability of MBIA Insurance Corporation shall not exceed US\$ 100,000,000 in any one calendar year.

Since its formation, MBIA Assurance has never recorded any claims.

#### *(b) Average number of employees*

The average number of employees for the years 2001 and 2000 was two persons in each year.

In addition, MBIA Insurance Corporation provided employees who have been seconded to the UK branch of MBIA Assurance.

#### *(c) Off-balance sheet commitments*

At 31 December 2001, the shares and cash pledged by AMBAC Assurance Corporation in relation to reinsurance transactions amounted to 10,456,816 euros and is broken down as follows:

- Fixed-term deposit of GBP 2,714,983 (€4,461,763)
- Cash deposit of 1,358 euros
- 234 Berri Monetaire C with a unit value of 24,794.42 euros (€5,801,894)
- 42 Berri Tresor C with a unit value of 4,566.69 euros (€191,801)

At 31 December 2001, the Company had no other off-balance sheet commitments and had not carried out any off-balance sheet financial instrument transactions.

(d) *Guarantees issued*

The following chart represents the amounts guaranteed by MBIA Assurance at 31 December 2001. Amounts are stated in par and gross of reinsurance.

	<i>2001</i>	<i>2000</i>	<i>1999</i>
	<i>(in thousands of euros)</i>		
Sovereign and Sub-sovereign .....	1,202,950	1,320,690	1,193,032
Public Utilities .....	3,675,475	1,377,540	1,009,911
Structured Finance .....	903,246	1,178,424	1,311,997
Financial Institutions <sup>(1)</sup> .....	173,591	251,185	320,164
<b>Total</b> .....	<b>5,955,262</b>	<b>4,127,839</b>	<b>3,835,104</b>

(1) mainly banks and insurance companies.

## FINANCIAL INFORMATION OF AWS FOR THE THREE YEARS ENDED 31 MARCH 2002

The financial information of AWS for the three years ended 31 March 2002 set forth below has been extracted from the financial statements of AWS for each of the three years ended 31 March 2002, 2001 and 2000. The financial information of AWS set forth below does not constitute the statutory accounts of AWS within the meaning of Section 240 of the Companies Act 1985. PricewaterhouseCoopers, Chartered Accountants and Registered Auditors, of Temple Court, 35 Bull Street, Birmingham B4 6JT, the auditors of AWS, gave an unqualified audit report within the meaning of Section 235 of the Companies Act 1985 in respect of each of such accounts and such reports did not contain a statement under Section 237(2) or (3) of the Companies Act 1985. The financial information should be read in conjunction with, and is qualified by reference to, the audited financial statements of AWS and notes thereon for the years ended 31 March 2002, 2001 and 2000 respectively, and the accounting policies adopted in respect thereof. These audited financial statements are available on the Company's website at [www.anglianwater.co.uk](http://www.anglianwater.co.uk).

During the year ended 31 March 2002 the Company adopted FRS 19 "Deferred Tax" (FRS 19) and accordingly restated comparative financial information for the year ended 31 March 2001. See note 1(a) later in this Chapter for a description of impact of the adoption of FRS 19 on the financial information for the years ended 31 March 2002 and 2001. The financial information of AWS for the year ended 31 March 2000 has not been restated for the adoption of FRS 19.

The financial information of AWS set forth below has been prepared in accordance with UK GAAP. Significant differences exist between UK GAAP and U.S. GAAP which might be material to the financial information herein. AWS has made no attempt to identify or quantify the impact of those differences. In making an investment decision, investors must rely upon their own examination of AWS, the terms of the offering and the financial information. Potential investors should consult their own professional advisers for an understanding of the differences between UK GAAP and U.S. GAAP, and how those differences might affect the financial information herein. See also later in this Chapter, "*Summary of Significant Differences between UK GAAP and U.S. GAAP*" below.

## PROFIT AND LOSS ACCOUNT

*For the year ended 31 March*

	2002			2001			2000			
	<i>Notes</i>	<i>Before Exceptional items £m</i>	<i>Exceptional items £m</i>	<i>Total £m</i>	<i>Before exceptional items (restated) £m</i>	<i>Exceptional Items £m</i>	<i>Total (restated) £m</i>	<i>Before exceptional items £m</i>	<i>Exceptional Items £m</i>	<i>Total £m</i>
Turnover.....	2	724.4	—	724.4	694.6	—	694.6	731.5	—	731.5
Operating costs:										
–Operating costs before depreciation.....	3, 4	(270.1)	(26.9)	(297.0)	(280.7)	(12.2)	(292.9)	(268.0)	(42.4)	(310.4)
–Depreciation net of amortisation of grants and contributions.....	3	(150.6)	—	(150.6)	(136.5)	—	(136.5)	(121.3)	—	(121.3)
Total operating costs.....	3, 4	(420.7)	(26.9)	(447.6)	(417.2)	(12.2)	(429.4)	(389.3)	(42.4)	(431.7)
Operating profit.....	5	303.7	(26.9)	276.8	277.4	(12.2)	265.2	342.2	(42.4)	299.8
Dividends receivable from trade investments.....		—	—	—	0.2	—	0.2	—	—	—
Profit/(loss) on sale of fixed assets		—	3.3	3.3	—	1.8	1.8	—	(1.0)	(1.0)
Profit on ordinary activities before interest.....		303.7	(23.6)	280.1	277.6	(10.4)	267.2	342.2	(43.4)	298.8
Interest payable (net).....	6	(102.7)	—	(102.7)	(120.1)	—	(120.1)	(96.3)	—	(96.3)
Profit on ordinary activities before taxation.....		201.0	(23.6)	177.4	157.5	(10.4)	147.1	245.9	(43.4)	202.5
Tax on profit on ordinary activities.....	7	21.3	7.3	28.6	(38.0)	2.4	(35.6)	(41.3)	8.0	(33.3)
Profit on ordinary activities after taxation for the financial year.....		222.3	(16.3)	206.0	119.5	(8.0)	111.5	204.6	(35.4)	169.2
Dividends payable.....	8	—	—	—	(923.3)	—	(923.3)	(148.9)	—	(148.9)
Movement in reserves.....		222.3	(16.3)	206.0	(803.8)	(8.0)	(811.8)	55.7	(35.4)	20.3

All the above results relate to continuing operations.

Trading results for the year ended 31 March 2001 include turnover of £6.3 million and operating profit of £1.6 million arising from the acquisition of the trade of Hartlepool Water Plc.

The comparatives for the year ended 31 March 2001 have been restated in respect of the adoption of Financial Reporting Standard (FRS) 19 “Deferred Tax” (see note 1(a)). The comparatives for the year ended 31 March 2000 have not been restated.

### STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	<i>£m</i>	<i>2002 £m</i>	<i>2001 (restated) £m</i>
Profit on ordinary activities after taxation.....		206.0	111.5
Total recognised gains and losses for the year before prior year adjustment.....		206.0	111.5
<b>Prior year adjustment in respect of adoption of FRS 19 “Deferred Tax” (see note 1(a) and 21)</b>			
Undiscounted provision for deferred taxation.....	(591.8)		
Effect of discounting the deferred tax provision.....	493.6		
Discounted provision for deferred taxation.....		(98.2)	
Total recognised gains and losses since the last annual report.....		107.8	

No statement of total recognised gains and losses for the year ended 31 March 2000 has been presented, as all gains and losses have been included in the profit and loss account.

## BALANCE SHEET

		<i>31 March</i>		
		<i>2002</i>	<i>2001</i>	<i>2000</i>
		<i>£m</i>	<i>(restated)</i>	<i>£m</i>
	<i>Notes</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
<b>Fixed assets</b>				
Tangible assets .....	13	3,607.0	3,516.5	3,387.2
Investments .....	14	0.2	0.2	0.3
		3,607.2	3,516.7	3,387.5
<b>Current assets</b>				
Stocks .....	15	4.1	4.0	3.9
Debtors .....	16	558.1	211.6	200.0
Cash and deposits .....		0.8	19.9	27.0
		563.0	235.5	230.9
<b>Creditors: amounts falling due within one year</b>				
Short-term borrowings .....	17	(257.0)	(96.9)	(321.0)
Other creditors .....	17	(1,030.5)	(1,174.3)	(359.8)
		(1,287.5)	(1,271.2)	(680.8)
Net current liabilities .....		(724.5)	(1,035.7)	(449.9)
Total assets less current liabilities .....		2,882.7	2,481.0	2,937.6
<b>Creditors: amounts falling due after more than one year</b>				
Loans and other borrowings .....	18	(1,714.7)	(1,493.5)	(1,153.4)
Other creditors .....	19	(86.1)	(90.2)	(92.2)
		(1,800.8)	(1,583.7)	(1,245.6)
Provisions for liabilities and charges .....	20	(114.1)	(135.5)	(29.1)
		967.8	761.8	1,662.9
<b>Capital and reserves</b>				
Called up equity share capital .....	23, 24	860.0	860.0	860.0
Profit and loss account .....	24	107.8	(98.2)	802.9
Total shareholder's funds (all equity) .....	24	967.8	761.8	1,662.9

The comparatives at 31 March 2001 have been restated in respect of the adoption of FRS 19 (see note 1(a)) and to transfer deferred grants and contributions due within one year from creditors due after more than one year to creditors due within one year (see note 17). The comparatives at 31 March 2000 have not been restated.

## CASH FLOW STATEMENT

*For the year ended 31 March*

	<i>Notes</i>	<i>2002 £m</i>	<i>2001 £m</i>	<i>2000 £m</i>
Net cash inflow from operating activities.....	(a)	378.7	389.7	455.2
Returns on investments and servicing of finance				
Interest received.....		16.7	6.9	2.3
Interest paid.....		(100.0)	(79.4)	(84.5)
Interest element of finance lease rental payments.....		(10.4)	(11.5)	(10.7)
Dividends received from trade investments.....		—	0.2	—
Net cash outflow for returns on investments and servicing of finance.....		(93.7)	(83.8)	(92.9)
Taxation				
Corporation Tax paid.....		(46.4)	(7.5)	(23.1)
Capital expenditure and financial investment				
Purchase of tangible fixed assets.....		(262.0)	(272.3)	(338.9)
Grants and contributions received.....		17.9	14.7	15.3
Short-term loan to group company.....		(309.5)	—	—
Disposal of tangible fixed assets.....		4.8	(1.1)	15.4
Net cash outflow for capital expenditure and financial investment.....		(548.8)	(258.7)	(308.2)
Acquisitions and disposals				
Acquisition of trade and certain assets of Hartlepool Water Plc (net of cash acquired).....		—	(7.3)	—
Disposals of investment.....		—	0.1	—
Net cash outflow for acquisitions and disposals.....		—	(7.2)	—
Equity dividends paid.....		(86.9)	(140.6)	(305.6)
Net cash outflow before financing.....		(397.1)	(108.1)	(274.6)
Financing				
Increase in loans.....		311.1	670.6	301.4
Repayments of amounts borrowed.....	(c)	(82.5)	(558.2)	(35.8)
Capital element of finance lease rental payments.....		(19.5)	(11.4)	(10.0)
Net cash inflow from financing.....		209.1	101.0	255.6
Decrease in cash.....	(c)	(188.0)	(7.1)	(19.0)

The notes on pages 262 to 263 form part of this cash flow statement.

## Notes to cash flow statement

*For the year ended 31 March*

	2002 £m	2001 £m	2000 £m
(a) Reconciliation of operating profit to net cash inflow from operating activities:			
Operating profit.....	276.8	265.2	299.8
Depreciation (net of amortisation of deferred grants and contributions).....	150.6	136.5	121.3
Net movement in prepaid pension contributions .....	(10.9)	(0.1)	—
Net movement on provisions .....	(5.6)	2.2	9.0
	410.9	403.8	430.1
(Increase)/decrease in working capital:			
Stocks.....	(0.1)	0.1	(0.7)
Debtors.....	(26.1)	(10.0)	(10.8)
Creditors.....	(6.0)	(4.2)	36.6
	(32.2)	(14.1)	25.1
Net cash inflow from operating activities .....	378.7	389.7	455.2

The cash flow statement for the year ended 31 March 2002 includes net cash outflows of £9.4 million in respect of 2002 exceptional charges and £7.8 million in respect of prior years' exceptional charges. The comparatives for the year ended 31 March 2001 include cash outflows of £5.7 million in respect of 2000/2001 exceptional charges and £4.3 million in respect of prior year exceptional charges. The comparatives for the year ended 31 March 2000 include cash outflows of £21.7 million in respect of prior year restructuring.

	Cash £m	Bank overdraft £m	Debt due within one year £m	Debt due after one year £m	Total £m
(b) Analysis of net debt					
31 March 2000.....	27.0	—	(321.0)	(1,153.4)	(1,447.4)
Cash flows.....	(8.0)	—	321.0	(422.0)	(109.0)
Acquisitions.....	0.9	—	—	(2.7)	(1.8)
Non cash movements.....	—	—	(96.9)	84.6	(12.3)
	19.9	—	(96.9)	(1,493.5)	(1,570.5)
31 March 2001.....	19.9	—	(96.9)	(1,493.5)	(1,570.5)
Cash flows.....	(19.1)	(168.9)	96.9	(306.0)	(397.1)
Non cash movements.....	—	—	(88.1)	84.8	(3.3)
	0.8	(168.9)	(88.1)	(1,714.7)	(1,970.9)
	0.8	(168.9)	(88.1)	(1,714.7)	(1,970.9)

Non cash movements comprise indexation of loan stock and transfers between categories of debt.

*For the year ended 31 March*

	<i>2002</i>	<i>2001</i>	<i>2000</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
(c) Movement in net debt:			
At beginning of year .....	(1,570.5)	(1,447.4)	(1,172.8)
Decrease in cash .....	(188.0)	(7.1)	(19.0)
Loan assumed from Hartlepool Water Plc .....	—	(2.7)	—
Increase in loans .....	(311.1)	(670.6)	(301.4)
Repayment of amounts borrowed .....	82.5	558.2	35.8
Indexation of loan stock .....	(3.3)	(12.3)	—
Capital element of finance lease rental payments .....	19.5	11.4	10.0
At end of year .....	<u>(1,970.9)</u>	<u>(1,570.5)</u>	<u>(1,447.4)</u>



## Notes to the financial information

### 1. Accounting Policies

The financial information has been prepared under the historical cost convention and in accordance with applicable accounting standards and in accordance with the Companies Act 1985, except as disclosed in note 1(d) below as relating to grants and contributions.

During the year ended 31 March 2002, three new accounting standards were introduced: FRS 17 "Retirement Benefits", FRS 18 "Accounting Policies", and FRS 19 "Deferred tax".

In respect of FRS 17 "Retirement Benefits", the Company has adopted the disclosure requirements only, and has not adopted the standard. This is permitted by FRS 17.

The effect of the implementation of FRS 19 is detailed below in 1(a) and in note 21.

The objective of FRS 18 is to ensure that accounting policies and estimation techniques adopted are the most appropriate for the purpose of giving a true and fair view; and that those policies are reviewed regularly by the board of directors. None of the Company's accounting policies have been changed as a result of the implementation of FRS 18.

The following principal accounting policies and estimation techniques have been consistently applied to the financial information as stated except for the change relating to FRS 19:

(a) Change in accounting policy

FRS 19 "Deferred Tax" has been adopted for the first time by the Company in the year ended 31 March 2002.

In previous years the Company has complied with the Statement of Standard Accounting Practice 15 "Deferred Taxation" (SSAP 15) which has now been superseded by the introduction of FRS 19. SSAP 15 required provision for deferred taxation to be made using the liability method to the extent that net deferred tax assets or liabilities were likely to crystallise in the foreseeable future. This method was commonly referred to as partial provisioning. FRS 19, by contrast, requires a form of full provisioning (see note 1(j) deferred taxation).

The effect of the implementation of FRS 19 on reported results is to reduce the tax charge for the year ended 31 March 2002 by £15.8 million (2001 – increase by £8.9 million) and to reduce net assets by £88.4 million (2001 – £104.2 million) as set out below. The financial information for the year ended 31 March 2000 has not been restated to give effect to adjustments that would be required in connection with the adoption of FRS 19.

	<i>2002</i> <i>£m</i>	<i>2001</i> <i>£m</i>
(Reduction)/increase in tax on profit on ordinary activities .....	(15.8)	8.9
(Increase)/reduction in profit for the period .....	(15.8)	8.9
Deferred tax liability.....	138.4	122.5
Deferred tax asset .....	(50.0)	(18.3)
Net deferred tax liability .....	<u>88.4</u>	<u>104.2</u>

The adoption of FRS 19 has resulted in a provision for deferred tax primarily in respect of accelerated capital allowances and other short term timing differences which were not recognised under SSAP15, partially offset by an Advance Corporation Tax (ACT) asset. These amounts are stated after discounting, in accordance with FRS 19.

The adjustment to the financial information for the year ended 31 March 2001 arising from the implementation of FRS 19 is set out below:

	<i>2001</i> <i>£m</i>
Net deferred tax liability recognised .....	104.2
ACT charge previously offset against Corporation Tax liability .....	(6.0)
	<hr/>
Prior year adjustment.....	98.2
	<hr/> <hr/>

(b) Turnover

Turnover represents the income receivable (excluding value added tax) in the ordinary course of business for goods and services provided and, in respect of unbilled charges, includes an accrual for measured income.

The measured income accrual is an estimation of the amount of main water and waste-water charges unbilled at the year end. The accrual is estimated using a defined methodology based upon weighted average water consumption by tariff, which is calculated based upon historical billing information.

(c) Tangible fixed assets and depreciation

Tangible fixed assets comprise:

Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) comprise a network of systems. Investment expenditure on infrastructure assets relating to increases in capacity or enhancements of the network and on maintaining the operating capability of the network in accordance with defined standards of service, is treated as an addition and included at cost after deducting grants and contributions. The depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network which is based on the Company's independently certified asset management plan.

Other assets (including properties, overground plant and equipment) are included at cost less accumulated depreciation. Freehold land is not depreciated. Depreciation of other assets is calculated at rates expected to write off cost less estimated residual value of the relevant assets over their estimated economic lives, which are principally as follows:

Operational structures.....	40-80 years
Buildings.....	30-60 years
Fixed plant.....	20-40 years
Vehicles, mobile plant and computers.....	3-10 years

Assets in the course of construction are not depreciated until they are commissioned.

Interest costs are not capitalised into the cost of fixed assets.

(d) Grants and contributions

Grants and contributions on capital expenditure, other than those relating to infrastructure assets, are credited to a deferral account within creditors and are released to revenue evenly over the expected useful life of the relevant asset in accordance with the provisions of the Companies Act 1985.

Grants and contributions to capital expenditure on infrastructure assets are deducted from the costs of these assets. This policy is not in accordance with the provisions of SSAP 4 "Accounting for Government Grants", but has been adopted in order to show a true and fair view as, in the opinion of the directors, while a provision is made for depreciation of infrastructure assets, these assets have no determinable finite economic life and hence no basis exists on which to recognise such contributions as deferred income. The financial effect of this departure is disclosed in note 13.

Revenue grants and contributions are credited to the profit and loss account in the year to which they apply.

(e) Leased assets

Where assets are financed by leasing arrangements which transfer substantially all the risks and rewards of ownership of an asset to the lessee (finance leases), the assets are treated as if they had been purchased and the corresponding capital cost is shown as an obligation to the lessor. Leasing payments are treated as consisting of a capital element and finance costs, the capital element reducing the obligation to the lessor, and the finance costs being written off to the profit and loss account over the primary period of the lease. The assets are depreciated over the shorter of their estimated useful lives and the lease period.

All other leases are regarded as operating leases. Rental costs arising under operating leases are expensed over the term of the lease.

(f) Investments

Investments held as fixed assets are stated at cost less any provision for impairment.

(g) Stocks

Stocks are stated at cost less any provision necessary to recognise damage and obsolescence.

(h) Pension costs

The Company is a member of the AWG plc group, which principally operates defined benefit pension schemes.

Contributions to the group's defined benefit pension scheme is charged to the profit and loss account so as to spread the regular cost of pensions over the average service lives of employees, in accordance with the advice of an independent qualified actuary. Actuarial surpluses and deficits are amortised, where appropriate, over the average remaining service lives of employees. The cost of defined contribution schemes is charged to the profit and loss account in the year in respect of which the contributions become payable.

(i) Research and development

Research and development expenditure is charged to the profit and loss account in the year in which it is incurred.

(j) Deferred taxation

Deferred taxation is provided on timing differences, arising from the different treatment for accounts and taxation purposes of event and transactions recognised in the financial statements of the current and previous years. Deferred taxation is calculated at the rates at which it is estimated that taxation will arise. The deferred taxation balances are discounted using the post tax yields to maturity that could be obtained at the balance sheet date on Government bonds with maturity dates similar to those of the deferred taxation assets and liabilities.

Deferred taxation is not provided in respect of timing differences arising from the sale or revaluation of fixed assets unless, by the balance sheet date, a binding commitment to sell the asset has been entered into, and it is unlikely that any gain will be rolled over.

Deferred taxation assets are recognised to the extent that it is regarded as more likely than not that there will be suitable taxable profits against which the deferred tax asset can be recovered in future periods.

*Calculation of deferred tax on infrastructure assets:*

Infrastructure assets have an effectively unlimited life and a notional depreciation charge, the infrastructure renewal charge, is applied to the network (see note 1(c) tangible fixed assets and depreciation).

For the purposes of estimating the deferred tax liability in relation to infrastructure assets, the useful life over which the underlying differences reverse is estimated by deflating the current cost

based infrastructure renewals charge to an appropriate deemed historic cost based depreciation charge.

(k) Related party transactions

The Company has taken advantage of the exemption not to disclose transactions with other members of the group under FRS 8 “Related Party Disclosures” as it is a wholly-owned subsidiary.

(l) Bad debts

The bad debt provision is calculated based on applying expected recovery rates to an aged debt profile.

(m) Financial instruments

The principal derivative instruments utilised by the Company are currency and interest rate swaps which are valued at cost. These instruments are used for hedging purposes in line with the group’s risk management policy and no trading in financial instruments is undertaken. Interest differentials are taken to net interest payable in the profit and loss account and premiums and fees are amortised at a constant rate over the life of the underlying instrument. The principal amounts under currency swaps are revalued at closing rates of exchange and included in the sterling value of loans.

## 2. Segmental analysis

The directors believe that the whole of the Company’s activities constitute a single class of business.

The Company’s turnover is wholly generated from within the United Kingdom.

## 3. Operating costs

	<i>Before operating exceptional items £m</i>	<i>Operating exceptional items £m</i>	<i>2002 Total £m</i>	<i>Before operating exceptional items £m</i>	<i>Operating exceptional items £m</i>	<i>2001 Total £m</i>	<i>Before operating exceptional items £m</i>	<i>Operating exceptional items £m</i>	<i>2000 Total £m</i>
Operating costs before depreciation:									
Raw materials and consumables .....	17.7	—	17.7	17.4	0.2	17.6	14.2	—	14.2
Other operating costs .....	183.2	22.5	205.7	201.1	4.9	206.0	199.4	17.1	216.5
Staff costs (see note 9) .....	104.2	4.4	108.6	95.1	7.1	102.2	95.3	25.3	120.6
Own work capitalised .....	(35.0)	—	(35.0)	(32.9)	—	(32.9)	(40.9)	—	(40.9)
<b>Total operating costs before depreciation .....</b>	<b>270.1</b>	<b>26.9</b>	<b>297.0</b>	<b>280.7</b>	<b>12.2</b>	<b>292.9</b>	<b>268.0</b>	<b>42.4</b>	<b>310.4</b>
Depreciation of tangible fixed assets.....	156.6	—	156.6	142.3	—	142.3	126.8	—	126.8
Amortisation of deferred grants and contributions..	(6.0)	—	(6.0)	(5.8)	—	(5.8)	(5.5)	—	(5.5)
Depreciation net of amortisation of grants and contributions.....	150.6	—	150.6	136.5	—	136.5	121.3	—	121.3
<b>Total operating costs.....</b>	<b>420.7</b>	<b>26.9</b>	<b>447.6</b>	<b>417.2</b>	<b>12.2</b>	<b>429.4</b>	<b>389.3</b>	<b>42.4</b>	<b>431.7</b>

#### 4. Exceptional items

	<i>For the year ended 31 March</i>		
	<i>2002</i>	<i>2001</i>	<i>2000</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Operating costs:			
Restructuring costs.....	4.4	12.2	37.3
Refinancing costs.....	22.5	—	—
Year 2000 costs.....	—	—	5.1
	<u>26.9</u>	<u>12.2</u>	<u>42.4</u>
Profit on sale of fixed assets.....	(3.3)	(4.5)	(7.0)
Loss on sale of fixed assets.....	—	2.7	8.0
	<u>(3.3)</u>	<u>(1.8)</u>	<u>1.0</u>
Total exceptional items	<u>23.6</u>	<u>10.4</u>	<u>43.4</u>
Taxation credit thereon.....	<u>(7.3)</u>	<u>(2.4)</u>	<u>(8.0)</u>

Restructuring costs of £4.4 million (2001 – £12.2 million, 2000 – £37.3 million) principally comprise redundancy and associated early retirement pension obligations.

The Company is undertaking a major refinancing project which, it is anticipated, will be completed during the financial year 2002/2003. The costs shown in the year ended 31 March 2002, which comprise legal and advisers' fees and bankers' costs, relate to that project.

The (profit)/loss on sale of fixed assets relates to various sales of surplus land and assets.

#### 5. Operating profit

	<i>For the year ended 31 March</i>		
	<i>2002</i>	<i>2001</i>	<i>2000</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Operating profit is stated after charging:			
Hire of plant and machinery.....	2.1	4.4	2.3
Other operating lease costs.....	11.1	10.3	12.2
Research and development expenditure.....	2.3	5.2	5.6
Fees paid to auditors:			
— for audit work.....	0.1	0.1	0.1
— for other work.....	1.1	0.1	0.1

Fees paid to the auditors for other work are primarily in respect of advisory services relating to refinancing proposals.

## 6. Interest payable (net)

	<i>For the year ended 31 March</i>		
	<i>2002</i>	<i>2001</i>	<i>2000</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Bank loans and overdrafts .....	1.2	0.3	0.4
Other loans including financing expenses.....	106.1	112.0	85.8
Finance leases .....	9.9	12.3	10.7
Amortisation of discount on long-term provisions (see note 20) .....	2.2	2.0	—
	119.4	126.6	96.9
Interest receivable .....	(16.7)	(6.5)	(0.6)
Total interest payable (net).....	102.7	120.1	96.3

Interest of £74.6 million (2001 – £73.8 million, 2000 – £63.8 million) is payable to the immediate parent company.

Interest of £14.9 million (2001 – nil, 2000 – nil) is receivable from the immediate parent company.

Other loans interest for 2001 includes an early redemption premium of £4.3 million paid to English Partnerships.

## 7. Taxation

	<i>For the year ended 31 March</i>		
	<i>2002</i>	<i>2001</i>	<i>2000</i>
	<i>£m</i>	<i>(restated)</i> <i>£m</i>	<i>£m</i>
(a) Analysis of tax (credit)/charge in the year			
Current tax:			
UK Corporation Tax at 30 per cent. (2001 – 30 per cent., 2000 – 30 per cent.).....	22.3	26.7	33.3
Adjustments in respect of previous periods.....	(35.1)	—	—
Total current tax (see note 7(b)) .....	(12.8)	26.7	33.3
Deferred tax			
Origination and reversal of timing differences.....	35.1	28.7	—
Increase in discount .....	(32.8)	(18.0)	—
Discounted effect of movements in ACT.....	(23.9)	(1.8)	—
Adjustments in respect of previous periods.....	5.8	—	—
Total deferred tax (see note 7(b)) .....	(15.8)	8.9	—
Tax (credit)/charge on ordinary activities.....	(28.6)	35.6	33.3
Analysed as:			
— before exceptional items.....	(21.3)	38.0	41.3
— exceptional items .....	(7.3)	(2.4)	(8.0)
Total taxation (credit)/charge .....	(28.6)	35.6	33.3

(b) Factors affecting tax charge for the periods

The tax assessed for the year is lower than the standard rate of corporation tax in the UK (30 per cent.).

The differences are explained below:

	<i>For the year ended 31 March</i>	
	<i>2002</i>	<i>2001 (restated)</i>
	<i>£m</i>	<i>£m</i>
Profit on ordinary activities before tax .....	177.4	147.1
Tax on profit on ordinary activities at the standard UK rate of tax (30 per cent.).....	53.2	44.1
Effects of:		
Expenses not deductible for tax purposes .....	2.4	3.2
Accounting for depreciation not eligible for tax purposes .....	1.7	2.9
Capital allowances for the year in excess of depreciation .....	(28.4)	(23.2)
Short-term timing differences .....	(6.6)	(0.3)
Adjustments to tax charge in respect of previous period .....	(35.1)	—
Current tax (credit)/charge for the year (see note 7(a)).....	(12.8)	26.7

The comparatives for the year ended 31 March 2001 have been restated in respect of the adoption of FRS 19 (see note 1(a)). The comparatives for the year ended 31 March 2000 have not been restated.

**8. Dividends**

	<i>For the year ended 31 March</i>		
	<i>2002</i>	<i>2001</i>	<i>2000</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Ordinary:			
Interim paid .....	—	37.2	45.5
Final payable .....	—	886.1	103.4
	—	923.3	148.9

**9. Employee information**

	<i>Before operating exceptional items £m</i>	<i>Operating exceptional items £m</i>	<i>2002 Total £m</i>	<i>Before operating exceptional items £m</i>	<i>Operating exceptional items £m</i>	<i>2001 Total £m</i>	<i>Before operating exceptional items £m</i>	<i>Operating exceptional items £m</i>	<i>2000 Total £m</i>
Staff costs:									
Wages and salaries .....	91.3	2.9	94.2	86.1	2.8	88.9	85.9	11.5	97.4
Social security costs ...	8.0	—	8.0	8.7	—	8.7	6.9	—	6.9
Pension costs (see note 25) .....	4.9	1.5	6.4	0.3	4.3	4.6	2.5	13.8	16.3
	104.2	4.4	108.6	95.1	7.1	102.2	95.3	25.3	120.6

Pension costs are stated after crediting £6.4 million (2001 – £9.9 million, 2000 – £6.8 million) in respect of the amortisation of an actuarial surplus in the main UK pension scheme.

Average number of full-time equivalent persons employed:

	<i>For the year ended 31 March</i>		
	<i>2002</i>	<i>2001</i>	<i>2000</i>
Number employed.....	3,705	3,773	3,989

#### 10. Non-executive directors' fees

The fees for the non-executive directors are set by the board. From 1 April 2002 these fees were £25,000 per annum (pa). The deputy chairman is entitled to additional remuneration of £15,000 pa (inclusive of remuneration for chairing the audit committee). Mr R Napier receives an additional remuneration of £6,000 pa for chairing the sustainable development committee.

The non-executive directors, other than Mr C J Mellor, do not receive benefits or pension contributions from the group, nor do they participate in any of the group's incentive schemes.

Mr C J Mellor receives the salary, benefits and pension contributions detailed in notes 11 below.

#### 11. Directors' emoluments

The emoluments of Mr C J Mellor, Mr R A Pointer, Mr A T Eckford and Mr E M Mannis were paid by Anglian Water Plc (AW Plc) and the following percentages of their total emoluments – C J Mellor 10 per cent (2001 – 10 per cent, 2000 – 50 per cent), R A Pointer 70 per cent (2001 – 70 per cent, 2000 – 90 per cent), A T Eckford nil per cent (2001 – nil per cent, 2000 – 10 per cent) and E M Mannis 10 per cent (2001 – 10 per cent, 2000 – 50 per cent) was included within the management charge by AW Plc to the Company. All the other directors were paid direct by the Company.

The emoluments of the directors of the Company for their services as directors of the Company are set out below (rounded to the nearest thousand pounds).

	<i>Salary/fees</i>	<i>Benefits</i>	<i>Bonus compensation</i>	<i>FURBS</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>Total</i>	<i>Total</i>	<i>Total</i>
					<i>£000</i>	<i>£000</i>	<i>£000</i>
C J Mellor.....	30	2	2	—	34	35	153
A T Eckford (resigned 26.11.2001)...	—	—	—	—	—	—	21
E M Mannis (resigned 26.11.2001)...	20	2	2	7	31	28	102
R A Pointer.....	142	11	30	—	183	157	170
R W Jewson (appointed 01.02.2002).	10	—	—	—	10	—	—
D S Hipple (appointed 26.11.2001)...	41	5	—	—	46	—	—
C L Brown (appointed 26.11.2001)...	41	6	—	—	47	—	—
R Napier (appointed 01.02.2002).....	5	—	—	—	5	—	—
R Whitcomb (appointed 15.03.2002).	2	—	—	—	2	—	—
	291	26	34	7	358	220	446



The amount of pension entitlements earned, the accrued pension liabilities and the changes therein during the period to 31 March 2002 are summarised below. The table shows the full amounts for each of the directors for their services to the AWG group. The pensions liabilities are calculated using the cash equivalent transfer value method, which is the method adopted in the Listing Rules of the Financial Services Authority (rounded to the nearest thousand pounds).

					<i>At 31 March 2001</i>		<i>At 31 March 2000</i>	
	<i>Accrued pension 2002</i>	<i>Increase in accrued pension 2002</i>	<i>Accrued pension lump sum 2002</i>	<i>Transfer value of increases 2002</i>	<i>Accrued pension 2001</i>	<i>Accrued pension lump sum 2001</i>	<i>Accrued pension 2000</i>	<i>Accrued pension lump sum 2000</i>
	<i>£000<sup>(1)</sup></i>	<i>£000<sup>(2)</sup></i>	<i>£000<sup>(3)</sup></i>	<i>£000<sup>(4)(5)</sup></i>	<i>£000<sup>(1)</sup></i>	<i>£000<sup>(3)</sup></i>	<i>£000<sup>(1)</sup></i>	<i>£000<sup>(3)</sup></i>
C J Mellor .....	147	11	371	154	134	337	109	273
A T Eckford .....	38	8	—	111	30	—	20	—
R A Pointer .....	105	10	290	161	94	259	74	205
E M Mannis .....	22	7	—	43	15	—	7	—
D S Hipple .....	28	5	—	49	—	—	—	—
C L Brown .....	32	1	—	11	—	—	—	—

- (1) The accrued pension entitlement shown is that which would be paid annually on retirement based on service to the end of the financial year.
- (2) The increase in accrued pension during the year excludes any increase for inflation.
- (3) The accrued pension lump sum shown is that which is payable on retirement based on service to the end of the financial year.
- (4) The transfer value of increases has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11, less directors' contributions.
- (5) The transfer value of increases includes adjustment of pensions to reflect salary increases granted on promotion as well as, where relevant, the value of benefits on improvement award.

Mr A T Eckford and Mr E M Mannis participate in funded, unapproved retirement benefit schemes (FURBS). For the year ended 31 March 2002 the group contributed to these schemes in respect of Mr A T Eckford £57,996 (2001 – £55,574, 2000 – £31,161) and in respect of Mr E M Mannis £36,686 (2001 – £30,442, 2000 – £18,532). The value of the benefits attributable to these amounts is included under directors' emoluments.

The transfer values disclosed in the previous table are actuarially determined to provide for pensions liability and not sums paid by the group to the individuals concerned. They cannot meaningfully be added to their annual remuneration.

## 12. Directors' interests in shares and contracts

These beneficial interests in shares and options for Mr C J Mellor, Mr R A Pointer, Mr A T Eckford and Mr E M Mannis are the same as, and not additional to, those disclosed in the annual report and accounts of AWG plc. Directors have the right to participate in the employee sharesave scheme. Details of directors' options are available in the Company's Register of Directors' Interests, which is open to inspection.

The interests of the directors in the shares of AWG plc and in options over such shares granted under that company's executive share option scheme, annual bonus scheme, long-term incentive plan and sharesave scheme are set out below.

Throughout this note, all interests in shares as at 31 March 2002 and 31 March 2001 are in relation to AWG plc ordinary shares of 10 pence each. The figures as at 31 March 2000 are in respect of ordinary shares of 47½ pence in the capital of Anglian Water Plc and have been given for comparative purposes.

**Beneficial and family interests in shares:**

	<i>31 March 2002</i> <i>No. of shares</i>	<i>31 March 2001</i> <i>No. of shares</i>	<i>31 March 2000</i> <i>No. of shares</i>
C J Mellor .....	21,575	19,650	15,972
E M Mannis <sup>(1)</sup> .....	11,663	10,380	9,067
A T Eckford <sup>(1)</sup> .....	5,404	4,121	2,720
R A Pointer .....	25,724	24,576	14,694
R W Jewson <sup>(3)</sup> .....	784	784	—
C L Brown <sup>(2)</sup> .....	5,615	5,615	—
D S Hipple <sup>(2)</sup> .....	—	—	—
R Napier <sup>(3)</sup> .....	—	—	—
R Whitcomb <sup>(4)</sup> .....	—	—	—

(1) at date of resignation (26.11.2001), 31 March 2001 and 31 March 2000

(2) at date of appointment (26.11.2001) and 31 March 2002

(3) at date of appointment (1.2.2002) and 31 March 2002

(4) at date of appointment (15.3.2002) and 31 March 2002

The figures at 31 March 2002 include ordinary shares held in trust for directors as the share element of the annual bonus scheme, being Mr C J Mellor 4,000, Mr A T Eckford 2,684, Mr R A Pointer 2,418 and Mr E M Mannis 2,596.

Each director has notified the Company that, for the purposes of Section 324 of the Companies Act 1985, he has a contingent interest in the following number of shares, representing the maximum number of shares to which he would become entitled under the group's long-term incentive plan: Mr C J Mellor 75,819 (2001 – 75,819, 2000 – 35,221); Mr A T Eckford 51,614 (2001 – 51,614, 2000 – 27,820); Mr R A Pointer 49,375 (2001 – 49,375, 2000 – 22,319), Mr E M Mannis 50,372 (2001 – 50,372, 2000 – 16,625) and Mr C L Brown 21,625 (2001 – 21,625).

Each executive director has notified the Company that, for the purposes of Section 324 of the Companies Act 1985, he has a contingent interest in the following number of shares, representing the maximum number of shares to which he would become entitled under the group's Executive Share Option Scheme: Mr C J Mellor 173,595; Mr A T Eckford 115,730; Mr R A Pointer 126,148 (2001 – 10,418) and Mr E M Mannis 115,730. All of these Executive Share Options, apart from the 10,418 granted to Mr R Pointer prior to 1996, are subject to performance targets details of which are shown in the Remuneration Report section of the AWG plc annual report and accounts 2002.

Options to subscribe for ordinary shares, under the sharesave and Executive Share Option schemes, granted to, lapsed and exercised by directors during the year, are summarised below. Details of these schemes, including exercise dates, are shown below.

	<i>Options outstanding 1 April 2001</i>			<i>Options exercised</i>					<i>Options Outstanding at 31 March 2002</i>		
	<i>Number</i>	<i>Number</i>	<i>Option price (£)</i>	<i>Number</i>	<i>Weighted average exercise price (£)</i>	<i>Weighted average market price (£)</i>	<i>Gain on exercise of options (£)</i>	<i>Option lapsed</i>	<i>Option price (£)</i>	<i>Number</i>	<i>Weighted average exercise price (£)</i>
<i>Sharesave scheme</i>											
C J Mellor .....	2,419	—	—	—	—	5.58	—	—	—	2,419	5.25
E M Mannis .....	2,232	—	—	—	—	5.58	—	—	—	2,232	4.34
A T Eckford .....	3,888	—	—	—	—	5.58	—	—	—	3,888	4.34
R A Pointer .....	2,133	—	—	—	—	5.58	—	—	—	2,133	4.54
C L Brown .....	4,642	—	—	1,483	4.65	5.58	1,379	—	—	3,159	4.43
D S Hipple .....	—	2,261	4.20	—	—	5.58	—	—	—	2,261	4.20
<i>Executive share option scheme</i>											
C J Mellor .....		173,595	5.27	—	—	5.58	—	—	—	173,595	5.27
E M Mannis .....		115,730	5.27	—	—	5.58	—	—	—	115,730	5.27
A T Eckford .....		115,730	5.27	—	—	5.58	—	—	—	115,730	5.27
R A Pointer .....	10,418 <sup>(1)</sup>	115,730	5.27	—	—	5.58	—	—	—	126,148	5.28

(1) Executive options granted to Mr R A Pointer prior to 1996

The market price of shares in AWG plc at 31 March 2002 was £5.255 and the range during the year was £4.92 to £5.85.

No director has an interest in the shares or debentures of the Company or any other group company other than as shown above.

Options granted under the Sharesave Scheme are exercisable within a period of six months after either the third, fifth or seventh anniversary of the date of the savings contract. Options under the Executive Share Option Scheme are exercisable during a period commencing on the third anniversary and ending on the tenth anniversary of grant. The dates of grant and the option prices at 31 March 2002 are set out below.

	<i>Date of grant</i>	<i>Option price</i>		<i>Date of grant</i>	<i>Option price</i>
Sharesave Scheme	14.12.1995	£4.65	Executive Share Option Scheme	15.12.1992	£4.73
Sharesave Scheme	12.12.1996	£4.52	Executive Share Option Scheme	7.7.1993	£4.74
Sharesave Scheme	10.12.1997	£6.19	Executive Share Option Scheme	1.12.1993	£5.30
Sharesave Scheme	9.12.1998	£7.12	Executive Share Option Scheme	15.8.1994	£5.375
Sharesave Scheme	12.1.2000	£4.34	Executive Share Option Scheme	10.6.1996	£5.71
Sharesave Scheme	31.1.2001	£4.68	Executive Share Option Scheme	7.11.1996	£5.50
Sharesave Scheme	6.2.2002	£4.20	Executive Share Option Scheme	21.12.2001	£5.27

No director had during the year, or has, a material interest in any contract of significance to which the Company or any of its subsidiaries is or was a party.

### 13. Tangible fixed assets

	<i>Land and buildings £m</i>	<i>Infrastructure assets £m</i>	<i>Operational structures £m</i>	<i>Vehicles plant and equipment £m</i>	<i>Total £m</i>
<b>Cost</b>					
At 31 March 2000.....	54.0	1,777.4	2,079.8	789.7	4,700.9
Acquired from Hartlepool Water Plc.....	0.7	7.9	3.1	0.3	12.0
Additions .....	1.3	80.6	65.0	116.0	262.9
Transfers from Group Undertaking.....	3.3	—	—	—	3.3
Disposals .....	—	(0.7)	(0.4)	(3.3)	(4.4)
At 31 March 2001.....	59.3	1,865.2	2,147.5	902.7	4,974.7
Additions .....	1.3	92.0	57.1	114.0	264.4
Disposals .....	(1.0)	(0.7)	(0.5)	(2.6)	(4.8)
At 31 March 2002.....	59.6	1,956.5	2,204.1	1,014.1	5,234.3
<b>Grants and contributions</b>					
At 31 March 2000.....	—	131.2	—	—	131.2
Acquired from Hartlepool Water Plc.....	—	1.5	—	—	1.5
Additions .....	—	4.7	—	—	4.7
At 31 March 2001.....	—	137.4	—	—	137.4
Additions .....	—	15.8	—	—	15.8
At 31 March 2002.....	—	153.2	—	—	153.2
<b>Depreciation</b>					
At 31 March 2000.....	19.3	281.6	584.3	297.3	1,182.5
Charge for the year.....	2.7	27.6	23.5	88.5	142.3
Disposals .....	—	(0.7)	(0.4)	(2.9)	(4.0)
At 31 March 2001.....	22.0	308.5	607.4	382.9	1,320.8
Charge for the year.....	1.7	27.1	24.2	103.6	156.6
Disposals .....	(0.1)	(0.7)	(0.4)	(2.1)	(3.3)
At 31 March 2002.....	23.6	334.9	631.2	484.4	1,474.1
<b>Net book amount</b>					
At 31 March 2002.....	36.0	1,468.4	1,572.9	529.7	3,607.0
At 31 March 2001.....	37.3	1,419.3	1,540.1	519.8	3,516.5
At 31 March 2000.....	34.7	1,364.6	1,495.5	492.4	3,387.2

Tangible fixed assets at 31 March 2002 include £197.5 million of assets in the course of construction (2001 – £269.9 million, 2000 – £380.6 million) and also include land of £15.0 million (2001 – £10.6 million, 2000 – £9.8 million) which is not subject to depreciation. The Company's interests in land and buildings are almost entirely freehold.

The net book value of tangible fixed assets held under finance leases at 31 March 2002 was £170.3 million (2001 – £190.3 million, 2000 – £160.2 million). Depreciation charged on assets held under finance leases during the year ended 31 March 2002 amounted to £19.8 million (2001 – £19.7 million, 2000 – £5.6 million).

### Capital commitments

The Company has a substantial long-term investment programme, which includes expenditure to meet regulatory requirements, shortfalls in performance and condition and to provide for new demand and growth. The commitments shown below reflect only the value of orders placed at 31 March.

	<i>31 March</i>		
	<i>2002</i>	<i>2001</i>	<i>2000</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Contracted for but not provided in the financial statements..	63.4	66.5	66.1

### 14. Fixed asset investments

	<i>31 March</i>		
	<i>2002</i>	<i>2001</i>	<i>2000</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Shares at cost in participating interests .....	0.1	0.1	0.2
Other loans .....	0.1	0.1	0.1
	<u>0.2</u>	<u>0.2</u>	<u>0.3</u>

The Company also owns a number of non-trading companies. A complete list of subsidiary undertakings is available on request to the Company and will be filed with the next Annual Return to the Registrar of Companies.

A new, wholly-owned subsidiary, Anglian Water Services Financing plc, whose principal activity is that of a financing company, was incorporated in England during the year ended 31 March 2002.

Consolidated financial statements have not been prepared as permitted under Section 228 of the Companies Act 1985, since the Company is itself a wholly-owned subsidiary of AWG plc. In the opinion of the directors the value of the Company's investments is not less than the amount at which they are stated in the balance sheet.

### 15. Stocks

	<i>31 March</i>		
	<i>2002</i>	<i>2001</i>	<i>2000</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Raw materials and consumables .....	4.1	4.0	3.9

The current replacement value of stocks does not materially exceed the historical costs stated above.

## 16. Debtors

	<i>31 March</i>		
	<i>2002</i>	<i>2001</i> <i>(restated)</i>	<i>2000</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Amounts falling due within one year			
Trade debtors.....	81.5	76.5	159.7
Amounts owed by other group undertakings.....	341.9	15.0	7.5
Other debtors.....	16.7	17.5	14.9
Prepayments and accrued income .....	93.7	89.2	4.6
	<u>533.8</u>	<u>198.2</u>	<u>186.7</u>
Amounts falling due after more than one year			
Prepaid pension contributions .....	24.3	13.4	13.3
	<u>558.1</u>	<u>211.6</u>	<u>200.0</u>

Prepayments and accrued income as at 31 March 2002 includes water and wastewater income not yet billed of £91.4 million (2001 – £85.0 million). In the 2001 financial statements this debtor was reported within trade debtors. The directors believe the 2002 classification to be more appropriate. The comparatives at 31 March 2000 have not been restated.

## 17. Creditors: amounts falling due within one year

	<i>31 March</i>		
	<i>2002</i>	<i>2001</i> <i>(restated)</i>	<i>2000</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Current portion of long-term loans (including £4.6 million (2001 – £21.8 million, 2000 – £300 million) from the parent company).....	75.3	77.8	309.2
Bank overdraft.....	168.9	—	—
Obligations under finance leases .....	12.8	19.1	11.8
	<u>257.0</u>	<u>96.9</u>	<u>321.0</u>
Trade creditors .....	95.9	108.3	104.7
Amounts owed to other group undertakings.....	13.2	28.5	30.6
Receipts in advance .....	54.1	55.2	48.6
Corporation Tax .....	7.7	65.9	52.7
Other taxation and social security.....	3.0	3.1	1.2
Deferred grants and contributions .....	6.0	5.8	—
Accruals and deferred income.....	51.4	21.4	18.6
Dividend payable .....	799.2	886.1	103.4
	<u>1,030.5</u>	<u>1,174.3</u>	<u>359.8</u>

The comparatives at 31 March 2001 have been restated in respect of the adoption of FRS 19 “Deferred Tax” (see note 1(a)) and to transfer deferred grants and contributions due within one year from long-term creditors (see note 19). The directors believe the current year classification to be more appropriate. The comparatives at 31 March 2000 have not been restated.

## 18. Loans and other borrowings falling due after more than one year

	31 March		
	2002 £m	2001 £m	2000 £m
<b>Repayable wholly after five years</b>			
7.01% US\$ 122.75m loan 2008 <sup>(b)</sup> .....	86.3	—	—
7.13% US\$ 23m loan 2009 <sup>(b)</sup> .....	16.2	—	—
7.23% US\$ 215m loan 2011 <sup>(b)</sup> .....	151.1	—	—
	253.6	—	—
US\$ loan costs <sup>(h)</sup> .....	(0.9)	—	—
Adjustment for swap agreements <sup>(b)</sup> .....	2.6	—	—
	255.3	—	—
12.0% Fixed Rate Loan 2014 (from the parent company).....	100.0	100.0	100.0
5.125% Index Linked Loan Stock 2008 (from the parent company) <sup>(c)</sup> .....	146.8	145.2	138.9
Euro 350m Loan 2009 (from the parent company) <sup>(c)</sup> .....	214.6	218.6	—
Adjustment for swap agreement on Euro 350m Loan 2009 <sup>(c)</sup> .....	14.7	10.7	—
3.875% Index Linked Loan Stock 2020 (from the parent company) <sup>(c)</sup> .....	157.7	156.0	—
6.66% Fixed Rate Loan 2023 (from the parent company).....	200.0	200.0	200.0
6.4% Fixed Rate Loan 2029 (from the parent company).....	200.0	200.0	200.0
	1,289.1	1,030.5	638.9
<b>Repayable by instalments, any of which is due for repayment after five years</b>			
Finance leases <sup>(f)</sup> .....	199.3	218.4	181.6
Other loans <sup>(g)</sup> .....	0.7	2.6	21.6
	200.0	221.0	203.2
<b>Repayable wholly within five years</b>			
6.57% US\$ 40m loan 2005 <sup>(b)</sup> .....	28.1	—	—
6.65% US\$ 35m loan 2006 <sup>(b)</sup> .....	24.6	—	—
US\$ loan costs <sup>(h)</sup> .....	(0.2)	—	—
Adjustment for swap agreements <sup>(b)</sup> .....	0.6	—	—
	53.1	—	—
US\$122m loan 2006 (from the parent company) <sup>(a)</sup> .....	85.7	85.1	76.5
Adjustment for swap agreements <sup>(a)</sup> .....	(6.4)	(5.8)	2.8
	79.3	79.3	79.3
LIBOR plus 0.45% Floating Rate Loan 2002 (from the parent company).....	—	20.0	—
LIBOR plus 0.5% Floating Rate Loan 2002 (from the parent company).....	1.8	1.8	—
LIBOR plus 1% Floating Rate Loan 2002 (from the parent company).....	1.0	—	—
LIBOR plus 1% Floating Rate Loan 2002 (from the parent company).....	0.8	—	—
Base Rate plus 1% Floating Rate Loan 2002 (from the parent company).....	1.0	—	—
6.56% Fixed Rate Loan 2000 (from the parent company).....	—	—	300.0
LIBOR minus 0.15% European Investment Bank Loan 2001 .....	—	50.0	50.0
7.985% European Investment Bank Loan 2002.....	60.0	60.0	60.0
6.6% European Investment Bank Loan 2003 <sup>(d)</sup> .....	10.0	10.0	10.0
11.5% European Investment Bank Loan 2004.....	6.3	8.0	9.5
6.62% European Investment Bank Loan 2005.....	20.0	25.0	30.0
8.2% European Investment Bank Loan 2005.....	60.0	60.0	60.0
7.38% European Investment Bank Loan 2007.....	4.5	5.5	6.4
5.28% (previously 9.9%) European Investment Bank Loan 2007 .....	15.0	18.0	21.0
Finance leases <sup>(f)</sup> .....	0.9	1.3	5.0
Other loans <sup>(g)</sup> .....	—	—	1.1
	313.7	338.9	632.3
<b>Total loans and other borrowings</b> .....	1,802.8	1,590.4	1,474.4
Less amounts included in creditors falling due within one year .....	(88.1)	(96.9)	(321.0)
	1,714.7	1,493.5	1,153.4
<b>Due for repayment as follows:</b>			
Between one and two years .....	36.0	96.5	67.3
Between two and five years .....	278.9	244.9	144.5
After five years .....	1,399.8	1,152.1	941.6
	1,714.7	1,493.5	1,153.4

- (a) The Company has entered into swap agreements which eliminate the risk of currency fluctuations in relation to the US\$ loan 2006. In addition, through interest rate swaps, £59.8 million of this loan is effectively at a fixed interest rate of 8.371 per cent and the balance is at a floating rate of LIBOR plus 0.385 per cent.
- (b) The Company has entered into swap agreements which eliminate the risk of currency fluctuations in relation to these US\$ loans.
- (c) The Company has entered into swap agreements which eliminate the risk of currency fluctuations in relation to the Euro loan 2009. In addition, through interest rate swaps, the loan is effectively at a fixed interest rate of 6.328 per cent.
- (d) Through interest rate swaps the loan is effectively at a floating interest rate of 6 month LIBOR + 0.18 per cent.
- (e) The value of capital and interest elements of the Index Linked Loan Stocks are linked to movements in the Retail Price Index. The increase in the capital value during 2002 of £3.3 million (2001 – £12.3 million, 2000 – £nil) has been taken to the profit and loss account as part of interest payable.
- (f) Amounts due under finance leases comprise £12.8 million (2001 – £19.1 million, 2000 – £11.8 million) payable within one year, £15.2 million (2001 – £30.4 million, 2000 – £8.0 million) payable within one to two years, £62.2 million (2001 – £53.4 million, 2000 – £36.9 million) payable between two and five years and £110.0 million (2001 – £116.8 million, 2000 – £129.9 million) payable after five years.
- (g) Of the unspecified loans and other borrowings, £0.7 million (2001 – £1.9 million, 2000 – £19.0 million) are at fixed rates and £nil (2001 – £0.7 million) are at variable rates. Loans and other borrowings include £0.5 million (2001 – £0.7 million, 2000 – £0.9 million) secured on the revenues of the Company.
- (h) These costs are amortised at a constant rate on the carrying amount of debt over the life of the underlying instruments.

## 19. Other creditors falling due after more than one year

	<i>31 March</i>		
	<i>2002</i>	<i>2001</i> <i>(restated)</i>	<i>2000</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Trade creditors .....	—	—	0.4
Deferred grants and contributions .....	86.1	90.2	91.8
	<u>86.1</u>	<u>90.2</u>	<u>92.2</u>

The comparatives at 31 March 2001 have been restated to allow for the element of deferred grants and contributions due within one year to be transferred to short-term creditors. The directors believe the current year classification to be more appropriate. The comparatives at 31 March 2000 have not been restated.

## 20. Provisions for liabilities and charges

	<i>Restructuring costs</i>	<i>Unfunded pension obligations</i>	<i>Deferred tax</i>	<i>2002 Total</i>	<i>2001 Total (restated)</i>	<i>2000 Total</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
Opening balance .....	5.5	25.8	—	31.3	29.1	20.1
Prior year adjustment .....	—	—	104.2	104.2		
Opening balance (restated).....	5.5	25.8	104.2	135.5		
Charge/(credit) for the year .....	4.4	—	(15.8)	(11.4)	12.2	37.3
Amortisation of discount.....	—	2.2	—	2.2	2.0	—
Utilised in the year.....	(9.9)	(2.3)	—	(12.2)	(12.0)	(28.3)
Closing balance .....	—	25.7	88.4	114.1	31.3	29.1
Prior year adjustment .....					104.2	
Closing balance (restated).....					<u>135.5</u>	

The provision for restructuring costs has been fully utilised in the year ended 31 March 2002.

The provision for pension obligations relates to the cost of unfunded pension enhancements. These pension payments are expected to be made over several future accounting periods. The provision is



determined using actuarial assumptions based on those used for the valuation of the AWG Group's pension scheme and has been discounted at a rate of 9 per cent. which reflects the AWG Group's cost of capital.

The balance at 31 March 2001 has been restated in respect of the adoption of FRS 19 (see note 1(a)). The comparatives for the year ended 31 March 2000 have not been restated.

The deferred tax provision is analysed in note 21.

## 21. Deferred taxation

FRS 19 has been adopted for the first time by the Company during the year ended 31 March 2002, the effects of which are explained in note 1(a), Accounting policies.

The total tax charge or credit in future years will include discounted deferred taxation. Consequently, changes in the medium and long-term interest rates used to discount deferred taxation assets and liabilities will affect the amount of deferred taxation charged or credited in the profit and loss account.

In addition, an ACT asset is offset against deferred tax liabilities: this would be liable to de-recognition if changes in the tax legislation were introduced which restricted the ability of companies to use ACT. In this event, an additional tax charge would arise in the profit and loss account.

	<i>£m</i>	
	<u>2002</u>	<u>2001</u>
	<i>£m</i>	<i>(restated)</i>
		<i>£m</i>
At 1 April 2001 (originally nil before prior year adjustment of £98.2 million and £6.0 million ACT charge provisionally offset against Corporation Tax liability) .....	104.2	
Deferred tax credited to the profit and loss account .....	(15.8)	
	<u>88.4</u>	
At 31 March 2002 .....		<u>88.4</u>
	<u>715.4</u>	<u>648.1</u>
Accelerated capital allowances.....	(16.2)	(19.8)
Short-term timing differences.....	(98.8)	(30.5)
Surplus ACT asset.....	<u>600.4</u>	<u>597.8</u>
Undiscounted provision for deferred tax.....	(512.0)	(493.6)
Discount.....	<u>88.4</u>	<u>104.2</u>
Discounted provision for deferred tax.....		

The comparatives for the year ended 31 March 2001 have been restated for the effect of the prior year adjustment which is necessary following the adoption of FRS 19. The comparatives for the year ended 31 March 2000 have not been restated for the effect of adoption of FRS 19.

## 22. Commitments under operating leases

At 31 March 2002 the Company had commitments to make payments during the next 12 months under non-cancellable operating leases which expire as follows:

	<i>2002</i>		<i>2001</i>		<i>2000</i>	
	<i>Land and buildings</i>	<i>Other</i>	<i>Land and buildings</i>	<i>Other</i>	<i>Land and buildings</i>	<i>Other</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
Within one year .....	0.1	—	—	2.2	0.5	2.0
Between one and five years .....	—	7.9	—	3.2	0.5	4.8
After five years .....	3.4	—	2.5	—	2.0	0.1
	<u>3.5</u>	<u>7.9</u>	<u>2.5</u>	<u>5.4</u>	<u>3.0</u>	<u>6.9</u>

## 23. Share capital – equity shares

	31 March		
	2002	2001	2000
	£m	£m	£m
<i>Authorised</i>			
Ordinary shares of £1 each.....	860.0	860.0	860.0
<i>Allotted, issued and fully paid</i>			
Ordinary shares of £1 each.....	860.0	860.0	860.0

## 24. Movement in shareholder's funds

	<i>Share capital</i>	<i>Profit and loss account</i>	2002 <i>Total</i>	2001 <i>Total</i> <i>(restated)</i>	2000 <i>Total</i>
	£m	£m	£m	£m	£m
At beginning of year .....	860.0	(98.2)	761.8	1,662.9	1,642.6
Prior year adjustment .....				(89.3)	
At beginning of year (restated)				1,573.6	
Profit for the financial year.....	—	206.0	206.0	111.5	169.2
Dividends.....	—	—	—	(923.3)	(148.9)
At end of year .....	860.0	107.8	967.8	761.8	1,662.9

The comparatives for the year ended 31 March 2001 have been restated in respect of the adoption of FRS 19 (see note 1(a)). The comparatives for the year ended 31 March 2000 have not been restated.

## 25. Pension commitments

Pension arrangements for the majority of the Company's employees are of the defined benefit type through the AWG Pension Scheme (AWGPS). The scheme's actuaries are Bacon and Woodrow.

The administration and investment of the pension fund is maintained separately from the finances of the AWG group. The accounting for pension costs have been based on the most recent actuarial valuations. Details of the most recent actuarial valuation of the pension scheme are summarised below:

### *Scheme*

Date of most recent valuation update.....	31 March 2001
Actuarial method .....	projected unit
Main assumptions:	
Excess of investment returns over:	
– general salary increases .....	1.9%
– annual increases in pensions.....	3.9%
Results:	
– market value of assets.....	£505 million
– funding level.....	116%
Due date of next full actuarial valuation.....	31 March 2002

The net pension cost for the year ended 31 March 2002 was £6.4 million (2001 – £4.6 million, 2000 – £2.5 million). The net pension cost includes a credit of £6.4 million (2001 – £9.9 million, 2000 – £6.8 million) in respect of the amortisation of actuarial surpluses. At 31 March 2002 there was a prepayment in respect of pensions of £24.3 million (2001 – £13.4 million, 2000 – £13.3 million).

In November 2000 the Accounting Standards board issued FRS 17 "Retirement benefits". FRS 17 is fully effective for periods ending on or after 22 June 2003, although certain disclosures are required in the transition period, for periods ending on or after 22 June 2001. These further disclosures are included below.

The valuation used for FRS 17 disclosures has been based on the most recent actuarial valuation for the AWG Pension Scheme which was at 31 March 2001. This has been updated by independent actuaries to

take account of the requirements of FRS 17 in order to assess the liabilities of the scheme at 31 March 2002. The Company also operates an unfunded pensioner arrangement (see note 20), which has been valued by independent actuaries under the requirements of FRS 17 as at 31 March 2002.

The liabilities of the schemes have been valued using the projected unit method and the following assumptions:

	<i>% pa</i>
Discount rate.....	6.0
Inflation rate.....	2.8
Increase to deferred benefits during deferment.....	2.8
Increase to inflation related pensions in payment.....	2.9
Salary increases.....	4.8

The long-term expected rate of return and the assets in the scheme are:

	<i>AWGPS</i>	<i>Unfunded pensions</i>	<i>2002 Total</i>
	<i>Expected rate of return % pa</i>	<i>Fair value of scheme assets £m</i>	<i>Fair value of scheme assets £m</i>
			<i>£m</i>
Equities.....	8.0	407.0	—
Corporate Bonds.....	6.0	28.0	—
Gilts.....	5.0	63.3	—
Property.....	8.0	15.7	—
Other.....	4.0	13.7	—
Total assets.....		527.7	—
Fair value of scheme liabilities.....		(540.5)	(36.7)
Deficit in the scheme.....		(12.8)	(36.7)
Related deferred tax asset.....		3.0	8.0
Net pension liability.....		(9.8)	(28.7)

If the above amounts had been recognised in the financial statements, the Company's net asset and reserves at 31 March 2002 would be as follows:

	<i>2002 £m</i>
<i>Net assets</i>	
Net assets.....	967.8
Exclude existing net pension liability and prepayment (under SSAP 24).....	1.4
	969.2
FRS 17 pension liability.....	(38.5)
Net assets including FRS 17 pension liability.....	930.7

	2002 £m
<i>Profit and loss reserve</i>	
Profit and loss account .....	107.8
Exclude existing net pension liability and prepayment (under SSAP 24).....	1.4
	<hr/> 109.2
FRS 17 pension liability.....	(38.5)
	<hr/> 70.7
	<hr/> <hr/>

## 26. Contingent liabilities

The Company has guaranteed the borrowings of Anglian Water Plc amounting to £804.5 million (2001 – £802.1 million, 2000 – £638.9 million). Otherwise, there are no material contingent liabilities at 31 March 2002 for which a provision has not been made in the financial information.

## 27. Ultimate parent company

Anglian Water plc, a company registered in England and Wales, is the immediate parent company of Anglian Water Services Limited and is the parent company of the smallest group to consolidate the accounts of Anglian Water Services Limited.

AWG plc, a company registered in England and Wales is the parent company of the largest group to consolidate the accounts of Anglian Water Services Limited. The directors consider AWG plc to be the ultimate parent company.

Copies of the Group accounts of Anglian Water plc and AWG plc can be obtained from the Company Secretary, Anglian House, Ambury Road, Huntingdon, Cambridgeshire PE29 3NZ.

## 28. Acquisitions

On 1 April 2000 the Company acquired the trade and the following assets and liabilities of Hartlepool Water Plc:

	£m
Fixed assets .....	10.5
Stock.....	0.2
Debtors .....	1.9
Cash at bank .....	0.9
Loans .....	(2.7)
Creditors.....	(2.6)
	<hr/>
Net assets acquired .....	8.2
Consideration paid.....	(8.2)
	<hr/>
	<hr/> <hr/>

Trading results for 2001 include turnover of £6.3 million and operating profit of £1.6 million arising from this acquisition.

## 29. Subsequent events

AWG plc proposes to ring-fence the operations of the regulated water and wastewater business to enable the transfer of existing debt across to the regulated business on a common set of terms and conditions, and subsequently allow new debt to be raised. AWG plc has reached agreement with Ofwat on the licence amendments necessary to implement the restructuring. Negotiations with existing lenders to the AWG group to transfer borrowings onto common terms are well advanced, with bondholder meetings scheduled for 31 May 2002 and if necessary adjourned meetings scheduled for 17 June 2002.



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1 Embankment Place  
London WC2N 6RH

The Directors  
Anglian Water Services Financing plc  
Anglian House  
Ambury Road  
Huntingdon  
Cambridgeshire PE29 3NZ

23 July 2002

Dear Sirs

**Anglian Water Services Financing plc**

**Introduction**

We report on the financial information set out below. This financial information has been prepared for inclusion in the offering circular dated 23 July 2002 (the "Offering Circular") of Anglian Water Services Financing plc (the "Company") in connection with the €10 billion Global Secured Medium Term Note Programme unconditionally and irrevocably guaranteed by, *inter alia*, Anglian Water Services Limited for the issuance of Guaranteed Wrapped Bonds and Guaranteed Unwrapped Bonds (the "Programme").

The Company was incorporated as Precis (2157) Limited on 28 November 2001, changed its name to Anglian Water Services Financing Limited on 10 January 2002 and was re-registered as a public limited company on 7 March 2002. The Company has not yet commenced to trade, has prepared no financial statements for presentation to its members and has not declared or paid a dividend.

**Basis of preparation**

The financial information set out below is based on the financial records of the Company, to which no adjustment was considered necessary.

**Responsibility**

The financial records are the responsibility of the directors of the Company.

The directors of the Company are responsible for the contents of the Offering Circular in which this report is included.

It is our responsibility to compile the financial information set out in our report from the financial records, to form an opinion on the financial information and to report our opinion to you.

**Basis of opinion**

We conducted our work in accordance with the Statements of Investment Circular Reporting Standards issued by the Auditing Practices Board. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. Our work also included an assessment of significant estimates and judgements made by those responsible for the preparation of the financial records underlying the financial information and whether the accounting policies are appropriate to the circumstances of the Company and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement, whether caused by fraud or other irregularity or error.

## Opinion

In our opinion, the financial information gives, for the purposes of the Offering Circular, a true and fair view of the state of affairs of the Company as at the date stated.

## Financial information

The balance sheet of the Company at 23 July 2002 was as follows:

	<i>Notes</i>	<i>£</i>
<b>Current assets</b>		
Cash at bank and in hand		12,502
<b>Net assets</b>		12,502
Represented by:		
<b>Called up share capital</b>	3	12,502

## Notes to the financial information

### 1. *Accounting policies*

The balance sheet has been prepared in accordance with the historical cost convention and in accordance with applicable accounting standards in the United Kingdom.

### 2. *Trading activity*

The Company did not trade during the period from incorporation on 28 November 2001 to 23 July 2002 nor did it receive any income nor did it incur any expense or pay any dividends. Consequently, no profit and loss account has been prepared.

### 3. *Share capital*

The Company was incorporated with an authorised share capital of £100,000, comprising 100,000 ordinary shares of £1 each. To date 50,000 ordinary shares were allotted for cash. The nominal value of these shares was £50,000 and the consideration received was £12,501.50.

### 4. *Post balance sheet events*

On 23 July 2002 the Company published the Offering Circular in connection with the Programme and entered into agreements detailed therein.

### 5. *Immediate and ultimate holding company*

The immediate parent undertaking is Anglian Water Services Limited, a company incorporated in England and Wales.

The ultimate parent undertaking and controlling party is awg plc, a company incorporated in England and Wales.

Yours faithfully

PricewaterhouseCoopers  
*Chartered Accountants*



PricewaterhouseCoopers  
1 Embankment Place  
London WC2N 6RH

The Directors  
Anglian Water Services Financing plc  
Anglian House  
Ambury Road  
Huntingdon  
Cambridgeshire PE29 3NZ

23 July 2002

Dear Sirs

**Anglian Water Services Holdings Limited (the “Company”)**

**Introduction**

We report on the financial information set out below. This financial information has been prepared for inclusion in the offering circular dated 23 July 2002 (the “Offering Circular”) of Anglian Water Services Financing plc (the “Issuer”) in connection with the €10 billion Global Secured Medium Term Note Programme unconditionally and irrevocably guaranteed by, *inter alia*, Anglian Water Services Limited for the issuance of Guaranteed Wrapped Bonds and Guaranteed Unwrapped Bonds (the “Programme”).

The Company was incorporated as Precis (2158) Limited on 28 November 2001 and changed its name to Anglian Water Services Holdings Limited with effect from 10 January 2002. The Company has not yet commenced to trade, has prepared no financial statements for presentation to its members and has not declared or paid a dividend.

**Basis of preparation**

The financial information set out below is based on the financial records of the Company, to which no adjustment was considered necessary.

**Responsibility**

The financial records are the responsibility of the directors of the Company.

The directors of the Company are responsible for the contents of the Offering Circular in which this report is included.

It is our responsibility to compile the financial information set out in our report from the financial records, to form an opinion on the financial information and to report our opinion to you.

**Basis of opinion**

We conducted our work in accordance with the Statements of Investment Circular Reporting Standards issued by the Auditing Practices Board. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. Our work also included an assessment of significant estimates and judgements made by those responsible for the preparation of the financial records underlying the financial information and whether the accounting policies are appropriate to the circumstances of the Company and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement, whether caused by fraud or other irregularity or error.

## Opinion

In our opinion, the financial information gives, for the purposes of the Offering Circular, a true and fair view of the state of affairs of the Company as at the date stated.

## Financial information

The balance sheet of the Company at 23 July 2002 is as follows:

	<i>Notes</i>	<i>£</i>
<b>Current assets</b>		
Cash at bank and in hand		2
<b>Net assets</b>		2
Represented by:		
<b>Share capital</b>	3	2

## Notes to the financial information

### 1. *Accounting policies*

The balance sheet has been prepared in accordance with the historical cost convention and in accordance with applicable accounting standards in the United Kingdom.

### 2. *Trading activity*

The Company did not trade during the period from incorporation on 28 November 2001 to 23 July 2002 nor did it receive any income nor did it incur any expense or pay any dividends. Consequently, no profit and loss account has been prepared.

### 3. *Share capital*

The Company was incorporated in England and Wales with an authorised share capital of £100, comprising 100 ordinary shares of £1 each. 2 ordinary shares were allotted for cash, and fully paid, on 9 January 2002.

### 4. *Post balance sheet events*

On 23 July 2002 the Company entered into certain transaction documents as detailed in the Offering Circular.

### 5. *Immediate and ultimate holding company*

The immediate parent undertaking is Anglian Water plc, a company incorporated in England and Wales.

The ultimate parent undertaking and controlling party is awg plc, a company incorporated in England and Wales.

Yours faithfully

PricewaterhouseCoopers  
*Chartered Accountants*



ACCOUNTANTS' REPORT IN RESPECT OF ANGLIAN WATER SERVICES OVERSEAS  
HOLDINGS LIMITED



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PricewaterhouseCoopers  
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London WC2N 6RH

The Directors  
Anglian Water Services Financing plc  
Anglian House  
Ambury Road  
Huntingdon  
Cambridgeshire PE29 3NZ

23 July 2002

Dear Sirs

**Anglian Water Services Overseas Holdings Limited (the “Company”)**

**Introduction**

We report on the financial information set out below. This financial information has been prepared for inclusion in the offering circular dated 23 July 2002 (the “Offering Circular”) of Anglian Water Services Financing plc (the “Issuer”) in connection with the €10 billion Global Secured Medium Term Note Programme unconditionally and irrevocably guaranteed by, *inter alia*, Anglian Water Services Limited for the issuance of Guaranteed Wrapped Bonds and Guaranteed Unwrapped Bonds (the “Programme”).

The Company was incorporated as Anglian Water Services Overseas Holdings Limited on 16 January 2002. The Company has not yet commenced to trade, has prepared no financial statements for presentation to its members and has not declared or paid a dividend.

**Basis of preparation**

The financial information set out below is based on the financial records of the Company, to which no adjustment was considered necessary.

**Responsibility**

The financial records are the responsibility of the directors of the Company.

The directors of the Company are responsible for the contents of the Offering Circular in which this report is included.

It is our responsibility to compile the financial information set out in our report from the financial records, to form an opinion on the financial information and to report our opinion to you.

**Basis of opinion**

We conducted our work in accordance with the Statements of Investment Circular Reporting Standards issued by the Auditing Practices Board. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. Our work also included an assessment of significant estimates and judgements made by those responsible for the preparation of the financial records underlying the financial information and whether the accounting policies are appropriate to the circumstances of the Company and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement, whether caused by fraud or other irregularity or error.

## Opinion

In our opinion, the financial information gives, for the purposes of the Offering Circular, a true and fair view of the state of affairs of the Company as at the date stated.

## Financial information

The balance sheet of the Company at 23 July 2002 was as follows:

	<i>Notes</i>	<i>£</i>
<b>Current assets</b>		
Cash at bank and in hand		1
<b>Net assets</b>		1
Represented by:		
<b>Share capital</b>	3	1

## Notes to the financial information

### 1. *Accounting policies*

The balance sheet has been prepared in accordance with the historical cost convention and in accordance with applicable accounting standards in the United Kingdom.

### 2. *Trading activity*

The Company did not trade during the period from incorporation on 16 January 2002 to 23 July 2002 nor did it receive any income nor did it incur any expense or pay any dividends. Consequently, no profit and loss account has been prepared.

### 3. *Share capital*

The Company was incorporated in the Cayman Islands with an authorised share capital of £30,000, comprising 30,000 ordinary shares of £1 each. 1 ordinary share was allotted for cash, and fully paid, on incorporation. On 23 July 2002, authorised share capital was increased to £300,000,000 comprising 300,000,000 ordinary shares of £1 each.

### 4. *Post balance sheet events*

On 23 July 2002 the Company entered into certain transaction documents as detailed in the Offering Circular.

### 5. *Immediate and ultimate holding company*

The immediate parent undertaking is Anglian Water plc, a company incorporated in England and Wales.

The ultimate parent undertaking and controlling party is awg plc, a company incorporated in England and Wales.

Yours faithfully

PricewaterhouseCoopers  
*Chartered Accountants*

**UNAUDITED PRO FORMA BALANCE SHEET OF AWS AND THE ISSUER (CONSOLIDATED)  
AS AT 31 MARCH 2002**

In order to show the effect of the financing arrangements described in this Offering Circular on the AWS consolidated balance sheet (including the Issuer), set out below is an unaudited pro forma balance sheet as at 31 March 2002. It is derived from the audited accounts of AWS as at 31 March 2002 (see “*Anglian Water Services Limited – Financial Information of AWS for the three years ended 31 March 2002*”), adjusted as described in notes (1) to (9) below and is based on the assumption that the bond issuance took effect on 31 March 2002 raising £1,743 million of new debt net of issue costs and that £1,720 million of existing AWG Group borrowings at nominal value had been assumed by the Issuer or were otherwise retained within the AWS Financing Group as of that date. This information is prepared for illustrative purposes only. Due to the nature of pro forma balance sheets, it may not give a true picture of what the consolidated financial position of AWS would have been had the bond issuance occurred on that date. No account has been taken of trading or transactions since 31 March 2002, or of any tax allowances associated with the transaction costs.

	<i>Balance Sheet at 31 March 2002</i>	<i>Adjustments</i>	<i>Notes</i>	<i>Pro forma Balance Sheet at 31 March 2002 Unaudited</i>
	<i>£m</i>	<i>£m</i>		<i>£m</i>
<b>Fixed Assets</b>				
Tangible assets.....	3,607.0	—		3,607.0
Investments .....	0.2	1,558.8	6	1,559.0
	<u>3,607.2</u>	<u>1,558.8</u>		<u>5,166.0</u>
<b>Current Assets</b>				
Stocks.....	4.1	—		4.1
Debtors.....	558.1	(310.0)	1	248.1
Cash at bank and in hand.....	0.8	204.2	1,2,4,5,6,7,8	205.0
	<u>563.0</u>	<u>(105.8)</u>		<u>457.2</u>
<b>Creditors: amounts falling due within one year</b>				
Short-term borrowings.....	(257.0)	244.0	2,8	(13.0)
Other creditors .....	(1,030.5)	821.0	3,5,8	(209.5)
	<u>(1,287.5)</u>	<u>1,065.0</u>		<u>(222.5)</u>
Net current assets/(liabilities).....	<u>(724.5)</u>	<u>959.2</u>		<u>234.7</u>
Total assets less current liabilities .....	<u>2,882.7</u>	<u>2,518.0</u>		<u>5,400.7</u>
<b>Creditors: amounts falling due after more than one year</b>				
Loans and other borrowings.....	(1,714.7)	(1,749.0)	4,7,8	(3,463.7)
Other creditors .....	(86.1)	—		(86.1)
	<u>(1,800.8)</u>	<u>(1,749.0)</u>		<u>(3,549.8)</u>
<b>Provisions for liabilities and charges .....</b>	<u>(114.1)</u>	<u>(31.0)</u>	9	<u>(145.1)</u>
	<u>967.8</u>	<u>738.0</u>		<u>1,705.8</u>
<b>Capital and reserves</b>				
Called up equity share capital.....	860.0	—		860.0
Profit and loss reserves.....	107.8	738.0	3,5,9	845.8
<b>Total shareholder’s funds (all equity).....</b>	<u>967.8</u>	<u>738.0</u>		<u>1,705.8</u>

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Notes to the unaudited pro forma balance sheet

- (1) Re-classification within cash at bank and in hand of £310 million loan to AW to be repaid prior to Effective Date.
- (2) Re-classification of £169 million bank overdraft to cash at bank and in hand.
- (3) Waiver by AW of £799 million of dividend declared with respect to the year ended 31 March 2001.
- (4) Assumption of debt from AW of £185 million. This comprises £171 million, reflecting the nominal value in the accounts of AW, and £14 million reflecting the additional mark-to-market value of the debt as at 16 July 2002 based on the interest rates applicable thereto, in exchange for a cash payment by AW.
- (5) Debt transfer and other transaction costs include £30 million to be incurred and paid as part of the transaction, excluding new debt issue costs (see note 7) and costs included in note 9. Also included is payment of £18 million of the £23 million of transaction costs incurred in the year ended 31 March 2002.
- (6) Creation of the UK Holdco/AWS Loan of £1,558.8 million. The actual value of the UK Holdco/AWS loan is dependent on the cash position of AWS and the Issuer on the Effective Date.
- (7) New debt to be raised from the initial issuance of wrapped and unwrapped Bonds for cash under the Programme in the amount of £1,765 million less associated issuance costs of £22 million.
- (8) Repayment of loans from European Investment Bank with a book value of £176 million and accrued interest of £4 million as at 31 March 2002, an inter-company loan from AW relating to U.S. private placement debt issued by AW but on-lent to AWS of which £44 million is repaid, AWS' own U.S. private placement debt of which £30 million is repaid and £4 million of other debt. The repayment of loans is split between loans and other borrowings due after more than one year £179 million, loans and other borrowings due within one year £75 million and other creditors due within one year £4 million.
- (9) Provision in respect of coupon enhancements and financial guarantee insurance premia arising from the proposed modifications to existing debt instruments under the debt transfer programme.

**ILLUSTRATIVE FINANCIAL PROJECTIONS OVER THE THREE YEARS  
ENDING 31 MARCH 2005**

The table below sets out the illustrative financial projections of cash flows, net debt, regulatory asset values and certain illustrative ratios of AWS over the three years up to 31 March 2005 (the “**projections**”). The projections have been prepared by AWS’s management, as of 22 July 2002, on the basis of present knowledge, fair estimates and assumptions set out below (other than in the case of “Net interest” which is provided purely for illustrative purposes) after due and careful consideration and are believed by AWS to be reasonable. The illustrative ratios and their underlying components have been calculated on a basis consistent with the definitions set out in Section 7.6.6, “*Financing Structure – Financial covenants*”. The projections do not constitute forecasts of the respective items, and no warranty or any other form of comfort is given by AWS or any other person as to the likelihood that the projections will prove to be reliable or accurate. The assumptions made for the purpose of preparing the projections are with respect to general business and economic conditions, other material contingencies and other matters not within the control of AWS and described in some detail below the table. These assumptions are inherently subject to significant uncertainties and their outcome cannot be predicted by AWS or any other person with any expectation of accuracy. Actual results are likely to differ, perhaps materially, from those projected due to a number of factors, including in particular the effect of those matters described in Chapter 6, “*Investment Considerations*”. Accordingly, the projections are not necessarily indicative of future performance and have been prepared for inclusion in this offering document for illustrative purposes only.

The projections are the responsibility of AWS’s management. PricewaterhouseCoopers has neither examined nor compiled this prospective financial information for the purpose of its inclusion in an offering document provided to investors, and accordingly, PricewaterhouseCoopers does not express an opinion or provide any form of assurance with respect thereto. The PricewaterhouseCoopers reports included herein relate to the Obligors’ and MBIA Assurance S.A.’s historical financial statements. They do not extend to the projections and should not be read to do so.

The projections were not prepared with a view toward compliance with published guidelines of the Securities and Exchange Commission or the guidelines established by the American Institute of Certified Public Accountants (AICPA) for the preparation and presentation of prospective financial information, for which the latter precludes the inclusion of any projections, as defined in the AICPA “Guide for Prospective Financial Information”, in a general purpose document.

**Potential investors should regard the assumptions and projections with considerable caution and are urged to evaluate the potential for actual results to deviate from the assumptions set out below and the implications of deviations in different assumptions on other assumptions and the cash flows of AWS.**

**Illustrative Financial Projections**

	<i>Year ending 31 March</i>		
	<u>2003</u>	<u>2004</u>	<u>2005</u>
	<i>(All figures in £m)</i>		
Net cash inflow from operating activities.....	430	457	488
Net interest.....	(186)	(215)	(221)
Capital expenditure.....	(309)	(321)	(287)
Net cash outflow before financing.....	(65)	(79)	(20)
Net debt (after dividends and indexation) (as at).....	3,392	3,563	3,679
Regulatory Asset Value (RAV) (as at).....	4,008	4,220	4,366
<b>Ratios (Note 1):</b>			
Class A ICR.....	2.5	2.6	2.6
Class A PMICR.....	1.6	1.6	1.7
Senior ICR.....	2.0	2.1	2.2
Senior PMICR.....	1.3	1.4	1.4
Senior RAR (as at).....	0.846	0.844	0.843

Note 1 – In order to provide comparability with the ratios for the years ending 31 March 2004 and 2005, the Class A ICR, Class A PMICR, Senior ICR and Senior PMICR for the year ending 31 March 2003 have been calculated by annualising the projected interest payable by AWS and the Issuer from 1 July 2002, the date on which the refinancing is assumed to be effective. The definitions of ratio components are set out in Chapter 19, “*Index of Defined Terms*”. Attention is drawn to the ratio limits and the associated consequences of any breach of those limits set out in Section 7.6.7, “*Financing Structure – Trigger Events*” and Section 7.6.10, “*Financing Structure – Events of Default*”.

## **Basis of preparation and assumptions**

The basis of preparation and the assumptions used by AWS for the purpose of preparing the projections set out in the table above for the three year period from 1 April 2002 to 31 March 2005 (the “**Relevant Period**”) are described below.

### *Economic and business environment*

It has been assumed that no material change will occur in the general economic and business environment during the Relevant Period.

### *Legislation*

The projections have been prepared on the basis of the principal legislative provisions relevant to AWS’s activities currently in force, including in particular environmental and taxation legislation. It is assumed that no material changes in such legislation will occur during the Relevant Period.

### *Effective date*

It has been assumed in the projections that the refinancing of the AWS Financing Group was completed on 1 July 2002 and that the new financing structure was in place at that date.

### *Future financing*

It has been assumed that the Issuer will be able to raise further new debt from time to time to finance the future capital enhancement expenditure of AWS and to refinance any debt the terms of which have become inefficient or for which there is a scheduled partial or final repayment on terms similar to those currently expected to be available in the debt capital market.

It has been further assumed that no repayment of the new debt raised under the Programme will occur during the Relevant Period and the amount of debt transferred on to the Common Terms Agreement assumed to be refinanced of £14 million, £28 million and £21 million in the years ending 31 March in 2003, 2004 and 2005, respectively is based on the maximum repayments due under the applicable current notional repayment terms of all the debt which may be so transferred.

### *Claims against AWS*

It is assumed that no material claims, whether arising from principal legislative or contractual provisions, which may give rise to an entitlement to compensation, payment of fines or other penalties or charges will arise during the Relevant Period.

### *Inflation*

Where information extracted from Ofwat’s 1999 Price Review issued on 25 November 1999 has been used in the projections, published RPI inflation factors have been applied for the period where available, and thereafter inflation has been assumed at 2.5 per cent. per annum throughout the term of the Relevant Period.

Specific provision is made in AWS’s Licence for determining the inflation factor to be applied to customer charges, in particular, inflation of 0.9 per cent. (being the movement in the RPI for the year ended November 2001) has been used for the year ended 31 March 2003. Thereafter an inflation rate of 2.5 per cent. has been used.

### *Taxation*

It is projected that no corporation tax will be payable during the Relevant Period.

### *Accounting Policies*

The projections are, or are based on, cash flow projections and accordingly a change in the accounting policies will not impact the projections unless it changes the definition of cash or net debt. It has been assumed that the accounting policies applied by AWS in its audited accounts for the year ended 31 March 2002 will continue to be applied throughout the Relevant Period, except that the treatment of pension costs is assumed to follow the transitional provisions of Financial Reporting Standard No 17 “Retirement Benefits” for accounting periods commencing 1 April 2002 and thereafter.

**Cash inflow from operating activities** is the net of cash flows from projected income and projected operating costs.

## **Income**

Projected income is based on reported turnover for the year ended 31 March 2001, which has been adjusted for:

- the effect of the price increases applicable under the 1999 Price Review; and
- volume assumptions in respect of the growth in the customer base, impact of customers switching from unmeasured to measured supply and expectations of consumption levels per customer.

## **Operating Costs**

Projected operating costs exclude depreciation and infrastructure renewals charge and are based on the operating cost allowance determined by Ofwat at the 1999 Price Review adjusted for:

- unanticipated items not allowed in that Price Review and the impact of Financial Reporting Standard No 15 “Tangible Fixed Assets” (FRS 15) which resulted in the reclassification of some costs as operating costs that were treated as capital expenditure for the purposes of the Price Review. There is a corresponding adjustment to the capital expenditure; and
- restatement of these items to outturn price levels using the inflation factors described above.

## **Net Interest**

Net interest is based on current expectations of the interest rates (net of the effect of the projected hedging arrangements and excluding indexation of Indexation Bonds) that will be applicable to debt using the following assumptions:

- interest paid on existing debt transferred on to the CTA is assumed at a weighted average interest rate of 6.7 per cent. per annum; and
- interest paid on the initial debt raised under the Medium Term Note Programme is assumed at a weighted average interest rate of 5.7 per cent. per annum; and
- interest paid on subsequent debt raised has been assumed at a weighted average rate of 4.4 per cent. per annum.

Interest for the year ending 31 March 2003 has been calculated based on the assumption that the new financing structure was in place on 1 July 2002. Accordingly, interest for the first three months to 30 June 2002 excludes interest payable on the debt raised on the assumed Effective Date. Interest for the year ending 31 March 2004 and 2005 has been calculated on the year end borrowing or cash balance. It is assumed that interest income is received in the year it is earned and that interest expense (other than indexation of Indexation Bonds) is paid in the year it is charged. It has been further assumed that the creditworthiness of the hedge counterparties will remain unchanged during the Relevant Period.

## **Capital Expenditure**

Capital expenditure is the aggregate of capital maintenance expenditure and capital enhancement expenditure.

### **Capital Maintenance Expenditure**

Capital maintenance expenditure is based on the respective allowances for current cost depreciation and infrastructure renewals charge given by Ofwat at the 1999 Price Review. Price adjustments have been made to restate these items to outturn price levels using the inflation factors described above.

### **Capital Enhancement Expenditure**

Capital enhancement expenditure has been defined in each year as a difference between the total Capital Expenditure allowance given by Ofwat at the 1999 Price Review and the Capital Maintenance Expenditure. Price adjustments have been made to restate these items to outturn price levels using the inflation factors described above.

### **Net Debt**

Net debt is the expected debt at each respective year end less the expected cash at that date. The amounts increase by, inter alia, net cash outflow before financing and dividends in each year and reflect the adjustments made to restate indexed bonds using the inflation factors described above, repayments and drawdowns of debt and dividend payments.

### **Dividend Payments**

It has been assumed that substantially all cash inflow from operating activities after net interest payments and Capital Maintenance Expenditure will be distributed to AWS's shareholders, subject to covenants set out in the CTA and the availability of distributable reserves (see Section 7.6, "*Financing Structure – Common Terms Agreement*").

### **Regulatory Asset Value (RAV)**

RAV is based on the RAV determined in the 1999 Price Review adjusted for the projected annual capital expenditure during the Review Period and the projected annual regulatory depreciation charge during the Review Period. RAV has also been adjusted for the published RPI factors for the years ended 31 March 2001 and 2002, and in respect of periods thereafter, based on an assumed RPI factor of 2.5 per cent. per annum. On 19 March 2002, Ofwat published regulatory capital values for Regulated Companies over the period 2001-05 at 2000-1 prices without applying inflation adjustments.

### **Working Capital Movements**

No specific assumptions with respect to working capital movements have been made in preparing the above projections. As such, working capital movements for each year of the projections could equate to a range of different positive or negative movements.



## REGULATORY INFORMATION RELATING TO AWS

In addition to its Statutory Accounts, as a condition of its Licence, AWS is required to submit regulatory accounts to Ofwat which are filed in June of each year (the “**Regulatory Information**”). The Regulatory Information is to a certain extent used by Ofwat in establishing a pricing regime for AWS. Potential investors should be aware that significant differences exist between the Regulatory Information and the Statutory Accounts. AWS has made no attempt to identify or quantify the impact of those differences. Unlike AWS’s Statutory Accounts which are prepared under the historical cost convention, its Regulatory Information values assets at their current cost value to the business (with the exception of assets acquired prior to 31 March 1990 which are valued at the replacement cost of their operating capability). As a result, AWS’s total fixed assets at 31 March 2002 were £18,087.6 million in its Regulatory Information and £3,607.2 million in its Statutory Accounts. In addition to having different valuation methods for tangible fixed assets, AWS’s Regulatory Information also has differing accounting policies with respect to grants and other third party contributions. There is also a corresponding adjustment to depreciation. Furthermore, AWS’s Regulatory Information includes certain additional disclosure required by Ofwat.

### **Basis of information**

The information set out on pages 296 to 311 includes information extracted, without material adjustment, from the regulatory information with respect to the year ended 31 March 2002 prepared to comply with Condition F of the Instrument of Appointment.

PricewaterhouseCoopers, chartered accountants, have audited, without qualification, the regulatory financial information of AWS in accordance with generally accepted auditing standards in the United Kingdom for the year ended 31 March 2002.

### **Statement of directors’ responsibilities for regulatory information**

Further to the requirements of company law, the directors are required to prepare accounting statements which comply with the requirements of Condition F of the Instrument of Appointment of the Company as a water and sewerage undertaker under the Water Industry Act 1991 and Regulatory Accounting Guidelines issued by Ofwat.

This additionally requires the directors to:

- confirm that, in their opinion, the Company has sufficient financial and management resources for the next 12 months;
- confirm that, in their opinion, the company has sufficient rights and assets which would enable a Special Administrator to manage the affairs, business and property of the Company;
- report to the Director General of Water Services (DGWS) changes in the Company’s activities which may be material in relation to the Company’s ability to finance its regulated activities;
- undertake transactions entered into by the appointed business, with or for the benefit of associated companies or other businesses or activities of the appointed business, at arm’s length;
- keep proper accounting records which comply with Condition F.

### **Notes on regulatory information**

#### 1. General

As discussed in the directors’ report above, the Company’s activities are regulated by the conditions of a Licence granted to the Company by the Secretary of State for the Environment. With certain exceptions, the regulatory provisions do not apply to business activities which are not connected with the carrying out of the water and sewerage functions.

An analysis of the historical cost profit and loss account and balance sheet between appointed and non-appointed business is set out on pages 297 and 298. A current cost profit and loss account and balance sheet are shown on pages 301 and 302. Other current cost disclosures appear on pages 303 to 311. Additional information required by the Licence is shown on pages 299 and 300.

Under the Regulatory Accounting Guidelines the treatment of certain turnover and expenditure items differs from that disclosed in the statutory financial statements.

2. Protection of the regulated business
- (a) In the opinion of the directors the Company 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 its obligations under the appointment).
- (b) In the opinion of the directors the Company will, for at least the next 12 months, have available to it management resources which are sufficient to enable it to carry out those functions.
3. Ring-fencing
- In the opinion of the directors, the Company was in compliance with paragraph 3.1 of Condition K of the Licence throughout the year.

### Regulatory historical cost profit and loss account for the year ended 31 March

	2002			2001		
	<i>Appointed</i>	<i>Non Appointed</i>	<i>Total</i>	<i>Appointed restated</i>	<i>Non appointed</i>	<i>Total restated</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
Turnover.....	717.9	5.4	723.3	687.4	6.8	694.2
Operating costs .....	(442.6)	(5.0)	(447.6)	(423.3)	(6.1)	(429.4)
Profit on sale of fixed assets .....	3.3	—	3.3	1.8	—	1.8
Operating profit* .....	278.6	0.4	279.0	265.9	0.7	266.6
Other income .....	1.1	—	1.1	0.6	—	0.6
Interest payable (net).....	(102.7)	—	(102.7)	(120.1)	—	(120.1)
Profit on ordinary activities before taxation..	177.0	0.4	177.4	146.4	0.7	147.1
Taxation .....	28.6	—	28.6	(35.6)	—	(35.6)
Profit on ordinary activities after taxation.....	205.6	0.4	206.0	110.8	0.7	111.5
Dividends .....	—	—	—	(910.1)	(13.2)	(923.3)
Movement in reserves .....	205.6	0.4	206.0	(799.3)	(12.5)	(811.8)

\* After exceptional items of £26.9 million (2001 – £12.2 million) within the appointed business.

The prior year comparatives have been restated in respect of the adoption of Financial Reporting Standard (FRS) 19 “Deferred Tax” (see “*Anglian Water Services Limited – Financial Information of AWS for the Three Years Ended 31 March 2002 – Notes to the Financial Information – Note 1*”).

## Regulatory historical cost balance sheet at 31 March

	2002			2001		
	<i>Appointed</i>	<i>Non appointed</i>	<i>Total</i>	<i>Appointed restated</i>	<i>Non appointed</i>	<i>Total restated</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
<b>Fixed assets</b>						
Tangible assets.....	3,602.3	—	3,602.3	3,526.3	—	3,526.3
Investments .....	0.2	—	0.2	0.2	—	0.2
	<u>3,602.5</u>	<u>—</u>	<u>3,602.5</u>	<u>3,526.5</u>	<u>—</u>	<u>3,526.5</u>
<b>Current assets</b>						
Stocks .....	4.1	—	4.1	4.0	—	4.0
Debtors .....	562.8	—	562.8	211.6	—	211.6
Cash at bank and in hand.....	(12.8)	13.6	0.8	6.7	13.2	19.9
	<u>554.1</u>	<u>13.6</u>	<u>567.7</u>	<u>222.3</u>	<u>13.2</u>	<u>235.5</u>
<b>Creditors: amounts falling due within one year</b>						
Short-term borrowings.....	(257.0)	—	(257.0)	(96.9)	—	(96.9)
Proposed dividend.....	(786.0)	(13.2)	(799.2)	(872.9)	(13.2)	(886.1)
Other creditors .....	(231.3)	—	(231.3)	(288.2)	—	(288.2)
	<u>(720.2)</u>	<u>0.4</u>	<u>(719.8)</u>	<u>(1,035.7)</u>	<u>—</u>	<u>(1,035.7)</u>
Net current liabilities.....						
	<u>(720.2)</u>	<u>0.4</u>	<u>(719.8)</u>	<u>(1,035.7)</u>	<u>—</u>	<u>(1,035.7)</u>
Total assets less current liabilities ...	<u>2,882.3</u>	<u>0.4</u>	<u>2,882.7</u>	<u>2,490.8</u>	<u>—</u>	<u>2,490.8</u>
<b>Creditors: amounts falling due after more than one year</b>						
Loans and other borrowings.....	(1,714.7)	—	(1,714.7)	(1,493.5)	—	(1,493.5)
Other creditors .....	(86.1)	—	(86.1)	(90.2)	—	(90.2)
	<u>(1,800.8)</u>	<u>—</u>	<u>(1,800.8)</u>	<u>(1,583.7)</u>	<u>—</u>	<u>(1,583.7)</u>
<b>Provisions for liabilities and charges.....</b>	<u>(114.1)</u>	<u>—</u>	<u>(114.1)</u>	<u>(145.3)</u>	<u>—</u>	<u>(145.3)</u>
	<u>967.4</u>	<u>0.4</u>	<u>967.8</u>	<u>761.8</u>	<u>—</u>	<u>761.8</u>
<b>Capital and reserves</b>						
Called up equity share capital.....	860.0	—	860.0	860.0	—	860.0
Profit and loss reserve .....	107.4	0.4	107.8	(98.2)	—	(98.2)
	<u>967.4</u>	<u>0.4</u>	<u>967.8</u>	<u>761.8</u>	<u>—</u>	<u>761.8</u>
<b>Total shareholder's funds (all equity).....</b>	<u>967.4</u>	<u>0.4</u>	<u>967.8</u>	<u>761.8</u>	<u>—</u>	<u>761.8</u>

The prior year comparatives have been restated in respect of the adoption of FRS 19 “Deferred Tax” (see “*Anglian Water Services Limited – Financial Information of AWS for the Three Years Ended 31 March 2002 – Notes to the Financial Information – Note 1*”) and to transfer deferred grants and contributions due within one year from creditors due after more than one year to creditors due within one year.

## Additional information required by the Licence

### 1. Accounting policies

The accounting policies are set out on pages 264 to 267, except that, as noted on page 296, under the Regulatory Accounting Guidelines certain turnover and expenditure items are treated differently in the regulatory financial statements. In addition, infrastructure renewals accounting has been retained in the regulatory accounts in accordance with Ofwat's requirements.

### 2. Information in relation to allocations and apportionments between the appointed and any other business or activity of the appointee or associated company.

The non-appointed business relates mainly to recreation, leisure and the provision of engineering and consultancy services.

A proportion of the operating costs relating to these activities is directly incurred and does not require allocation. Other relevant costs have been allocated according to time spent on these activities.

### 3. Allocation to principal service

(a) Operating costs are incurred directly by specific service and have not required allocation. Indirect costs are allocated on either a casual link basis or according to local managers' assessments. The allocation to principal service of the charge for infrastructure renewals is based on the asset management plan.

(b) Capital costs and hence the related depreciation charges, are incurred directly by specific service and have not required allocation.

### 4. Information in respect of transactions with any other business or activity of the appointee or any associated company

To the best of the directors' knowledge, all appropriate transactions with associated companies have been disclosed in notes (a) to (f) below.

#### (a) Borrowings or sums lent

£309.5 million of private placement debt received by the Company in July 2001 was temporarily onlent on identical terms to the immediate parent company. The £309.5 million will be repaid to the Company on or before the date of the refinancing which is currently being undertaken by the Company.

No other sums were lent by the appointee to associated companies at 31 March 2002.

Sums borrowed by the appointee from associated companies were:

<i>Lender</i>	<i>Principal amount £m</i>	<i>Repayment date</i>	<i>Interest rate %</i>
Anglian Water Plc – fixed rate loan.....	100.0	2014	12.000
Anglian Water Plc – US\$ loan.....	79.3	2006	*
Anglian Water Plc – fixed rate loan.....	200.0	2023	6.660
Anglian Water Plc – fixed rate loan.....	200.0	2029	6.400
Anglian Water Plc – € loan.....	229.3	2009	**
Anglian Water Plc – index linked loan stock† .....	146.8	2008	5.125
Anglian Water Plc – index linked loan stock† .....	157.7	2020	3.875
Anglian Water Plc – floating rate loan.....	1.8	2002	LIBOR plus 0.500
Anglian Water Plc – floating rate loan.....	1.0	2002	LIBOR plus 1.000
Anglian Water Plc – floating rate loan.....	0.8	2002	LIBOR plus 1.000
Anglian Water Plc – floating rate loan.....	1.0	2002	Base Rate plus 1.000

\* The Company has entered into swap agreements which eliminate the risk of currency fluctuations in relation to the US\$ loan. In addition, through interest rate swaps, £59.8 million of this loan is effectively at a fixed interest rate of 8.371 per cent. and the balance is at a floating rate of 6 month LIBOR plus 0.385 per cent.

\*\* The Company has entered into swap agreements which eliminate the risk of currency fluctuations in relation to the € loan. In addition, through interest rate swaps, the loan is effectively at a fixed interest rate of 6.328 per cent.

† The value of the capital and interest elements of the Index Linked Loan Stock are linked to movements in the Retail Price Index.

#### (b) Dividends payable

No dividend is proposed for the year (2001 – total dividend cost of £923.3 million).

(c) **Guarantees/securities**

The appointee has guaranteed the following borrowings of Anglian Water Plc:

	<i>Principal amount £m</i>	<i>Repayment date</i>	<i>Interest rate %</i>
Index Linked Loan Stock .....	146.8	2008	5.125
Fixed Rate Bond .....	100.0	2014	12.000
Index Linked Loan Stock .....	157.7	2020	3.875
Fixed Rate Bond .....	200.0	2023	6.625
Fixed Rate Bond .....	200.0	2029	6.375

(d) **Supply of services**

Services supplied by the appointee to associated companies:

<i>Nature of transaction</i>	<i>Company</i>	<i>Terms of supply</i>	<i>Value £m</i>
Various services .....	Various	Market rates	1.4

Services supplied to the appointee by associated companies:

<i>Nature of transaction</i>	<i>Company</i>	<i>Turnover of associated company £m</i>	<i>Terms of supply</i>	<i>Value £m</i>
Management charge .....	Anglian Water Plc	n/a	Recharge of appropriate costs	8.7
Fleet management .....	Powermarque Ltd	57.7	Competitive tendering	9.7
Insurance services .....	Rutland Insurance Company Ltd	3.0	Other market testing	1.7
Rental of office accommodation .....	Ambury Investments Ltd	7.6	Negotiated	1.6
Estate management, etc. ....	Ambury Estates Ltd	2.7	Negotiated	0.8
Acquisition of land, etc. ....	Ambury Estates Ltd	2.7	Other market testing	0.6
Engineering, construction and fabrication.....	PURAC Ltd	42.5	Competitive tendering	22.9
Asset management services....	Geodesys Ltd	7.2	Other market testing Negotiated	0.2 1.7
Sewerage maintenance services .....	Alpheus Environmental Ltd	10.2	Competitive tendering	1.5
Tankering, legionella testing, etc. ....	Alpheus Environmental Ltd	10.2	Negotiated	0.3
Engineering, construction and fabrication	Morrison Construction	211.5	Competitive tendering	1.9
Facilities management services	Morrison FM	10.0	Other market testing	1.9
Client management	H <sub>2</sub> Go	0.9	Negotiated	0.9
Other	n/a	n/a	n/a	0.7
				<hr/> <hr/> 55.1*

\* This total includes amounts of £24.6 million which were capitalised by the appointed business.

(e) **Omissions of rights**

No material omissions took place during the year.

(f) **Waivers**

There were no material waivers during the year.

**Current cost profit and loss account for appointed business for the year ended 31 March**

	<i>Notes</i>	<i>2002</i>	<i>2001 restated</i>
		<i>£m</i>	<i>£m</i>
<b>Turnover</b> .....	2	717.9	687.4
Current cost operating costs .....	4	(500.1)	(480.2)
Operating income.....	3	1.8	(0.6)
		219.6	206.6
Working capital adjustment.....	1(d), 3	1.3	2.0
<b>Current cost operating profit*</b> .....		220.9	208.6
Other income.....		1.1	0.6
Interest payable .....		(119.4)	(126.6)
Interest receivable .....		16.7	6.5
Financing adjustment.....	1(d)	21.9	34.1
<b>Current cost profit before taxation</b> .....		141.2	123.2
Current tax .....		12.8	(26.7)
Deferred tax .....		15.8	(8.9)
<b>Current cost profit attributable to shareholder</b> .....		169.8	87.6
Dividends.....		—	(910.1)
<b>Current cost profit/(loss)</b> .....	7	169.8	(822.5)

\* After exceptional items of £26.9 million (2001 – £12.2 million).

The notes on pages 304 to 311 form part of these current cost financial statements.

The prior year comparatives have been restated in respect of the adoption of FRS 19 “Deferred Tax” (see “*Anglian Water Services Limited – Financial Information of AWS for the Three Years Ended 31 March 2002 – Notes to the Financial Information – Note 1*”).

**Current cost balance sheet for appointed business at 31 March**

	<i>Notes</i>	<i>2002</i>	<i>2001</i> <i>restated</i>
		<i>£m</i>	<i>£m</i>
<b>Assets employed</b>			
Fixed assets .....	5	18,087.6	17,823.1
Third party contributions since 31 March 1990 .....		(554.0)	(535.1)
		<hr/>	<hr/>
Working capital.....	6	17,533.6	17,288.0
		287.8	(100.8)
		<hr/>	<hr/>
<b>Net operating assets</b> .....		17,821.4	17,187.2
Cash and investments .....		0.2	0.2
Non-trade debtors.....		41.0	30.9
Dividends payable.....		(786.0)	(872.9)
Other non-trade creditors due within one year.....		(257.0)	(96.9)
Creditors due after one year .....		(1,714.7)	(1,493.5)
Provisions for liabilities and charges			
Deferred tax .....		(88.4)	(104.2)
Other provisions .....		(25.7)	(31.3)
		<hr/>	<hr/>
<b>Net assets employed</b> .....		14,990.8	14,619.5
		<hr/> <hr/>	<hr/> <hr/>
<b>Financed by</b>			
Called up share capital .....		860.0	860.0
Profit and loss reserve.....	7	(449.6)	(619.4)
Current cost reserve .....	8	14,580.4	14,378.9
		<hr/>	<hr/>
<b>Total capital and reserves</b> .....		14,990.8	14,619.5
		<hr/> <hr/>	<hr/> <hr/>

The notes on pages 304 to 311 form part of these current cost financial statements.

The prior year comparatives have been restated in respect of the adoption of FRS 19 “Deferred Tax” (see “*Anglian Water Services Limited – Financial Information of AWS for the Three Years Ended 31 March 2002 – Notes to the Financial Information – Note 1*”).

**Current cost cash flow statement for appointed business for the year ended 31 March 2002**

	<i>Notes</i>	<i>2002</i>	<i>2001</i>
		<i>£m</i>	<i>£m</i>
<b>Net cash inflow from operating activities</b> .....	9(a)	378.3	389.0
<b>Returns on investments and servicing of finance</b>			
Interest received .....		16.7	6.9
Interest paid .....		(100.0)	(79.4)
Interest element of finance lease rental payments .....		(10.4)	(11.5)
Dividends received from trade investments .....		—	0.2
Net cash outflow for returns on investments and servicing of finance .....		(93.7)	(83.8)
<b>Taxation</b>			
Corporation Tax paid .....		(46.4)	(7.5)
<b>Capital expenditure and financial investment</b>			
Gross cost of purchase of fixed assets .....		(220.5)	(234.8)
Grants and contributions received .....		17.9	14.7
Infrastructure renewals expenditure .....		(41.5)	(37.5)
Disposal of tangible fixed assets .....		4.8	(1.1)
Short-term loan to group company .....		(309.5)	—
Net cash outflow for capital expenditure and financial investment...		(548.8)	(258.7)
<b>Acquisitions and disposals</b> .....		—	(7.2)
<b>Equity dividends paid</b> .....		(86.9)	(140.6)
<b>Net cash outflow before financing</b> .....		(397.5)	(108.8)
<b>Financing</b>			
Increase in loans .....		311.1	670.6
Repayments of amounts borrowed .....		(82.5)	(558.2)
Capital element of finance lease payments .....		(19.5)	(11.4)
<b>Net cash inflow from financing</b> .....		209.1	101.0
<b>Decrease in cash</b> .....		(188.4)	(7.8)

Note 9 on page 310 forms part of this current cost cash flow statement.



## Notes to the current cost financial statements

### 1. Accounting policies

#### (a) General

These financial statements have been prepared in accordance with guidance issued by the Director General of Water Services for modified real terms financial statements suitable for regulation in the water industry.

They measure profitability on the basis of real financial capital maintenance, in the context of assets which are valued at their current cost value to the business, with the exception of assets acquired prior to 31 March 1990.

The accounting policies used are the same as those adopted in the statutory historical cost financial statements, except as set out below:

#### (b) Tangible fixed assets

Assets acquired prior to 31 March 1990 and in operational use are valued at the replacement cost of their operating capability. To the extent that the regulatory regime does not allow such assets to earn a return high enough to justify that value, this represents a modification of the value to the business principle.

No provision is made for possible funding of future replacement of assets by contributions from third parties and, to the extent that some of those assets would on replacement be so funded, replacement cost again differs from value to the business.

Redundant assets are valued at their recoverable amounts.

#### *Land and buildings*

Non-specialised operational properties are valued on the basis of open market value for existing use as part of the periodic asset management plan (AMP) reviews and are expressed in real terms by indexation using the Retail Price Index (RPI) thereafter.

Specialised operational properties acquired since 31 March 1990 are valued at the lower of depreciated replacement cost and recoverable amount, restated annually between periodic AMP reviews by adjusting for inflation as measured by changes in the RPI. The unamortised portion of third party contributions received is deducted in arriving at net operating assets (as described below).

#### *Infrastructure assets*

Mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls are valued at replacement cost, determined principally on the basis of data provided by the AMP.

A process of continuing refinement of asset records is expected to produce adjustments to existing values when periodic reviews of the AMP take place. In the intervening years, values are restated to take account of changes in the general level of inflation, as measured by changes in the RPI over the year.

#### *Other fixed assets*

All other fixed assets are valued periodically at depreciated replacement costs. Between periodic AMP reviews, values are restated for inflation as measured by changes in the RPI.

#### *Surplus land*

Surplus land is valued at recoverable amount, taking into account that part of any proceeds to be passed on to customers under Condition B of the Licence.

#### (c) Grants and other third party contributions

Grants, infrastructure charges and other third party contributions received since 31 March 1990 are carried forward to the extent that any balance has not been credited to revenue. The balance carried forward is after restatement for the change in the RPI for the year. This balance is treated as deferred income.

#### (d) Real financial capital maintenance adjustments

These adjustments are made to historical cost profit in order to arrive at profit after the maintenance of financial capital in real terms.

Depreciation adjustment – this is the difference between depreciation based on the current cost value of assets in these financial statements and depreciation charged in arriving at historical cost profit.

Disposal of fixed assets adjustment – the difference between the values of realised assets in these current cost financial statements and in the historical cost financial statements.

The depreciation adjustment is incorporated within operating costs in the profit and loss account. The disposal of fixed assets adjustment is incorporated within operating income in the profit and loss account.

Working capital adjustment – this is calculated by applying the changes in the RPI over the year to the opening total of trade debtors and stock less trade creditors.

Financing adjustment – this is calculated by applying the changes in the RPI over the year to the opening balance of net finance, which comprises all monetary assets and liabilities in the balance sheet apart from those included in working capital and dividends payable. No adjustment has been made to the Financing adjustment for the effect of FRS 19 in the prior year as the adjustment is not material.

## 2. Turnover for the appointed business

	<i>Water service</i>	<i>Sewerage service</i>	<i>Appointed business 2002</i>	<i>Water service</i>	<i>Sewerage service</i>	<i>Appointed business 2001</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
Measured.....	123.9	188.3	312.2	112.6	166.6	279.2
Unmeasured .....	115.9	214.1	330.0	118.2	210.7	328.9
Trade effluent .....	—	29.1	29.1	—	24.0	24.0
Large user revenues .....	22.9	—	22.9	20.0	—	20.0
Third party services.....	18.6	1.4	20.0	18.9	1.4	20.3
Other sources.....	1.1	2.6	3.7	3.8	11.2	15.0
<b>Total turnover.....</b>	<b>282.4</b>	<b>435.5</b>	<b>717.9</b>	<b>273.5</b>	<b>413.9</b>	<b>687.4</b>

## 3. Operating income and working capital adjustment for the appointed business

	<i>Water service</i>	<i>Sewerage service</i>	<i>Appointed business 2002</i>	<i>Water service</i>	<i>Sewerage service</i>	<i>Appointed business 2001</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
Current cost profit/ (loss) on disposal of fixed assets.....	0.9	0.9	1.8	(0.3)	(0.3)	(0.6)
Working capital adjustment.....	0.7	0.6	1.3	1.0	1.0	2.0

#### 4. Analysis of operating costs and fixed asset net book values by service

	Service analysis							Business activities			
	Water service			Sewerage service				Customer services	Scientific services	Other business activities	
	Resources and treatment	Distribution	Water service subtotal	Sewerage	Sewerage treatment	Sludge treatment & disposal	Sewerage T&D subtotal				Sewerage service subtotal
£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	
<b>Direct costs:</b>											
Employment costs .....	5.9	7.0	12.9	9.1	13.1	5.0	18.1	27.2	10.8	4.9	1.0
Power .....	6.4	5.8	12.2	2.8	7.0	3.9	10.9	13.7	—	0.1	—
Hired and contracted services .....	2.8	9.4	12.2	6.5	8.4	13.9	22.3	28.8	6.3	1.1	0.2
Materials and consumables .....	3.2	1.3	4.5	1.7	5.1	5.0	10.1	11.8	—	0.8	—
Service charges .....	6.7	—	6.7	0.8	4.4	—	4.4	5.2	—	—	—
Bulk supply imports .....	0.6	—	0.6	—	—	—	—	—	—	—	—
Other direct costs .....	0.1	0.3	0.4	0.5	0.5	0.2	0.7	1.2	6.1	0.5	1.4
<b>Total direct costs</b> .....	<b>25.7</b>	<b>23.8</b>	<b>49.5</b>	<b>21.4</b>	<b>38.5</b>	<b>28.0</b>	<b>66.5</b>	<b>87.9</b>	<b>23.2</b>	<b>7.4</b>	<b>2.6</b>
General and support expenditure .....	6.9	7.6	14.5	6.4	10.0	7.2	17.2	23.6	4.5	1.4	0.6
<b>Functional expenditure</b> .....	<b>32.6</b>	<b>31.4</b>	<b>64.0</b>	<b>27.8</b>	<b>48.5</b>	<b>35.2</b>	<b>83.7</b>	<b>111.5</b>	<b>27.7</b>	<b>8.8</b>	<b>3.2</b>
Total business activities .....			21.1					18.6			
Rates .....			19.0					5.5			
Doubtful debts .....			4.5					8.3			
Exceptional items .....			13.5					13.4			
<b>Total less third party services</b> .....			122.1					157.3			
Third party services .....			11.8					0.8			
			133.9					158.1			
<b>Capital costs:</b>											
Infrastructure renewals expenditure .....	—	22.8	22.8	18.9	(0.2)	—	(0.2)	18.7			
Movement in infrastructure renewal accrual/prepayment .....	(0.2)	(7.8)	(8.0)	(6.5)	—	—	—	(6.5)			
Depreciation† (allocated) .....	47.1	15.7	57.4	19.6	86.2	5.1	91.3	110.9			
Amortisation of deferred credits .....			(2.1)					(3.9)			
Business activities depreciation† (non-allocated) .....			7.8					8.3			
Capital maintenance excluding third party services .....			77.9					127.5			
Third party services – capital maintenance .....			2.1					0.6			
<b>Total capital maintenance</b> .....			80.0					128.1			
<b>Total operating costs</b> <sup>(1)</sup> .....			213.9					286.2			
<b>2001 total operating costs</b> .....			205.7					274.5			
<b>CCA (MEA) values*</b>											
Service activities .....	1,053.1	4,175.2	5,228.3	11,067.2	1,536.1	84.1	1,620.2	12,687.4			
Business activities .....			22.3	5.1			16.1	21.2			
Service totals .....			5,250.6	11,072.3			1,636.3	12,708.6			
Service assets for third parties .....			121.5					6.9			
<b>Total MEA values</b> .....			5,372.1					12,715.5			
<b>2001 total MEA values</b> .....			5,294.6					12,528.5			

\* On a modern equivalent asset (MEA) basis.

† On a current cost basis.

(1) Included within total operating costs are reactive and planned maintenance expenditure on infrastructure assets of £16.8 million. This is split £9.7 million water distribution and £7.1 million sewerage.

## 5. Fixed assets

	<i>Specialised operational assets</i>	<i>Non- specialised operational properties</i>	<i>Infra- structure assets</i>	<i>Other tangible assets</i>	<i>Total</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
<b>(a) Fixed assets by type – water service</b>					
<b>Gross replacement cost</b>					
At 1 April 2001 .....	1,338.1	9.4	4,619.9	253.2	6,220.6
RPI adjustment .....	17.4	0.1	60.1	3.3	80.9
Disposals .....	(1.0)	(0.4)	(0.1)	(1.2)	(2.7)
Additions .....	29.6	0.5	35.5	11.2	76.8
<b>At 31 March 2002</b> .....	<b>1,384.1</b>	<b>9.6</b>	<b>4,715.4</b>	<b>266.5</b>	<b>6,375.6</b>
<b>Depreciation</b>					
At 1 April 2001 .....	777.1	2.8	—	146.1	926.0
RPI adjustment .....	10.1	—	—	1.9	12.0
Disposals .....	(0.6)	(0.1)	—	(1.1)	(1.8)
Charge for the year .....	45.4	0.1	—	21.8	67.3
<b>At 31 March 2002</b> .....	<b>832.0</b>	<b>2.8</b>	<b>—</b>	<b>168.7</b>	<b>1,003.5</b>
<b>Net book amount at 31 March 2002</b> .....	<b>552.1</b>	<b>6.8</b>	<b>4,715.4</b>	<b>97.8</b>	<b>5,372.1</b>
Net book amount at 31 March 2001 .....	561.0	6.6	4,619.9	107.1	5,294.6
<b>(b) Fixed assets by type – sewerage service</b>					
<b>Gross replacement cost</b>					
At 1 April 2001 .....	3,234.0	9.6	10,962.4	256.7	14,462.7
RPI adjustment .....	42.0	0.1	142.5	3.4	188.0
Disposals .....	(0.9)	(0.6)	—	(2.0)	(3.5)
Additions .....	112.0	0.8	16.6	16.7	146.1
<b>At 31 March 2002</b> .....	<b>3,387.1</b>	<b>9.9</b>	<b>11,121.5</b>	<b>274.8</b>	<b>14,793.3</b>
<b>Depreciation</b>					
At 1 April 2001 .....	1,760.2	2.9	—	171.1	1,934.2
RPI adjustment .....	23.0	—	—	2.2	25.2
Disposals .....	—	(0.2)	—	(1.2)	(1.4)
Charge for the year .....	84.3	0.1	—	35.4	119.8
<b>At 31 March 2002</b> .....	<b>1,867.5</b>	<b>2.8</b>	<b>—</b>	<b>207.5</b>	<b>2,077.8</b>
<b>Net book amount at 31 March 2002</b> .....	<b>1,519.6</b>	<b>7.1</b>	<b>11,121.5</b>	<b>67.3</b>	<b>12,715.5</b>
Net book amount at 31 March 2001 .....	1,473.8	6.7	10,962.4	85.6	12,528.5
<b>(c) Fixed assets by type – total</b>					
<b>Gross replacement cost</b>					
At 1 April 2001 .....	4,572.1	19.0	15,582.3	509.9	20,683.3
RPI adjustment .....	59.4	0.2	202.6	6.7	268.9
Disposals .....	(1.9)	(1.0)	(0.1)	(3.2)	(6.2)
Additions .....	141.6	1.3	52.1	27.9	222.9
<b>At 31 March 2002</b> .....	<b>4,771.2</b>	<b>19.5</b>	<b>15,836.9</b>	<b>541.3</b>	<b>21,168.9</b>
<b>Depreciation</b>					
At 1 April 2001 .....	2,537.3	5.7	—	317.2	2,860.2
RPI adjustment .....	33.1	—	—	4.1	37.2
Disposals .....	(0.6)	(0.3)	—	(2.3)	(3.2)
Charge for the year .....	129.7	0.2	—	57.2	187.1
<b>At 31 March 2002</b> .....	<b>2,699.5</b>	<b>5.6</b>	<b>—</b>	<b>376.2</b>	<b>3,081.3</b>
<b>Net book amount at 31 March 2002</b> .....	<b>2,071.7</b>	<b>13.9</b>	<b>15,836.9</b>	<b>165.1</b>	<b>18,087.6</b>
Net book amount at 31 March 2001 .....	2,034.8	13.3	15,582.3	192.7	17,823.1

- (d) In the preparation of its statutory financial statements, the Company has adopted the infrastructure renewals accounting basis as required by FRS 15 “Tangible Fixed Assets”. However, for the purposes of the regulatory financial statements, Ofwat has requested that FRS 15 is not applied for infrastructure renewals accounting, thereby providing a basis consistent with prior years. A reconciliation to the balance sheet shown in the statutory financial statements is set out below:

	<i>Infrastructure assets</i>
	<u>£m</u>
<b>Cost</b>	
At 31 March 2002 per regulatory financial statements .....	15,836.9
Adjustment to opening balance at 31 March .....	(13,921.9)
Infrastructure renewals expenditure capitalised in the year .....	41.5
	<hr/>
<b>At 31 March 2002 per statutory financial statements .....</b>	<b>1,956.5</b>
	<hr/> <hr/>
<b>Grants and contributions</b>	
At 31 March 2002 per regulatory financial statements .....	—
Adjustment to opening balance at 31 March .....	(153.2)
	<hr/>
<b>At 31 March 2002 per statutory financial statements .....</b>	<b>(153.2)</b>
	<hr/> <hr/>
<b>Depreciation</b>	
At 31 March 2002 per regulatory financial statements .....	—
Adjustment to opening balance at 31 March .....	(307.9)
Depreciation charge for infrastructure renewal expenditure .....	(27.0)
	<hr/>
<b>At 31 March 2002 per statutory financial statements .....</b>	<b>(334.9)</b>
	<hr/> <hr/>
<b>Net book value</b>	
At 31 March 2002 per regulatory financial statements .....	15,836.9
Adjustment to opening balance at 31 March .....	(14,383.0)
Infrastructure renewals expenditure capitalised in the year .....	41.5
Depreciation charge for infrastructure renewal expenditure .....	(27.0)
	<hr/>
<b>At 31 March 2002 per statutory financial statements .....</b>	<b>1,468.4</b>
	<hr/> <hr/>
<b>Working capital</b>	
At 31 March 2002 per regulatory financial statements .....	(4.7)
Less infrastructure renewals (accrual)/prepayment .....	4.7
	<hr/>
<b>At 31 March 2002 per statutory financial statements .....</b>	<b>—</b>
	<hr/> <hr/>

## 6. Working capital

	2002	2001 <i>restated</i>
	<i>£m</i>	<i>£m</i>
Cash .....	(12.8)	6.7
Stocks .....	4.1	4.0
Trade debtors.....	81.5	76.5
Trade creditors .....	(73.8)	(89.8)
Short-term capital creditors .....	(22.1)	(18.5)
Infrastructure renewals (accrual)/prepayment.....	4.7	(9.8)
Other trade prepayments/(accruals).....	(105.5)	(76.6)
Corporation Tax .....	(7.7)	(65.9)
Payroll related taxes and social security contributions .....	(3.0)	(3.1)
Group trade debtors (net) .....	328.7	(13.5)
Prepayments .....	93.7	89.2
<b>Total working capital .....</b>	<b>287.8</b>	<b>(100.8)</b>

The prior year comparatives have been restated in respect of the adoption of FRS 19 “Deferred Tax” (see “*Anglian Water Services Limited – Financial Information of AWS for the Three Years Ended 31 March 2002 – Notes to the Financial Information – Note 1*”) and to transfer the measured income accrual (£81.4 million) and the trade effluent accrual (£3.6 million) from Trade debtors to Prepayments as the directors believe that this is a more appropriate classification.

## 7. Current cost profit and loss reserve

	2002	2001 <i>restated</i>
	<i>£m</i>	<i>£m</i>
At beginning of year.....	(619.4)	203.1
Retained profit/(loss) for the year for appointed business.....	169.8	(822.5)
<b>At end of year.....</b>	<b>(449.6)</b>	<b>(619.4)</b>

The prior year comparatives have been restated in respect of the adoption of FRS 19 “Deferred Tax” (see “*Anglian Water Services Limited – Financial Information of AWS for the Three Years Ended 31 March 2002 – Notes to the Financial Information – Note 1*”).

## 8. Current cost reserve

	2002	2001
	<i>£m</i>	<i>£m</i>
At beginning of year.....	14,378.9	13,913.7
Acquired from Hartlepool Water Plc.....	—	113.6
RPI adjustments:		
Fixed assets .....	231.7	399.5
Working capital.....	(1.3)	(2.0)
Financing.....	(21.9)	(34.1)
Deferred grants and contributions.....	(7.0)	(11.8)
<b>At end of year.....</b>	<b>14,580.4</b>	<b>14,378.9</b>

**9(a) Reconciliation of current cost operating profit to net cash inflow from operating activities**

	<i>2002</i>	<i>2001</i>
	<i>£m</i>	<i>£m</i>
Current cost operating profit* .....	220.9	208.6
Working capital adjustment.....	(1.3)	(2.0)
Decrease/(increase) in stocks .....	(0.1)	0.1
Other income received.....	1.1	0.4
Current cost depreciation.....	187.1	172.2
Current cost (profit)/loss on sale of fixed assets .....	(1.8)	0.6
Increase in debtors and prepaid expenses.....	(26.1)	(10.0)
Increase in creditors and accrued expenses.....	(6.0)	(4.2)
Provision for infrastructure renewals.....	27.0	27.0
Net movement in restructuring provision.....	(5.6)	2.2
Amortisation of deferred grants and contributions.....	(6.0)	(5.8)
Net movement in prepaid pension contributions.....	(10.9)	(0.1)
<b>Net cash inflow from operating activities .....</b>	<b>378.3</b>	<b>389.0</b>

\* After exceptional items of £26.9 million (2001 – £12.2 million).

**9(b) Analysis of net debt**

	<i>1 April 2001</i>	<i>Cash flows</i>	<i>Non-cash movements</i>	<i>31 March 2002</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
Cash.....	6.7	(19.5)	—	(12.8)
Bank overdrafts.....	—	(168.9)	—	(168.9)
	6.7	(188.4)	—	(181.7)
Debt due within one year.....	(96.9)	96.9	(88.1)	(88.1)
Debt due after one year.....	(1,493.5)	(306.0)	84.8	(1,714.7)
	(1,583.7)	(397.5)	(3.3)	(1,984.5)

Non-cash movements comprise indexation of loan stock and transfers between categories of debt.

## 10. Current cost profit and loss account for appointed business

	2002	2001 <i>restated</i>	2000 <i>restated</i>	1999 <i>restated</i>	1998 <i>restated</i>
	£m	£m	£m	£m	£m
<b>Turnover</b> .....	717.9	697.8	757.1	776.9	780.1
Current cost operating costs .....	(500.1)	(487.5)	(499.2)	(501.0)	(455.7)
Operating income .....	1.8	(0.6)	(2.2)	3.8	1.5
Working capital adjustment .....	1.3	2.0	1.0	(0.2)	4.1
<b>Current cost operating profit*</b> .....	220.9	211.7	256.7	279.5	330.0
Other income .....	1.1	0.6	0.2	0.6	1.0
Interest payable (net) .....	(102.7)	(121.9)	(100.6)	(97.2)	(85.2)
Financing adjustment .....	21.9	34.6	33.1	24.7	33.5
<b>Current cost profit before taxation</b> ..	141.2	125.0	189.4	207.6	279.3
Taxation .....	28.6	(36.1)	(42.1)	(62.4)	4.2
<b>Current cost profit attributable to shareholder</b> .....	169.8	88.9	147.3	145.2	283.5
Dividends .....	—	(923.9)	(155.6)	(346.1)	(216.8)
<b>Current cost (loss)/profit</b> .....	169.8	(835.0)	(8.3)	(200.9)	66.7

\* After historical exceptional charge of £26.9 million (2001 – exceptional charge of £12.2 million, 2000 – exceptional charge of £44.3 million, 1999 – exceptional charge of £34.9 million, 1998 – exceptional credit of (£6.6) million).

## Current cost balance sheet for appointed business

	2002	2001 <i>restated</i>	2000 <i>restated</i>	1999 <i>restated</i>	1998 <i>restated</i>
	£m	£m	£m	£m	£m
<b>Assets employed</b>					
Fixed assets .....	18,087.6	18,061.2	17,870.3	16,655.7	16,506.3
Third party contributions since 31 March 1990 .....	(554.0)	(542.2)	(533.0)	(523.0)	(515.6)
Working capital .....	287.8	(102.1)	(89.3)	(41.5)	11.2
<b>Net operating assets</b> .....	17,821.4	17,416.9	17,248.0	16,091.2	16,001.9
Cash and investments .....	0.2	0.2	0.3	0.3	0.3
Non-trade debtors .....	41.0	31.3	29.2	26.4	36.0
Dividends payable .....	(786.0)	(884.7)	(107.1)	(276.6)	(100.9)
Other non-trade creditors due within one year .....	(257.0)	(98.2)	(332.6)	(49.1)	(106.7)
Creditors due after one year .....	(1,714.7)	(1,513.4)	(1,195.7)	(1,250.5)	(1,120.3)
Provisions for liabilities and charges ..	(114.1)	(137.3)	(122.7)	(108.9)	(86.7)
<b>Net assets employed</b> .....	14,990.8	14,814.8	15,519.4	14,432.8	14,623.6
<b>Financed by</b>					
Called up share capital .....	860.0	871.5	891.2	914.5	933.3
Profit and loss reserve .....	(449.6)	(627.7)	210.5	224.5	434.4
Current cost reserve .....	14,580.4	14,571.0	14,417.7	13,293.8	13,255.9
<b>Total capital and reserves</b> .....	14,990.8	14,814.8	15,519.4	14,432.8	14,623.6

The financial information set out above for the four years ended 31 March 2001 is based on the audited current cost financial statements for those years, as adjusted to 2001/2002 prices for changes in the RPI.

On 1 April 2000 the Company acquired the trade and certain assets and liabilities from Hartlepool Water Plc. The trading results and balance sheet figures for the year ending 31 March 2002 and the year ending 31 March 2001 reflect this acquisition and are therefore not strictly comparable to previous years.

The prior year comparatives have been restated in respect of the adoption of FRS 19 “Deferred Tax” (see “*Anglian Water Services Limited – Financial Information of AWS for the Three Years Ended 31 March 2002 – Notes to the Financial Information – Note 1*”).



## SUMMARY OF SIGNIFICANT DIFFERENCES BETWEEN UK GAAP AND U.S. GAAP

The Statutory Accounts of AWS have been prepared in accordance with UK GAAP which differs in certain significant respects from U.S. GAAP. Such differences involve the methods for measuring the amounts shown in the financial statements, as well as additional disclosures required by U.S. GAAP.

Management has not quantified the effect of the differences between UK GAAP and U.S. GAAP on the profits or shareholders' funds of AWS. Accordingly there can be no assurances that such profits or shareholders' funds determined in accordance with UK GAAP would not be significantly different if they had been determined under U.S. GAAP.

This summary should not be taken as a complete list of all differences between UK GAAP and U.S. GAAP. No attempt has been made to identify all disclosures, presentations or classifications that would affect the manner in which transactions or events are presented in the financial statements or notes thereto.

Further, no attempt has been made to identify future differences between UK GAAP and U.S. GAAP as the result of prescribed changes in accounting standards. Regulatory bodies that promulgate UK GAAP and U.S. GAAP have significant projects ongoing that could affect future comparisons such as this one.

The identified significant differences as they relate to AWS for the years ended 31 March 1999, 2000 and 2001 are summarised in the following paragraphs.

### **Basis of preparation**

AWS owns a number of non-trading companies. Consolidated financial statements have not been prepared as permitted under Section 228 of the Companies Act 1985, since AWS is itself a wholly-owned subsidiary of AWG plc.

Under U.S. GAAP there is no exception for intermediary companies and therefore consolidated financial statements would have to be prepared. Such accounts would have to include the assets, liabilities and results of the entities in which AWS holds controlling interests through majority ownership of voting shares or by contract.

### **Water and sewerage infrastructure assets**

In accordance with accepted practice in the UK water industry, investment expenditure on infrastructure assets (as defined in AWS's accounting policies) relating to increases in capacity or enhancements of the network and on maintaining the operating capability of the network in accordance with defined standards of service, is treated as an addition to tangible fixed assets at cost. The depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network which is based on AWS's independently certified asset management plan.

Under U.S. GAAP, any expenditure on the maintenance of infrastructure assets would be expensed and infrastructure assets would be depreciated over their expected useful lives and the depreciation expense would be charged in lieu of the infrastructure renewals charge.

### **Grants and contributions**

In accordance with accepted practice in the UK water industry, grants and capital contributions received in respect of infrastructure assets are deducted from the cost of these assets. This policy is not in accordance with the provisions of the Companies Act 1985 but has been adopted to show a true and fair view as while a provision is made for depreciation of infrastructure assets, these assets have no determinable finite economic life and hence no basis exists on which to recognise such contributions as deferred income. Grants and capital contributions in respect of other capital expenditure are credited to a deferred income account and released to the profit and loss account over the expected useful economic life of the relevant asset.

Under U.S. GAAP, all such grants and contributions are deducted from the cost of the asset. In addition, there is no concept of the true and fair override under U.S. GAAP.

### **Capitalisation of borrowing costs**

AWS expenses all borrowing costs and, accordingly, does not capitalise any borrowing costs associated with the funding of fixed assets during their construction.

Under U.S. GAAP, the borrowing costs of funds invested in the construction of major qualifying assets must be capitalised up to the date the assets are ready for use, and amortised over the average life of the assets. The

amount to be capitalised is an allocation of the interest cost incurred during the period required to complete the asset. The interest rate for capitalisation purposes is based on the interest rates of AWS's outstanding borrowings. If a specific new borrowing is associated with the asset the rate on that borrowing may be applied to the appropriate portion of the expenditure for that asset.

### **Leases**

While U.S. GAAP is similar in concept to UK GAAP its detailed requirements are more extensive and differences exist. Leases classified as finance leases under UK GAAP are likely to be classified as capital leases under U.S. GAAP. Certain operating leases under UK GAAP, however, may also be classified as capital leases under U.S. GAAP depending on the specific terms and conditions attaching to the lease.

### **Pensions**

Under UK GAAP, Statement of Standard Accounting Practice 24 "Accounting for Pension Costs" aims to produce an estimate of cost, based on long-term actuarial assumptions under a triennial actuarial valuation. The schemes' assets are valued based on the discounted value of expected future dividend/investment income using a long-term risk adjusted discount rate, rather than on a market value basis. Asset valuation methods are consistent with the method and assumptions used to value the liabilities to pay future pensions (i.e. the discount and long-term return on assets are required to be the same). Differences between the actual experience of the schemes and the actuarial assumptions made are normally spread over the expected remaining service lives of the current employees in the schemes after making suitable allowances for future withdrawals.

Under U.S. GAAP, the annual pension cost comprises the estimated cost of benefits accruing in the period adjusted to reflect the cost of benefit improvements and any surplus/deficit that emerge as a result of the actuarial assumptions made not being borne out in practice. The pension cost is based on an annual actuarial valuation of the schemes and the valuation basis uses market rates of interest in the valuation of the scheme assets and obligations.

### **Share option schemes**

The AWG Group Sharesave Scheme and Executive Share Option Scheme grant options to the employees and executives of AWS in relation to the shares of AWS's parent, AWG plc. AWG plc does not recharge any costs relating to compensation under these Schemes to AWS. Therefore, under UK GAAP, AWS does not recognise any compensation cost under the AWG Group Sharesave Scheme and Executive Share Options Scheme.

Under U.S. GAAP, stock-based employee compensation is accounted for under either APB 25 "Accounting for Stock Issued to Employees" or Statement of Financial Accounting Standards No. 123 "Accounting for Stock Based Compensation" ("SFAS 123"). The cost of options granted to employees is recognised over the period to which the employee's service relates (vesting period) under either the intrinsic value method of APB 25 or the fair value method of SFAS 123. Under both these methods, the measurement date is the date at which both the number of shares to be received and option price are known.

Under SFAS 123, compensation costs are measured either as the difference between the fair value of the underlying shares at the measurement date and the price to be contributed by the employee in accordance with APB 25, or is based on the fair value of the option at the date of grant, which is estimated using an option pricing model.

### **Deferred taxation**

For periods commencing before 1 April 2001, UK GAAP required provision for deferred taxation to be calculated using the partial method to the extent that such taxation is expected to crystallise in the foreseeable future. This means that the full potential liability is not necessarily provided for in the financial statements. Additionally, deferred tax assets were recognised only when they were expected to be recoverable within the foreseeable future. Deferred tax liabilities or assets are recognised at the known future rates of tax.

For periods commencing after 1 April 2001, Financial Reporting Standard 19 "Deferred Tax" has been adopted by AWS. This requires full provision to be made for deferred tax assets and liabilities that arise from timing differences between the recognition of gains and losses in the financial statements and their recognition in the tax computation. The deferred tax balances are discounted using the post tax yields to maturity on government bonds with similar maturity dates. This change in accounting policy has been treated as a prior year adjustment and, accordingly, comparative figures for the year ended 31 March 2001 will be presented on a restated basis. However, the comparative figures for the year ended 31 March 2000 have not been restated.

Under U.S. GAAP, deferred taxation is provided on all temporary differences between the tax and book bases of assets and liabilities at the applicable enacted statutory tax rate at the reporting date, subject to a valuation allowance to reduce deferred tax assets to the amount which “more likely than not” will be realised in the future tax returns. The adoption of FRS 19 by AWS resulted in the year ended 31 March 2001 being restated. However, the comparative figures for the year ended 31 March 2000 were not restated for FRS 19. Under U.S. GAAP, the application of a new accounting standard that requires retroactive restatement would result in the restatement of all periods presented. In addition, U.S. GAAP does not allow discounting of deferred tax assets and liabilities.

#### **Accounting for derivatives and hedging activities**

Under UK GAAP, the interest differentials on interest rate swaps treated as hedges are taken to net interest payable in the profit and loss account. Financial instruments are recorded at cost or proceeds received and any premiums or fees are amortised over the life of the instrument. Under UK GAAP, Financial Reporting Standard No. 13 “Derivatives and Other Financial Instruments: Disclosures” (“FRS 13”) applies only to those entities that have any of their capital instruments listed or publicly traded on a stock exchange or market (domestic or foreign) and, accordingly, does not apply to AWS.

For the three year period to 31 March 2001, U.S. GAAP accounting for hedging instruments was provided by SFAS 52 “Foreign Currency Translation” which was similar to UK GAAP for the transactions entered into by AWS.

Under U.S. GAAP, Statement of Financial Accounting Standards No. 133 “Accounting for Derivative Instruments and Hedging Activities” (“SFAS 133”) became effective on 1 April 2001. It requires all derivative financial instruments to be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in earnings or other comprehensive income (outside earnings) depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction and whether or not the hedge is effective. Gains and losses on derivative instruments reported in other comprehensive income are reclassified into earnings in the periods in which earnings are affected by the hedge item.

#### **Dividends**

Under UK GAAP, dividends are provided for in the year in respect of which they are proposed by the Board of Directors for approval of shareholders. These dividends are recorded in the statement of operations as an appropriation of the current year’s earnings. U.S. GAAP recognises dividends as a reduction of retained earnings in the accounting period in which they are formally declared.

#### **Exceptional items**

UK GAAP requires profits and losses in relation to the disposal of fixed assets to be shown separately on the face of the profit and loss account below operating profit. In addition, exceptional items that are a result of the ongoing activities but significant because of their size or nature may be separately highlighted on the face of the profit and loss account.

Under U.S. GAAP there is no concept of exceptional items and, accordingly, no such items can be separately disclosed on the face of the profit and loss account. Accordingly, profits and losses in relation to the disposal of fixed assets are included in operating income.

#### **Balance sheet presentation**

The balance sheet prepared in accordance with UK GAAP differs in certain respects from U.S. GAAP. Under UK GAAP, current assets are netted against current liabilities in the balance sheet whereas U.S. GAAP requires the separate presentation of total assets and total liabilities. UK GAAP requires assets to be presented in ascending order of the liquidity in accordance with the requirements of the Companies Act 1985, whereas under U.S. GAAP assets are presented in descending order of liquidity. In addition, current assets under UK GAAP include amounts that fall due after more than one year. Under U.S. GAAP, such assets would be reclassified as non-current assets.

#### **Cash flows**

Under UK GAAP, the consolidated cash flow statements are presented in accordance with Financial Reporting Standard No. 1 (revised) “Cash flow statements” (“FRS 1”). Its objectives and principles are similar to U.S. GAAP as set out in Statement of Financial Accounting Standards No. 95 “Statement of Cash Flows” (“SFAS 95”). The principal difference between the standards is in respect of classification. Under FRS 1 (Revised), AWS presents its cash flows for: (a) operating activities; (b) returns on investments and services of finance; (c) taxation; (d) capital expenditure and financial investment; (e) acquisitions and disposals; (f) equity dividends paid; (g)

management of liquid resources; and (h) financing. SFAS 95 requires only three categories of cash flow activity: (x) operating activities; (y) investing activities; and (z) financing activities.

Under FRS 1 (Revised), cash includes deposits and overdrafts repayable on demand while movements on short-term investments are included in management of liquid resources. SFAS 95 defines cash and cash equivalents as also including highly liquid short-term investments, with original maturities of three months or less, and excludes overdrafts.

Cash flows arising from taxation and returns on investments and servicing of finance under FRS 1 (Revised) would be included as operating activities under SFAS 95. Cash flows relating to capital expenditure and financial investment and acquisitions and disposals would be included as investing activities under SFAS 95. Equity dividend payments would be included as a financing activity under SFAS 95.

#### **Related parties**

Under UK GAAP, AWS is exempt from making related party disclosures of transactions and balances with other members of the AWG plc group since it is a wholly-owned subsidiary of AWG plc although disclosures of this nature are contained in the Regulatory Information prepared to comply with Condition F of the Instrument of Appointment.

Under U.S. GAAP, there is no such exemption and, accordingly, related party disclosures are required.

## CHAPTER 19

### INDEX OF DEFINED TERMS

The following terms are used throughout this Offering Circular:

<b>“Acceleration of Liabilities” or “Acceleration”</b>	means an acceleration of any Secured Liabilities or termination of a commitment (or equivalent action) including: (a) the delivery of a termination notice from a Finance Lessor or AWS terminating the leasing of any Equipment under a Finance Lease; (b) the delivery of a notice by AWS or a Finance Lessor requesting the prepayment of any Rentals under a Finance Lease; (c) the early termination of any hedging obligations (whether by reason of an event of default, termination event or other right of early termination) under a Hedging Agreement; or (d) the taking of any other steps to recover any payment due in respect of any Secured Liabilities which have matured for repayment and are overdue, by a Secured Creditor or Secured Creditors pursuant to the terms of the applicable Finance Documents and in accordance with the STID;
<b>“Accession Memorandum”</b>	means each memorandum entered into by an additional Secured Creditor pursuant to the STID;
<b>“Account”</b>	means any bank account of any member of the AWS Financing Group;
<b>“Account Bank”</b>	means Barclays Bank PLC of Huntingdon, Market Hill PE18 6AE or any successor account bank appointed pursuant to the Account Bank Agreement;
<b>“Account Bank Agreement”</b>	means the account bank agreement dated on or about the Effective Date between, inter alios, the Obligors, the Cash Manager, the Account Bank and the Security Trustee;
<b>“Additional Secured Creditor”</b>	means any person not already a Secured Creditor which becomes a Secured Creditor pursuant to the provisions of the STID;
<b>“Advance”</b>	means any advance or other credit accommodation provided under any Authorised Credit Facility;
<b>“AFC Amounts”</b>	means any amount which constitutes the Annual Finance Charge and which is actually due and payable, calculated in accordance with the CTA;
<b>“Affiliate”</b>	means (other than in any Hedging Agreement when used in relation to a Hedge Counterparty, where “Affiliate” has the meaning given to it in that Hedging Agreement) a Subsidiary or a Holding Company of a person or any other Subsidiary of that Holding Company;
<b>“Agency Agreement”</b>	means the agreement dated 30 July 2002 between, inter alia, the Issuer, the Bond Trustee and the agents referred to therein under which, amongst other things, the Principal Paying Agent is appointed as issuing agent, principal paying agent and agent bank for the purposes of the Programme;

<b>“AMP3”</b>	means the five-year period commencing on 1 April 2000;
<b>“AMP4 Period”</b>	means the five-year period commencing on 1 April 2005;
<b>“Anglian Group”</b>	means awg plc and all persons directly or indirectly Controlled by awg plc;
<b>“Annual Finance Charge”</b>	means, in respect of the Pre-Test Period and thereafter each 12 month period commencing on 1 April in any subsequent year, the aggregate of all interest due or to become due (after taking account of the impact of interest rates on any Hedging Agreements then in place) during that Pre-Test Period or 12 month period, all premia payable to any Financial Guarantor within that Pre-Test Period or 12 month period and the Lease Reserve Amounts and adjusted Lease Reserve Amounts falling due in that Pre-Test Period or 12 month period;
<b>“Applicable Accounting Principles”</b>	means accounting principles, standards and practices generally accepted in the United Kingdom as applied from time to time and making such adjustments (if any) as the Auditors may consider appropriate arising out of changes to applicable accounting principles or otherwise from time to time;
<b>“Associate”</b>	means any person associated with or in whom any member of the AWG Group or any successor of any of them or any member of any successor group of companies owning or controlling any interest in the AWS Financing Group has an interest (whether directly or indirectly);
<b>“Assumptions”</b>	means those assumptions which formed the basis for the AWS Business Financial Model;
<b>“Auditors”</b>	means PricewaterhouseCoopers or such other firm of accountants of international repute as may be appointed by AWS in accordance with the CTA as the Auditors for the AWS Financing Group;
<b>“Authorised Adviser”</b>	means Salomon Brothers International Limited which will be the authorised adviser in respect of the Programme;
<b>“Authorised Credit Facilities”</b>	means any facility or agreement entered into by the Issuer (or in the case of a Finance Lease, AWS) for Class A Debt or Class B Debt as permitted by the terms of the Common Terms Agreement or for the issue of Bond Policies in relation thereto, the providers of which have acceded to the STID and the Common Terms Agreement and includes (without limitation) the Initial Authorised Loan Agreement, the Bridging Facility, the Liquidity Facilities, the Existing Finance Leases, the AWS Loan Notes, the Issuer/AWS Loan Agreement, the Bond Trust Deed, the Existing Bond Trust Deeds, the Bonds, the Existing Hedging Agreements, the Premium Letters, the I&I Agreements and any other document entered into in connection with an Authorised Credit Facility or the transactions in an Authorised Credit Facility;
<b>“Authorised Credit Provider”</b>	means a lender or other provider of credit or financial accommodation under any Authorised Credit Facility and includes each Financial Guarantor for so long as any Bond Policy issued by that Financial Guarantor is outstanding, and each Bondholder;

<b>“Authorised Investments”</b>	<p>means:</p> <ul style="list-style-type: none"> <li>(a) securities issued by the government of the United Kingdom;</li> <li>(b) demand or time deposits, certificates of deposit and short-term unsecured debt obligations, including commercial paper, provided that the issuing entity or, if such investment is guaranteed, the guaranteeing entity, is rated the Minimum Short-term Rating;</li> <li>(c) any other obligations provided that in each case the relevant investment has the Minimum Short-term Rating and is either denominated in Sterling or (following the date on which the UK becomes a Participating Member State) euro or has been hedged in accordance with the Hedging Policy; or</li> <li>(d) any money market funds or equivalent investments which have a rating of at least A+m by S&amp;P or A+ by Fitch or A1 by Moody’s, provided that in AWS’ reasonable opinion it is able to liquidate such funds on a same day basis without material cost penalties being imposed;</li> </ul>
<b>“AW”</b>	means Anglian Water Plc, a company incorporated under the laws of England and Wales and formerly listed on the London Stock Exchange, a wholly-owned subsidiary of AWG;
<b>“AWCT”</b>	means AW Creative Technologies Limited, a wholly-owned subsidiary of AWG;
<b>“AWG”</b>	means awg plc, a company incorporated under the laws of England and Wales which is admitted to the Official List and to trading on the London Stock Exchange, the holding company of the AWG Group;
<b>“AWG Group”</b>	means AWG and its subsidiaries;
<b>“AW Group”</b>	means the group of companies of AW and its subsidiaries prior to the introduction of AWG as parent company in 2000;
<b>“AWL”</b>	means Anglian Water Licensing Limited, a wholly-owned subsidiary of AWCT;
<b>“AWS”</b>	means Anglian Water Services Limited, a United Kingdom incorporated wholly-owned subsidiary of AWS Overseas Holdings which has been appointed a water and sewerage undertaker under the Instrument of Appointment;
<b>“AWS Business Financial Model”</b>	means the business financial model prepared by AWS and delivered to the Security Trustee from time to time and which, in relation to Trigger Events, must be prepared on the basis of actual figures then in issue from the Director General, rather than from any projected figures that may arise from any pending IDOK application or Competition Commission referral;
<b>“AWS Change of Control”</b>	<p>means the occurrence of any of the following events or circumstances:</p> <ul style="list-style-type: none"> <li>(a) AWS Holdings ceasing to hold legally and beneficially all rights in 100 per cent. of the issued share capital of, or otherwise ceasing to Control, AWS Overseas Holdings;</li> </ul>

- (b) AWS Overseas Holdings ceasing to hold legally and beneficially all rights in 100 per cent. of the issued share capital of, or otherwise ceasing to Control, AWS; or
- (c) AWS ceasing to hold legally and beneficially all rights in 100 per cent. of the issued share capital of, or otherwise ceasing to Control, the Issuer;

<b>“AWS Financing Group”</b>	means AWS Holdings, AWS Overseas Holdings, AWS and the Issuer;
<b>“AWS Holdings”</b>	means Anglian Water Services Holdings Limited, a United Kingdom incorporated wholly-owned subsidiary of AW;
<b>“AWS Loan Notes”</b>	means the loan notes issued by AWS to the Issuer and the rights of the Issuer under certain assigned intercompany loans as more particularly described in Section 7.5.1, “ <i>Financing Structure – Intercompany Loan Arrangements – AWS Loan Notes</i> ”;
<b>“AWS Overseas Holdings”</b>	means Anglian Water Services Overseas Holdings Limited, a Cayman Islands incorporated wholly-owned subsidiary of AWS Holdings;
<b>“Base Cash Flows”</b>	means the annual cash flows of the amounts of costs netted off against the amount of receipts and savings in respect of each Relevant Change of Circumstance, Notified Item and relevant disposal of land;
<b>“BBV”</b>	means Binnie Black & Veatch Ltd;
<b>“Bearer Bonds”</b>	means those of the Bonds which are in bearer form;
<b>“Bondholders”</b>	means the holders from time to time of the Bonds;
<b>“Bond Policies”</b>	means the financial guarantee insurance policy issued by a Financial Guarantor in respect of Class A Wrapped Bonds and/or Class B Wrapped Bonds which includes the Initial Bond Policies;
<b>“Bonds”</b>	means the Class A Bonds and the Class B Bonds;
<b>“Bond Trustee”</b>	means Deutsche Trustee Company Limited or any successor trustee appointed pursuant to the Bond Trust Deed and/or the Existing Bond Trust Deeds, for and on behalf of the relevant Bondholders;
<b>“Bond Trust Deed”</b>	means (a) in respect of Bonds issued under the Programme, the Bond Trust Deed dated 30 July 2002 between, inter alia, the Issuer, the Initial Financial Guarantor and the Bond Trustee under which Bonds will, on issue, be constituted and which sets out the terms and conditions on which the Bond Trustee has agreed to act as bond trustee; and (b) in respect of the Existing Bonds, the Existing Bond Trust Deeds;
<b>“Bridging Facility”</b>	means the bridge facility made available under the Bridging Facility Agreement (which amongst other things is to cover any Early Redemption Amount);
<b>“Bridging Facility Agent”</b>	means Barclays Bank PLC or any successor thereto;
<b>“Bridging Facility Agreement”</b>	means the bridging facility agreement dated 18 April 2002 between the Issuer, the other Obligor, the Facility Arrangers,



	the Original Lenders and the Facility Agent (each as defined therein);
<b>“Business”</b>	means Regulated Business and Permitted Non-Statutory Business whether under a Permitted Joint Venture or otherwise as permitted under the Finance Documents;
<b>“Business Day”</b>	means (other than in any Hedging Agreement where “Business Day” has the meaning given to it in that Hedging Agreement): <ul style="list-style-type: none"> <li>(a) in relation to any sum payable in euro, a TARGET Settlement Day and a day on which commercial banks and foreign exchange markets settle payments generally in London and each (if any) additional city or cities specified in the relevant Pricing Supplement;</li> <li>(b) in relation to any sum payable in a currency other than euro, a day on which commercial banks and foreign exchange markets settle payments generally in London, in the principal financial centre of the currency in which such financial indebtedness is denominated (which in the case of a payment in US dollars shall be New York) and in each (if any) additional city or cities specified in the relevant Pricing Supplement; and</li> <li>(c) in relation to the definition of Lease Calculation Date, a day on which commercial banks and foreign exchange markets settle payments generally in London;</li> </ul>
<b>“Calculation Date”</b>	means (other than in any Hedging Agreement where “Calculation Date” has the meaning given to it in that Hedging Agreement), 31 March and 30 September in each year starting on 31 March 2002 or any other calculation date agreed as a result of a change in the financial year end date of any Obligor;
<b>“CAMS”</b>	means Catchment Abstraction Management Strategies, which are part of the Government’s plans to reform water resources planning;
<b>“CCD”</b>	means expenditure designated under the heading current cost depreciation in the financial projections contained in the supplementary report issued by Ofwat detailing the numbers and assumptions specific to AWS in the DGWS’s most recent Final Determination adjusted as appropriate for any subsequent IDOK and for Out-turn Inflation;
<b>“Capex Contract”</b>	means any agreement pursuant to which AWS outsources any investment, construction works and other capital expenditure;
<b>“Capex Reserve Account”</b>	means the account of AWS titled “Capex Reserve Account” held at the Account Bank and includes any sub-account relating to that account and any replacement account from time to time;
<b>“Capital Maintenance Expenditure”</b>	means investment expenditure incurred (or, in respect of any future period, forecast to be incurred in the AWS Business Financial Model) on maintaining base service levels in the Regulated Business and excluding any investment expenditure relating to increases in capacity or enhancement of service levels, quality or security of supply;

<b>“Cash Expenses”</b>	means the aggregate of all expenses incurred by AWS in any period (excluding depreciation, IRC and interest on Financial Indebtedness);
<b>“Cash Manager”</b>	means Barclays Bank PLC during and after a Standstill Period (except where the Standstill Period is terminated because the Event of Default giving rise to the Standstill is remedied or waived), in its capacity as Cash Manager under the CTA, or any successor Cash Manager, and at all other times AWS;
<b>“Class”</b>	means each class of Bonds, the available Classes of Bonds being Class A Wrapped Bonds, Class A Unwrapped Bonds, Class B Wrapped Bonds and Class B Unwrapped Bonds;
<b>“Class A Average PMICR”</b>	means the sum of the ratios of Net Cash Flow less the greater of (a) the aggregate of CCD and IRC and (b) Capital Maintenance Expenditure to Class A Debt Interest for each of the Test Periods comprised in a Rolling Average Period divided by 3;
<b>“Class A Bonds”</b>	means the Class A Wrapped Bonds and the Class A Unwrapped Bonds;
<b>“Class A Debt”</b>	<p>means any financial accommodation that is, for the purposes of the STID, to be treated as Class A Debt and includes as at the Effective Date all debt outstanding under:</p> <ul style="list-style-type: none"> <li>(a) the Class A Wrapped Bonds and the Class A Unwrapped Bonds (if any) issued by the Issuer on or after the Effective Date;</li> <li>(b) the Existing Bonds and the USPP 2001 Bonds which the Issuer will assume liability for on the Effective Date;</li> <li>(c) the Initial Authorised Loan Agreement;</li> <li>(d) the Existing Finance Leases;</li> <li>(e) the Existing Hedging Agreements;</li> <li>(f) Tranche A1 and Tranche B and the Class A portion of Tranche A2 of the Bridging Facility;</li> <li>(g) the Debt Service Reserve Liquidity Facilities;</li> <li>(h) the O&amp;M Reserve Facility;</li> <li>(i) the MBIA Premium Letter; and</li> <li>(j) the first I&amp;I Agreement;</li> </ul>
<b>“Class A Debt Instructing Group” or “Class A DIG”</b>	<p>means a group of representatives (each a <b>“Class A DIG Representative”</b>) of Qualifying Class A Debt, comprising of:</p> <ul style="list-style-type: none"> <li>(a) in respect of each Series of Class A Wrapped Bonds (if no FG Event of Default has occurred and is continuing), the Financial Guarantor;</li> <li>(b) in respect of each Series of Class A Wrapped Bonds (after an FG Event of Default has occurred and is continuing in respect of the Financial Guarantor of those Bonds) and each Series of Class A Unwrapped Bonds (other than USPP Bonds), the Bond Trustee;</li> </ul>

- (c) in respect of Class A USPP Bonds (i) prior to the occurrence of an Event of Default, any USPP Bondholder who has outstanding to it or any of its affiliates more than US\$70,000,000 of Class A USPP Bonds or (ii) after an Event of Default has occurred and is continuing, any USPP Bondholder;
- (d) in respect of Tranche A1 and Tranche B and the Class A portion of Tranche A2 of the Bridging Facility, the Bridging Facility Agent;
- (e) in respect of the Initial Authorised Loan Agreement, the Initial Authorised Credit Facility Agent;
- (f) in respect of any Existing Finance Leases, the relevant Finance Lessor; and
- (g) in respect of any other Secured Liabilities of the type referred to in paragraphs (a) to (f) above or (with the approval of the Majority Creditors) other types of Secured Liabilities that rank pari passu with all other Class A Debt, the relevant representative appointed under the terms of the relevant Finance Document and named in the relevant Accession Memorandum as the Class A DIG Representative,

each of which provides an appropriate indemnity to the Security Trustee each time it votes irrespective of whether it is a Majority Creditor;

**“Class A Debt Interest”**

means, in relation to any Test Period, and without double counting an amount equal to the aggregate of all interest paid, due but unpaid or in respect of forward looking ratios payable on the Issuer’s and/or AWS’ obligations under or in connection with all Class A Debt, all premia paid, due but unpaid or in respect of forward looking ratios, payable, to any Financial Guarantor of Class A Debt and adjusted Lease Reserve Amounts or Lease Reserve Amounts paid, due but unpaid or in respect of forward looking ratios, payable on the Issuer’s and/or AWS’ obligations under and in connection with all Class A Debt in each case during such Test Period (after taking account of the impact on interest rates of all related Hedging Agreements then in force) (excluding all indexation of principal to the extent it has been included in such interest or other amounts) and excluding amortisation of the costs of issue of any Class A Debt within such Test Period and all other costs incurred in connection with the raising of such Class A Debt less all interest received or in respect of forward looking ratios receivable by any member of the AWS Financing Group from a third party during such period;

**“Class A Debt Service Reserve Account”  
or “Class A DSRA”**

means the account of the Issuer titled “Class A Debt Service Reserve Account” held at the Account Bank and includes any sub-account relating to that account and any replacement account from time to time;

**“Class A Debt Provider”**

means a provider of, or Financial Guarantor of, Class A Debt;

**“Class A Net Indebtedness”**

means, as at any date, all the Issuer’s and AWS’s nominal debt outstanding under and in connection with any Class A Debt (other than pursuant to tranche B of the Initial Authorised

Loan Agreement) including all indexation accrued on any such liabilities which are indexed together with any interest due but unpaid (after taking into account the effect of all Interest Rate Hedging Agreements then in force) and less the value of all Authorised Investments and other amounts standing to the credit of any Account other than the Customer Payment Account or the Distributions Account) (where such debt is denominated other than in Sterling, the nominal amount outstanding will be calculated: (i) in respect of debt with associated Currency Hedging Agreements, by reference to the applicable hedge rates; or (ii) in respect of debt with no associated Currency Hedging Agreements, by reference to the Exchange Rate);

<b>“Class A ICR”</b>	means the ratio of Net Cash Flow for each Test Period to Class A Debt Interest for each of the same Test Periods;
<b>“Class A RAR”</b>	means the ratio of Class A Net Indebtedness to RAV;
<b>“Class A PMICR”</b>	means the ratio of Net Cash Flow less the greater of (a) the aggregate of CCD and IRC and (b) Capital Maintenance Expenditure for each Test Period to Class A Debt Interest for the same Test Period;
<b>“Class A Unwrapped Bonds”</b>	means the Class A Bonds that do not have the benefit of a guarantee from a Financial Guarantor, which includes the Transferred USPP Bonds and some of the Existing Bonds;
<b>“Class A Unwrapped Debt”</b>	means the Class A Debt that does not have the benefit of a guarantee from a Financial Guarantor;
<b>“Class A USPP Bonds”</b>	means USPP Bonds which are also Class A Bonds;
<b>“Class A Wrapped Bonds”</b>	means the Class A Bonds that have the benefit of a guarantee from a Financial Guarantor, which includes some of the Existing Bonds;
<b>“Class A Wrapped Debt”</b>	means Class A Debt that has the benefit of a guarantee from a Financial Guarantor;
<b>“Class B Bonds”</b>	means the Class B Wrapped Bonds and the Class B Unwrapped Bonds;
<b>“Class B Debt”</b>	means any financial accommodation that is, for the purposes of the STID, to be treated as Class B Debt and includes as at the Effective Date all debt outstanding under:  (a) the Class B Bonds; and  (b) the Class B portion of Tranche A2 of the Bridging Facility;
<b>“Class B Debt Instructing Group” or “Class B DIG”</b>	means a group of representatives (each a <b>“Class B DIG Representative”</b> ) of Qualifying Class B Debt, comprising of:  (a) in respect of each series of Class B Wrapped Bonds (if no FG Event of Default has occurred and is continuing), the Financial Guarantor;  (b) in respect of each Series of Class B Wrapped Bonds (after an FG Event of Default, has occurred and is continuing in respect of the Financial Guarantor of

those Bonds) and each Series of Class B Unwrapped Bonds, the Bond Trustee;

- (c) in respect of the Class B Debt portion of Tranche A2 of the Bridging Facility, the Bridging Facility Agent; and
- (d) in respect of any other Secured Liabilities of the type referred to in paragraphs (a) to (c) above or (with the approval of the Majority Creditors) other types of Secured Liabilities that rank pari passu with all other Class B Debt, the relevant representative appointed under the terms of the relevant Finance Document and named in relevant Accession Memorandum, as the Class B DIG Representative,

each of which provides an appropriate indemnity to the Security Trustee each time it votes irrespective of whether it is a Majority Creditor;

<b>“Class B Debt Service Reserve Account” or “Class B DSRA”</b>	means the account of the Issuer titled “Class B Debt Service Reserve Account” held at the Account Bank and includes any sub-account relating to that account and any replacement account from time to time;
<b>“Class B Debt Provider”</b>	means any provider of, or Financial Guarantor of, Class B Debt;
<b>“Class B Unwrapped Bonds”</b>	means the Class B Bonds that do not have the benefit of a guarantee from a Financial Guarantor;
<b>“Class B Unwrapped Debt”</b>	means Class B Debt that does not have the benefit of a guarantee from a Financial Guarantor;
<b>“Class B USPP Bonds”</b>	means Class B Bonds which are also USPP Bonds;
<b>“Class B Wrapped Bonds”</b>	means the Class B Bonds that have the benefit of a guarantee from a Financial Guarantor;
<b>“Class B Wrapped Debt”</b>	means Class B Debt that has the benefit of a guarantee from a Financial Guarantor;
<b>“Clearstream, Luxembourg”</b>	means Clearstream Banking, <i>société anonyme</i> ;
<b>“Co-Arrangers”</b>	means Barclays Bank PLC and Salomon Brothers International Limited, the co-arrangers of the Programme;
<b>“Combined Contract”</b>	means any agreement pursuant to which AWS sub-contracts, tenders or outsources both investment or construction works or other capital expenditure as well as the day to day operation of its assets and service delivery or any maintenance expenditure;
<b>“Common Terms Agreement” or “CTA”</b>	means the Common Terms Agreement dated 30 July 2002 between the Obligors and, inter alia, the Security Trustee, which contains certain representations and covenants of the Obligors and Events of Default;
<b>“Companies Act”</b>	means the United Kingdom Companies Act 1985, as amended from time to time;
<b>“Company”</b>	means AWS;
<b>“Company Collective”</b>	means the recognised body of employee, trade union and management representatives for collective bargaining in determining the terms and conditions of employment for

	AWS employees and consultation on issues affecting those employees, for example, redundancies and TUPE transfers;
<b>“Compensation Account”</b>	means the account of AWS entitled “Compensation Account” held at the Account Bank and includes any sub-account relating to that account and any replacement account from time to time;
<b>“Competition Act”</b>	means the United Kingdom Competition Act 1998;
<b>“Competition Commission”</b>	means the Competition Commission in the United Kingdom;
<b>“Competition Consultation Paper”</b>	means the DETR April 2000 consultation paper “Competition in the Water Industry in England and Wales”;
<b>“Conditions”</b>	means the terms and conditions of the Bonds set out in the Bond Trust Deed as may from time to time be amended, varied or supplemented in the manner permitted under the STID;
<b>“Construction Output Price Index”</b>	means the index issued by the Department of Trade and Industry, varied from time to time, relating to price levels of new build construction based on a combination of logged values of tender price indices, labour and materials cost indices and on the value of new construction orders in the United Kingdom;
<b>“Contractors”</b>	means any person (being either a single entity or joint venture) that is a counterparty to an Outsourcing Agreement or Capex Contract or Combined Contract;
<b>“Control”</b>	of one person by another person means that the other (whether directly or indirectly and whether by the ownership of share capital, the possession of voting power, contract or otherwise) and whether acting alone or in concert with another or others has the power to appoint and/or remove the majority of the members of the governing body of that person or otherwise controls or has the power to control the affairs and policies of that person (and references to <b>“Controlled”</b> and <b>“Controlling”</b> shall be construed accordingly);
<b>“Council”</b>	means the Ofwat National Customer Council;
<b>“Coupon”</b>	means an interest coupon appertaining to a definitive Bearer Bond (other than a Zero Coupon Bond);
<b>“Couponholders”</b>	means the several persons who are for the time being holders of the Coupons and includes, where applicable, the Talonholders;
<b>“Court”</b>	means the High Court of England and Wales;
<b>“CP Document”</b>	means the agreement entitled “Conditions Precedent Agreement” dated 30 July 2002 and entered into, inter alios, between the Obligors, the Bond Trustee and the Security Trustee;
<b>“CSCs”</b>	means regional customer service committees established by the DGWS;
<b>“Currency Hedging Agreement”</b>	means any Hedging Agreement with a Hedge Counterparty in respect of a currency exchange transaction;
<b>“Customer Payment Account”</b>	means the account of AWS titled “Customer Payment Account” held at the Account Bank and includes any sub-account relating to that account and any replacement account from time to time;

<b>“Customer Payment Account Required Balance”</b>	means, at any time during a Financial Year, the amount calculated in accordance with the following formula:  $\frac{\text{CRA}}{12} \times m$ where CRA means, in respect of such Financial Year, the aggregate Customer Rebates declared, and m means the number of accounting months unexpired in such Financial Year;
<b>“Customer Rebates”</b>	means, in respect of any Financial Year, an amount equal to the difference between the total revenue that is projected by AWS to be raised during such Financial Year on the basis of the announced charges and the revenue that would have accrued if AWS had established prices at the full price cap available to it under the Instrument of Appointment;
<b>“Date Prior”</b>	means, at any time, the date which is one day before the next Periodic Review Effective Date;
<b>“Dealers”</b>	means Barclays Bank PLC and Salomon Brothers International Limited and any other entity which the Issuer and the Obligors may appoint as a Dealer and notice of whose appointment has been given to the Principal Paying Agent and the Bond Trustee by the Issuer in accordance with the provisions of the Programme Agreement but excluding any entity whose appointment has been terminated in accordance with the provisions of the Programme Agreement and notice of such termination has been given to the Principal Paying Agent and the Bond Trustee by the Issuer in accordance with the provisions of the Programme Agreement and references to a <b>“relevant Dealer”</b> or the <b>“relevant Dealer(s)”</b> mean, in relation to any Tranche or Series of Bonds, the Dealer or Dealers with whom the Issuer has agreed the issue of the Bonds of such Tranche or Series and <b>“Dealer”</b> means any one of them;
<b>“Debt Service Payment Account”</b>	the account of the Issuer entitled the “Debt Service Payment Account” held at the Account Bank and includes any sub-account relating to that account and any replacement account from time to time;
<b>“Debt Service Reserve Account”</b>	means any or both of the Class A Debt Service Reserve Account and/or the Class B Debt Service Reserve Account;
<b>“Debt Service Reserve Liquidity Facility”</b>	means a debt service reserve liquidity facility made available under a Liquidity Facility Agreement;
<b>“Debt Service Reserve Liquidity Facility Agreement”</b>	means any agreement establishing a Debt Service Reserve Liquidity Facility as more particularly described in Section 7.10.4, <i>“Financing Structure – Additional Resources Available – The Liquidity Facilities”</i> ;
<b>“Debt Service Reserve Liquidity Facility Provider”</b>	means Barclays Bank PLC or any other provider of Debt Service Liquidity Facilities;
<b>“Default”</b>	means: <ul style="list-style-type: none"> <li>(a) an Event of Default;</li> <li>(b) a Trigger Event; or</li> </ul>

	(c) a Potential Event of Default;
<b>“Default Situation”</b>	means any period during which there subsists:
	(a) a Standstill Period; or
	(b) an Event of Default;
<b>“Definitive IAI Registered Bond”</b>	means a Registered Bond sold to an Institutional Accredited Investor pursuant to Section 4(2) under the Securities Act;
<b>“DEFRA”</b>	means the Department of the Environment, Food and Rural Affairs in the United Kingdom;
<b>“DETR”</b>	means the Department of the Environment, Transport and the Regions which had responsibility for the Environment prior to DEFRA;
<b>“DGWS” or “Director General”</b>	means the Director General of Water Services in England and Wales;
<b>“DIG Directions Request”</b>	means a written notice of each DIG Proposal sent by the Security Trustee to the relevant DIG Representatives pursuant to the STID;
<b>“DIG Proposal”</b>	means a proposal pursuant to the STID requiring a Majority Creditor decision only;
<b>“DIG Representatives”</b>	means the Class A DIG Representatives or the Class B DIG Representatives, as the context requires and <b>“DIG Representatives”</b> means each of them;
<b>“Directors”</b>	means the board of directors for the time being of the Issuer or as the case may be the relevant Obligor;
<b>“Discharge Date”</b>	means the date on which all obligations of the Issuer under the Finance Documents have been irrevocably satisfied in full and no further obligations are capable of arising under the Finance Documents;
<b>“Distribution”</b>	means:
	(a) any payments (including, without limitation, any payments of distributions, dividends (including any Special Distribution), bonus issues, return of capital, fees, interest, principal or other accounts whatsoever) (by way of loan or repayment of any loan or otherwise) (in cash or in kind) to any member of the AWG Group or any successor entity having an interest in AWS Holdings or any Associate or Affiliate of any such person other than:
	(i) payments made to such persons pursuant to arrangements entered into on bona fide arm’s length terms in the ordinary and usual course of trading to the extent that the aggregate of all such payments does not exceed £5,000,000 (indexed) in any consecutive twelve month period; or
	(ii) any payments made to such persons pursuant to any Outsourcing Agreement and/or Capex Contracts entered into in compliance with the Outsourcing Policy; or



(iii) payments made to such persons pursuant to arrangements entered into on terms that are not bona fide and arm's length in the ordinary and usual course of trading to the extent that the aggregate of all such payments does not exceed £500,000 (indexed) in any consecutive twelve month period; or

(iv) a UK Holdco Debt Service Distribution; or

(b) payments made in respect of any Financial Indebtedness falling within paragraph (f) of the definition of Permitted Financial Indebtedness;

<b>“Distributions Account”</b>	means the account of AWS titled “AWS Distributions Account” held at the Account Bank and includes any sub-account relating to that account and any replacement account from time to time;
<b>“DTC”</b>	means The Depository Trust Company;
<b>“DWI”</b>	means the Drinking Water Inspectorate in the United Kingdom, including its successor office or body;
<b>“EA”</b>	means the UK Environment Agency;
<b>“Early Redemption Amount”</b>	means for the purposes of the USPP 2001 Bonds, the principal and Make-Whole Amount (if any), but excluding any accrued interest payable, to the Bondholder on redemption of a USPP 2001 Bond as a result of an Early Redemption Event occurring and in relation to any other Bonds, as defined in the Conditions relating to such Bonds;
<b>“Early Redemption Event”</b>	means a notice is given pursuant to Clause 8.3(a)A of the Note Purchase Agreement;
<b>“Early Redemption Shortfall”</b>	means a time when the aggregate Early Redemption Amount due and payable exceeds the amount available for drawing under the Bridging Facility to pay Early Redemption Amounts;
<b>“Effective Date”</b>	means the date on which the conditions precedent contained in the CP Document, have been fulfilled or waived in accordance with the CP Document;
<b>“Emergency”</b>	means the disruption of the normal service of the provision of water or waste water services which is treated as an emergency under AWS's policies, standards and procedures for emergency planning manual (EMPROC) (as amended from time to time);
<b>“Emergency Instruction Notice”</b>	means a notice as set out in Section 7.4.9 “ <i>Financing Structure – Intercreditor Arrangements – Emergency Instruction Notice</i> ”;
<b>“EIN Signatories”</b>	has the meaning as set out in Section 7.4.9 “ <i>Financing Structure – Intercreditor Arrangements – Emergency Instruction Notice</i> ”;
<b>“Enforcement Action”</b>	means any step (other than the exercise of any rights of inspection of any asset or other immaterial actions taken under any Finance Lease) that a Secured Creditor is entitled to take to enforce its rights against an Obligor under a Finance

Document following the occurrence of an Event of Default including, without limitation, the declaration of an Event of Default or an Early Redemption Event, the institution of proceedings, the making of a demand for payment under a guarantee, the making of a demand for cash collateral under a guarantee or the Acceleration of Liabilities (other than a Permitted Lease Termination, a Permitted Hedge Termination or a Permitted Acceleration) by a Secured Creditor or Secured Creditors pursuant to the terms of the applicable Finance Documents;

<b>“Enforcement Notice”</b>	means a notice in writing from the Security Trustee to the Issuer and/or AWS specifying that all or any of the Secured Liabilities have or has become immediately enforceable;
<b>“Enforcement Order”</b>	means an enforcement order, a final enforcement order or a provisional enforcement order, each as referred to and defined in the WIA;
<b>“Entrenched Rights”</b>	means the rights of the Secured Creditors set out in Section 7.4.19, “ <i>Financing Structure – Intercreditor Arrangements – Entrenched Rights</i> ”;
<b>“Equipment”</b>	means, in relation to a Finance Lease, any items of equipment, plant and/or machinery, system, asset, software licence, intellectual property right, software and any other item leased under that Finance Lease;
<b>“Equivalent Amount”</b>	means the amount in question expressed in the terms of pounds sterling, calculated on the basis of the Exchange Rate;
<b>“EU”</b>	means the European Union;
<b>“Euroclear”</b>	means Euroclear Bank S.A./N.V. as operator of the Euroclear System;
<b>“Event of Default”</b>	means (other than in any Hedging Agreement when used in relation to a Hedge Counterparty, where “Event of Default” has the meaning given to it in that Hedging Agreement) an event specified as such in Schedule 7 of the Common Terms Agreement, as more particularly described under Section 7.6.10, “ <i>Financing Structure – Common Terms Agreement – Events of Default</i> ”;
<b>“Exchange Agent”</b>	means Deutsche Bank Trust Company Americas as exchange agent to the Issuer in respect of Registered Bonds;
<b>“Exchange Rate”</b>	means the spot rate at which the relevant currency is converted to pounds sterling as quoted by the Agent Bank as at 11.00 a.m:  (a) for the purposes of Clause 9.3 (Notice to Secured Creditors of STID Proposal) and Clause 9.6 (DIG Directions Request) of the STID, respectively, on the date that the STID Proposal or DIG Proposal (as applicable) is dated; and  (b) in any other case, on the date as of which calculation of the Equivalent Amount of the Outstanding Principal Amount is required,  and, in each case, as notified by the Agent Bank to the Security Trustee;

**“Existing Agency Agreements”**

means each of those agency agreements in respect of the Existing Bonds as the same shall have been amended on the Effective Date;

**“Existing Bonds”**

means such of the following Bonds issued by AW pursuant to the Existing Bond Trust Deeds for which the Issuer assumes liability on the Effective Date:

- (a) £150,000,000 8.25 per cent. bonds due 2006;
- (b) £100,000,000 5½ per cent. index-linked loan stock 2008;
- (c) £100,000,000 12 per cent. bonds 2014;
- (d) £150,000,000 3.875 per cent. index-linked guaranteed notes due 2020;
- (e) £200,000,000 6.625 per cent. guaranteed bonds due 2023;
- (f) £200,000,000 6.375 per cent. guaranteed bonds due 2029; and
- (g) €350,000,000 5.375 per cent. bonds due 2009.

With regard to the assumption of liability by the Issuer of the Existing Bonds on the Effective Date, listing particulars will be prepared and submitted to the UK Listing Authority for approval prior to the Effective Date.

**“Existing Bond Trust Deeds”**

means the bond trust deeds in relation to:

- (a) £100,000,000 5½ per cent. index-linked loan stock 2008 dated 4 July 1990, between AW as issuer, AWS as guarantor and Royal Exchange Trust Company Limited as trustee;
- (b) £100,000,000 12 per cent. bonds 2014 dated 7 January 1991, between AW Plc as issuer, AWS as guarantor and Sun Alliance Trust Company Limited as trustee;
- (c) £150,000,000 8.25 per cent. bonds due 2006 dated 29 November 1996, between AW as issuer and Royal Exchange Trust Company Limited as trustee;
- (d) £200,000,000 6.625 per cent. guaranteed bonds due 2023 dated 21 August 1998, between AW as issuer, AWS as guarantor and Royal Exchange Trust Company Limited as trustee;
- (e) £200,000,000 6.375 per cent. guaranteed bonds due 2029 dated 15 January 1999, between AW as issuer, AWS as guarantor and Royal Exchange Trust Company Limited as trustee;
- (f) €350,000,000 5.375 per cent. bonds due 2009 dated 2 July 1999, between AW as issuer and Royal Exchange Trust Company Limited as trustee; and
- (g) €1,500,000,000 MTN Programme dated 22 March 2000, between AW as issuer, AWS as guarantor and IRG Trustees Limited as trustee, pursuant to which £150,000,000 3.875 per cent. index-linked guaranteed notes due 2020 were issued on 28 April 2000,

as shall have been amended pursuant to a consent solicitation on the Effective Date;

<b>“Existing Finance Leases”</b>	means the leases currently between AWS and the Existing Finance Lessors and which were entered into prior to the Effective Date and each as amended supplemented, assigned and novated prior to the Effective Date, and each an <b>“Existing Finance Lease”</b> ;
<b>“Existing Finance Lessors”</b>	means each of Mercantile Leasing Company (No. 132) Limited, D-LAF Limited or Moon Leasing Limited in its capacity as a general partner of Brahms Leasing Limited Partnership (if the novation to it of the D-LAF Existing Finance Lease has occurred prior to the Effective Date), Deutsche Bank AG London, CSC Computer Sciences Limited (which has sold its rights to the receivables under the relevant Existing Finance Lease to Dresdner Kleinwort Wasserstein Limited which in turn has assigned such rights to DrKW Finance Limited) and DrKW Finance Limited, who lease or agree to lease Equipment to AWS, under the terms of the Existing Finance Leases, including any of their successors or assigns and each an <b>“Existing Finance Lessor”</b> ;
<b>“Existing Framework Agreements”</b>	means the framework agreements between AWS and Contractors entered into prior to the Effective Date under which AWS subcontracts, tenders and outsources its operation and maintenance expenditure and/or construction works and other capital expenditure;
<b>“Existing Hedge Counterparties”</b>	means Barclays Bank PLC, Citibank, N.A., London Branch, Deutsche Bank AG London, Dresdner Bank AG, HSBC Bank plc and The Royal Bank of Scotland plc including their successors and assigns;
<b>“Existing Hedging Agreements”</b>	means the Treasury Transactions entered into by the Issuer and the Existing Hedge Counterparties dated on or about the Effective Date or any such agreement entered into by AWS or AW and one or more of the Existing Hedge Counterparties prior to the Effective Date and novated to the Issuer on or before the Effective Date;
<b>“Existing Joint Venture”</b>	means: <ul style="list-style-type: none"> <li>(a) a joint venture called “AB Water” entered into between AWS and Persimmon Homes (formerly Beazer Homes) for effluent recycling;</li> <li>(b) a joint venture called “BREG” (Bio-solids Reduction and Energy Generation Plant) entered into between AWS and TXU Europe Power Ltd. for the design, development, construction and operation of plants to generate heat and electricity in a combined cycle power station from natural gas and gasified sewage sludge;</li> <li>(c) a joint venture called “Logica” entered into between AWS and Logica UK Ltd. for the development, supply and support of telemetry systems;</li> <li>(d) a joint venture called “ABB Kent” entered into between AWS and ABB Metering Limited to develop an automatic meter reading system;</li> <li>(e) a joint venture called “Ardleigh Reservoir” pursuant to the Ardleigh Reservoir Order 1967; and</li> </ul>

- (f) any Existing Framework Agreements existing at the Effective Date,

details of which have been provided to the Security Trustee and MBIA prior to the Effective Date;

**“Extended Outsourcing Agreements”**

means:

- (i) the agreement entitled “Computer Network (PA no. EPAF)” between CSC and AWS which has a PA end date of 31 October 2005;
- (ii) the agreement entitled “Development Framework Agreement (PA no.01/27)” between Logica and AWS which has a PA end date of 31 October 2005; and
- (iii) the agreement entitled “Fleet Maintenance (PA no. 00/75)” between PowerMarque Ltd and AWS which has a PA end date of 31 March 2004,

copies of which have been provided to each Financial Guarantor and the Security Trustee on or prior to the Effective Date;

**“Facility Agent”**

means any facility agent under any Authorised Credit Facility;

**“FG Event of Default”**

means in relation to the Initial Financial Guarantor:

- (a) any Insured Amount which is Due for Payment (each as defined under the relevant Bond Policy) is unpaid by reason of non-payment by the Issuer and is not paid by such Financial Guarantor on the date stipulated in the relevant Bond Policy;
- (b) such Financial Guarantor disclaims, disaffirms, repudiates and/or challenges the validity of any of its obligations under the relevant Bond Policy or seeks to do so;
- (c) such Financial Guarantor:
  - (i) presents any petition, commences any case or takes any proceedings for the winding-up or the appointment of an administrator or receiver (including as administrative receiver or manager), conciliator, trustee, assignee, custodian, sequestrator, liquidator or similar official under any bankruptcy law, of such Financial Guarantor (or as the case may be, of a material part of its property or assets) under any Bankruptcy Law;
  - (ii) makes or enters into any general assignment, composition, arrangement (including a voluntary arrangement under the Insolvency Act 1986) or compromise with or for the benefit of any of its creditors;
  - (iii) has a final and non-appealable order for relief entered against it under any Bankruptcy Law; or
  - (iv) has a final and non-appealable order, judgment or decree of a court of competent jurisdiction entered against it appointing any conciliator, receiver, administrative receiver, trustee, assignee, custodian, sequestrator, liquidator, administrator or similar official under any

Bankruptcy Law (each a “**Custodian**”) for such Financial Guarantor or all or any material portion of its property or authorising the taking of its possession by a Custodian of such Financial Guarantor;

For the purpose of this definition, “**Bankruptcy Law**” means Law No. 85-98 of 25 January 1985 and Law No 84-148 of 1 March 1984 of the French Republic, any similar or future federal or state bankruptcy, insolvency, reorganisation, moratorium, rehabilitation, fraudulent conveyance or similar law, statute or regulation of the French Republic or of any other applicable jurisdiction for the relief of debtors,

and, in relation to any other Financial Guarantor, such events as are specified in that Financial Guarantor’s I&I Agreement or equivalent document and set out in the relevant Pricing Supplement;

**“Final Determination”**

means the final price determination made by the DGWS on a five-yearly basis;

**“Finance Documents”**

the Security Documents, Bond Trust Deed and the Existing Bond Trust Deeds, the Bonds (including the applicable Pricing Supplement), the Bond Policies, the I&I Agreements, the Premium Letters, the Finance Lease Documents, the Hedging Agreements, the CTA, the Issuer/AWS Loan Agreement, the AWS Loan Notes, the Initial Authorised Loan Agreement, the Bridging Facility Agreement, the Liquidity Facility Agreements, the Agency Agreement, the Existing Agency Agreements, the Master Definitions Agreements, the Account Bank Agreement, the CP Document, the Note Purchase Agreement, any other Authorised Credit Facilities, the Indemnification Deed, the Tax Deed of Covenant, the Programme Agreement and each agreement or other instrument between AWS or the Issuer (as applicable) and an additional Secured Creditor designated as a Finance Document by AWS or the Issuer (as applicable) and such additional Secured Creditor in the Accession Memorandum for such additional Secured Creditor;

**“Finance Lease Documents”**

means each Finance Lease together with any related or ancillary documentation;

**“Finance Leases”**

means the Existing Finance Leases and any new finance lease entered into by AWS or the Issuer in respect of plant, machinery, software, computer systems or equipment (the counterparty to which has acceded to the terms of the STID and the CTA and has agreed to be bound by the terms of Part 2 of Schedule 14 (Finance Lease Terms) of the CTA) permitted to be entered into under the terms of the CTA, each a “**Finance Lease**”;

**“Finance Lessors”**

means the Existing Finance Lessors and any other person entering into a Finance Lease with AWS, as permitted by the CTA and the STID, who accedes to the STID and the CTA as a Finance Lessor (each a “**Finance Lessor**”);

<b>“Finance Party”</b>	means any person providing financial accommodation pursuant to an Authorised Credit Facility including all arrangers, agents and trustees appointed in connection with any such Authorised Credit Facilities;
<b>“Financial Guarantor”</b>	means any person, including the Initial Financial Guarantor, which provides a financial guarantee insurance policy, including the Bond Policies, in respect of any of the Wrapped Debt, and <b>“Financial Guarantors”</b> means all of them if there is more than one at any time;
<b>“Financial Indebtedness”</b>	means any indebtedness for or in respect of: <ul style="list-style-type: none"> <li>(a) moneys borrowed or raised (whether or not for cash);</li> <li>(b) any documentary or standby letter of credit facility;</li> <li>(c) any acceptance credit;</li> <li>(d) any bond, note, debenture, loan stock or other similar instrument;</li> <li>(e) any finance, capital lease or hire purchase contract which would, in accordance with Applicable Accounting Principles, be treated as such;</li> <li>(f) any amount raised pursuant to any issue of shares which are capable of redemption;</li> <li>(g) receivables sold or discounted (otherwise than on a non-recourse basis);</li> <li>(h) the amount of any liability in respect of any advance or deferred purchase agreement if either one of the primary reasons for entering into such agreement is to raise finance or the relevant payment is advanced or deferred for a period in excess of 90 days;</li> <li>(i) any termination amount due from any member of the AWS Financing Group in respect of any Treasury Transaction that has terminated;</li> <li>(j) any other transaction (including any forward sale or purchase agreement) which has the commercial effect of a borrowing;</li> <li>(k) any counter-indemnity obligation in respect of any guarantee, indemnity, bond, letter of credit or any other instrument issued by a bank or financial institution; or</li> <li>(l) any guarantee, indemnity or similar assurance against financial loss of any person in respect of any item referred to in paragraphs (a) to (k) above;</li> </ul>
<b>“Financial Year”</b>	means the twelve months ending on the 31 March in each year or such other period as may be approved by the Security Trustee;
<b>“Fitch”</b>	means Fitch Ratings Limited;
<b>“Global Bond”</b>	means a Temporary Bearer Global Bond and/or a Permanent Bearer Global Bond and/or a Regulation S Global Bond and/or a Rule 144A Global Bond, as the context may require;

<b>“Good Industry Practice”</b>	means the standards, practices, methods and procedures as practised in the United Kingdom conforming to all applicable laws and that degree of skill, diligence, prudence and foresight which would reasonably be expected from a skilled and experienced person undertaking all or part of the Business as the case may be, under the same or similar circumstances having regard to the regulatory pricing allowances and practices in the United Kingdom’s regulated water and sewerage industry at the relevant time;
<b>“Habitats Regulations”</b>	means the Conservation (Natural Habitats etc.) Regulations 1994 implemented pursuant to Council Directive 92/43/EEC;
<b>“Hedge Counterparty”</b>	means any counterparty to a Hedging Agreement which is or becomes a party to the STID in accordance with the STID, including the Existing Hedge Counterparties and <b>“Hedge Counterparties”</b> means any or all parties as the context requires;
<b>“Hedging Agreement”</b>	means: <ul style="list-style-type: none"> <li>(a) the Existing Hedging Agreements;</li> <li>(b) any Treasury Transaction entered or to be entered into by the Issuer with Hedge Counterparties in accordance with the Hedging Policy (the counterparties to which have acceded to the terms of the STID and the CTA and agreed to be bound by the terms of Schedule 8 (Hedging Policy and Overriding Provisions relating to Hedging Agreements) of the CTA); and</li> <li>(c) any other Treasury Transaction (the counterparties to which have acceded to the terms of the STID and the CTA and agreed to be bound by the terms of Schedule 8 (Hedging Policy and Overriding Provisions relating to Hedging Agreements) of the CTA) designated a Hedging Agreement by the Security Trustee and the Issuer;</li> </ul>
<b>“Hedging Policy”</b>	means the initial hedging policy applicable to AWS and the Issuer set out in Schedule 8 (Hedging Policy and Overriding Provisions relating to Hedging Agreements) of the CTA as such hedging policy may be amended from time to time by agreement between the Security Trustee and the Issuer in accordance with the STID;
<b>“Holding Company”</b>	means a holding company within the meaning of section 736 of the Companies Act 1985;
<b>“I&amp;I Agreement”</b>	means each insurance and indemnity agreement (or similarly named agreement) between, inter alia, the Issuer and a Financial Guarantor in connection with a particular Series of Class A Wrapped Bonds and/or Class B Wrapped Bonds;
<b>“IDOK”</b>	means an interim determination of K as provided for in Part IV of Condition B of the Instrument of Appointment;
<b>“Indemnification Deed”</b>	means the deed so named and dated on or about the Effective Date between the Obligors, any Financial Guarantor and the Dealers;
<b>“Independent Review”</b>	means an independent review resulting from a Trigger Event as defined in Section 7.6.8 (iii), <i>“Financing Structure –</i>



<b>“Initial Authorised Credit Providers”</b>	means any party to the Initial Authorised Loan Agreement as lender or Finance Party;
<b>“Initial Authorised Loan Agreement”</b>	means the bank facility entered into between, inter alios, the Issuer and the Initial Authorised Loan Providers on or about the Effective Date;
<b>“Initial Authorised Credit Facility Agent”</b>	means Barclays Bank PLC or any successor thereto;
<b>“Initial Authorised Credit Facility Arranger”</b>	means Barclays Capital, or any successor thereto;
<b>“Initial Bond Policies”</b>	means the financial guarantee policy/ies to be issued by the Initial Financial Guarantor (subject to the satisfaction of certain conditions) in connection with the first Series of Wrapped Bonds;
<b>“Initial Financial Guarantor”</b>	means MBIA Assurance S.A.;
<b>“Initial Liquidity Facility Provider”</b>	means Barclays Bank PLC;
<b>“Insolvency Act”</b>	means the Insolvency Act 1986;
<b>“Insolvency Act 2000”</b>	means the Insolvency Act 2000, that received Royal Assent on 30 November 2000 and is due to be brought into force on a date yet to be appointed;
<b>“Insolvency Event”</b>	means, in respect of any company: <ul style="list-style-type: none"><li>(a) the initiation of or consent of Insolvency Proceedings by such company or any other company or the presentation of a petition for the making of an administration order and, in the opinion of the Security Trustee, such proceedings not being disputed in good faith with a reasonable prospect of success;</li><li>(b) the making of an administration order in relation to such company;</li><li>(c) an encumbrancer (excluding in relation to the Issuer, the Bond Trustee or any receiver) taking possession of the whole or any part of the undertaking or assets of such company;</li><li>(d) any distress, execution, attachment or other process being levied or enforced or imposed upon or against the whole or any part of the undertaking or assets of such person (excluding in relation to the Issuer, the Security Trustee or any receiver) and such order, appointment, possession or process (as the case may be) not being discharged or otherwise ceasing to apply within 30 days;</li><li>(e) the making of an arrangement, composition, reorganisation with or conveyance to or assignment for the creditors of such company generally or the making of an application to a court of competent jurisdiction for protection from the creditors of such company generally;</li><li>(f) a meeting is convened for the purpose of considering a resolution or an effective resolution is passed or an order is made by a court of competent jurisdiction for</li></ul>

the winding-up or dissolution of such company (except, in the case of the Issuer, a winding-up for the purpose of a merger, reorganisation or amalgamation the terms of which have previously been approved either in writing by the Security Trustee or by an Extraordinary Resolution);

- (g) the appointment of an Insolvency Official in relation to such company or in relation to the whole or any substantial part of the undertaking or assets of such company;
- (h) save as permitted in the STID, the cessation or suspension of payment of its debts generally or a public announcement by such person of an intention to do so; or
- (i) save as provided in the STID, a moratorium is declared in respect of any indebtedness of such person;

**“Insolvency Official”**

means, in respect of any company, a liquidator, provisional liquidator, administrator, Special Administrator, administrative receiver, receiver or manager, nominee, supervisor, trustee, conservator, guardian or other similar official in respect of such company or in respect of all or substantially all of the company’s assets or in respect of any arrangement or composition with creditors;

**“Insolvency Proceedings”**

means the winding-up, dissolution, administration or special administration of a company, corporation or other person or any equivalent or analogous proceedings under the law of the jurisdiction in which such company or corporation is incorporated or of any jurisdiction in which such company or corporation carries on business, including the seeking of liquidation, winding-up, reorganisation, dissolution, administration, special administration, arrangement, adjustment, protection or relief of debtors;

**“Institutional Accredited Investor”**

means an institutional investor that qualifies as an “accredited investor” (as defined in Rule 501(a)(1), (2), (3) or (7) under the Securities Act) and that is not a QIB;

**“Instructing Group”**

means the Class A DIG or, following repayment in full of the Class A Debt, the Class B DIG;

**“Instrument of Appointment” or “Licence”**

means the instrument of appointment dated August 1989 under sections 11 and 14 of the Water Act 1989 (as in effect on 1 August 1989) under which the Secretary of State for the Environment appointed AWS as a water and sewerage undertaker under that Act for the areas described in the Instrument of Appointment as modified or amended from time to time;

**“Intercompany Loan”**

means the principal amount of all advances from time to time outstanding under the Intercompany Loan Arrangements;

**“Intercompany Loan Arrangements”**

means the Issuer/AWS Loan Agreement and/or the AWS Loan Notes, as the context requires;

**“Intercreditor Arrangements”**

means the arrangements between the Secured Creditors of the AWS Financing Group in the STID summarised in Section 7.4, “*Financing Structure – Intercreditor Arrangements*”;

<b>“Interest Payment Date”</b>	means any date upon which interest or payment equivalent to interest become payable under the terms of any Authorised Credit Facility;
<b>“Interest Rate Hedging Agreement”</b>	means a Treasury Transaction to swap interest rates;
<b>“Investment Company Act”</b>	means the U.S. Investment Company Act of 1940, as amended, and the rules and regulations promulgated thereunder;
<b>“Investment Grade”</b>	means a rating of at least BBB– by Fitch, Baa3 by Moody’s or BBB– by S&P;
<b>“Investors Report”</b>	means each report produced by AWS and the Issuer within the earlier of 45 days after publication of the relevant Financial Statements or 180 days from 31 March or 90 days from 30 September in each year in respect of the immediately preceding calendar half year starting with 30 September 2002, in substantially the form set out in the CTA provided that ratio calculations will be adjusted only for every second Investors’ Report;
<b>“IP”</b>	means intellectual property;
<b>“IPPC”</b>	means the integrated pollution prevention and control regime introduced by the United Kingdom Pollution Prevention and Control Act 1999;
<b>“IRC”</b>	means the amounts set out under the heading infrastructure renewals charge in the financial projections contained in the supplementary report issued by Ofwat detailing the numbers and assumptions specific to AWS in the DGWS’s most recent Final Determination adjusted as appropriate for any subsequent IDOK and for Out-turn Inflation;
<b>“Issue Date”</b>	means the date of issue of any Series of Bonds or the date upon which all conditions precedent to any other Authorised Credit Facility have been fulfilled or waived and the Issuer makes a utilisation of that facility;
<b>“Issuer”</b>	means Anglian Water Services Financing Plc;
<b>“Issuer/AWS Loan Agreement”</b>	means the loan agreement entered into between the Issuer and AWS on the Effective Date as more particularly defined in Section 7.5.2, “ <i>Financing Structure – Intercompany Loan Arrangements – Issuer/AWS Loan Arrangements</i> ”;
<b>“IT”</b>	means information technology;
<b>“K”</b>	means the adjustment factor set for each year by the DGWS by which charges made by Regulated Companies for water supply and sewerage services may be increased, decreased or kept constant;
<b>“Lease Calculation Cashflow”</b>	means, in respect of any Test Period or, as the case may be, the Pre-Test Period, for any Finance Lease, a cashflow statement produced by the relevant Finance Lessor on, or as soon as reasonably practicable after, its Lease Calculation Date occurring prior to the commencement of such Test Period and in accordance with its terms and Schedule 14 ( <i>Finance Lease Terms</i> ) of the CTA and, in the case of an Additional Secured Creditor, in accordance with the terms of the relevant

Accession Memorandum and using, inter alia, for the purposes of calculating the amount shown for each rental payment date falling within the Test Period or, as the case may be, the Pre-Test Period under the heading “interest” (or the equivalent thereof (howsoever worded)) in such cashflow statement, a rate of LIBOR, estimated, as at its Lease Calculation Date, by reference to the average of those rates per annum being offered by the reference banks specified in the relevant finance lease (or where there is none, Barclays Bank PLC and Citibank N.A.) to prime banks in the London interbank market for entry into 12 month (or such other period as is equal to the relevant rental period under such Finance Lease) forward contracts, commencing on each rental payment date arising during the period commencing on such Lease Calculation Date and ending on the last rental payment date to occur during the relevant Test Period and as agreed between AWS and the relevant Finance Lessor (provided that, where any Finance Lease contains Rentals which are calculated by reference to a fixed rate of interest, any Lease Calculation Cashflow produced in respect of that Finance Lease shall reflect the actual fixed rate of interest implicit in such Rental calculations), provided that where in respect of any Finance Lease there has been a change of assumption resulting in an increase or decrease in the Rental payable thereunder during any Test Period or the Pre-Test Period, as the case may be, the Lease Calculation Cashflow applicable to that Finance Lease for such Test Period or the Pre-Test Period shall also include a cashflow statement, produced as soon as reasonably practicable after the time of recalculating the Rental in accordance with the terms of that Finance Lease and Schedule 14 (Finance Lease Terms) of the CTA or, as the case may be, that Accession Memorandum and using, in such cashflow statement, the same estimated interest rates as were used in preparation of the original cashflow statement prepared on or as soon as reasonably practicable after the Lease Calculation Date applicable to that Test Period or the Pre-Test Period, as the case may be;

**“Lease Calculation Date”**

means in respect of any Existing Finance Lease:

- (a) the Effective Date; and
- (b) the date falling 10 days before the rental payment date immediately preceding 1 April 2003; and
- (c) each yearly anniversary of the date referred to in (b) above,

and in respect of any Finance Lease which is not an Existing Finance Lease:

- (x) the date of the Accession Memorandum executed by the relevant Finance Lessor relating to such Finance Lease; and
- (y) the date falling 10 days before the rental payment date immediately preceding the commencement date of the first Test Period to commence immediately after the date referred to in (x) above; and

(z) each yearly anniversary of the date referred to in (y) above,

save that where any date referred to in (b), (c), (x), (y) or (z) is not a Business Day, such date shall be deemed to be the preceding Business Day.

<b>“Lease Reserve Amount”</b>	means in respect of any Finance Lease in any Test Period, the lower of (i) the aggregate Notional Amount calculated with respect to such Finance Lease; and (ii) the aggregate amount of rental payments payable to the Finance Lessor under such Finance Lease in respect of such Test Period or, as the case may be, the Pre-Test Period (inclusive of value added tax) (after adding back any additional rentals (inclusive of value added tax) payable and deducting any estimated rental rebates (inclusive of any credit for value added tax), in each case as determined in accordance with the provisions of the relevant Finance Lease);
<b>“Licence” or “Instrument of Appointment”</b>	means the instrument of appointment dated August 1989 under Sections 11 and 14 of the Water Act 1989 (as in effect on 1 August 1989) under which the Secretary of State for the Environment appointed AWS as a water and sewerage undertaker under the Act for the areas described in the Instrument of Appointment, as modified or amended from time to time;
<b>“Liquidity Facility”</b>	means a Debt Service Reserve Liquidity Facility or an O&M Reserve Facility made available under a Liquidity Facility Agreement and <b>“Liquidity Facilities”</b> means all of them;
<b>“Liquidity Facility Agent”</b>	means in respect of the Debt Service Reserve Liquidity Facility Agreements and the O&M Reserve Facility Agreement, Barclays Bank PLC;
<b>“Liquidity Facility Agreements”</b>	means the Debt Service Reserve Liquidity Facility Agreements and the O&M Reserve Facility Agreement;
<b>“Liquidity Facility Provider”</b>	means any lender from time to time under a Liquidity Facility Agreement, including, the Debt Service Reserve Liquidity Facility Provider and the O&M Reserve Facility Provider;
<b>“Liquidity Facility Requisite Ratings”</b>	means the Minimum Short-term Rating and a minimum long-term rating of at least “A” from Fitch and S&P and at least “A2” from Moody’s from at least two Rating Agencies;
<b>“Local Authority Loan”</b>	means the local authority loan in the amount of approximately £195,000 provided to AWS by Castle Point Borough Council;
<b>“London Stock Exchange”</b>	means the London Stock Exchange plc;
<b>“Majority Creditors”</b>	means Class A DIG Representatives in respect of more than 50 per cent. of the Voted Qualifying Class A Debt or following the repayment in full of the Class A Debt, Class B DIG Representatives in respect of more than 50 per cent. of the Voted Qualifying Class B Debt, in each case subject to Clause 8 (Modifications, Consents and Waivers) and Clause 9 (Voting Instructions and Notification of Outstanding Principal Amounts of Qualifying Debt) of the STID;

<b>“Make-Whole Amount”</b>	means the Make-Whole Amount as defined in the Conditions and/or the Note Purchase Agreement relating to the USPP 2001 Bonds and any other amount above par payable on redemption of any Class A Debt or Class B Debt except where such amount is limited to accrued interest;
<b>“Master Definitions Agreement”</b>	means the Master Definitions Agreement dated 30 July 2002 between the Obligors and the other parties named therein;
<b>“Material Adverse Effect”</b>	means the effect of any event or circumstance which is materially adverse, taking into account the timing and availability of any rights or remedies under the WIA or the Instrument of Appointment, to: <ul style="list-style-type: none"> <li>(a) the business, property, operations or financial condition of AWS or of the AWS Financing Group as a whole;</li> <li>(b) the ability of any member of the AWS Financing Group to perform its obligations under any Finance Document;</li> <li>(c) the validity or enforceability of any Finance Document or the rights or remedies of any Secured Creditor thereunder; or</li> <li>(d) the ability of AWS to perform or comply with any of its obligations under the Instrument of Appointment or the WIA;</li> </ul>
<b>“Material Agreement”</b>	means any Tier 1 Material Agreement or Tier 2 Material Agreement;
<b>“Material Entity Event”</b>	means any of the events or circumstances in Schedule 2 to the CTA and described in Section 7.6.11, “ <i>Financing Structure – Common Terms Agreement – Material Entity Events</i> ”;
<b>“Maturity Date”</b>	means the date on which a Bond is expressed to be redeemable or any other Authorised Credit Facility is expressed to be repayable in full;
<b>“Maximum Early Redemption Amount”</b>	means the aggregate of all Early Redemption Amounts which would become payable upon redemption of USPP 2001 Bonds following the occurrence of an Early Redemption Event, assuming the holders of all USPP 2001 Bonds which would be entitled to do so elect to have their USPP 2001 Bonds redeemed as a result of an Early Redemption Event occurring;
<b>“MBIA ”</b>	means MBIA Assurance S.A.;
<b>“MBIA Make-Whole Amount”</b>	means the amount of market value in excess of par paid out by MBIA in respect of £100,000,000 5½ per cent. index-linked loan stock due 2008 and £100,000,000 12 per cent. bonds due 2014, as further defined in the Bond Policy relating to such bonds;
<b>“Meter Optants”</b>	means domestic customers who have opted to be charged on the basis of a meter reading rather than by rateable value;
<b>“Minimum Long-term Rating”</b>	means, in respect of any person, such person’s long-term unsecured debt obligations being rated, in the case of Moody’s, “Aa3”; in the case of S&P, “AA-”; and in the case of Fitch, “AA-”;

<b>“Minimum Short-term Rating”</b>	means, in respect of any person, such person’s short-term unsecured debt obligations being rated, in the case of Moody’s, “Prime-1”; and in the case of S&P, “A-1”; and in the case of Fitch, “F-1”;
<b>“MI/d”</b>	means megalitres per day;
<b>“Monthly Payment Amount”</b>	means the amount paid on a monthly basis by AWS to the Debt Service Payment Account, as defined in Section 7.7.4, “ <i>Financing Structure – Cash Management – Payment Account</i> ”;
<b>“Moody’s”</b>	means Moody’s Investors Service Limited;
<b>“Net Cash Flow”</b>	means: <ul style="list-style-type: none"> <li>(a) in respect of any historical element of a Test Period, the aggregate of net cash flow from operating activities as shown in the AWS financial statements, (after adding back, without double counting, and to the extent that such items are included in net cash flow from operating activities, any exceptional items, any customer rebates, any recoverable VAT, any capital maintenance expenditure and any movement in debtors and/or creditors relating to capital expenditure) minus corporation tax paid; and</li> <li>(b) in respect of any forward looking element of a Test Period shall have the same meaning set out in (a) above save that that paragraph shall be amended by adding the words “less any net cash flow from operating activities of its business other than its Regulated Business and after adding back corporation tax paid arising as a result of such businesses” after the words “corporation tax paid”;</li> </ul>
<b>“New Money Advance”</b>	means any drawing during a Standstill under a Liquidity Facility or any Authorised Credit Facility which is not made (or to the extent not made) for the purpose of refinancing a maturing Advance under such Liquidity Facility or refinancing a drawing under such Authorised Credit Facility;
<b>“Non-Regulatory Allowable Expense”</b>	means any expense incurred in connection with activities that are not the subject of, or fall outside the scope of, any Periodic Review;
<b>“Note Purchase Agreement”</b>	means the note purchase agreement dated 25 July 2001 pursuant to which AWS issued the USPP 2001 Bonds;
<b>“Notified Item”</b>	means any item formally notified by the DGWS to the Regulated Company as not having been allowed for in K, provided that there has been no Periodic Review subsequent to that notification;
<b>“Notional Amount”</b>	means, in respect of any Finance Lease, a sum, certified by any duly authorised signatory of the relevant Finance Lessor on each Lease Calculation Date and using the relevant Lease Calculation Cashflow relating thereto as being, for the succeeding Test Period, the amount shown for each rental payment date falling in that relevant Test Period or, as the case may be, the Pre-Test Period under the headings “interest” and “margin” (or any equivalents thereof (howsoever worded)) in

the relevant Lease Calculation Cashflow, together with an amount equal to VAT on such amount at the rate applicable to rentals payable under the relevant Finance Lease;

<b>“NPV”</b>	means, in respect of any amount payable or receivable at a future date, such amount discounted back to the date of calculation on an annual basis at the long term weighted average cost of funds of AWS calculated on the basis of all Financial Indebtedness of AWS having a residual maturity in excess of 12 months and the applicable rates of interest thereon;
<b>“O&amp;M Reserve Account”</b>	means the account of AWS entitled “O&M Reserve Account” held at the Account Bank and includes any sub-account relating to that account and any replacement account from time to time;
<b>“O&amp;M Reserve Facility”</b>	means an operation and maintenance reserve liquidity facility made available under a Liquidity Facility Agreement;
<b>“O&amp;M Reserve Facility Agreement”</b>	means an agreement establishing an O&M Reserve Facility as more particularly described in Section 7.10.4, “ <i>Financing Structure – Additional Resources Available – The Liquidity Facilities</i> ”;
<b>“O&amp;M Reserve Facility Provider”</b>	means the provider of the O&M Reserve Facility from time to time;
<b>“Obligor”</b>	means any member of the AWS Financing Group and “ <b>Obligors</b> ” means all of them;
<b>“Official List”</b>	means the official list of the United Kingdom Listing Authority;
<b>“OFT”</b>	means the Office of Fair Trading in the United Kingdom;
<b>“Ofwat”</b>	means the Office of Water Services in England and Wales;
<b>“Ordinary Distribution”</b>	means a Distribution which is paid out of Net Cash Flow generated, but taking account of interim dividends, during the twelve months up to 31 March (being the final dividend for that Financial Year) or Net Cash Flow generated during the six months up to 30 September (being the interim dividend for the first half of that Financial Year);
<b>“Original Lender” or “Bridging Facility Provider”</b>	means a lender under the Bridging Facility;
<b>“Outsourcing Agreement”</b>	means any agreement pursuant to which AWS sub-contracts, tenders or outsources either the day-to-day operation of its assets and service delivery (including any maintenance expenditure) that AWS could, if not outsourced, perform itself and which has (or would have were it entered into on arm’s length terms) an annual value in excess of £100,000 (indexed);
<b>“Outsourcing Policy”</b>	means each of the obligations in Schedule 9 (Outsourcing Policy) of the CTA;
<b>“Outstanding Principal Amount”</b>	means, as at any date that the same falls to be determined:  (a) in respect of Wrapped Bonds prior to the occurrence of an FG Event of Default which is continuing, the



aggregate of any unpaid amounts owing to a Financial Guarantor under an I&I Agreement to reimburse it for any amount paid by it under a Bond Policy in respect of unpaid principal on a Wrapped Bond and the principal amount outstanding (or the Equivalent Amount) of the Wrapped Bonds (including any premium);

- (b) in respect of Wrapped Bonds after an FG Event of Default which is continuing, the principal amount outstanding (or the Equivalent Amount) of the Wrapped Bonds (including any premium);
- (c) in respect of Unwrapped Bonds, the principal amount outstanding (or the Equivalent Amount) of the Unwrapped Bonds (including any premium);
- (d) in respect of any Authorised Credit Facilities that are loans, the principal amount (or the Equivalent Amount) of any drawn amounts that are outstanding;
- (e) in respect of each Finance Lease, the Equivalent Amount of either (i) prior to an Acceleration of Liabilities (other than a Permitted Lease Termination) and subject to any increase or reduction calculated in accordance with Clause 9.9 (Notification of Outstanding Principal Amount of Qualifying Debt) of the STID, the highest termination value which may fall due during the rental period encompassing such date, calculated upon the assumptions set out in the cashflow report provided by the relevant Finance Lessor on the first day of each such rental period (or in the most recently generated cash flow report which is current on such date) or (ii) following any Acceleration of Liabilities (other than a Permitted Lease Termination), the actual amount (if any) that would be payable to the relevant Finance Lessor in respect of a termination of the leasing of the Equipment on the date of such Acceleration of Liabilities (other than a Permitted Lease Termination);
- (f) in respect of each Hedging Agreement, the Equivalent Amount of the amount (if any) that would be payable to the relevant Hedge Counterparty if an early termination date was designated in respect of the transaction or transactions arising under the Hedging Agreement pursuant to the ISDA Master Agreement governing such transaction or transactions and subject to the Hedging Policy; and
- (g) in respect of any other Secured Liabilities, the Equivalent Amount of the outstanding principal amount of such debt on such date in accordance with the relevant Finance Document;

all as most recently certified or notified to the Security Trustee, where applicable, pursuant to Clause 9.9 (Notification of Outstanding Principal Amount of Qualifying Debt) of the STID;

<b>“Out-turn Inflation”</b>	means, in respect of any period for which the relevant indices have been published, the actual inflation rate applicable to such period determined by reference to movements in the RPI adjusted, as appropriate, in the case of capital additions, for any divergence between the actual movement of national construction costs, as evidenced by the Construction Output Price Index (or such other index as the DGWS may specify) relative to the RPI from their base levels as used in the most recent Final Determination or IDOK and their relative movement as projected by the DGWS for the purposes of that determination, and in respect of any period, including future periods, for which the relevant indices have not yet been published, by reference to forecast rates consistent with the average monthly movement in such indices over the previous 12 months for which published indices are available;
<b>“Participating Member State”</b>	means a member state of the European Community that adopts or has adopted the euro as its lawful currency under the legislation of the European Union for European Monetary Union;
<b>“Paying Agents”</b>	means, in relation to all or any Series of the Bonds, the several institutions (including, where the context permits, the Principal Paying Agent) at their respective specified offices initially appointed as paying agents in relation to such Bonds by the Issuer and the Obligors pursuant to the Agency Agreement and/or, if applicable, any successor paying agents at their respective specified offices in relation to all or any Series of the Bonds;
<b>“Payment Account”</b>	means the account of AWS titled “Payment Account” held at the Account Bank and includes any sub-account relating to that account and any replacement account from time to time;
<b>“Payment Date”</b>	means each date on which a payment is made or is scheduled to be made by any Obligor in respect of any obligations or liabilities under any Authorised Credit Facility;
<b>“Payment Priorities”</b>	means the provisions relating to the order of priority of payments set out in Section 7.7.6, “ <i>Financing Structure – Cash Management – Debt Service Payment Account</i> ”;
<b>“Periodic Review”</b>	means the periodic review of K (as that term is defined in the Instrument of Appointment) as provided for in Part III of Condition B of the Instrument of Appointment;
<b>“Period Review Effective Date”</b>	means the date with effect from which the new K (as that term is defined in the Instrument of Appointment) will take effect, following a Periodic Review;
<b>“Permanent Bearer Global Bond”</b>	means a global bond comprising some or all of the Bearer Bonds of the same Series issued by the Issuer in exchange for the whole or part of any Temporary Bearer Global Bond issued in respect of such Bearer Bonds;
<b>“Permitted Acceleration”</b>	means an acceleration of the Bridging Facility and certain share pledges permitted pursuant to the STID;
<b>“Permitted Acquisition”</b>	means any of the following carried out by AWS:

- (a) acquisitions (including Authorised Investments) made on arm's length terms and in the ordinary course of trade;
- (b) acquisitions of assets required to replace surplus, obsolete, worn-out, damaged or destroyed assets which in the reasonable opinion of AWS are required for the efficient operation of its Business or in accordance with the Finance Leases; or
- (c) acquisition of assets (but not companies or joint ventures) made on arm's length terms entered into for *bona fide* commercial purposes in furtherance of AWS's statutory and regulatory obligations;

but not an acquisition of a water business or interest therein (except (i) for inset business in the United Kingdom which is or will be included in RAV and which breaches neither the Instrument of Appointment nor the Act or (ii) with the prior consent of the Security Trustee and each Financial Guarantor);

**“Permitted Book Debt Disposal”**

means the disposal (with the prior consent of the Security Trustee and each Financial Guarantor) of book debts by AWS on arm's length terms to any person other than an Affiliate, provided that where such book debts are sold on recourse terms:

- (a) AWS has made a prudent provision in its accounts against the non-recoverability of such debts;
- (b) the recourse period does not exceed 24 months;
- (c) any write-back of any provision for non-recoverability arising from the sale can only be treated as operating profit for the purposes of the financial ratios once the relevant recourse period against AWS has expired; and
- (d) the AWS Business Financial Model is updated to ensure the transaction is taken into account in calculating all relevant financial ratios under the CTA;

**“Permitted Demerger”**

means a demerger, reconstruction, scheme of arrangement or other like process immediately following which either (i) no person Controls AWS Holdings or (ii) all of AWS Holdings' shares (or the shares of any company of which AWS Holdings is a direct or indirect wholly-owned subsidiary) are held by the then existing shareholders of AWG;

**“Permitted Disposal”**

means any disposal made by AWS which:

- (a) is made in the ordinary course of trading of the disposing entity or in connection with an arm's length transaction entered into for *bona fide* commercial purposes for the benefit of the Business;
- (b) is of assets in exchange for other assets comparable or superior as to type, value and quality;
- (c) is of Equipment pursuant to the Finance Leases;
- (d) would not result in the Senior RAR, calculated for each Test Period by reference to the most recently occurring Calculation Date (adjusted on a pro-forma basis to take

into account the proposed disposal) being less than or equal to 0.9:1;

- (e) is a disposal for cash on arm's length terms of any surplus or obsolete or worn-out assets which, in the reasonable opinion of AWS, are not required for the efficient operation of its Business and which does not cause a Trigger Event under paragraph 1 of Schedule 6, Part 1 of the CTA;
- (f) is a Permitted Book Debt Disposal;
- (g) is a disposal of Protected Land (as that term is defined in the Act) in accordance with the terms of the Instrument of Appointment;
- (h) is a disposal or surrender of tax losses which is a Permitted Tax Loss Transaction; or
- (i) is any other disposal which is in accordance with the Instrument of Appointment provided that the consideration (both cash and non-cash) received by AWS (or which would be received by AWS if such disposal was made on arm's length terms for full commercial value to an unconnected third party) in respect of any such disposal when aggregated with all other such disposals by it made in (y) the immediately preceding 12 month period does not exceed 2½ per cent. of RAV (or its equivalent) and (z) in the immediately preceding five-year period does not exceed 10 per cent. of RAV (or its equivalent);

provided that in each case such disposal does not cause the Trigger Event Ratio Levels to be breached;

**“Permitted Emergency Action”**

means any remedial action taken by AWS during an Emergency which is in accordance with the policies, standards and procedures for emergency planning manual (EMPROC) of AWS (as amended from time to time), Ofwat guidance notes and Public Procurement Rules and which AWS considers necessary and which continues only so long as required to remedy the Emergency but in any event no longer than 28 days or such longer period as is agreed by AWS, the Security Trustee and each Financial Guarantor;

**“Permitted Existing Non-Statutory Business”**

means any business other than the Regulated Business which is carried on by AWS at the Effective Date and (a) which falls within the Permitted Non-Statutory Business Limits applicable to Permitted Existing Non-Statutory Business and (b) in respect of which all material risks related thereto are fully insured and (c) which does not give rise to any material, actual or contingent liabilities for AWS that are not properly provided for in its financial statements;

**“Permitted Financial Indebtedness”**

means:

- (a) Financial Indebtedness incurred under the Intercompany Loan Arrangements or the UK Holdco/ AWS Loan;
- (b) Financial Indebtedness incurred under any Finance Document as at the Effective Date;

- (c) Financial Indebtedness incurred under a Treasury Transaction provided it is in compliance with the Hedging Policy;
- (d) the Local Authority Loan provided that the aggregate amount thereof does not exceed the amount at the date of the CTA;
- (e) any unsecured indebtedness which is fully subordinated to the Class A Debt and Class B Debt in a manner satisfactory to the Security Trustee provided that the aggregate amount of such Financial Indebtedness, when aggregated further with those amounts outstanding under the facilities referred to in paragraph (d) above does not exceed £15,000,000 (indexed);
- (f) any Subordinated Debt;
- (g) such further Financial Indebtedness incurred by the Issuer or AWS that complies with the following conditions:
  - (i) at the time of incurrence of that Financial Indebtedness, no Default is continuing or will arise as a result of the incurrence of such Financial Indebtedness;
  - (ii) the Financial Indebtedness is made available pursuant to an Authorised Facility Agreement the counterparty to which has acceded to the CTA and STID;
  - (iii) as a result of the incurrence of the Financial Indebtedness:
    - (A) AWS and the Issuer will not be in breach of its covenant to maintain the Debt Service Reserve Liquidity Facility to the required level as more particularly described in Section 7.6.6(ii)(a), “*Financing Structure – Common Terms Agreement – Covenants – Financial Covenants*” and its covenant to ensure scheduled final repayments are controlled, as more particularly described in Section 7.6.5(vii)(e), “*Financing Structure – Common Terms Agreement – Covenants – Covenants General*”;
    - (B) no Authorised Credit Provider will have better or additional Entrenched Rights under the STID than those Authorised Credit Providers of the same class; and
    - (C) the Hedging Policy shall continue to be complied with in all respects;
  - (iv) the Financial Indebtedness which is Class A Debt ranks *pari passu* in all respects with all other Class A Debt and the Financial

Indebtedness that is Class B Debt ranks *pari passu* in all respects with all other Class B Debt;

- (v) if such further Financial Indebtedness is Class A Debt or Class B Debt then the Senior RAR (adjusted on a proforma basis to take into account the proposed incurrence of such further Financial Indebtedness) must be less than or equal to 0.90:1 for each Test Period calculated by reference to the then most recently occurring Calculation Date;
  - (vi) if such further Financial Indebtedness is Class A Debt then (taking into account the incurrence of such debt) the Class A RAR must be less than or equal to 0.75:1 and the Class A PMICR must be greater than or equal to 1.30:1 for each Test Period calculated by reference to the then most recently occurring Calculation Date;
  - (vii) if such further Financial Indebtedness is incurred under a Finance Lease, the amount of that Financial Indebtedness, when aggregated with all other Financial Indebtedness under Finance Leases shall not exceed an amount of £570,000,000 (indexed);
- (h) Financial Indebtedness incurred with the consent of the Security Trustee and each Financial Guarantor.

For the purposes of this definition only, the termination sums payable under a Treasury Transaction that has been terminated shall not be treated as Financial Indebtedness and the occurrence of such event shall not be construed as the incurrence of Financial Indebtedness;

**“Permitted Hedge Termination”**

means the termination of a Hedging Agreement in accordance with the CTA;

**“Permitted Joint Venture”**

means, after the Effective Date, the financing, development, design, carrying out and management by or on behalf of AWS of any new Joint Venture to which the Security Trustee and each Financial Guarantor has consented (such consent not to be unreasonably withheld) pursuant to the terms of the CTA and the operation by or on behalf of AWS of that joint venture in accordance with the criteria set out in the CTA and, in relation to any Existing Joint Venture, the above-mentioned terms do not apply;

**“Permitted Lease Termination”**

means any termination of the leasing (or the prepayment of Rentals arising by reason of such termination) of all or any part of the Equipment in the following circumstances:

- (a) *Total Loss*: Pursuant to Clause 7.2 of the Mercantile Existing Finance Lease, Clause 7.2 of the D-LAF Existing Finance Lease, Clause 10(A) of the Deutsche Bank Existing Finance Lease, Clause 6 of the DrKW Finance Existing Finance Lease and Clause 6 of the DrKW Industrial Finance Existing Finance Lease or any other provision of a Finance Lease whereby the

leasing of all or any part of the Equipment thereunder will terminate following a total loss of such Equipment save that AWS or the Issuer (as applicable) will not make payment to the relevant Finance Lessor of any sums due and payable under the relevant Finance Lease in respect of such total loss if (i) an Acceleration of Liabilities has occurred or (ii) a Default Situation is subsisting or would occur as a result of such payment;

- (b) *Illegality*: Pursuant to Clause 10(E)(i) of the Deutsche Bank Existing Finance Lease, or any other provision of a Finance Lease which permits the relevant Finance Lessor to terminate the leasing of the Equipment thereunder and to require payment of a termination sum or sums where it is unlawful for such Finance Lessor to continue to lease the relevant Equipment save that AWS or the Issuer (as applicable) will not make payment to the relevant Finance Lessor of any sums due and payable under the Finance Lease in respect of such circumstances if either (i) an Acceleration of Liabilities has occurred or (ii) a Default Situation is subsisting or would occur as a result of such payment; and
- (c) *Voluntary Prepayment/Termination*: Pursuant to Clause 11.3 of the Mercantile Existing Finance Lease, Clause 11.3 of the D-LAF Existing Finance Lease, Clause 10(B) of the Deutsche Bank Existing Finance Lease, Clause 2.2 of the DrKW Industrial Finance Existing Finance Lease, Clause 2.2. of the DrKW Finance Existing Finance Lease and any other provision of a Finance Lease whereby AWS or the Issuer (as applicable) will be entitled to voluntarily terminate (and require payment of a termination sum), or prepay the Rentals due to, the leasing of certain Equipment under such Finance Lease provided that (i) no Acceleration of Liabilities has occurred or (ii) no Default Situation is subsisting or would occur as a result of such prepayment or termination;

**“Permitted New Non-Statutory Business”**

means any business other than the Regulated Business, and Permitted Existing Non-Statutory Business provided that (a) such business: (i) requires the utilisation of assets or resources that are already owned or controlled by AWS; and (ii) is prudent in the context of the overall business of AWS and continues to be prudent for the duration of that Permitted New Non-Statutory Business; and (iii) is not reasonably likely to be objected to by the DGWS; and (iv) falls within the Permitted Non-Statutory Business Limits applicable to Permitted New Non-Statutory Business and, (b) all material risks related thereto are fully insured and (c) such business does not give rise to any material actual or contingent liabilities for AWS that are not properly provided for in its financial statements;

**“Permitted Non-Statutory Business”**

means Permitted Existing Non-Statutory Business and Permitted New Non-Statutory Business;

**“Permitted Non-Statutory Business Limits”**

means, in respect of Permitted Non-Statutory Business, that the aggregate Non-Regulatory Allowable Expense in any Test Period does not exceed 2.5 per cent. of Cash Expenses of AWS in that period;

**“Permitted Security Interest”**

means:

- (1) any security interest created by any Obligor that is:
  - (a) a Security Interest created under the Security Documents or contemplated by the Finance Documents;
  - (b) any Security Interest specified in Schedule 12 of the CTA as set out in Section 7.7, “*Financing Structure – Cash Management*”, if the principal amount thereby secured is not increased;
  - (c) a Security Interest comprising a netting or set-off arrangement entered into by a member of the AWS Financing Group in the ordinary course of its banking arrangements for the purpose of netting debit and credit balances;
  - (d) a right of set-off, banker’s liens or the like arising by operation of laws or by contract by virtue of the provision of any overdraft facility and like arrangements arising as a consequence of entering into arrangements on the standard terms of any bank providing an overdraft;
  - (e) any Security Interest arising under statute or by operation of law in favour of any government, state or local authority in respect of taxes, assessments or government charges which are being contested by the relevant member of the AWS Financing Group in good faith and with a reasonable prospect of success;
- (2) any security interest created by either AWS or the Issuer that is:
  - (a) a security interest comprising a netting or set-off arrangement entered into under any hedge arrangement entered into in accordance with the Hedging Policy where the obligations of other parties thereunder are calculated by reference to net exposure thereunder (but not any netting or set-off relating to such hedge arrangement in respect of cash collateral or any other Security Interest except as otherwise permitted hereunder);
  - (b) a lien in favour of any bank over goods and documents of title to goods arising in the ordinary course of documentary credit transactions entered into in the ordinary course of trade;
  - (c) a Security Interest created over shares and/or other securities acquired in accordance with the CTA held in any clearing system or listed on any exchange which arise as a result of such shares and/or securities being so held in such clearing system or listed on such exchange as a result of the rules and regulations of such clearing system or exchange;
  - (d) a Security Interest approved by the Security Trustee, the holder of which has become a party to the STID;



- (3) any security interest that is created by AWS that is:
  - (a) a Security Interest over or affecting any asset acquired on arm's length terms after the date hereof and subject to which such asset is acquired, if:
    - (i) such Security Interest was not created in contemplation of the acquisition of such asset;
    - (ii) the amount thereby secured has not been increased in contemplation of, or since the date of, the acquisition of such asset by a member of the AWS Financing Group; and
    - (iii) unless such Security Interest falls within any of Paragraphs (d) to (h) below and (A) such Security Interest is removed or discharged within three months of the date of acquisition of such asset; or (B) the holder thereof becomes party to the STID;
  - (b) a Security Interest arising in the ordinary course of business and securing amounts not more than 90 days overdue or if more than 90 days overdue, the original deferral was not intended to exceed 90 days and such amounts are being contested in good faith;
  - (c) a Security Interest arising under or contemplated by any Finance Leases, hire purchase agreements, conditional sale agreements or other agreements for the acquisition of assets on deferred purchase terms (other than the Existing Finance Leases) where the counterparty becomes party to the STID;
  - (d) a right of set-off existing in the ordinary course of trading activities between AWS and its suppliers or customers;
  - (e) a lien arising under statute or by operation of law (or by agreement having substantially the same effect) and in the ordinary course of business provided that such lien is discharged within 30 days of any member of the Group becoming aware that the amount owing in respect of such lien has become due;
  - (f) a Security Interest arising on rental deposits in connection with the occupation of leasehold premises in the ordinary course of business; or
  - (g) in addition to any Security Interests subsisting pursuant to the above any other Security Interests provided that the aggregate principal amount secured by such Security Interests does not at any time exceed £10,000,000 (or its equivalent) (indexed),

to the extent and for so long, in each case, as the creation or existence of such Security Interest would not contravene the terms of the Instrument of Appointment, the WIA or any requirement under the Instrument of Appointment or the WIA;

**“Permitted Tax Loss Transaction”**

means any surrender of tax losses or agreement relating to tax benefit or relief (including for the avoidance of doubt an election under Section 171A Taxation of Chargeable Gains Act 1992) or other agreement relating to tax between:

- (a) an Obligor (other than AWS or the Issuer if, in either case, it is the company making the surrender or providing the benefit or relief) and any other member of the AWS Financing Group; or
- (b) AWS or the Issuer and any other member of the AWS Financing Group or an Obligor and any other member of the AWG Group (not being a member of the AWS Financing Group) provided that:
  - (i) a payment is made by the company receiving the benefit, tax loss or relief made available under a transaction pursuant to paragraph (b) above (the “**Recipient Company**”) which is equal to the tax saved by the Recipient Company; and
  - (ii) the payment for any such benefit, tax loss or relief is made within 30 days of the claim being made by the Recipient Company to include the benefit, tax loss or relief in the tax return (whether the tax return originally filed or an amendment to that tax return) it files with the Inland Revenue;

**“Permitted Volume Trading Arrangements”**

means:

- (a) (for the period 12 months from the Effective Date only) contracts entered into by AWS with suppliers for the supply of goods and services to the AWG Group and the AWS Financing Group on terms that discounts are available as a result of such arrangements provided that any member of the AWG Group making use of such arrangements agrees to reimburse and indemnify the AWS Financing Group for any amounts payable by the AWS Financing Group to such suppliers as a result of that member of the AWG Group making use of such arrangements; and
- (b) from the Effective Date, contracts entered into by the AWG Group with suppliers for the supply of goods and services to the AWG Group and the AWS Financing Group on terms that discounts are available as a result of such arrangements, provided that any Obligor making use of such arrangements will reimburse the AWG Group for any Financial Indebtedness by way of amounts payable by the AWG Group to such supplier as a result of such Obligor making use of such arrangements;

**“Potential Event of Default”**

means an event (other than in any Hedging Agreement, where “Potential Event of Default” has the meaning given to it in that Hedging Agreement) which would be (with the expiry of a grace period, the giving of notice or the making of any determination under the Finance Documents or any combination of them), an Event of Default;

**“Potential Trigger Event”**

means an event which would be (with the expiry of any relevant grace period or the giving of notice or any combination thereof) if not remedied or waived become a Trigger Event;

<b>“Premium Letter”</b>	means the letter or other agreement between a Financial Guarantor and one or more of the Obligors setting the terms on which premia are payable in relation to one or more Bond Policies issued or to be issued by that Financial Guarantor;
<b>“Pre-Test Period”</b>	means the period from the Effective Date up to 31 March 2003;
<b>“Pricing Supplement”</b>	means the pricing supplement issued in relation to each Tranche of Bonds as a supplement to the conditions and giving details of that Tranche;
<b>“Principal Paying Agent”</b>	means Deutsche Bank AG London as principal paying agent under the Agency Agreement, or its successors thereto;
<b>“Procurement Plan”</b>	means the plan for the procurement of services which AWS will prepare pursuant to the Licence as modified;
<b>“Programme”</b>	means the €10 billion global secured medium term note programme established by the Issuer and listed on the London Stock Exchange;
<b>“Programme Agreement”</b>	means the agreement dated 23 July 2002 between the Issuer, the Obligors and the Dealers named therein (or deemed named therein) concerning the purchase of Bonds to be issued pursuant to the Programme together with any agreement for the time being in force amending, replacing, novating or modifying such agreement and any accession letters and/or agreements supplemental thereto;
<b>“Projected Operating Expenditure”</b>	means at any time, the operating expenditure projected in the operating budget for the Test Period in which such date falls;
<b>“Protected Land”</b>	means (as the term is defined in the WIA) any land which, or any interest or right in or over land which: <ul style="list-style-type: none"> <li>(a) was transferred to that Regulated Company in accordance with a scheme under Schedule 2 to the Water Act 1989 or, where that company is a statutory water company, was held by that company at any time during the financial year ending 31 March 1990;</li> <li>(b) is or has at any time on or after 1 September 1989 been held by that company for the purposes connected with the carrying out of its functions as a water undertaker or sewerage undertaker; or</li> <li>(c) has been transferred to that company in accordance with a scheme under Schedule 2 to the WIA from another company in relation to which that land was protected when the other company held an Instrument of Appointment;</li> </ul>
<b>“Public Procurement Rules”</b>	means public procurement rules of the United Kingdom (including the Utilities Contracts Regulations 1996 (SI 1996/2911)) and of the European Communities (including Directive 93/98 as amended by Directive 98/4) affecting the water and sewerage sector and including any jurisprudence of the courts of the United Kingdom and of the European Communities and decisions of the European Commission in respect of such rules;

<b>“Qualifying Class A Debt”</b>	means the aggregate Outstanding Principal Amount of Class A Debt to be voted by the Class A DIG Representatives;
<b>“Qualifying Class A Debt Provider”</b>	means a provider of Qualifying Class A Debt;
<b>“Qualifying Class B Debt”</b>	means the aggregate Outstanding Principal Amount of Class B Debt to be voted by the Class B DIG Representatives;
<b>“Qualifying Class B Debt Provider”</b>	means a provider of Qualifying Class B Debt;
<b>“Qualifying Debt”</b>	means the Qualifying Class A Debt or the Qualifying Class B Debt, as the context requires;
<b>“Qualifying Debt Provider”</b>	means a provider of Qualifying Debt;
<b>“QIBs”</b>	means a “qualified institutional buyer” within the meaning of Rule 144A under the Securities Act;
<b>“RAG 5”</b>	means Regulatory Accounting Guidelines 5 “Transfer pricing in the water industry”, version 5.03;
<b>“Rating Agencies”</b>	means Fitch, Moody’s and S&P and any further or replacement rating agency appointed by the Issuer with the approval of the Security Trustee (acting upon the instructions of the Majority Creditors) to provide a credit rating or ratings for the Class A Debt and the Class B Debt and shadow ratings in respect of Class A Wrapped Debt and Class B Wrapped Debt for so long as they are willing to provide credit ratings generally (and “ <b>Rating Agency</b> ” means any one of them);
<b>“Rating Confirmation on Change of Control”</b>	means, in respect of a UK Holdco Change of Control, confirmation from any two Rating Agencies that the shadow rating of the Class A Wrapped Bonds will not be downgraded to BBB+ in the case of Fitch and S&P or, as the case may be, Baa1 in the case of Moody’s, or below;
<b>“Rating Requirement”</b>	means confirmation from any two Rating Agencies that, in respect of any matter where such confirmation is required, that the shadow rating is in the case of the Class A Wrapped Debt, A- by Fitch and S&P and A3 by Moody’s or above and in the case of the Class A Unwrapped Debt, is A- by Fitch and S&P and A3 by Moody’s or above;
<b>“RAV” or “Regulated Asset Value”</b>	means, in relation to any date, the regulated asset value for such date as last determined and notified to AWS by the DGWS at the most recent Periodic Review or IDOK or other procedure through which in future the DGWS may make such determination on an equally definitive basis to that of a Periodic Review or IDOK (interpolated as necessary and adjusted as appropriate for Out-turn Inflation);
<b>“Receipt”</b>	means a receipt attached on issue to a definitive Bearer Bond redeemable in instalments for the payment of an instalment of principal and includes any replacements for Receipts issued pursuant to Condition 15 of the Conditions;
<b>“Receiptholders”</b>	means the several persons who are for the time being holders of the Receipts;
<b>“Receipts Account”</b>	means the joint account of AWS and the Issuer titled “Receipts Account” held at the Account Bank and includes any sub-account relating to that account and any replacement account from time to time;

<b>“Registered Bonds”</b>	means those of the Bonds which are in registered form;
<b>“Registered Global Bonds”</b>	means a Rule 144A Global Bond and/or a Regulation S Global Bond;
<b>“Registrar”</b>	means Deutsche Bank Trust Company Americas, which will act as registrar and will provide certain registrar services to the Issuer in respect of Registered Bonds;
<b>“Regulated Business”</b>	means the business of a “relevant undertaker” (as that term is defined in the WIA) in the United Kingdom carried out by AWS;
<b>“Regulated Company”</b>	means one of the 10 water and sewerage companies and 14 water only companies in England and Wales subject to the regulatory regime contained in the WIA, together the <b>“Regulated Companies”</b> (except as otherwise stated in Chapter 11);
<b>“Regulation S”</b>	means Regulation S under the Securities Act;
<b>“Regulation S Global Bond”</b>	means a global bond in registered form comprising some or all of the Registered Bonds of the same Series sold outside the United States or to non-U.S. persons in reliance on Regulation S under the Securities Act;
<b>“Regulatory Information”</b>	means the regulatory accounts AWS is required to submit to Ofwat which are filed in June of each year;
<b>“Relevant Change of Circumstance”</b>	has the same meaning as in Part IV of Condition B of the Licence;
<b>“Remedial Plan”</b>	means any remedial plan agreed by AWS and the Security Trustee under Part 2 of Schedule 6 (Trigger Events) of the CTA as more particularly described in Section 7.6.8(ii), <i>“Financing Structure – Common Terms Agreement – Trigger Event Consequences – Further Information and Remedial Plan”</i> ;
<b>“Rental”</b>	means any scheduled payment of rental, periodic charge or equivalent sum under a Finance Lease;
<b>“Requisite Ratings”</b>	means together the Minimum Short-term Rating and the Minimum Long-term Rating;
<b>“Reserved Matters”</b>	means the rights of the Secured Creditors set out in Section 7.4.20, <i>“Financing Structure – Intercreditor Arrangements – Reserved Matters”</i> ;
<b>“Restricted Payment”</b>	means any Distribution or Customer Rebate other than: <ul style="list-style-type: none"> <li>(a) to the extent required to make any payment under an Authorised Credit Facility in accordance with the provisions of the CTA and the STD, a payment by AWS under the Intercompany Loan Arrangements; or</li> <li>(b) a payment made under a Permitted Tax Loss Transaction; or</li> <li>(c) a UK Holdco Debt Service Distribution;</li> </ul>
<b>“Rolling Average Period”</b>	means on each Calculation Date the Test Period ending on 31 March that falls in the same calendar year as that

Calculation Date and the next subsequent two consecutive Test Periods, save that, where the test comes to be calculated at a time when information is not available in respect of any forward looking Test Period (as a result of the DGWS's determination of price limits for a Periodic Review not having been published in draft or final form) then such Rolling Average Period will be the three 12 month periods which run consecutively backwards and/or forwards from such Calculation Date for which such information is available for the last Test Period in such calculation;

**“RPI”**

means the United Kingdom Retail Price Index;

**“Rule 144A Global Bond”**

means a global bond in registered form comprising some or all of the Registered Bonds of the same Series sold to QIBs in reliance on Rule 144A under the Securities Act;

**“SDRT”**

means stamp duty reserve tax;

**“Secretary of State”**

means one of Her Majesty's principal secretaries of state;

**“Secured Creditor Representative”**

means:

- (a) in respect of the Bondholders (other than holders of the USPP 2001 Bonds), the Bond Trustee;
- (b) in respect of the Original Lenders under the Initial Authorised Credit Facility Providers, Barclays Bank PLC (as agent);
- (c) in respect of the Original Lenders under the Bridging Facility Agreement, Barclays Bank PLC (as agent);
- (d) in respect of the Intercompany Loan Arrangements, the Security Trustee (on behalf of the Issuer);
- (e) in respect of any Liquidity Facility Provider, the Liquidity Facility Agent; and
- (f) in respect of any Additional Secured Creditor, the representative of such Additional Secured Creditor (if any) appointed as its Secured Creditor Representative under the terms of the relevant Finance Document and named as such in the relevant Accession Memorandum;

**“Secured Creditors”**

means the Security Trustee (in its own capacity and on behalf of the other Secured Creditors), the Bond Trustee (in its own capacity and on behalf of the Bondholders (other than the USPP 2001 Bondholders)), the Bondholders, the Initial Financial Guarantor, the Existing Finance Lessors, the Existing Hedge Counterparties, the Issuer, the Initial Authorised Credit Facility Agent, the Initial Authorised Credit Facility Arranger, the Original Lenders, the Bridging Facility Agent, the Bridging Facility Arranger, the Debt Service Reserve Liquidity Facility Provider, the Liquidity Facility Agent, the O&M Reserve Facility Provider, the Cash Manager (other than when the Cash Manager is AWS), the Agent Bank, the Principal Paying Agent, the Registrar, the Exchange Agent, the Transfer Agent, the USPP Paying Agent and any Additional Secured Creditors;

<b>“Secured Liabilities”</b>	means all present and future sums, liabilities and obligations whatsoever (actual or contingent) payable, owing, due or incurred by an Obligor to the Secured Creditors (or any of them) under any Finance Document;
<b>“Securities Act”</b>	means the United States Securities Act of 1933, as amended;
<b>“Security”</b>	means the security constituted by the Security Documents including any guarantee or obligation to provide cash collateral or further assurance thereunder;
<b>“Security Agreement”</b>	means the deed of charge and guarantee executed in favour of the Security Trustee by each of the Obligors on 30 July;
<b>“Security Assets”</b>	means all property, assets, rights and undertakings the subject of the Security created by the Obligors pursuant to any Security Document;
<b>“Security Documents”</b>	means: <ul style="list-style-type: none"> <li>(a) the Security Agreement;</li> <li>(b) the STID; and</li> <li>(c) any other document evidencing or creating security over any asset of an Obligor to secure any obligation of any Obligor to a Secured Creditor under the Finance Documents;</li> </ul>
<b>“Security Interest”</b>	means: <ul style="list-style-type: none"> <li>(a) any mortgage, pledge, lien, charge, assignment, or hypothecation, or other encumbrance securing any obligation of any person;</li> <li>(b) any arrangement under which money or claims to money, or the benefit of, a bank or other account may be applied, set off or made subject to a combination of accounts so as to effect discharge of any sum owed or payable to any person; or</li> <li>(c) any other type of preferential arrangement (including any title transfer and retention arrangement) having a similar effect;</li> </ul>
<b>“Security Trustee”</b>	means Deutsche Trustee Company Limited or any successor appointed pursuant to the STID;
<b>“Senior Average PMICR”</b>	means the sum of the ratios of Net Cash Flow less the greater of (a) the aggregate of CCD and IRC and (b) Capital Maintenance Expenditure, to Senior Debt Interest for each of the Test Periods comprised in a Rolling Average Period divided by 3;
<b>“Senior Debt”</b>	means all Class A Debt and Class B Debt and any other debt ranking in priority to subordinated debt of any member of the AWS Financing Group;
<b>“Senior Debt Interest”</b>	means, in relation to any Test Period and without double counting, an amount equal to the aggregate of all interest paid, due but unpaid or in respect of forward looking ratios, payable (whether or not payable within the terms of the Finance Documents) on the Issuer’s and/or AWS’s obligations under

and in connection with all Class A Debt and Class B Debt, all premia paid, due but unpaid or, in respect of forward looking ratios, payable to any Financial Guarantor and adjusted Lease Reserve Amounts or Lease Reserve Amounts paid, due but unpaid or in respect of forward looking ratios, payable on the Issuer's and/or AWS's obligations under and in connection with all Class A Debt and Class B Debt in each case during such Test Period (after taking account of the impact on interest rates of all and related Hedging Agreements then in force) (excluding all indexation of principal to the extent it has been included in such interest or other amounts and all other costs incurred in connection with the raising of such Class A Debt and/or Class B Debt), and excluding amortisation of the costs of issue of any Class A Debt and Class B Debt within such Test Period less all interest received or in respect of forward looking ratios receivable by any member of the AWS Financing Group from a third party during such Test Period;

**“Senior ICR”**

means the ratio of Net Cash Flow for each Test Period to Senior Debt Interest for each of the same Test Periods;

**“Senior Net Indebtedness”**

means, as at any date, all the Issuer's and AWS's nominal debt outstanding under and in connection with any Class A Debt and Class B Debt (other than pursuant to tranche B of the Initial Authorised Loan Agreement) and any nominal amounts of Financial Indebtedness falling within paragraph (e) of the definition of Permitted Financial Indebtedness including (in each case) all indexation accrued but unpaid (after taking account of the impact on interest rates of all related Hedging Agreements then in force) on any such liabilities which are indexed together with any interest due and unpaid (after taking account of the impact on interest rates of all related Hedging Agreements then in force) and less the value of all Authorised Investments and other amounts standing to the credit of any Account other than the Customer Payment Account or the Distributions Accounts (where such debt is denominated other than in Sterling, the nominal amount outstanding will be calculated (i) in respect of debt with associated Currency Hedging Agreements, by reference to the applicable hedge rates; or (ii) in respect of debt with no associated Currency Hedging Agreements, by reference to the Exchange Rate);

**“Senior PMICR”**

means the ratio of Net Cash Flow less the greater of (a) the aggregate CCD and IRC and (b) Capital Maintenance Expenditure for each Test Period to Senior Debt Interest for each of the same Test Periods for that period;

**“Senior RAR”**

means the ratio of Senior Net Indebtedness to RAV;

**“Series”**

means a Tranche of Bonds together with any further Tranche or Tranches of Bonds which are (i) expressed to be consolidated and form a single series and (ii) identical in all respects (including as to listing) except for their respective Issue Dates, Interest Commencement Dates and/or Issue Prices;

**“Shipwreck Clause”**

means a clause which may be contained in the licence of a Regulated Company and which is contained in the Licence of AWS at Part IV of Condition B, pursuant to which the Regulated Company may, if so permitted by the conditions of its licence, request price limits to be reset if the Regulated



Business either (i) suffers a substantial adverse effect which could not have been avoided by prudent management action or (ii) enjoys a substantial favourable effect which is fortuitous and not attributable to prudent management action;

<b>“Special Administration”</b>	means the insolvency process specific to Regulated Companies under Sections 23-26 of the WIA;
<b>“Special Administration Order”</b>	means an order of the High Court under Sections 23-25 of the WIA under the insolvency process specific to Regulated Companies;
<b>“Special Administration Petition Period”</b>	means the period beginning with the presentation of the petition for Special Administration under Section 24 of the WIA and ending with the making of a Special Administration Order or the dismissal of the petition;
<b>“Special Administrator”</b>	means the person appointed by the High Court under Sections 23-25 of the WIA to manage the affairs, business and property of the Regulated Company during the period in which the Special Administration Order is in force;
<b>“Special Distribution”</b>	means a Distribution: <ul style="list-style-type: none"><li>(a) that is made out of amounts in excess of Net Cash Flow, less any Distribution which has already been paid in respect of that Financial Year, generated in the 12 months to the most recently occurring 31 March or generated in the six months up to 30 September (as the case may be) less Capital Maintenance Expenditure, less Senior Debt Interest, less any amounts required to restore the Liquidity Facilities to the required levels (in each case calculated for the same period); or</li><li>(b) that is not an Ordinary Distribution;</li></ul>
<b>“Standard &amp; Poor’s” or “S&amp;P”</b>	means Standard & Poor’s Ratings Services, a Division of the McGraw-Hill Companies Inc.;
<b>“Standby Drawing”</b>	means a drawing made under a Liquidity Facility Agreement as a result of a downgrade of a Liquidity Facility Provider below the required ratings or in the event that the Liquidity Facility Provider fails to renew its commitment on the expiry of its term;
<b>“Standstill”</b>	means, as provided for in the STID, a standstill of claims of the Secured Creditors against AWS and the Issuer immediately upon notification to the Security Trustee of the occurrence of an Event of Default;
<b>“Standstill Event”</b>	means an event giving rise to a Standstill in accordance with the STID;
<b>“Standstill Period”</b>	means a period during which a standstill arrangement is subsisting;
<b>“Statutory Accounts”</b>	means the statutory accounts which AWS is required to prepare in compliance with the Companies Act;
<b>“STID”</b>	means the security trust and intercreditor deed dated 30 July 2002 between the Obligors and the Secured Creditors pursuant to which the Security Trustee holds the Security on trust for

	the Secured Creditors and the Secured Creditors agree to certain intercreditor arrangements;
<b>“STID Directions Request”</b>	means a written notice of each STID Proposal sent by the Security Trustee to the Secured Creditors pursuant to the STID;
<b>“STID Proposal”</b>	means a proposal pursuant to the STID requiring a Majority Creditor decision and the consent of any Secured Creditor having an Entrenched Right in respect of such proposal;
<b>“Subordinated Authorised Loan Amounts”</b>	means, in relation to any Authorised Credit Facility, the aggregate of any amounts payable by the Issuer to the relevant Authorised Credit Provider on an accelerated basis as a result of illegality on the part of the Authorised Credit Provider or any other amounts not referred to in any other paragraph of the Payment Priorities;
<b>“Subordinated Coupon Amounts”</b>	means, in respect of any Floating Rate Bonds, any amounts (other than deferred interest) by which the margin on the Coupon on such Bonds exceeds the initial margin on the Coupon on such Bonds as at the date on which such Bonds were issued;
<b>“Subordinated Debt”</b>	means any secured Financial Indebtedness that is fully subordinated, in a manner satisfactory to the Security Trustee and each Financial Guarantor, to the Class A Debt and Class B Debt and where the relevant credit provider has acceded to the Common Terms Agreement and the STID;
<b>“Subordinated Liabilities”</b>	means, all present and future liabilities (actual or contingent) payable or owing by an Obligor to another Obligor whether or not matured and whether or not liquidated other than (until the Security Trustee directs otherwise) any amounts payable or owing by UK Holdco to AWS under the UK Holdco/AWS Loan and any amounts payable or owing under the AWS Loan Notes or the Issuer/AWS Loan Agreement;
<b>“Subordinated Liquidity Facility Amounts”</b>	means, in relation to any Liquidity Facility, the amount by which the cost of regulatory compliance or the interest rate payable exceeds what it was on the Issue Date and the aggregate of amounts payable by the Issuer to the relevant Liquidity Provider on an accelerated basis as a result of illegality, gross up or increased costs on the part of such Liquidity Facility Provider or any other amounts not referred to in in any other paragraph of the Payment Priorities;
<b>“Subordinated O&amp;M Reserve Facility Amounts”</b>	means, in relation to the O&M Reserve Facility, the aggregate of any amounts payable by the Issuer to the O&M Reserve Facility Provider on an accelerated basis as a result of illegality on the part of the O&M Reserve Facility Provider or any other amounts not referred to in any other paragraph of the Payment Priorities;
<b>“Talons”</b>	means the talons (if any) appertaining to, and exchangeable in accordance with the provisions therein contained for further Coupons appertaining to, the definitive Bearer Bonds (other than Zero Coupon Bonds) and includes any replacements for Talons issued pursuant to Condition 15 of the Conditions;
<b>“Talonholders”</b>	means the several persons who are for the time being holders of the Talons;

<b>“Tax Deed of Covenant”</b>	means the deed of covenant entered into on or about the Effective Date between, inter alios, the Security Trustee and the Obligors;
<b>“Temporary Bearer Global Bond”</b>	means a temporary global bond comprising some or all of the Bearer Bonds of the same Series issued by the Issuer;
<b>“Test Period”</b>	means: (a) the period of 12 months ending on 31 March in the then current year; (b) the period of 12 months starting on 1 April in the same year; (c) each subsequent 12 month period up to the Date Prior; and (d) where the Calculation Date falls within the 13 month period immediately prior to the Date Prior, includes the 12 month period from the Date Prior;
<b>“Tier 1 Material Agreement”</b>	means any Tier 1 Material O&M Agreement or a Tier 1 Material Capex Agreement;
<b>“Tier 2 Material Agreement”</b>	means any Tier 2 Material O&M Agreement or a Tier 2 Material Capex Agreement;
<b>“Tier 1 Material Capex Agreement”</b>	means any Capex Contract entered into by AWS for the purposes of, or in connection with, AWS carrying out its Regulated Business, where the NPV at the later of (a) the Effective Date or (b) the date at which it is entered into or amended, supplemented or novated, of the agreed target cost payable by AWS under that contract (which in each case has not been terminated or expired in accordance with its terms), is, or would be if such contract was entered into on arm’s length terms and for full value, equal to or greater than £15,000,000 (indexed);
<b>“Tier 2 Material Capex Agreement”</b>	means any Capex Contract entered into by AWS for the purposes of, or in connection with, AWS carrying out its Regulated Business, where the NPV at the later of (a) the Effective Date or (b) the date at which it is entered into or amended, supplemented or novated, of the agreed target cost payable by AWS under that contract (which in each case has not been terminated or expired in accordance with its terms), is, or would be if such contract was entered into on arm’s length terms and for full value, less than £15,000,000 (indexed) but more than or equal to £5,000,000 (indexed);
<b>“Tier 1 Material O&amp;M Agreement”</b>	means any Outsourcing Agreement or series of Outsourcing Agreements (taken together) where the annual value of which is equal to or greater than contracts entered into between AWS and any Contractor (or its affiliates) (which in each case has not been terminated or expired in accordance with its terms) exceeds (or would exceed were it entered into on arm’s length terms) 25 per cent. of the Projected Operating Expenditure;
<b>“Tier 2 Material O&amp;M Agreement”</b>	means any Outsourcing Agreement or series of Outsourcing Agreements (taken together), the annual value of which is equal to or greater than £5,000,000 (indexed), entered into with any Contractor and where the annual value of contracts entered into between AWS and that Contractor (or its affiliates) (which in each case has not been terminated or expired in accordance with its terms) is less than 25 per cent. of the Projected Operating Expenditure;
<b>“Tranche”</b>	means all Bonds which are identical in all respects (including as to listing);

<b>“Transaction Documents”</b>	means:  (a) a Finance Document;  (b) a Tier 1 Material Agreement; and  (c) any other document designated as such by the Security Trustee and the Issuer;
<b>“Transfer Agent”</b>	means Deutsche Bank AG London under the Agency Agreement, including any successor thereto;
<b>“Transfer Scheme”</b>	means a transfer scheme under Schedule 2 of the WIA;
<b>“Transferred USPP Bonds”</b>	means those Bonds identified as USPP Bonds in the relevant Pricing Supplement and issued by the Issuer on the Effective Date in exchange for those of the following bonds previously issued by AW:  (a) \$4,000,000 6.71 per cent. bonds due 2006;  (b) \$25,000,000 6.57 per cent. bonds due 2009;  (c) \$10,000,000 6.54 per cent. bonds due 2008;  (d) \$156,000,000 6.84 per cent. bonds due 2013; and  (e) \$122,000,000 6.35 per cent. bonds due 2006,  and the USPP 2001 Bonds;
<b>“Treasury Transaction”</b>	means any currency or interest rate purchase, cap or collar agreement, forward rate agreement, interest rate agreement, interest rate or currency or future or option contract, foreign exchange or currency purchase or sale agreement, interest rate swap, currency swap or combined similar agreement or any derivative transaction protecting against or benefiting from fluctuations in any rate or price;
<b>“Trigger Credit Rating”</b>	means each of the credit ratings referred to in Section 7.6.7(ii), <i>“Financing Structure – Common Terms Agreement – Trigger Events – Credit Rating Downgrade”</i> ;
<b>“Trigger Event”</b>	means any of the events or circumstances identified as such in the CTA, as more particularly described in Section 7.6.7, <i>“Trigger Events”</i> ;
<b>“Trigger Event Consequences”</b>	means any of the consequences of a Trigger Event as identified as such in the CTA, as more particularly described in Section 7.6.8, <i>“Financing Structure – Trigger Event Consequences”</i> ;
<b>“Trigger Event Ratio Levels”</b>	means the financial ratios set out in Section 7.6.7(i), <i>“Financing Structure – Common Terms Agreement – Trigger Events – Financial Ratios”</i> ;
<b>“Trigger Event Remedies”</b>	means any remedy to a Trigger Event as identified in the CTA, as more fully particularised in Section 7.6.9, <i>“Financing Structure – Trigger Event Remedies”</i> ;
<b>“UK Holdco”</b>	means AWS Holdings Limited;
<b>“UK Holdco/AWS Loan”</b>	means the interest-bearing loan made to AWS Holdings by AWS to enable AWS Holdings to pay the consideration to

	AW to purchase the shares held by AW in AWS Overseas Holdings in an amount consistent with the limitations under permitted post closing events;
<b>“UK Holdco Change of Control”</b>	<p>means the occurrence of any of the following events or circumstances or the reasonable likelihood of such events or circumstances happening:</p> <p>(a) any person which previously Controls AWS Holdings ceasing to have Control of AWS Holdings; or</p> <p>(b) any person which does not previously Control AWS Holdings obtaining Control of AWS Holdings,</p> <p>of which any Obligor has actual knowledge;</p>
<b>“UK Holdco Debt Service Distribution”</b>	means a dividend payment declared and paid by AWS and/or AWS Overseas Holdings that meets the criteria specified in Section 7.6.5(iv)(v)(E), “ <i>Covenants – General</i> ” and the payment by AWS Holdings of sums payable to AWS under the UK Holdco/AWS Loan in each Financial Year;
<b>“UK Listing Authority”</b>	means the Financial Services Authority in its capacity as competent authority under the Financial Services and Markets Act 2000, as amended;
<b>“Unwrapped Bonds”</b>	means those Bonds that do not have the benefit of a guarantee from a Financial Guarantor;
<b>“Unwrapped Debt”</b>	means any indebtedness that does not have the benefit of a guarantee from a Financial Guarantor;
<b>“USPP Bonds”</b>	means the USPP 2001 Bonds and those Bonds identified as USPP Bonds in the relevant Pricing Supplement relating to any Class A Unwrapped Bonds or Class B Unwrapped Bonds issued by the Issuer on the Effective Date;
<b>“USPP 2001 Bonds”</b>	means such amount of the Series A 6.57 per cent. Senior Notes due 2005, Series B 6.62 per cent. Senior Notes due 2006, Series C 7.01 per cent. Senior Notes due 2008, Series D 7.13 per cent. Senior Notes due 2009 and Series E 7.23 per cent. Senior Notes due 2011, all issued by AWS in July 2001 which remain outstanding immediately after the Effective Date;
<b>“USPP Bondholders”</b>	means the holders of USPP Bonds;
<b>“USPP Paying Agent”</b>	means Deutsche Bank Trust Company Americas or any successor thereto;
<b>“UWWTD”</b>	means the Urban Waste Water Treatment Directive;
<b>“Voted Qualifying Class A Debt”</b>	means the aggregate Outstanding Principal Amount of Class A Debt voted by the Class A DIG Representatives in accordance with the applicable provisions of the STID as part of the Class A DIG;
<b>“Voted Qualifying Class B Debt”</b>	means the aggregate Outstanding Principal Amount of Class B Debt voted by the Class B DIG Representatives in accordance with the applicable provisions of the STID as part of the Class B DIG;
<b>“Voted Qualifying Debt”</b>	means the Voted Qualifying Class A Debt or the Voted Qualifying B Debt, as the context requires;

<b>“Water Authorities”</b>	means the 10 regional public sector water authorities supplying water and sewerage services in England and Wales prior to privatisation in 1989;
<b>“Water Bill Consultation Paper”</b>	means the consultation document “Water Bill – Consultation on draft legislation” published by the United Kingdom Government on 6 November 2000;
<b>“Water Quality Regulations”</b>	means the Water Supply (Water Quality) Regulations 1989, as amended, inter alia, by the Water Supply (Water Quality) Regulations 2000 and the Water Supply (Water Quality) (Amendment) Regulations 2001;
<b>“White Paper”</b>	means the United Kingdom government white paper entitled “ <i>Productivity and Enterprise – Insolvency – a Second Chance</i> ” published in July 2000;
<b>“WIA”</b>	means the United Kingdom Water Industry Act 1991 (as amended by subsequent legislation, including the Competition and Service (Utilities) Act 1992 and the Water Industry Act 1999); and
<b>“WRA”</b>	means the United Kingdom Water Resources Act 1991, as amended by subsequent legislation including the United Kingdom Environment Act 1995;
<b>“Wrapped Bonds”</b>	means those bonds that have the benefit of a guarantee from a Financial Guarantor;
<b>“Wrapped Debt”</b>	means any indebtedness that has the benefit of a guarantee from a Financial Guarantor;
<b>“Wrongful Payment”</b>	means any Distributions (otherwise than pursuant to an agreement, contract or other similar arrangement) in breach of Section 7.6.5(iv)(v), “ <i>Financing Structure – Common Terms Agreement – Covenants – General</i> ”, which are in an aggregate amount of £500,000 (indexed) or less in each Financial Year; and
<b>“Zero Coupon Bond”</b>	means a Bond on which no interest is payable.

## APPENDIX 1

### OFWAT LETTER

The following extract is taken from the letter to the Managing Directors of all Regulated Companies from the present DGWS issued on 31 January 2001, in which he indicated the general principles he would follow in carrying out periodic reviews.

#### **The Duties of the Director General of Water Services and the Regulatory Framework**

##### **1. The Director's duties**

The Director's primary duties, as set out in the Water Industry Act 1991 (the "Act"), are to act in a manner that he considers best calculated to secure that the functions of Appointees are properly carried out and that Appointees are able to finance the proper carrying out of those functions. The Director also has duties to protect the interests of customers, to promote economy and efficiency and to facilitate competition and has certain environmental and recreational duties.

##### **2. The Director's approach to Periodic Reviews**

- (i) The Director is required to reset price limits at five yearly reviews. In doing so, he must have regard to his primary duties. Although the detailed methodology is not set out either in the Act or in companies' licence conditions, Ofwat has sought to conduct the reviews in an open and transparent manner and will continue to do so. The principles and methodology that have been adopted have been subject to wide consultation and consequent refinement.
- (ii) Prices are set so that revenues cover the cost of the efficient provision of operations and capital investment, and allow a reasonable return on capital. The ability of the Appointee to maintain an adequate level and trend of critical financial indicators is also taken into account. This is with a view to ensuring that, provided the Appointee is efficiently managed and financed, it will remain able to finance its functions (including new investment), readily and at reasonable cost. Where appropriate, account is taken of the Appointee's duty to maintain investment grade credit ratings.
- (iii) Ofwat has taken 'capital' to be the 'Regulatory Capital Value' ("RCV") of the Appointed Business. The criteria for determining the RCV are set out in Setting price limits for water and sewerage services: *The framework and business planning process for the 1999 Review (February 1998)* and updated in MD145, *The framework for setting prices*, published in March 1999. The approach taken at the 1999 Periodic Review built on that adopted at the 1994 review. The initial capital value, as placed on the holding companies of the Appointees by the financial markets in 1989, was adjusted for net new allowable capital expenditure and depreciation charges since then, including at the 1999 review an adjustment to reflect past capital efficiencies, to arrive at the RCV. The implications of subsequent capital transactions including mergers and takeovers have not been taken into account when considering the RCV at Periodic Reviews.
- (iv) At the 1999 Review the return on capital allowed was based on an assessment of the real post-tax weighted average cost of debt and equity for an efficiently-financed stand-alone listed water and sewerage company. This assessment was based on the market's view of a forward-looking cost of capital. Amongst other things, this assessment reflected Ofwat's perception that investors, despite the significant capital investment requirements, viewed the water industry as relatively low risk and that it represents a lower risk than the United Kingdom stock market as a whole.
- (v) Ofwat included in the allowed return at the 1999 Periodic Review an adjustment to reflect the prudently incurred cost of long-term fixed rate debt. This adjustment was made to take into account a change in the 1999 methodology from the glidepath of returns on existing assets set in 1994. Ofwat also placed greater emphasis on current market evidence of the cost of capital rather than on longer term historical averages. There can, however, be no guarantee that such financing costs will be passed on to customers at future reviews since similar circumstances are unlikely to occur. The Director will be guided primarily by consideration of the Appointee's relative efficiency in managing its financial affairs, just as he will be guided by this consideration with regard to other areas of costs. An Appointee that fails to maintain the flexibility to respond to changing market conditions risks being judged relatively inefficient.

- (vi) In setting prices, either at a five yearly Periodic Review or if a company applies for an Interim Determination of price limits, the Director must make judgements as to the efficient level of costs to assume. A wide range of comparative techniques has been used to inform these judgements since privatisation.
- (vii) Ultimately, the Director has discretion over the ways in which price limits are set and he needs to keep under review the regulatory framework in the light of all relevant developments. Consequently, whilst there can be no assurance that future Periodic Reviews will be conducted in the same manner as past ones, nevertheless, the principles underlying the present price review methodology have been developed over the past ten years and have proved robust. For the next Periodic Review, Ofwat will, of course, take into account the conclusions of the recent Competition Commission reviews in respect of Mid Kent Water and Sutton & East Surrey Water.

### **3. Regulation between five yearly reviews**

- (i) Companies may seek a change to their price limits between Periodic Reviews under the Interim Determination arrangements set out in their Licences. These can be triggered in defined circumstances, for example, where a new legal obligation is imposed which was not taken into account at the last Periodic Review. These instances have, so far, not been very frequent.
- (ii) A modification to the assessment of materiality for Interim Determinations was published with the Final Determination of price limits for 2000-05. This has now been accepted by the majority of companies. The Director believes that this licence modification strengthens the protection available to companies because it includes the effect of revenue loss and operating expenditure over a 15 year horizon in the assessment as to whether the materiality threshold for triggering a price limit adjustment has been met.
- (iii) The Director has proposed in MD167 (31 January 2001) that the provisions commonly known as the 'shipwreck' clause be extended to all companies. The clause enables companies' price limits to be reset between Periodic Reviews if there has been a substantial adverse or favourable effect that could not have been avoided or is not attributable to prudent management action. The clause was (in its original form) included in all companies' licences at privatisation but was removed or revised as part of a review of Condition B of the licence before the 1995 Periodic Review. Less than half of the companies now have the clause in its licence. One company has asked the Director to reinsert this clause in their licence. The Director believes that it is desirable in principle that water companies' licences should not differ unnecessarily and hence has proposed making the modification to all companies' licences.

### **4. Consistency and new ownership structures**

- (i) Following the 1999 Periodic Review a number of companies have explored the possibility of establishing new structural arrangements for the carrying out of their duties as water and sewage undertakers. Companies that choose to structure their business in ways other than the equity-owned, vertically-integrated structure established at privatisation will receive no special or preferential treatment from Ofwat. Licence holders will continue to bear all of the licence obligations of a water and sewerage undertaker. They will continue to be regulated in the same way as other Appointees, and will operate under a price cap and be subject to Periodic Reviews.
- (ii) A consistent approach is particularly important when considering whether licence conditions should be modified from the model which currently applies to the other Appointees. In each case the Director would consider carefully the need for licence modifications and would consult publicly on these.
- (iii) The performance of all companies (in terms of efficiency and customer services) will be judged in a consistent manner, both through the league tables and analysis that Ofwat publishes annually and at Periodic Reviews. The ability to compare companies is an important tool for the regulator of the water and sewerage companies. It is an essential part of the system of incentive regulation and has led to substantial improvements in efficiency since privatisation.
- (iv) Where Appointees have put in place new structural arrangements, the approach at Periodic Reviews will follow that for an equity-owned, vertically integrated Appointee. For example, the approach to RCVs will be assessed similarly and the weighted average cost of capital will be that



which applies to the industry as a whole. The Director will, at the time, take account of the market's view of the cost of capital for the water industry.

- (v) The proposal by a number of companies to separate the ownership of the assets from their operations and to contract out the latter will provide additional information to assist the Director with his assessment of relative efficiency. However, the appropriate level of costs to be assumed within price limits will continue to be assessed on a comparative basis and the existence of competitively tendered prices will not be seen, a priori, as evidence of efficiency nor guarantee that such costs will be fully reflected in price limits.
- (vi) By way of illustration, Ofwat's approach to comparisons of capital programmes has identified widespread differences between companies' unit costs. This is despite these being based upon competitively tendered work or actual costs for capital works. Consequently, at the last Periodic Review, adjustments to capital costs varied from nil to a reduction of 25 per cent.
- (vii) As for all Appointees, Ofwat will ensure that customers' interests continue to be protected after any new structural arrangements are in place through the provisions in the Water Industry Act 1991. This includes, in the last resort, using the powers to apply for the appointment of a Special Administrator in particular circumstances (as set out in Section 5(iv) and 5(v), together with sections 6(iii) and 6(vii)). The main reasons for doing this would be a breach by the company of one of its principal duties in the Act (see sections 47 and 94 of the Act), insolvency or non-compliance with an enforcement order following breach of a licence condition.

## **5. Licence termination**

There are a number of circumstances as provided in the Act in which a particular company could cease to be the licence holder for all or part of its area. These are set out below.

- (i) An Appointee could consent to the making of a replacement Appointment or a Variation, which changes its Water Supply or Sewerage Service Area. In these circumstances the Director has the authority to appoint a new licence holder.
- (ii) An Appointee's Licence could be terminated in the circumstances set out in Condition O of its Licence. These are that it is at least 25 years after the "Transfer Date" (1 September 1989) and 10 years after notice has been served by the Secretary of State (DEFRA). Termination would occur when a successor had been appointed. The power to terminate each Appointee's licence and appoint a successor in these circumstances lies with the Secretary of State although the Director may be authorised to do those things. When required to do so, Ofwat will advise the Secretary of State on the issue of notice of licence termination for any or all undertakers.
- (iii) An Appointee's Licence could be terminated under the provisions of Special Administration. The Secretary of State may apply to the High Court for a Special Administration Order and can also authorise the Director to do so. The main reasons for doing this would be a breach by the Appointee of one of its principal duties in the Act (see sections 37 and 94 of the Act) insolvency or noncompliance with an enforcement order following breach of a licence condition.
- (iv) A Special Administration Order requires the appointment by the High Court of a Special Administrator. The Special Administrator would have responsibility for transferring the water and sewerage business as a going concern to a successor company or companies, under a scheme which must be approved by the Secretary of State, and running the business in the meantime.
- (v) The Act also provides in certain circumstances for the appointment of a new Appointee for part of the existing Appointee's Water Supply or Sewerage Service Area. These appointees are more commonly known as 'Inset Appointments'. These are allowed where the appointment relates to a part of the Appointee's area where no premises are served by the licence holder or the premises are supplied with not less than 100 megalitres of water in any period of twelve months or if the licence holder consents. The Director is authorised to appoint a new licence holder when making Inset Appointments.

## **6. Creditor protection in the event of licence termination**

- (i) In the event of licence termination by agreement or under the circumstances set out in Condition O (see 5(iii) above) the outgoing Appointee should prepare a 'Transfer Scheme', covering the

transfer of property, rights and liabilities to new Appointee(s). The scheme may provide for debt obligations to be transferred to the new Appointee(s). The scheme would have to be agreed by the outgoing Appointee and the new Appointee and approved by the Secretary of State or the Director if authorised.

- (ii) In making an Appointment or Variation replacing the incumbent as the Appointee, the Secretary of State (or Director) would (so far as is consistent with his other duties, particularly those in Section 2 of the Act) have to ensure that the interests of its creditors were not unfairly prejudiced by the transfer terms. This would be addressed through the requirement for approval of the Transfer Scheme.
- (iii) Under Special Administration, the Act provides for the replacement of the Appointee by a successor. In the meantime the Special Administrator must run the business in a manner which protects the interests of shareholders and creditors of the company.
- (iv) The Secretary of State, or with his consent the Director, may approve a Transfer Scheme which moves the Appointed Business into the control of a successor. The Special Administrator would oversee the preparation of the Transfer Scheme.
- (v) There can be no assurance that the transfer following Special Administration could be achieved on terms that enabled creditors of the Appointee to recover amounts due to them in full. The successor Appointee would be subject to the price limits applicable to the original Appointee prior to the transfer becoming effective. Ofwat's duty to protect customers would preclude the granting of price limit relief in such circumstances, unless these were justified by reference to factors other than the Special Administration and the transfer.
- (vi) In addition under Special Administration the Secretary of State may, with Treasury consent, arrange for financial assistance to be provided for the purpose of achieving the transfer of the business and its running in the meantime.
- (vii) Although the protection of creditors is explicit in the Act, no licence has, as yet, been terminated under Condition O, nor has a Special Administration Order been made or sought.

## APPENDIX 2

### BBV LETTER

1 July 2002

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Dear Sirs

This letter draws together the findings and conclusions of a technical study covering the operations of Anglian Water Services Limited (AWSL) that you have engaged us to undertake. The study has focused on identifying technical risks and how those risks are mitigated under the contractual and financial structure of AWSL's business.

The findings and conclusions in this letter reflect the professional judgement of Binnie Black & Veatch Ltd (BBV) based upon the information made available to it. BBV, subject to its duty to exercise reasonable skill and care, has relied on, and not independently verified, such information. A number of key assumptions, such as the validity of forward projections of expenditure, the probabilities of outputs within the capital expenditure planned, the developments in the regulatory regime, and the likely risks, have been made during the course of the analysis. While BBV has no reason to believe that these assumptions are unreasonable, it is noted that if any prove incorrect, actual results could vary from those projected.

We have based the study on:

- An assessment of AWSL's submissions to Ofwat and the comments of the appointed Reporter for AWSL on the submissions.
- Ofwat's "Final Determination: Future Water Supply and Sewerage Charges 2000-5 – Supplementary Report for AWSL.
- Detailed meetings and contacts with AWSL's management and detailed study of documents provided and requested during the study.

We conclude as follows:

- Following a full and detailed review of AWSL's assets undertaken by AWSL for Ofwat and audited by the Reporter in 1998, and having taken note of asset improvements since then, we consider the asset condition to be predominantly sound. Such deterioration, as may occur during the period 2000/5, should not significantly reduce the water supply and sewerage service to customers provided that the existing levels of careful management continue.
- AWSL has taken management action to procure its capital programme for the AMP3 period (2000 – 2005) by forming alliances with a select group of contractors. The proposals are sensible, and the concept of an alliance is a positive way to control and drive down costs. The management systems, procurement methods and supply chain management procedures required to implement the capital programme are in place. From our studies we conclude that there is only a very low probability of AWSL exceeding their capital budget.

- AWSL has successfully managed its operating costs in the past, and has proven management systems in place to ensure that it can meet the continuing efficiencies that it will have to make. It has appropriate governance and funding processes in place.
- Based on the foregoing, we consider that AWSL should be able to operate within the Ofwat price determination, without taking undue risks with compliance or levels of service. AWSL has a sound management structure in place and appears to operate in line with water industry best practice.
- AWSL face a number of environmental risks, including contamination of water supplies, chemical discharges, flooding from sewers, pollution of sources of supply, and discharges of effluents and sludges from water and wastewater treatment works. We consider that risk levels are generally low and AWSL have appropriate mitigation measures and emergency plans in place to prevent disruption of supplies of adequate quality to customers and any serious environmental impacts.
- AWSL may seek an 'Interim Determination', which may arise from a matter notified by the Regulator, or a change in legal obligations. Such an 'Interim Determination' is subject to a materiality threshold. For AWSL the materiality limit is effectively at 1% of turnover.

During the study BBV have only reviewed the technical risks and mitigating factors associated with all the above elements. We are satisfied that AWSL have taken appropriate steps, and have the management capability to mitigate the identified risks in the short to medium term.

Any reliance on this letter by a third party or decision therefrom by a third party is the sole responsibility of such third party. BBV shall not accept, and does not owe, any duty of care to any third parties relying on this letter and shall have no financial or other liability to any such party with respect to any matter related to decisions made by any such party based in whole or in part on this letter. This letter is submitted pursuant to the terms of engagement between AWSL and BBV dated 5 November 2001 and the Addressees' attention is drawn to the limitations of liability therein. BBV shall have no further or other liability.

Yours faithfully

**W THOMSON**  
**Project Director**

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