



SOUTHERN WATER SERVICES (FINANCE) LIMITED

(incorporated with limited liability in the Cayman Islands with registered number 112331)

**Multicurrency programme for the issuance of Guaranteed Bonds
financing
Southern Water Services Limited**

(incorporated in England and Wales with limited liability with registered number 2366670)

On 23 July 2003, Southern Water Services (Finance) Limited (the “**Issuer**”), entered into a multicurrency programme for the issuance of up to £6,000,000,000 Guaranteed Bonds (the “**Programme**”). The Programme was last updated on 12 April 2011. This Prospectus supersedes the prospectus relating to the Programme dated 12 April 2011. This Prospectus does not affect any bonds issued under the Programme before the date of this Prospectus. The payment of all amounts owing in respect of the bonds issued under the Programme (the “**Bonds**”) will be unconditionally and irrevocably guaranteed by Southern Water Services Limited (“**SWS**”), SWS Holdings Limited (“**SWSH**”) and SWS Group Holdings Limited (“**SWSGH**”) as described herein (each a “**Guarantor**”). SWS, the Issuer, SWSH and SWSGH are together referred to herein as the “**Obligors**”. Neither SWSH nor SWSGH has any significant assets other than the shares in its respective subsidiary.

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 (“**FSMA**”) (the “**UK Listing Authority**” or “**UKLA**”) for Bonds issued under the Programme during the period of twelve months after the date hereof, 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 either the London Stock Exchange’s Regulated Market (the “**Market**”) or on the London Stock Exchange’s Professional Securities Market (“**PSM**”). References in this Prospectus to Bonds being “**listed**” (and all related references) shall mean that such Bonds have been admitted to trading on the Market or the PSM and have been admitted to the Official List. The Market is a regulated market for the purposes of Directive 2004/39/EC (the “**Markets in Financial Instruments Directive**”) of the European Parliament and of the Council on markets in financial instruments. The PSM is not a regulated market for the purposes of the Markets in Financial Instruments Directive.

The Bonds may be issued on a continuing basis, to one or more of the Dealers specified under Chapter 1 “*The Parties*” 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 Prospectus to the “**relevant Dealer**” shall, in the case of an issue of Bonds being (or intended to be) subscribed by more than one Dealer or in respect of which subscriptions will be procured by more than one Dealer, be to all Dealers agreeing to subscribe to such Bonds or to procure subscriptions for such Bonds, as the case may be.

For the avoidance of doubt, the Issuer may not as of the date of this Prospectus issue Wrapped Bonds pursuant to this Prospectus.

Interests in a Temporary Global Bond (as defined below) will be exchangeable for a Permanent Global Bond or definitive securities in bearer form as more fully described in Chapter 8 “*The Bonds*” under “*Forms of the Bonds*”. Please see Chapter 3 “*Risk Factors*” to read about certain factors you should consider before buying any Bonds.

Arranger

Barclays

Dealers

Barclays

BNP PARIBAS

HSBC

Santander Global Banking & Markets

The Royal Bank of Scotland

Prospectus dated 28 February 2013

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Under the Programme the Issuer may, subject to all applicable legal and regulatory requirements, from time to time issue Bonds in bearer and/or registered form (respectively “**Bearer Bonds**” and “**Registered Bonds**”). Copies of the Final Terms (as defined below) will be available (in the case of all Bonds) from the specified office set out below of Deutsche Trustee Company Limited as bond trustee (the “**Bond Trustee**”), (in the case of Bearer Bonds) from the specified office set out below of each of the Paying Agents (as defined below) and (in the case of Registered Bonds) from the specified office set out below of each of the Registrar and the Transfer Agent (each as defined below), provided that, in the case of Bonds which are not listed on any stock exchange, copies of the relevant Final Terms will only be available for inspection by the relevant Bondholders.

The maximum aggregate nominal amount of all Bonds from time to time outstanding under the Programme will not exceed £6,000,000,000 (or its equivalent in other currencies calculated as described herein), subject to increase as described herein.

Details of the aggregate principal amount, interest (if any) payable, the Issue Price (as defined below) and any other conditions not contained herein, which are applicable to each Tranche of each Sub-Class of each Class of each Series (all as defined below) will be set forth in a set of final terms (the “**Final Terms**”) which, in the case of Bonds to be admitted to the Official List and to trading on the Market or the PSM, will be delivered to the UK Listing Authority and the London Stock Exchange on or before the relevant date of issue of the Bonds of such Tranche.

Bonds issued under the Programme will be issued in series (each a “**Series**”) and in one or more of four classes (each a “**Class**”). The guaranteed unwrapped Bonds will be designated as either “**Class A Unwrapped Bonds**” or “**Class B Unwrapped Bonds**”. Each Class may comprise one or more sub-classes (each a “**Sub-Class**”) with each Sub-Class pertaining to, among other things, the currency, interest rate and Maturity Date (as defined below) of the relevant Sub-Class. Each Sub-Class may be zero-coupon, fixed rate, floating rate or index-linked Bonds and may be denominated in sterling, euro or U.S. dollars (or in other currencies subject to compliance with applicable laws).

Each Class of Bonds is expected on issue to have the following credit ratings:

Class	Standard &		
	Poor’s	Moody’s	Fitch
Class A Unwrapped Bonds	A-	Baa1	A-
Class B Unwrapped Bonds	BBB	Ba1	BBB

For the avoidance of doubt, the Issuer may not as of the date of this Prospectus issue Wrapped Bonds pursuant to this Prospectus.

In general, European regulated investors are restricted from using a rating for regulatory purposes if such rating is not issued by a credit rating agency established in the European Community and registered under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (the “**CRA Regulation**”). The credit ratings included or referred to in this Prospectus will be treated for the purposes of the CRA Regulation as having been issued by Standard & Poor’s Credit Market Services Europe Limited (“**Standard & Poor’s**”), Moody’s Investors Service Limited (“**Moody’s**”) and Fitch Ratings Ltd. (“**Fitch**”, and, together with Standard & Poor’s and Moody’s, the “**Rating Agencies**”). Each of Standard & Poor’s, Moody’s and Fitch is a credit rating agency established and operating in the European Community and is registered under the CRA Regulation.

Whether a rating in relation to any Tranche of Bonds will be treated as having been issued by a credit rating agency established in the European Union and registered under the CRA Regulation will be disclosed in the relevant Final Terms.

Each Sub-Class of Bearer Bonds may be represented initially by a Temporary Global Bond (as defined below), without interest coupons, which will be deposited with a common depositary for Euroclear and

Clearstream, Luxembourg (as defined below) on or about the Issue Date (as defined below) of such Sub-Class. Ratings ascribed to all of the Bonds reflect only the views of the Rating Agencies.

A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by any one or all of the Rating Agencies. A suspension, reduction or withdrawal of the rating assigned to any of the Bonds may adversely affect the market price of such Bonds.

If any withholding or deduction for or on account of tax is applicable to the Bonds, payments of interest on, principal of and premium (if any) on, the Bonds will be made subject to such withholding or deduction, without the Issuer being obliged to pay any additional amounts as a consequence.

In the case of any Bonds which are to be admitted to trading on a regulated market within the European Economic Area or offered to the public in a Member State of the European Economic Area in circumstances which require the publication of a prospectus under the Prospectus Directive (2003/71/EC), as amended (the “**Prospectus Directive**”), the minimum denomination shall be €100,000 (or its equivalent in any other currency as at the date of issue of the Bonds). Bonds may be issued in such denominations and higher integral multiples of a smaller amount specified in the relevant Final Terms.

The Obligors may agree with any Dealer and the Bond Trustee that Bonds may be issued in a form not contemplated by the Conditions (as defined below) herein, in which event (in the case of Bonds admitted to the Official List only) a supplementary prospectus or further prospectus, if appropriate, will be made available which will describe the effect of the agreement reached in relation to such Bonds.

IMPORTANT NOTICE

This prospectus (the “**Prospectus**”) comprises (i) a base prospectus for the purposes of Article 5.4 of the Prospectus Directive and for the purpose of giving information with regard to the Issuer and the other Obligors which, according to the particular nature of the Issuer and the Bonds, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses and prospects of the Issuer and (ii) listing particulars for the purposes of LR2.2.11 of the Listing Rules of the Financial Services Authority.

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

The information relating to Abbey National Treasury Services plc, Bank of America, N.A., Barclays Bank PLC, Citibank, N.A., London Branch, Commerzbank Aktiengesellschaft, Deutsche Bank Aktiengesellschaft, London Branch, HSBC Bank plc, ING Bank N.V., J.P. Morgan Chase Bank, N.A., National Australia Bank, Santander UK plc, The Royal Bank of Scotland plc, The Royal Bank of Scotland Group plc and UBS AG, London Branch and their affiliates contained in Chapter 10 “*Description of Hedge Counterparties*” has been accurately reproduced and as far as the Issuer is aware and is able to ascertain from such information, no facts have been omitted which would render the reproduced information inaccurate or misleading.

The reference relating to Published Regulatory Accounts of Water Companies in England and Wales 2011/12 on page 50 has been accurately reproduced and as far as the Issuer is aware and is able to ascertain from such information, no facts have been omitted which would render the reproduced information inaccurate or misleading.

This Prospectus is being distributed only to, and is directed only at, persons who (i) are 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 2005 (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**”) and in each case who do not constitute the public in the Cayman Islands. This Prospectus, 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 Prospectus 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.

Copies of each set of Final Terms (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 or the Registrar and Transfer Agents (as applicable).

This Prospectus is to be read in conjunction with all documents which are incorporated herein by reference (see “*Documents Incorporated by Reference*” below).

No person has been authorised to give any information or to make representations other than the information or the representations contained in this Prospectus in connection with the Issuer, any member of the SWS Financing Group (as defined below) or of the Full Greensands Group (as defined below) or the offering or sale of the Bonds and, if given or made, such information or representations must not be relied upon as having been authorised by the Issuer, any member of the SWS Financing Group or of the Full Greensands Group, the Arranger, the Dealers, the Bond Trustee or the Security Trustee. Neither the delivery of this Prospectus nor any offering or sale of Bonds made in connection herewith shall, under any circumstances, constitute a representation or create any implication that there has been no change in the affairs of the Issuer or any member of the SWS Financing Group since the date hereof. Unless otherwise indicated herein, all information in this Prospectus is given as of the date of this Prospectus. This document does not constitute an

offer of, or an invitation by, or on behalf of, the Issuer or any Dealer to subscribe for, or purchase, any of the Bonds.

None of the Arranger, Dealers, the Financial Guarantors, the Bond Trustee or the Security Trustee nor any of the Hedge Counterparties, the Liquidity Facility Providers, the Authorised Credit Providers, the Agents, the Account Bank, the Standstill Cash Manager, the Senior Mezzanine Facility Providers or the members of the Full Greensands Group (other than the Obligor) (each as defined below and, together, the “**Other Parties**”) has separately verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by any Dealer, Financial Guarantor, the Bond Trustee or the Security Trustee or Other Party as to the accuracy or completeness of the information contained in this Prospectus or any other information supplied in connection with the Bonds or their distribution. The statements made in this paragraph are without prejudice to the respective responsibilities of the Issuer and the other Obligor. Each person receiving this Prospectus acknowledges that such person has not relied on any Dealer, Financial Guarantor, the Bond Trustee or the Security Trustee or Other Party nor on any person affiliated with any of them in connection with its investigation of the accuracy of such information or its investment decision.

None of the Issuer, the Obligor, any member of the SWS Financing Group, the Arranger, the Dealers, the Bond Trustee, the Security Trustee, the Financial Guarantors or the Other Parties accept responsibility to investors for the regulatory treatment of their investment in the Bonds in any jurisdiction or by any regulatory authority. If the regulatory treatment of an investment in the Bonds is relevant to an investor’s decision whether or not to invest, the investor should make its own determination as to such treatment and for this purpose seek professional advice and consult its regulator.

Neither the delivery of this Prospectus nor the offering, sale or delivery of any Bonds shall in any circumstances imply that the information contained herein concerning the Obligor 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 or the other Obligor as of any time subsequent to the date indicated in the document containing the same. None of the Arranger, Dealers, the Financial Guarantors, the Bond Trustee, the Security Trustee or the Other Parties expressly undertakes to review the financial condition or affairs of any of the Obligor during the life of the Programme or to advise any investor in the Bonds of any information coming to their attention. Investors should review, among other things, the most recently published documents incorporated by reference into this Prospectus when deciding whether or not to purchase any Bonds.

This Prospectus is not intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by the Issuer, any Financial Guarantor, any member of the SWS Financing Group, any member of the Full Greensands Group, any Dealer, the Bond Trustee, the Security Trustee or any of the Other Parties that any recipient of this Prospectus should purchase any of the Bonds.

Each person contemplating making an investment in the Bonds must make its own investigation and analysis of the creditworthiness of the Issuer and the other Obligor and its own determination of the suitability of any such investment, with particular reference to its own investment objectives and experience and any other factors which may be relevant to it in connection with such investment. A prospective investor who is in any doubt whatsoever as to the risks involved in investing in the Bonds should consult independent professional advisers. Any prospective Bondholder should take its own legal, financial, accounting, tax and other relevant advice as to the structure and viability of its investment.

THE BONDS AND THE GUARANTEES HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER 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

ACCOUNT OR BENEFIT OF, U.S. PERSONS (AS DEFINED IN REGULATION S UNDER THE SECURITIES ACT (“REGULATION S”)).

THE BONDS ARE BEING OFFERED AND SOLD OUTSIDE THE UNITED STATES TO NON-U.S. PERSONS IN RELIANCE ON REGULATION S. FOR A DESCRIPTION OF THESE AND CERTAIN FURTHER RESTRICTIONS ON OFFERS, SALES AND TRANSFERS OF BONDS AND DISTRIBUTION OF THIS PROSPECTUS SEE CHAPTER 12 “*SUBSCRIPTION AND SALE*”.

THE BONDS AND THE GUARANTEES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE U.S. SECURITIES AND EXCHANGE COMMISSION, ANY STATE SECURITIES COMMISSION IN THE UNITED STATES OR ANY OTHER U.S. REGULATORY AUTHORITY, NOR HAS ANY OF THE FOREGOING AUTHORITIES PASSED UPON OR ENDORSED THE MERITS OF THE OFFERING OF BONDS OR THE ACCURACY OR THE ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENCE IN THE UNITED STATES.

TO NEW HAMPSHIRE RESIDENTS: NEITHER THE FACT THAT A REGISTRATION STATEMENT NOR AN APPLICATION FOR A LICENSE 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 PERSONS, 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.

The distribution of this Prospectus and the offering, sale or delivery of the Bonds in certain jurisdictions may be restricted by law. Persons into whose possession this Prospectus comes are required by the Issuer and the Dealers to inform themselves about and to observe any such restrictions. For a description of certain restrictions on offers and sales of the Bonds and on distribution of this Prospectus, see Chapter 12 “*Subscription and Sale*” below. This Prospectus does not constitute, and may not be used for the purposes of, an offer to or solicitation by any person to subscribe or purchase any Bonds in any jurisdiction or in any circumstances in which such an offer or solicitation is not authorised or is unlawful.

No invitation may be made to the public in the Cayman Islands to subscribe for any of the Bonds.

All references herein to “pounds”, “sterling” or “£” are to the lawful currency of the United Kingdom, all references to “\$”, “U.S.\$”, “U.S. dollars” or “dollars” are to the lawful currency of the United States of America, and references to “€”, “Euro” or “euro” are to the single 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, from time to time.

In connection with the issue of any Tranche of Bonds, one or more Dealer or Dealers (if any) (the “Stabilising Manager(s)”) (or persons acting on behalf of any Stabilising Manager(s)) may over-allot such Bonds or effect transactions with a view to supporting the market price of the Bonds of the Series of which such Tranche forms part, at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager(s) or persons acting on behalf of any Stabilising Manager will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the relevant Tranche of Bonds is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the Issue Date of the relevant Tranche of Bonds and 60 days after the date of the allotment of the relevant Tranche of Bonds. Any stabilisation action or over-allotment must be conducted by the relevant Stabilising Manager(s) (or person(s) acting on behalf of the Stabilising Manager(s)) in accordance with all applicable laws and rules.

DOCUMENTS INCORPORATED BY REFERENCE

This Prospectus should be read and construed in conjunction with the audited non-consolidated financial statements of each of the Obligors for the financial years ended 31 March 2011 and 2012 together in each case with the audit report thereon, which have been previously published or are published simultaneously with this Prospectus and which have been approved by the Financial Services Authority or filed with it (see Chapter 13 “*General Information – Documents Available*” for a description of the financial statements currently available for each of the Obligors) 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 Prospectus 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). Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Prospectus.

The following information shall be deemed to be incorporated in, and form part of, this Prospectus:

- (a) the Terms and Conditions of the Bonds as contained at pages 125 to 152 (inclusive) of the offering circular dated 17 July 2003;
- (b) the Terms and Conditions of the Bonds as contained at pages 134 to 166 (inclusive) of the offering circular dated 24 May 2005;
- (c) the Terms and Conditions of the Bonds as contained at pages 174 to 207 (inclusive) of the prospectus dated 23 October 2006;
- (d) the Terms and Conditions of the Bonds as contained at pages 173 to 211 (inclusive) of the prospectus dated 27 February 2009; and
- (e) the Terms and Conditions of the Bonds as contained at pages 181 to 219 (inclusive) of the prospectus dated 12 April 2011,

in each case, in connection with the Programme.

Each Obligor will provide, without charge, to each person to whom a copy of this Prospectus 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 Prospectus.

Each of the Obligors has undertaken to the Dealers in the Dealership Agreement (as defined in Chapter 12 “*Subscription and Sale*”) to comply with Section 81 of the FSMA.

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

Copies of documents deemed to be incorporated by reference in this Prospectus may be viewed on the website of the Regulatory News Service operated by the London Stock Exchange at <http://www.londonstockexchange.com/exchange/prices-and-news/news/market-news/market-news-home.html>. The contents of this website, other than copies of those documents deemed to be incorporated by reference into this Prospectus, do not form part of this Prospectus.

The hyperlinks included in this Prospectus, or included in any documents incorporated by reference into the Prospectus, and the websites and their content are not incorporated into, and do not form part of, this Prospectus.

SUPPLEMENTARY PROSPECTUS

The Issuer has undertaken, in connection with the admission of the Bonds to the Official List and to trading on the Market, that, if there shall occur any significant new factor, material mistake or inaccuracy relating

to information contained in this Prospectus which is capable of affecting the assessment of any Bonds whose inclusion would reasonably be required by investors and their professional advisers, and would reasonably be expected by them to be found in this Prospectus, for the purpose of making an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the relevant Issuer, and the rights attaching to the Bonds, the Issuer shall prepare a supplement to this Prospectus or publish a replacement prospectus for use in connection with any subsequent issue by the Issuer of Bonds and will supply to each Dealer and the Bond Trustee such number of copies of such supplement hereto or replacement prospectus as such Dealer and Bond Trustee may reasonably request. The Issuer will also supply to the UK Listing Authority such number of copies of such supplement hereto or replacement prospectus 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).

If at any time any Issuer shall be required to prepare a supplemental prospectus pursuant to Section 87(G) of the Financial Services and Markets Act 2000 (“FSMA”), the Issuer shall prepare and make available an appropriate supplement to this Prospectus or a further prospectus which, in respect of any subsequent issue of Bonds to be listed on the Official List and admitted to trading on the Market, shall constitute a supplemental prospectus as required by the UK Listing Authority and Section 87(G) of the FSMA.

SUPPLEMENTARY LISTING PARTICULARS

The Issuer has undertaken, in connection with the admission of the Bonds to the Official List and to trading on the PSM, that, if there shall occur a significant change affecting any matter contained in this Prospectus whose inclusion would reasonably be required by investors and their professional advisers, and would reasonably be expected by them to be found in this Prospectus, for the purpose of making an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the relevant Issuer, and the rights attaching to the Bonds, the Issuer shall prepare a supplement to this Prospectus or publish a replacement prospectus for use in connection with any subsequent issue by the Issuer of Bonds and will supply to each Dealer and the Bond Trustee such number of copies of such supplement hereto or replacement prospectus as such Dealer and Bond Trustee may reasonably request. The Issuer will also supply to the UK Listing Authority such number of copies of such supplement hereto or replacement prospectus 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).

If at any time any Issuer shall be required to prepare supplementary listing particulars pursuant to Section 81 of the FSMA, the Issuer shall prepare and make available an appropriate supplement to this Prospectus or a further prospectus which, in respect of any subsequent issue of Bonds to be listed on the Official List and admitted to trading on the PSM, shall constitute supplementary listing particulars as required by the UK Listing Authority and Section 81 of the FSMA.

FINAL TERMS

In the following paragraphs, the expression “necessary information” means, in relation to any Tranche of Bonds, the information necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the Issuer and of the rights attaching to the Bonds. In relation to the different types of Bonds which may be issued under the Programme the Issuer has endeavoured to include in this Prospectus all of the necessary information except for information relating to the Bonds which is not known at the date of this Prospectus and which can only be determined at the time of an individual issue of a Tranche of Bonds.

Any information relating to the Bonds which is not included in this Prospectus and which is required in order to complete the necessary information in relation to a Tranche of Bonds will be contained in the relevant Final Terms. Such information will be contained in the relevant Final Terms unless any of such information constitutes a significant new factor relating to the information contained in this Prospectus in which case such information will be contained in a supplement to this Prospectus.

For a Tranche of Bonds which is the subject of Final Terms, those Final Terms will, for the purposes of that Tranche only, supplement this Prospectus and must be read in conjunction with this Prospectus.

CHAPTER 1 THE PARTIES

The Issuer	Southern Water Services (Finance) Limited, a company incorporated in the Cayman Islands on 17 August 2001 with limited liability with registered number 112331, is the funding vehicle for raising funds to support the long term debt financing requirements of SWS. The Issuer is a 100% subsidiary of SWS.
SWS	Southern Water Services Limited, a company incorporated in England and Wales with limited liability (registered number 2366670) on 1 April 1989, which holds an Instrument of Appointment dated August 1989 under sections 11 and 14 of the Water Act 1989 (as in effect on 1 September 1989) under which the Secretary of State for the Environment appointed SWS as a water and sewerage undertaker under the WIA for the areas described in the Instrument of Appointment. SWSH owns 100% of the issued ordinary share capital in SWS.
SWSH	SWS Holdings Limited, a company incorporated in England and Wales with limited liability (registered number 04324499). SWSH is a 100% subsidiary of SWSGH.
SWSGH	SWS Group Holdings Limited, a company incorporated in England and Wales with limited liability (registered number 04324498). SWSGH is a 100% subsidiary of Southern Water Services Group Limited.
Guarantors	Pursuant to the terms of the Security Agreement, SWSH and SWSGH each guarantee the obligations of each other and of SWS and the Issuer under each Finance Document in favour of the Security Trustee. In addition, SWS and the Issuer each guarantee the obligations of each other (but not those of SWSH and SWSGH) under each Finance Document in favour of the Security Trustee. SWSH, SWSGH, SWS and the Issuer are collectively referred to herein as the “ Guarantors ”
SWS Financing Group	The SWS Financing Group comprises SWSGH, SWSH, SWS, the Issuer and the Pension Companies (as defined below).
SWSG	Southern Water Services Group Limited, a company incorporated in England and Wales with limited liability (registered number 04374956), whose registered office is at Southern House, Yeoman Road, Worthing, West Sussex BN13 3NX. Southern Water Services Group Limited is a 100% subsidiary of SWI.
SWI	Southern Water Investments Limited, a company incorporated in England and Wales (registered number 04650294), whose registered office is at Southern House, Yeoman Road, Worthing, West Sussex BN13 3NX. SWI owns the Class A2 Preference Shares. SWI is a 100 per cent. subsidiary of SWC.
SWC	Southern Water Capital Limited, a company incorporated in England and Wales (registered number 04608528) whose registered office is Southern House, Yeoman Road, Worthing, West Sussex BN13 3NX. SWC owns the Class A1 Preference Shares and the Class B Preference Shares.

Group	SWI and its Subsidiaries from time to time.
Arranger	Barclays Bank PLC is the Arranger of the Programme.
Dealers	Banco Santander, S.A., Barclays Bank PLC, BNP Paribas, HSBC Bank plc and The Royal Bank of Scotland plc, will act as dealers (together with any other dealer appointed from time to time by the Issuer and the other Guarantors, “ Dealers ”) either generally with respect to the Programme or in relation to a particular Tranche, Sub-Class, Class or Series of Bonds.
Financial Guarantors	Each of, (i) MBIA UK Insurance Limited (“ MBIA UK ”) as initial financial guarantor under the terms of a financial guarantee which it has issued in respect of Sub-Class A9 Wrapped Bonds issued on 18 October 2006 (the “ MBIA UK Initial Financial Guarantee ”), and in respect of Class A Wrapped Bonds issued on 23 July 2003 (the “ Initial Issue Date ”) and on 27 May 2005 and (ii) Assured Guaranty (Europe) Limited formerly known as Financial Security Assurance (U.K.) Limited (“ Assured Guaranty (Europe) ”) (as initial financial guarantor, and together with MBIA UK, the “ Initial Financial Guarantors ” and each, an “ Initial Financial Guarantor ”) under the terms of a financial guarantee (together with the MBIA UK Initial Financial Guarantee, the “ Initial Financial Guarantees ”) which it has issued in respect of Sub-Class A10 Wrapped Bonds issued on 17 July 2007. For the avoidance of doubt, the Issuer shall not issue any Wrapped Bonds pursuant to this Prospectus.
Hedge Counterparties	Each of (i) Abbey National Treasury Services plc acting through its office at 2 Triton Square, Regent’s Place, London, NW1 3AN, (ii) Bank of America, N.A., (iii) Barclays Bank PLC acting through its office at 5 The North Colonnade, Canary Wharf, London, E14 4BB (iv) Citibank, N.A., London Branch acting through its office at Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB, (v) Commerzbank Bank AG acting through its London Office at 30 Gresham Street, London EC2V 7PG, (vi) Deutsche Bank Aktiengesellschaft, London Branch (vii) HSBC Bank plc acting through its office at 8 Canada Square, London, E14 5HQ, (viii) ING Bank N.V., (ix) J.P. Morgan Chase Bank N.A. acting through its office at 25 Bank Street, Canary Wharf, London, E14 5JP, (x) National Australia Bank Limited (ABN 12004044937) acting through its office at 88 Wood Street, London EC2Y 7QQ, (xi) Santander UK plc acting through its office at 2 Triton Square, Regent’s Place, London, NW1 3AN, (xii) The Royal Bank of Scotland plc acting through its office at 135 Bishopsgate London EC2M 3UR, (xiii) The Royal Bank of Scotland Group plc and (xvi) UBS AG, London Branch (together the “ Existing Hedge Counterparties ”) and together with any counterparties to future Hedging Agreements, the “ Hedge Counterparties ”). The Existing Hedge Counterparties are under no obligation to enter into any further Treasury Transactions.

Bond Trustee	Deutsche Trustee Company Limited (or any successor trustee appointed pursuant to the Bond Trust Deed) acts as trustee (the “ Bond Trustee ”) for and on behalf of the holders of each Class of Bonds of each Series (each a “ Bondholder ”).
Mezzanine Facility Provider	SWC (as the current “ Senior Mezzanine Facility Provider ”) has provided the Issuer with a £127,200,000 senior mezzanine credit facility (the “ Senior Mezzanine Facility ”), which it acquired from Royal Bank Investments Limited acting through its office at 280 Bishopsgate, London EC2M 4RB and a syndicate of lenders (the “ Initial Mezzanine Facility Providers ”). The Senior Mezzanine Facility has been partially prepaid and the outstanding balance of the Senior Mezzanine Facility is £15,400,000 as at the date of this Prospectus.
Security Trustee	Deutsche Trustee Company Limited (or any successor trustee appointed pursuant to the STID) acts as security trustee for itself and on behalf of the Secured Creditors (as defined below) (the “ Security Trustee ”) and holds, and will be entitled to enforce, the Security (as defined below) subject to the terms of the STID (as defined below).
Secured Creditors	The Secured Creditors comprise any person who is a party to, or has acceded to, the STID as a Secured Creditor.
DSR Liquidity Facility Providers	The Royal Bank of Scotland plc acting through its office at 135 Bishopsgate, London EC2M 3UR, Abbey National Treasury Services Plc, Barclays Bank PLC, BNP Paribas, London Branch and HSBC Bank plc (the “ Existing DSR Liquidity Facility Providers ”) provide the Issuer with a 364-day revolving credit facility (as may be renewed from time to time) for interest requirements on the Class A Debt and, within certain limits, for interest requirements on the Class B Debt. The scheduled renewal date of the DSR Liquidity Facility is currently 20 June 2013.
O&M Reserve Facility Provider	A provider of a liquidity facility pursuant to an O&M Reserve Facility Agreement to fund SWS’s operating and maintenance expenditure, which, among others, the Issuer and such O&M Reserve Facility Provider may enter into from time to time.
Authorised Credit Providers	RBS and a syndicate of banks (the “ Existing RCF Providers ”) provide SWS with revolving credit facilities to fund the working capital and capital expenditure requirements of SWS until 24 June 2015. Artesian Finance II plc and Artesian Finance plc have made index-linked advances to the Issuer. National Australia Bank Limited (the “ NAB Facility Provider ”) provides SWS with a £100,000,000 term facility for refinancing any existing term facility between amongst others, National Australia Bank Limited as lender and SWS as borrower and for SWS’s general corporate purposes.
Paying Agents	Deutsche Bank AG, London Branch acts and will act as principal paying agent (the “ Principal Paying Agent ”) and, together with any other paying agents appointed by the Issuer, the “ Paying Agents ”) to provide certain issue and paying agency services to the Issuer in respect of the Bearer Bonds.

Agent Bank	Deutsche Bank AG, London Branch acts as agent bank (the “ Agent Bank ”) under the Agency Agreement.
Account Bank	National Westminster Bank Plc, acting through its office at 27 South Street, Worthing, West Sussex BN11 3AR or any person for the time being acting as Account Bank (pursuant to the Account Bank Agreement). National Westminster Bank Plc is a company incorporated in England and Wales with registered number 929027 and has its registered office at 135 Bishopsgate, London EC2M 3UR. National Westminster Bank Plc is part of the RBS Group.
Cash Manager	SWS acts, or during a Standstill Period The Royal Bank of Scotland plc (the “ Standstill Cash Manager ”) will act, pursuant to the terms of the cash management provisions of the CTA as cash manager in respect of moneys credited from time to time to the Accounts (as defined below).
Registrar and Transfer Agent	Deutsche Bank AG, London Branch will act as transfer agent (the “ Transfer Agent ”) and will provide certain transfer agency services to the Issuer in respect of the Registered Bonds. Deutsche Bank Luxembourg S.A. will act as registrar (the “ Registrar ”) and will provide certain registrar services to the Issuer in respect of the Registered Bonds.

CHAPTER 2 OVERVIEW OF THE PROGRAMME

The following overview does not purport to be complete and is taken from, and is qualified in its entirety by, the remainder of this Prospectus and, in relation to the Conditions of any particular Tranche of Bonds, the applicable Final Terms. Words and expressions not defined in this overview shall have the same meanings as defined in Chapter 8 “*The Bonds*”. Please note that any references to Wrapped Bonds in this overview are for informational purposes only. The Issuer shall not issue any Wrapped Bonds pursuant to this Prospectus.

Description	Guaranteed Bond Programme.
Programme Size	Up to £6,000,000,000 (or its equivalent in other currencies) aggregate nominal amount of Bonds outstanding at any time.
Issuance in Classes	<p>Bonds issued under the Programme have been and will be issued in Series. For the avoidance of doubt, the Issuer shall not issue any Wrapped Bonds pursuant to this Prospectus.</p> <p>The Unwrapped Bonds are and will be designated as one of Class A Unwrapped Bonds or Class B Unwrapped Bonds.</p> <p>Each Class comprises or (in the case of Unwrapped Bonds only) will comprise one or more Sub-Classes of Bonds and each Sub-Class can be issued in one or more Tranches, the specific terms of each Tranche of a Sub-Class being identical in all respects, save for the issue dates, interest commencement dates and/or issue prices, to the terms of the other Tranches of such Sub-Class.</p> <p>The specific terms of each Tranche of Bonds are and will be set out in the applicable Final Terms.</p>
Issue Dates	23 July 2003 (the “ Initial Issue Date ”), 27 May 2005, 18 October 2006, 17 July 2007, 5 March 2009 and thereafter the date of issue of a Tranche of Bonds as specified in the relevant Final Terms (each an “ Issue Date ”).
Certain Restrictions	<p>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 restrictions applicable at the date of this Prospectus. See Chapter 12 “<i>Subscription and Sale</i>”.</p> <p>Bonds with a maturity of less than one year</p> <p>Bonds having a maturity of less than one year from the date of issue will constitute deposits for the purposes of the prohibition on accepting deposits contained in section 19 of the FSMA 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 12 “<i>Subscription and Sale</i>”.</p>
Distribution	Bonds have been and 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 and, subject to any applicable legal or regulatory restrictions, any other currency agreed between

	the Issuer and the relevant Dealer.
Redenomination	The applicable Final Terms may provide that certain Bonds may be redenominated in euro. The relevant provisions applicable to any such redenomination will be contained in Condition 19 (<i>European Economic and Monetary Union</i>).
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 (as defined in the Conditions).
Issue Price	Bonds have been and may be issued on a fully-paid basis and at an issue price which is at par or at a discount to, or premium over, par.
Interest	Bonds are and will, unless otherwise specified in the relevant Final Terms, be interest-bearing and interest is or will be calculated (unless otherwise specified in the relevant Final Terms) on the Principal Amount Outstanding (as defined in the Conditions) of such Bond. Interest accrues or will accrue at a fixed or floating rate (plus, in the case of Indexed Bonds, amounts in respect of indexation) and is or will be payable in arrear, as specified in the relevant Final Terms. Interest is or will be calculated on the basis of such Day Count Fraction (as defined in the Conditions) as may be agreed between the Issuer and the relevant Dealer as specified in the relevant Final Terms.
Form of Bonds	The Series 1 Bonds, Series 2 Bonds, Series 3 Bonds, Series 4 Bonds and Series 5 Bonds have been issued under the Programme in bearer form. Each further Sub-Class of Bonds will be issued in bearer or registered form as described in Chapter 8 " <i>The Bonds</i> ". Registered Bonds will not be exchangeable for Bearer Bonds.
Fixed Rate Bonds	Fixed Rate Bonds bear interest at a fixed rate of interest payable on such date or dates as may be agreed between the Issuer and the relevant Dealer and on redemption, as specified in the relevant Final Terms.
Floating Rate Bonds	Floating Rate Bonds bear interest at a rate determined: <ul style="list-style-type: none"> (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 (A) in the case of Bonds issued before the date of this Prospectus, 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 Sub-Class) and (B) in the case of Bonds issued on or after the date of this Prospectus, the 2006 ISDA Definitions (as published by the International Swaps and Derivatives Association, Inc.); or

- (ii) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service (being EURIBOR or LIBOR).

The margin (if any) relating to such floating rate has been or will be agreed between the Issuer and the relevant Dealer for each Sub-Class of Floating Rate Bonds.

Indexed Bonds	Payments (whether in respect of principal or interest and whether at maturity or otherwise) in respect of Indexed Bonds (including Limited Indexed Bonds as defined in Condition 7(a) (<i>Indexation – Definitions</i>)) are and may be calculated in accordance with Condition 7 by reference to the UK Retail Price Index.
Interest Payment Dates	Interest in respect of Fixed Rate Bonds is or will be payable annually in arrear, in respect of Floating Rate Bonds is or will be payable quarterly in arrear and in respect of Indexed Bonds is or will be payable semi-annually in arrear (or, in each case, as otherwise specified in the relevant Final Terms).
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.
Partly Paid Bonds	Partly Paid Bonds will be issued in the amount as specified in the relevant Final Terms and further instalments will be payable in the amounts and on the dates as specified in the relevant Final Terms.
Instalment Bonds	The applicable Final Terms 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 Final Terms.
Redemption	The applicable Final Terms indicate or 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 Index Event or 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.
Redemption for Index Event, Taxation or Other Reasons	Upon the occurrence of certain index events (as set out in Condition 8(c) (<i>Redemption for Index Event, Taxation or Other Reasons</i>)), the Issuer may redeem the Indexed Bonds at their Principal Amount Outstanding together with accrued but unpaid interest and amounts in respect of indexation. No single Sub-Class of Indexed Bonds may be redeemed in these circumstances unless all the other Sub-Classes of Indexed Bonds are also redeemed.

In addition, in the event of the Issuer becoming obliged to make any deduction or withholding from payments in respect of the Bonds (although the Issuer will not be obliged to pay any additional amounts in respect of such deduction or withholding) the Issuer may (a) use its reasonable endeavours to arrange for the substitution of another company incorporated in an alternative jurisdiction (subject to certain conditions as set out in Condition 8(c) (*Redemption for Index Event, Taxation or Other Reasons*) of the Bonds) and, failing this, (b) redeem (subject to certain conditions as set out in Condition 8(c) (*Redemption for Index Event, Taxation or Other Reasons*) of the Bonds) all (but not some only) of the Bonds at their Principal Amount Outstanding (plus, in the case of Indexed Bonds, amounts in respect of indexation) together with accrued but unpaid interest. No single Class or Sub-Class of Bonds may be redeemed in these circumstances unless all the other Classes and Sub-Classes of Bonds are also redeemed in full at the same time.

In the event of SWS electing to prepay an advance (in whole or in part) under an Issuer/SWS Loan Agreement, the Issuer shall be obliged to redeem all or the relevant part of the corresponding Sub-Class of Bonds or the proportion of the relevant Sub-Class which the proposed prepayment amount bears to the amount of the relevant advance under the relevant Issuer/SWS Loan Agreement

Bonds having a maturity of less than one year from the date of issue are subject to restrictions on their denomination and distribution. See "*Certain Restrictions – Bonds with a maturity of less than one year*" above.

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.

Denomination of Bonds

Bonds have been and will be issued in such denominations as were or may be agreed between the Issuer and the relevant Dealer save that (i) in the case of any Bonds which are to be admitted to trading on a regulated market within the European Economic Area or offered to the public in a Member State of the European Economic Area in circumstances which require the publication of a prospectus under the Prospectus Directive, the minimum specified denomination shall be €100,000 (or its equivalent in any other currency as at the date of issue of the Bonds); and (ii) in any other case, the minimum specified 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 "*Certain Restrictions – Bonds with a maturity of less than one year*" above.

Bonds which are admitted to trading on the Market may be issued in such denomination and higher integral multiples of a smaller amount specified in the relevant Final Terms.

From the date of entry into force of Directive 2010/73/EU, the

EU directive amending the Prospectus Directive 2003/71/EC and the Transparency Directive 2004/109/EC (the “**Amending Directive**”), Bonds which are admitted to trading on the Market and with a maturity date which falls after the implementation date of the Amending Directive in any relevant European Economic Area Member State must have a minimum specified denomination of €100,000 (or its equivalent in any other currency as at the date of issue of such Bonds).

Taxation

Payments in respect of Bonds are and 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.

Status of the Bonds

The Bonds in issue constitute and any future Bonds (in the case of Unwrapped Bonds only) issued under the Programme will constitute secured obligations of the Issuer. Each Class of Bonds ranks *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 dated 23 July 2003 as amended, supplemented or restated from time to time (the “**Bond Trust Deed**”) entered into by the Obligors, MBIA Assurance S.A. and the Bond Trustee in connection with the Programme and (b) in the case of the Wrapped Bonds in issue only, the relevant Financial Guarantor in certain circumstances in accordance with the relevant Financial Guarantee.

For the avoidance of doubt, the Issuer shall not issue any Wrapped Bonds pursuant to this Prospectus.

The Class A Wrapped Bonds in issue and the Class A Unwrapped Bonds in issue rank, and any further Class A Unwrapped Bonds issued under the Programme will rank, *pari passu* with respect to payments of interest and principal. However, only the Class A Wrapped Bonds in issue have the benefit of the relevant Financial Guarantee. All claims in respect of the Class A Wrapped Bonds in issue and the Class A Unwrapped Bonds in issue and any further Class A Unwrapped Bonds issued will rank in priority to payments of interest and principal due on all Class B Unwrapped Bonds.

For the avoidance of doubt, the Issuer shall not issue any Wrapped Bonds pursuant to this Prospectus.

The Class B Unwrapped Bonds in issue rank and any further Class B Unwrapped Bonds issued under the Programme will rank, *pari passu* with respect to payments of interest and principal.

Covenants

The representations, warranties, covenants (positive, negative and financial) and events of default which apply and will apply

to, among other things, the Bonds are set out in a common terms agreement dated 23 July 2003 (and as amended, supplemented or restated from time to time) (the “CTA”, see Chapter 7 “*Summary of the Financing Agreements*” under “*Common Terms Agreement*”).

Guarantee and Security

The Bonds in issue are, and further Bonds issued under the Programme will be, unconditionally and irrevocably guaranteed and secured by each of SWS, SWSGH and SWSH pursuant to a guarantee and security agreement (the “**Security Agreement**”) entered into by each such Obligor in favour of the Security Trustee over the entire property, assets, rights and undertaking of each such Obligor (the “**Security**”), in the case of SWS to the extent permitted by the WIA and Licence. Each such guarantee constitutes a direct, unconditional and secured obligation of each such Obligor. The Security is 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).

SWS’s business (together with the facilities available to the SWS Financing Group) have characteristics that demonstrate the capacity to produce funds to service any payments due and payable on the Bonds issued.

Inter-creditor Arrangements

The Secured Creditors and each Obligor are each party to a security trust and intercreditor deed (the “**STID**”), which regulates, among other things, (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 Chapter 7 “*Summary of the Financing Agreements*” under “*Security Trust and Intercreditor Deed*”.

Authorised Credit Facilities

Subject to certain conditions being met, the Issuer and (for certain indebtedness) SWS are permitted to incur indebtedness under authorised credit facilities (each an “**Authorised Credit Facility**”) with an Authorised Credit Provider, providing loan, hedging and other facilities (including Financial Guarantees) which may rank *pari passu* with the Class A Bonds, the Class B Bonds or the Senior Mezzanine Debt. Each Authorised Credit Provider is or will become party to the CTA and the STID and may have voting rights thereunder. See Chapter 7 “*Summary of the Financing Agreements*”.

DSR Liquidity Facility

The DSR Liquidity Facility Providers make available to the Issuer a credit facility for the purpose of meeting certain shortfalls in revenues for the Issuer to meet, among other things, its obligations to pay interest on the Bonds. The Issuer is obliged, pursuant to the CTA, to maintain through a DSR Liquidity Facility (or DSR Liquidity Facilities) and/or amounts in the Debt Service Reserve Account an amount or amounts

which is/are at least equal to the aggregate of projected interest payments on the Class A Debt and the Class B Debt for the succeeding 12 months.

O&M Reserve and O&M Reserve Facility	SWS has established a reserve in the amount of approximately £46.3 million (as at 31 March 2012) in the O&M Reserve Account of SWS. The principal amount credited to the O&M Reserve Account (the “ O&M Reserve ”) may only be used by SWS for the purpose of meeting its operating and maintenance expenses. O&M Reserve Facility Providers may additionally make available to the Issuer a liquidity facility, the proceeds from which will be on-lent by the Issuer to SWS for the purpose of meeting SWS’s operating and maintenance expenses.
Listing	<p>The Bonds issued on the Initial Issue Date and all subsequent issues under the Programme have been admitted to the Official List and admitted to trading on the Market and were subsequently migrated to the PSM in 2006. Application has been made to admit further Bonds issued under the Programme to the Official List and to admit them to trading on the Market or the PSM. 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>The applicable Final Terms will state that the relevant Bonds are to be listed and on which stock exchange(s).</p>
Ratings	<p>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. The initial ratings of a Series of Bonds will be specified in the relevant Final Terms.</p> <p>A rating is not a recommendation to buy, sell or hold securities and will depend, among other things, on certain underlying characteristics of the business and financial condition of SWS.</p> <p>A rating may be subject to suspension, change or withdrawal at any time by the assigning Rating Agency.</p>
Governing Law	The Bonds in issue are and any further Bonds issued under the Programme 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 and the Cayman Islands and such other restrictions as may be required in connection with the offering and sale of a particular Sub-Class of Bonds. See Chapter 12 “ <i>Subscription and Sale</i> ”.

Investor Information

SWS is required to produce an investors' report (the "**Investors' Report**") semi-annually to be delivered within 120 days from 31 March or 60 days from 30 September of each year. Such Investors' Report will include, among other things: (i) a general overview of the SWS business in respect of the six month period ending on the immediately preceding Calculation Date; (ii) the calculations of the Class A ICR, Class A Adjusted ICR and the Senior Adjusted ICR for each Test Period (historic and projected); (iii) the ratio of Net Cash Flow minus Capital Maintenance Expenditure to Class A Debt Interest for the twelve month period ending on such Calculation Date; (iv) the Class A RAR and Senior RAR (historic and projected); and (v) reasonable detail of the computations of these financial ratios. Each such Investors' Report will be made available by SWS and the Issuer to the Secured Creditors, including the Bondholders on SWS's website. SWS is also required to make available unaudited interim financial statements and audited financial statements, within 60 days of 30 September and 120 days of 31 March, respectively and, in any event within five Business Days of the date on which they are made available. SWS will also place certain additional information on its website, as and when available. This will include, among other things, the most recently published: (a) annual charges scheme for SWS, with details of tariffs; (b) a summary of SWS's strategic business plan at each Periodic Review; (c) SWS's current Procurement Plan (as defined below) (if any); (d) SWS's annual drinking water quality report; (e) SWS's annual environment report; (f) SWS's annual conservation and access report; and (g) such other periodic information compiled by SWS for Ofwat.

CHAPTER 3 RISK FACTORS

The following sets out certain aspects of the Programme documentation and the activities of the SWS Financing Group about which prospective Bondholders should be aware. The occurrence of any of the events described below could have a material adverse impact on the business, financial condition or operational performance of the Issuer, SWS or the other Obligors and could lead to, among other things:

- (a) an SWS Event of Default;*
- (b) an Event of Default under the terms and conditions of the Bonds; and*
- (c) non-payment of amounts in respect of the Class A Unwrapped Bonds or the Class B Unwrapped Bonds.*

Prospective Bondholders should note that the risks described below are not the only risks that the Issuer, SWS or the other Obligors face. The Issuer, SWS or the other Obligors have described only those risks relating to their operations and the Bonds that they consider to be material. There may be additional risks that the Issuer, SWS or the other Obligors currently consider not to be material or of which they are not currently aware, and any of these risks could have the effects set forth above. The following 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. Bondholders may lose the value of their entire investment in certain circumstances. If the Issuer has insufficient funds, the Bonds may not be repaid in full on their respective maturity dates.

In addition, 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 of any Sub-Class receive payment of interest or repayment of principal from the Issuer in respect of such Bonds on a timely basis or at all.

Financing Considerations

High Leverage

The SWS Financing Group has indebtedness that is substantial in relation to its shareholders equity. Taking into account retained cash reserves, such leverage of the SWS Financing Group was 81.2 per cent. of RCV as at 31 March 2012. In addition, the Issuer has borrowings of £15.4 million under the Senior Mezzanine Facility and SWS has in issue Preference Shares for a consideration of £142.6 million, each of which are subordinated to the Class A Debt and the Class B Debt pursuant to the Intercreditor Arrangements. The ability of SWS 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, inflation and other general economic conditions in the United Kingdom.

In addition, Ofwat assesses the cost of debt at price reviews on the basis of a hypothetical efficiently financed company. According to Ofwat, 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 and if Ofwat took the view that such debt had not been prudently incurred. Accordingly, there can be no assurance as to SWS's ability to meet its financing requirements and no assurance that SWS's high degree of leverage will not have a material adverse impact on its ability to pay amounts under the Issuer/SWS Loan Agreements, which would enable the Issuer to pay amounts due and owing in respect of the Bonds. Incurrence of additional indebtedness by SWS or the Issuer, which is permitted under the Finance Documents, may materially affect the ability of SWS, the Issuer or the other Obligors to pay amounts due and owing in respect of the Bonds.

Future Financing

The SWS Financing Group will need to raise further debt from time to time in order, among other things, to:

- (i) finance future capital enhancements to SWS's asset base;
- (ii) on each Interest Payment Date on which principal is required to be repaid and on the maturity date of the relevant Sub-Classes of Bonds, refinance the Bonds; and
- (iii) 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.

While the CTA and the STID contemplate the terms and conditions on, and circumstances under, which such additional indebtedness can be raised, there can be no assurance that the SWS Financing Group will be able to raise sufficient funds, or funds at a suitable interest rate, or on suitable terms, at the requisite time such that the purposes for which such financing is being raised are fulfilled, and in particular such that all amounts then due and payable on the Bonds or any other maturing indebtedness will be capable of being so paid when due.

Financing Structure Considerations

Special Purpose Vehicle Issuer

The Issuer is a special purpose financing entity with no business operations other than raising the original acquisition finance for the First Aqua Acquisition, refinancing part of such financing, upon the acquisition by SWI of the Issuer, and further refinancing the same and raising external funding for SWS through the issuance of the Bonds and borrowing under the Senior Mezzanine Facility, the Liquidity Facilities and Authorised Credit Facilities and entering into various Hedging Agreements. Other than the proceeds of the issuance of additional Bonds, the Issuer's principal source of funds will be pursuant to the Issuer/SWS Loan Agreements and funds available to it pursuant to the Liquidity Facilities and other Authorised Credit Facilities.

Therefore, the Issuer is subject to all the risks relating to revenues and expenses to which SWS is subject. Such risks could limit funds available to SWS to enable SWS to satisfy in full and on a timely basis its obligations under the Issuer/SWS Loan Agreements and/or its guarantee under the Security Agreement (See "*SWS Revenue and Cost Considerations*" below).

The DSR Liquidity Facilities

The DSR Liquidity Facilities and any amounts credited to the Debt Service Reserve Account are intended to cover certain shortfalls in the ability of the Issuer to service payments in relation to the Class A Debt and Class B Debt on any Interest Payment Date (excluding the repayment of principal under the Bonds and the payment of any Subordinated Coupon Amounts under the Class B Bonds). However, on any such Interest Payment Date, there are no assurances that any such shortfalls will be met in whole or in part by amounts standing to the credit of the Debt Service Reserve Account or by the DSR Liquidity Facilities.

Bond Considerations

Subordination of the Class B Bonds

Payments under the Class A Bonds (whatever Sub-Class) rank in priority to payments of principal and interest due on all Sub-Classes of the Class B Bonds.

If, on any Interest Payment Date, prior to the taking of Enforcement Action after the termination of a Standstill Period, there are insufficient funds available to the Issuer to pay accrued interest or principal on the Class B Bonds (after taking into account any amounts available to be drawn under any DSR Liquidity Facility or from the Debt Service Reserve Account), the Issuer's liability to pay such accrued interest will be treated as not having fallen due and will be deferred until the earliest of (i) the next following Interest Payment Date on which the Issuer has, in accordance with the Payment Priorities, sufficient funds available to pay such deferred amounts (including any interest accrued thereon); (ii) the date on which all Class A Debt has been paid in full; and (iii) an Acceleration of Liabilities (other than a Permitted Hedge Termination or a Permitted Lease Termination) and, in the case of a Permitted Share Pledge Acceleration, only to the extent

that there would be sufficient funds available in accordance with the Payment Priorities to pay such deferred amounts (including accrued interest thereon). Interest will, however, accrue on such deferred amounts.

Notwithstanding the subordination of, and credit enhancement provided by, the Class B Bonds to the Class A Bonds, the Issuer may, subject to certain conditions, optionally redeem some or all of the Bonds subordinated and providing credit enhancement to other classes of Bonds.

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 holder of a Class B Bond (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 falls due on a later date.

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 any Hedging Agreement. A Hedging Agreement may be terminated in the circumstances set out in Chapter 7 “*Summary of the Financing Agreements – Hedging Agreements*”, including where the Hedge Counterparty is required to gross up for, or receive, payments from which tax has been required to be deducted or withheld by law, which requirement has not been able to be avoided, notwithstanding the Issuer and the Hedge Counterparty having used reasonable endeavours to do so in accordance with the relevant Hedging Agreement. 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, as a result of adverse fluctuations in interest rates and exchange rates or making any termination payment to the Hedge Counterparty, which payment will be in accordance with the Payment Priorities (see Chapter 7 “*Summary of the Financing Agreements – Cash Management*”).

Rights Available to Bondholders

The Bond Trust Deed contains provisions detailing the Bond Trustee’s obligations to consider the interests of the Bondholders as regards all powers, trusts, authorities, duties and discretions of the Bond Trustee (except where expressly provided otherwise). Where, in the sole opinion of the Bond Trustee, there is a conflict of interest between the holders of two or more Sub-Classes of Bonds of such Class, the Bond Trustee shall consider the interests of the holders of the Sub-Class 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 any other Bondholders or any other person.. The STID provides that the Security Trustee (except in relation to certain Reserved Matters and Entrenched Rights as set out in the STID) will act on instructions of the relevant DIG Representative(s). When so doing, the Security Trustee is not required to have regard to the interests of any Finance Party (including the Bond Trustee as trustee for the Bondholders) in relation to the exercise of such rights and, consequently, has no liability to the Bondholders as a consequence of so acting.

Intercreditor Rights of Bondholders

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 Chapter 7 “*Summary of the Financing Agreements - Security Trust and Intercreditor Deed – Entrenched Rights and Reserved Matters*”. 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. Prior to a Default Situation, a Bondholder will not be entitled to vote other than in respect of Entrenched Rights and Reserved Matters.

Prior to a Default Situation, the Bond Trustee may vote on behalf of the Unwrapped Bondholders and (if an FG Event of Default has occurred and is continuing in relation to the relevant Financial Guarantor) 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 in issue (during the continuance of an FG

Event of Default in relation to the relevant Financial Guarantor) and the Unwrapped 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. The Security Trustee will be required to act upon the instructions contained in the Emergency Instruction Notice (see further Chapter 7 “*Summary of the Financing Agreements – 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 Chapter 7 “*Summary of the Financing Agreements*” under “*Security Trust and Intercreditor Deed*”.

Under the terms of the STID and the CTA, any further issues of debt securities by the Issuer 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, Class B Bonds may be made without the consent of the relevant Bondholders.

These Entrenched Rights and Reserved Matters may materially and adversely affect the exercise and proceeds of any enforcement of the Security which may, in turn, reduce any recovery amounts in respect of the Bonds.

Subject to such Entrenched Rights and Reserved Matters, the Majority Creditors or, where appropriate, Super-Majority Creditors may make a modification to, or grant any consent or waiver in respect of, the Finance Documents without the need to seek a confirmation from the Rating Agencies as to the then current ratings of the Bonds.

Limited Liquidity of the Bonds; Absence of Secondary 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 issued after the date of the Prospectus, that it will provide any holder of 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 SWS, developments and trends in the water industry generally and events in the appointed area of SWS.

Indexed Bonds and Dual Currency Bonds

The Issuer may issue Bonds with principal or interest determined by reference to an index or formula, to changes in the prices of securities or commodities, to movements in currency exchange rates or other factors (each, a “**Relevant Factor**”). In addition, the Issuer may issue Bonds with principal or interest payable in one or more currencies which may be different from the currency in which the Bonds are denominated. Potential investors should be aware that:

- (i) the market price of such Bonds may be volatile;
- (ii) they may receive no interest;
- (iii) payment of principal or interest may occur at a different time than expected;

- (iv) the amount of principal payable at redemption may be less than the nominal amount of such Bonds or even zero;
- (v) a Relevant Factor may be subject to significant fluctuations that may not correlate with changes in interest rates, currencies or other indices;
- (vi) if a Relevant Factor is applied to Bonds in conjunction with a multiplier greater than one or contains some other leverage factor, the effect of changes in the Relevant Factor on principal or interest payable likely will be magnified; and
- (vii) the timing of changes in a Relevant Factor may affect the actual yield to investors, even if the average level is consistent with their expectations. In general, the earlier the change in the Relevant Factor, the greater the effect on yield.

Prospective Bondholders should be aware that any one or more of these factors may have an adverse impact on the timing and/or amounts paid under the Bond.

Rating of the Bonds

The ratings assigned by the Rating Agencies to the Class A Unwrapped Bonds and the Class B Unwrapped Bonds reflect only the views of the Rating Agencies and in assigning the ratings the Rating Agencies take into consideration the credit quality of SWS and structural features and other aspects of the transaction.

A rating is not a recommendation to buy, sell or hold securities and will depend, among other things, on certain underlying characteristics of the business and financial condition of SWS.

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 SWS and/or circumstances relating to the water industry generally, could have an adverse impact on the ratings of the Bonds.

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 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; or
- (ii) arranging for the substitution of another company in an alternative jurisdiction (subject to certain conditions).

(See Chapter 8 "*The Bonds – Terms and Conditions of the Bonds*" and Condition 8(c) (*Redemption for Index Event, Taxation or Other Reasons*)).

EU Savings Directive

EU Council Directive 2003/48/EC regarding the taxation of savings income (the "**EU Savings Directive**") requires Member States to provide to the tax authorities of another Member State details of payments of interest and other similar income paid by a person established within its jurisdiction to (or for the benefit of) an individual or to certain other persons in that other Member State, except that, Austria and Luxembourg will instead impose a withholding system for a transitional period unless during such period they elect otherwise. A number of third countries including Switzerland and certain dependent or associated territories of certain Member States have adopted similar measures to the EU Savings Directive.

The European Commission has proposed certain amendments to the EU Savings Directive, which may, if implemented, amend or broaden the scope of the requirements described above.

Prospective Bondholders who are in any doubt as to their position should consult their professional advisers.

Change of Law

The structure of the transaction and, among other things, 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 date of this Prospectus which change might impact on the Bonds and the expected payments of interest and repayment of principal.

Changes in Financial Reporting Standards

Certain provisions of the Transaction Documents contain certain conditions and/or triggers which are based upon an assessment of the financial condition of the SWS Financing Group calculated by reference to the financial statements produced in respect of the companies in the SWS Financing Group. These financial and other covenants have been set at levels which are based on the current accounting principles, standards, conventions and practices adopted by the relevant companies.

It is possible that any future changes in these accounting principles, standards, conventions and practices which are adopted by the companies in the SWS Financing Group may result in significant changes in the reporting of its financial performance (e.g. the introduction of International Financial Reporting). This, in turn, may necessitate that the terms of the conditions and triggers referred to above are renegotiated.

Legal, Regulatory and Competition Considerations

Regulated Business

The water industry is subject to extensive legal and regulatory controls with which SWS must comply. The application of the laws, regulations and standards and the policies published by Ofwat, Defra, DWI, Environment Agency, Natural England and other regulators, could have a material adverse effect on the business, financial condition or operational performance of SWS.

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

Licence

As further described in Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*”, SWS operates in accordance with its Licence. Under the WIA, the conditions of the Licence may be modified by Ofwat with SWS’s consent or without SWS’s consent where following a reference to the Competition Commission, the Competition Commission concludes that there are effects adverse to the public interest which can be remedied or prevented by modifications. Modifications could also result from a decision on a merger or market investigation reference by the Competition Commission. In addition, the Secretary of State has a power to veto certain proposed modifications agreed by Ofwat and SWS. Other proposed modifications agreed by Ofwat and SWS may be vetoed if it appears to the Secretary of State that the modifications should only be made, if at all, after a reference to the Competition Commission.

Finally, primary legislation can create powers for the making of modifications by Ofwat without the consent of Regulated Companies. When the Flood and Water Management Act 2010 (the “**FWM Act**”) was at the bill stage there was a proposal to include a collective modification regime whereby Ofwat could make changes to all standard conditions of appointment of Regulated Companies where a certain proportion of the companies (to be specified in an order) agree to the change. These provisions were not included in the FWM Act which received Royal Assent on 8 April 2010, but may be included in future legislation. In the Draft Water Bill (published in July 2012) clause 23 would allow Ofwat to modify the conditions of Regulated Companies and licensees where that was considered necessary or expedient as a consequence of amendments made by the Draft Water Bill (see Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales – Competition in the Water Industry – General*” below).

Any modification to the conditions of the Licence could have a material adverse impact on the business, financial condition or operational performance of SWS.

Proposed Changes to Future Price Controls and Ofwat's Section 13 Notice

In December 2011, Ofwat published a notice of proposed modifications to Condition B under section 13 of the WIA. All water companies objected to these proposals. Following a period of consultation, Ofwat published a further section 13 notice containing revised proposals on 26 October 2012 (the “**Further Section 13 Notice**”). Out of 24 written responses, Ofwat received eight acceptances and 16 rejections. SWS responded to The Further Section 13 Notice on 23 November 2012 stating that it did not accept the proposed amendment to its conditions of appointment. On 21 December 2012, Ofwat published a third section 13 notice (the “**December 2012 Notice**”) containing newly revised proposals. (As described in more detail in Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales – Modification of a Licence*”, the proposals set out include moves to separate price controls for retail and wholesale, rather than using a single price control).

In the December 2012 Notice, Ofwat states that, even if its proposed changes are accepted, it will need to adapt its regulation further “to meet future challenges” and that additional modifications to the licence provisions governing price controls will be required perhaps early in the next Periodic Review Period. If the proposals in the December 2012 Notice are implemented, Regulated Companies will be required to “use all reasonable endeavours” to cooperate with Ofwat in developing appropriately targeted price controls.

The deadline for responses to the December 2012 Notice elapsed on 23 January 2013. SWS, along with the other 19 Regulated Companies which responded accepted Ofwat’s proposals, although many companies requested clarification regarding the proposed “all reasonable endeavours” obligation. Ofwat has stated that it will now amend Regulated Companies’ licences in line with its proposals in the December 2012 Notice (see Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales – Modification of a Licence*”). It has not yet provided clarification regarding the “all reasonable endeavours” obligation.

The impacts of the proposed modifications to SWS’s licence are uncertain as Ofwat has not yet defined its regulatory policies and methodology.

When these proposed modifications are implemented in accordance with the December 2012 Notice, or if they are later modified in accordance with any further section 13 notice, such changes could have a material impact on SWS’s business and cash flows and, ultimately, on the ability of the Issuer to meet its obligations under the Bonds.

Breach of Licence

A failure by SWS to comply with the conditions of the Licence or certain statutory duties, as modified from time to time, may lead to the making of an enforcement order by Ofwat or the Secretary of State, or the imposition of financial penalties of up to 10 per cent. of SWS’s turnover, which could have an adverse impact on SWS’s financial position. Failure by it to comply with any enforcement order (as well as certain other defaults) may lead to the making of a Special Administration Order (see Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales - Special Administration Orders*”, which could also have an adverse impact on SWS.

Penalties imposed by Ofwat or the Secretary of State must be reasonable in all the circumstances. In 2007, Ofwat imposed a penalty of £8.5 million on United Utilities for non-compliant trading arrangements with associate companies in breaches of Condition F of its licence. In February 2008, Ofwat penalised SWS a total of £20.3 million for breaching Condition J and/or M of the Licence in respect of regulatory reporting. In April 2008, Ofwat imposed a penalty on Severn Trent Water of 3 per cent. of its turnover (£35.8 million) for breaching the same conditions of its licence. In that same month it also imposed a penalty on Thames Water Utilities Limited of 0.7 per cent. of its turnover (£9.7 million), again for breaching the same conditions of its licence. In October 2008 Ofwat imposed a penalty on Tendring Hundred of 0.3 per cent. of its turnover (£42,000) for breaching Condition M of its licence. There have been no further such penalties imposed by Ofwat since October 2008.

Termination of the Licence

Under the terms of the Licence, SWS' appointment may be terminated without its consent following the giving of notice by the Secretary of State of at least 25 years. The Licence may also be transferred from SWS at any time following the making of a Special Administration Order. As described in Chapter 6 "*Regulation of the Water and Wastewater Industry in England and Wales*" under "*Termination of a Licence*", there are certain circumstances under which SWS could cease to hold its Licence. The termination, non-renewal or transfer of the Licence could have a material adverse impact on SWS and, consequently, on the Issuer's ability to meet its obligations (including the payment of principal and interest) under the Bonds.

Thus far there is no precedent to indicate how compulsory licence terminations or Special Administration Orders would work in practice for Regulated Companies, nor is there any precedent for such Regulated Companies to indicate the extent to which creditors' interests would be protected (see paragraphs on "*Security*" and "*Special Administration*" below).

Competition in the Water Industry

It is not possible to assess if the recent changes and new methods under current consultation will affect the interests of Bondholders. Either the extension of competition within the water industry or the bringing of proceedings against SWS in respect of its competitive position in the area in which it operates could have a material adverse impact on SWS. The following paragraphs provide an outline of competition in the Water Industry:

Inset appointments: Inset appointments allow one Regulated Company to replace another as the provider of water or wastewater services in a specified geographical area within the other Regulated Company's appointed territory. Inset appointments give rise to a potential material adverse impact through a reduction in revenue from any customers within an inset area that would otherwise be supplied by SWS. At the date of this Prospectus, four inset appointments have been granted within SWS's region and further inset appointments may be made in the future.

WSL regime: The Water Act 2003 contained certain changes to the regulatory system applicable to the water industry. Ofwat and the Secretary of State are required to protect customers' interests by promoting effective competition in relation to water and wastewater services whenever appropriate as a primary rather than a secondary duty.

The Water Act amended the WIA and introduced the WSL regime, as further described in Chapter 6 "*Regulation of the Water and Wastewater Industry in England and Wales*". There are currently seven holders of water supply licences. As at the date of this Prospectus, SWS has received one application (in 2007) from a water supply licensee to supply to premises within the Region, but this application was not pursued.

The Water Supply (Amendment to the Threshold Requirement) Regulation 2011 (the "**Regulation**") (which came into force on 15 December 2011) reduced the non-household consumer threshold in relation to the water supply licensing regime from 50 megalitres per annum to 5 megalitres per annum. This change in threshold represents an increase in the size of the number of SWS's non-household customers who are now able to choose their water supplier from approximately 71 to 1117. The Government's Water White Paper, issued in December 2011 and the Draft Water Bill, published on 10 July 2012 (and described further in Chapter 6 "*Regulation of the Water and Wastewater Industry in England and Wales*" under "*Regulatory Developments*") contained proposals to reduce the threshold level further to 0 megalitres for non-household consumers.

The ability of customers already enabled under the Regulation to obtain their water supply from a different supplier could adversely affect SWS's turnover, which could adversely affect SWS's business, operational performance, profitability or financial condition.

Competition Act: Ofwat has also stated that it will use its powers under the Competition Act, which provides Ofwat and the Office of Fair Trading ("**OFT**") with power to investigate and prohibit anti-competitive agreements and conduct relating to the water and wastewater sector (see Chapter 6 "*Regulation of the Water and Wastewater Industry in England and Wales - Competition in the Water Industry*"). These powers include

the power to impose penalties of up to 10 per cent of SWS worldwide group-wide turnover for the business year preceding the finding of the infringement. Any agreement which infringes the Competition Act may be void and unenforceable. Breaches of the Competition Act may also give rise to claims for damages from third parties.

In addition to the measures which are currently in force, the Draft Water Bill proposes to enact the methods proposed in the Water White Paper to increase competition. Thus, in addition to the extension of the WSL regime (*see above*), the Draft Water Bill proposes to introduce self-supply licences enabling “suitably qualified” large customers to purchase water in the wholesale market. The Draft Water Bill also proposes to facilitate the entry of new market participants by reforming existing pricing rules for new entrants, by harmonising regulation to create unified codes for operating standards and aligning these to create a market with Scotland and by introducing licences for the provision of network services (such as water treatment and sewerage).

On 1 February 2013, the House of Commons Environment, Food and Rural Affairs Committee published a report on the Draft Water Bill. It made certain key recommendations regarding the Draft Water Bill’s proposals for competitive reform including functional separation of retail activities from wholesale activities and allowing incumbent water companies to exit retail markets (see Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales – Competition in the Water Industry*” for details of these recommendations). Defra is now considering the Committee’s proposals.

More detail in relation to competition in the water industry is included at Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales - Competition in the Water Industry*”.

SWS Revenue and Cost Considerations

The net operating revenues generated by SWS from its water and wastewater business may not be sufficient to enable it to make full and timely payment of amounts due to creditors, including under the Issuer/SWS Loan Agreements. This could have a material adverse impact on the Issuer’s ability to meet its obligations (including the payment of principal and interest) under the Bonds. In addition to the regulatory and competition risks described above which could adversely affect the revenues and costs of SWS, other potential events which could result in SWS having insufficient net operating revenues to meet its financing obligations include:

Periodic Review

The turnover, profitability and cashflow of the Appointed Business is substantially influenced by the service levels, regulatory targets and price limits established every five years by Ofwat in its Periodic Review, and Ofwat’s assessment of delivery against those factors. A more detailed description of the process under which Ofwat determines price limits for SWS is described in Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*” under “*Economic Regulation*”.

Although Ofwat has a duty to exercise and perform its duties in the manner it considers best calculated to, amongst other primary duties, ensure that SWS is able (in particular, by securing reasonable returns on its capital) to finance the proper carrying out of its functions, an adverse price determination, which would adversely affect turnover, profitability and cashflow, may occur as a result of a number of factors. These include an inadequate allowed cost of capital or regulatory assumptions concerning operating expenses and required capital expenditure as well as turnover forecasts proving not to be sufficiently accurate. In addition, unforeseen financial obligations or costs may arise (for example, as a result of ensuring regulatory compliance or changes to legislation or regulatory requirements, some instances of which are provided below) after a Periodic Review which were not taken into account by Ofwat in setting price limits and are consequently not compensated for, which could adversely affect financial performance.

Interim Determinations

As described in Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*” under “*Interim Determinations of K*”, an interim determination of price limits (an “**IDOK**”) may be made between Periodic Reviews in specified circumstances, including, in the cases of SWS and most other Regulated

Companies, the circumstances contemplated by the substantial effects clause in the Licence. In contrast to Periodic Reviews, the methodology to be applied for any IDOK is set out in detail in the Licence and the scope for discretion is narrower.

There is, however, no assurance that any IDOK sought by SWS will be made or, if an IDOK or determination pursuant to the provisions of the substantial effects clause is made, that any adjustment made pursuant to such an IDOK, or determination pursuant to the substantial effects clause, as the case may be, will provide adequate revenue compensation to SWS. Therefore SWS would have to bear any additional loss from its own resources.

The following are examples of factors which may give rise to unforeseen financial obligations or costs which may not be compensated for under any Periodic Review or IDOK:

Revenue Deviations from Ofwat's Projections

Under Licence Condition B, which relates to the level of SWS' charges for the supply of water, the RPI + K price cap limits the annual "weighted average increase" in the standard charges of SWS. This, in turn, is calculated by reference to the "tariff basket formula" (see Chapter 6 "*Regulation of the Water and Wastewater Industry in England and Wales*" under "*Price Control*").

Historically, SWS has not been protected, in respect of each Periodic Review Period, against decreased revenue arising from any revenue deviations during that Periodic Review Period from Ofwat's projections for such Periodic Review Period. This includes deviations resulting from demographic changes affecting SWS' customer base, the loss of a major customer, unexpected reductions in customers or reduction in volumes consumed or discharged by customers, and loss of business through inset appointments.

At Periodic Reviews, Ofwat has factored into its projections assumptions about numbers of customers and volumes consumed or discharged. Before the 2009 Periodic Review, SWS has borne the risk that actual numbers of customers and volumes consumed or discharged will fall short of the assumptions reflected in the RPI+K price cap but will equally get the benefit of any out-performance.

In the 2009 Periodic Review, Ofwat introduced a revenue correction mechanism concept covering the AMP5 Period (the "**Revenue Correction Mechanism**"). Ofwat indicated that, under the mechanism, the revenue requirements for the next Periodic Review Period will be reduced or increased by the amount of any under-recovery or over-recovery of revenues from charges in the tariff basket between 2010/11 and 2014/15. It will also include an adjustment so that companies have an incentive to maintain accurate billing records. This incentive would operate principally by increasing or decreasing the revenue correction by an "efficient billing factor" (being the cost that an efficient company incurs in finding and billing an additional property) for every property actually found and billed by the company above or below the number that Ofwat expects.

Since actual out-turn revenues are used as the basis for the setting of price limits for the subsequent five-year period, any deviation from revenue projections in the previous five-year period may be reflected in such price limits. However, there is no certainty that the Revenue Correction Mechanism will result in SWS being fully compensated.

In certain circumstances, SWS may apply for an IDOK as described in Chapter 6 "*Regulation of the Water and Wastewater Industry in England and Wales*" under "*Economic Regulation - Interim Determinations of K*".

SWS recognised a shortfall in revenue of £24.5 million in 2010/11, and approximately £27 million in 2011/12, and believes it will remain at or above these levels for the whole of the five year period. It is expected this shortfall can be recovered under the "Revenue Correction Mechanism". SWS held discussions with Ofwat during 2011/12 regarding smoothing the effect a recovery may have on customers' bills for 2015/16, by recovering part of the revenue in the current five year period and part in the next five year period, which would require an Interim Determination of K (IDOK). SWS concluded that given the prevailing economic climate and level of prevailing inflation (plus K factors), it would not be appropriate for customers to face higher bill increases.

New regulatory mechanisms introduced for PR09

At the 2009 Periodic Review, a number of new regulatory mechanisms were introduced including the Revenue Correction Mechanism (RCM) (detailed above), the Service Incentive Mechanism (SIM) and the Capital Expenditure Incentive Scheme (CIS). Under each of these mechanisms, performance in the current AMP Period leads to adjustments in the following AMP Period.

The SIM is a measure of customer service performance. It comprises a quantitative element based on telephone call handling, unwanted contacts and complaints and a qualitative element based on an independent customer satisfaction survey. The two elements are combined into a single score. Companies are ranked on the basis of their combined SIM score and a reward of up to 0.5% of K or a penalty of up to 1% of K is available depending on companies' ranking.

The CIS mechanism is designed to incentivise efficient business planning and capital investment delivery. At the 2009 Periodic Review each company's forecast capital expenditure was compared with Ofwat's estimate (the baseline) and a revenue reward or penalty given depending on whether the company's business plan was above or below the baseline. At the next Periodic Review, companies' actual performance will be compared with the level allowed in price limits (after adjustment for movements in the Construction Output Price Index). Under or over-performance against the Final Determination assumptions is reflected in a further revenue penalty or reward.

Each of these mechanisms was introduced for the first time at the 2009 Periodic Review and the rewards and penalties available under them will not be evident until the 2014 Periodic Review.

Failure by SWS to meet Ofwat level regulatory outputs or its capital investment programme

The Appointed Business requires significant capital expenditure for additions to, or replacement of, plant and equipment for its water supply and sewerage facilities and networks. The price limits set by Ofwat every five years take into account the level of capital expenditure expected to be incurred during the relevant Periodic Review Period and the associated funding costs and operating costs.

If SWS is unable to deliver its capital investment programme at expected expenditure levels, is unable to secure the expected level of efficiency savings on its capital investment programme, or the programme falls behind schedule or contains incorrect assumptions by SWS as to the capital investment required, SWS's profitability might suffer because of a need for increased capital expenditure. Ofwat may also factor such failure into future Periodic Reviews by seeking to recover amounts equivalent to the "allowed costs" of any parts of the programme that are not delivered. SWS's ability to meet regulatory output targets and environmental performance standards could also be adversely affected by such failure, which may result in penalties imposed by Ofwat of an amount up to 10 per cent. of turnover or other sanctions and the need for further increases in capital expenditure and operating expenditure by SWS.

Ofwat asset serviceability

The latest reported performance of SWS's assets, for 2011-12, shows "stable" performance for both water and sewerage underground and above ground water service assets. There is a risk of specific factors leading to a lower performance assessment for individual services and years, with a risk of a "Marginal" serviceability assessment for sewerage above ground for 2012/13. Failure to deliver "stable" serviceability in the future could lead to an adverse adjustment in future price determinations, which could have a material adverse impact on the business, financial condition or operational performance of SWS. Failure may result in penalties of up to 50% of the relevant capital maintenance budget, or other sanctions, and further increases in capital expenditure and operating expenditure.

Failure to deliver operational performance or cost savings implicit in the Periodic Reviews

Operating cost savings to be achieved during the AMP5 Period are implicit in the Periodic Review. To assist the achievement of these operating cost savings, efficiency programmes are underway. If operational performance were to deteriorate, this deterioration may be reflected by less favourable outcomes in future Periodic Reviews which could cause SWS's profitability to suffer.

Non-recovery of customer debt

Non-recovery of customer debt is a risk to SWS and may cause SWS's profitability and operating cash flows to suffer. This risk is exacerbated by the WIA, which prohibits the disconnection for non-payment of a water supply for domestic use in any premises and the limiting of a supply with the intention of enforcing payment for domestic use in any premises; although allowance is made by Ofwat in the price limits at each Periodic Review for a proportion of debt deemed to be irrecoverable. To achieve a re-setting of its price limits through an IDOK outside a Periodic Review Period when changes in the regulatory assumptions as to the level of non-recoverable debt are material, SWS would need to demonstrate (a) the increase was due to a deterioration in the economy, and (b) it has put in place appropriate procedures and measures to mitigate the increase in debt levels. SWS may therefore suffer losses from its inability to recover its debts fully, which could have a material adverse impact on the business, financial condition or operational performance of SWS.

Sewer flooding

SWS's combined sewerage systems (as described more fully in Chapter 5 "*Description of the SWS Financing Group*") can, during prolonged heavy rainfall, reach their hydraulic capacity resulting in flooding. As it is not possible to forecast accurately the occurrence and effects of sewer flooding, forward planning and the making of full and reliable provision for the effects, or the alleviation of the risk, of sewer flooding is difficult. The financial costs of measures required to deal with sewer flooding, or measures designed to alleviate the risk of sewer flooding to properties which become at risk, may therefore not be taken into account fully in a Periodic Review, which could have a material adverse impact on the business, financial condition or operational performance of SWS.

Increases in the price of input and/or treatment costs

Energy prices and the cost of chemicals and other substances used by SWS in its treatment processes have increased in recent years. These increases have been included within the 2009 Final Determination and SWS continues to seek ways to mitigate the impact of known increases through efficiency savings built into its business plans. Planned savings include energy efficiency measures as well as increased use of power generated from SWS' own combined heat and power (CHP) plants that burn bio-methane as a product of wastewater sludge digestion processes. However, further increases in energy prices and/or the cost of other commodities could lead to greater operating costs which could adversely affect SWS' business, results of operations, profitability or financial condition. This could result in SWS having insufficient revenues to meet its financing obligations.

Water shortages

In the event of water shortages, additional costs may be incurred by SWS in order to provide emergency reinforcement to supplies in areas of shortage, which may adversely affect its business, results of operations, profitability or financial condition. In addition, restrictions on the use or supply of water (including temporary use bans and Drought Orders or Drought Permits) may adversely affect SWS's turnover and may, in very extreme circumstances requiring an Emergency Drought Order (which have never been experienced by SWS), lead to significant compensation becoming due to customers because of interruptions to supply, both of which could have a material adverse impact on the business, financial condition or operational performance of SWS.

SWS obtains a high proportion (approximately 64 per cent.) of the water which it supplies from underground sources rather than rivers and reservoirs, and inadequate winter rainfall over two or more years may prejudice the adequate recharging of such sources.

Potential water shortages may be exacerbated by reductions in the volume of water licensed to be abstracted imposed by the EA to mitigate environmental damage or to achieve sustainable levels of abstraction. Costs may be incurred by SWS in implementing replacement sources for which SWS may not be compensated and abstraction charges could be increased by the EA to cover compensation payments made to other abstractors whose licences are revoked or varied to alleviate environmental impact, each of which could have a material adverse impact on the business, financial condition or operational performance of SWS.

Service interruptions due to key site or installation disruption

Unexpected failure or disruption (including criminal acts or major health and safety incidents) at a key site or installation (including a reservoir or treatment works) could cause a significant interruption to the supply of services (in terms of duration or number of customers affected), materially affecting the way that SWS operates, prejudicing its reputation and resulting in additional costs including liability to customers or loss of revenue, each of which could have a material adverse impact on the business, financial condition or operational performance of SWS. This could result in SWS having insufficient revenues to meet its financing obligations.

Contamination of water supplies

Water supplies may be subject to contamination, including contamination from the presence of naturally occurring compounds and pollution from man-made substances or criminal acts. In the event that SWS's water supply is contaminated and it is unable to substitute water supply from an uncontaminated water source, or to treat adequately the contaminated water source in a cost-effective manner, there may be an adverse effect on its business, results of operation, profitability or financial condition because of the resulting prejudice to reputation and required capital and operational expenditures. SWS could also be fined for breaches of statutory requirements or regulations, or held liable for human exposure to hazardous substances in its water supplies or other environmental damage, which could have a material adverse impact on the business, financial condition or operational performance of SWS.

Such operational costs may be partly recoverable through the mechanisms referred to in Chapter 6 "*Regulation of the Water and Wastewater Industry in England and Wales*" or future Periodic Reviews but, in the event that such recovery is not possible, such costs could be significant and could have a material adverse impact on the business, financial condition or operational performance of SWS. SWS also maintains insurance policies in relation to legal liabilities likely to be associated with these risks. However, all the costs of any such liabilities may not be covered by insurance and insurance coverage may not continue to be available in the future. In addition, contamination of supplies could exacerbate water shortages, giving rise to the issues described above.

Disruption at key sites or installations

Some of SWS' sites or installations (including certain reservoirs, pumping stations and/or water or wastewater treatment works) account for a relatively large percentage of the operations of the Appointed Business. These sites and installations are therefore key to the ongoing proper operation of the Appointed Business and as a result SWS' business, results of operations, profitability or financial condition could be adversely affected in the event of an unexpected major disruption (including because of criminal acts or a major health and safety incident) at one or more of these sites or installations.

There is also a risk that extreme weather conditions could cause flooding, prolonged periods of drought and/or operational difficulties, which could adversely affect SWS's service performance and give rise to potential penalties, the need to pay compensation to customers or other regulatory action. In this regard, SWS maintains insurance cover consistent with the generally accepted practices of prudent water and sewage companies and this includes business interruption insurance.

Asset Resilience

Widespread flooding in Yorkshire and the Home Counties in 2008 demonstrated the potential vulnerability to flooding of some key SWS assets and operational sites, which could adversely affect SWS's business, results of operations, profitability or financial condition. In recognition of this, SWS has assessed the risk of severe fluvial flooding to its water and sewerage assets. The risk is greatest to those sites within the flood risk area identified from EA flood maps and as a general rule, the consequences are greatest for those sites serving the highest population. Full assessment of risk has been undertaken in accordance with guidance contained within the service risk framework for flood hazards commissioned by Ofwat (the "**Service Risk Framework**") that companies are advised to follow.

Using the Service Risk Framework, SWS has identified the total number of sites at risk and those sites that would have a significant impact should loss of output occur due to flooding. Mitigation measures are being

developed to ensure their protection against significant flood events, so that their outputs are not compromised. Several of these solutions are included in the Final Business Plan and SWS anticipates Ofwat funding for those schemes where the benefits (expressed as a monetary value) are greater than the solution costs.

Changes in the rate of inflation

SWS's turnover is linked to the underlying rate of inflation (measured by the Retail Price Index) and as such is subject to fluctuations in line with changes in the rate of inflation. In addition, changes in the rate of inflation are likely to impact on the operating costs and capital expenditure of SWS and on customers' ability to pay any increased charges.

SWS's reported RCV is adjusted by RPI each year when calculating Class A RAR and Senior RAR, and as such is subject to changes in the rate of inflation. In addition, the reported carrying value of index-linked debt and derivatives at the SWS Financing Group is also adjusted by RPI, at different points in time, during each year. In particular, deflation (negative inflation) could result in an increase in the Class A RAR and Senior RAR as a result of the reported carrying value of nominal debt remaining fixed in value.

COPI

Under the Final Determination for the AMP5 Period, the allowed annual capital expenditure was indexed using the Construction Output Prices Index ("COPI"). There is a risk that the actual costs of capital investment in the AMP5 Period will be higher than the ex-post COPI-adjusted allowed capital expenditure, resulting in a revenue penalty applied in the Periodic Review process for the next AMP Period. This may arise where contract conditions do not allow for index tracking (e.g. fixed cost contracts or linked to RPI) and could lead to material adverse consequences on SWS's financial performance and thus impact on the Issuer's ability to meet its obligations (including the payment of principal and interest) under the Bonds.

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 to or destruction of SWS's operational assets. Subject to a possible IDOK under the substantial effects clause, any costs resulting from suspension of operations of SWS could have a material adverse effect on the ability of SWS to meet its financing obligations.

Although the CTA requires SWS to maintain insurance (including business interruption insurance) to protect against certain of these risks, the proceeds from such insurance may not be adequate to cover reduced revenues, increased expenses or other losses or liabilities arising from the occurrence of any of the events described above. Moreover, there can be no assurance that such insurance coverage will be available for some or all of these risks in the future at commercially reasonable rates or at all (see further Chapter 5 "*Description of the SWS Financing Group — Insurance*").

Legal Considerations

Special Administration

The WIA contains provisions enabling the Secretary of State or Ofwat (with the permission of the Secretary of State) to secure the general continuity of water supply, and where applicable, sewerage services by petitioning the High Court for the appointment of a Special Administrator, in certain circumstances (for example, where SWS is in breach of its principal duties under its Licence or of the provisions of a final or confirmed provisional enforcement order (and in either case the breach is serious enough to make it inappropriate for SWS to continue to hold its Licence) or is unable, or is unlikely to be able, to pay its debts) (as set out in Chapter 6 "*Regulation of the Water and Wastewater Industry in England and Wales — Special Administration Orders*"). In addition, a petition by a creditor of SWS to the High Court for the winding up of SWS, could lead to the appointment of a Special Administrator where the Court is satisfied that it would be appropriate to make such a winding up order if the company were not a company holding an appointment under the WIA. The duties and functions of a Special Administrator differ in certain important respects to those of an administrator of a company which is not a Regulated Company.

During the period of the Special Administration Order, SWS has to be managed by the Special Administrator for the purposes of the order and in a manner which protects the interests of shareholders and creditors. As noted above, while the order is in force, no steps may be taken to enforce any security over the property of SWS except with the consent of the Special Administrator or the leave of the Court. A Special Administrator would be able to dispose of assets free of any floating charge existing in relation to them. On such a disposal, however, the proceeds would be treated as if subject to a floating charge which has the same priority as that afforded to the original security. A Special Administrator may not dispose of property which is the subject of a fixed charge without the agreement of the relevant creditor except under an order of the Court. On such a disposal, the Special Administrator must account for the proceeds to the chargee, although the disposal proceeds to which the chargee is entitled are 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 company which is not a Regulated Company.

Because of the statutory purposes of a Special Administration Order, it is not open to a Special Administrator to accept an offer to purchase the assets on a break-up basis in circumstances where the purchaser would be unable to properly carry out the relevant functions of a Regulated Company. The transfer is effected by a transfer scheme which the Special Administrator puts in place (the “**Transfer Scheme**”), subject to the approval of the Secretary of State or Ofwat on behalf of the existing Regulated Company. The Transfer Scheme which 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 instrument of appointment (with modifications as set out in the Transfer Scheme) to the new Regulated Company(ies).

The FWM Act, which received Royal Assent on 8 April 2010, (see Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales – General*” below) amends the special administration regime in the WIA to bring it in line with modern insolvency practice in unregulated industries. The FWM Act also streamlines the procedures for transferring a failing company to new owners. The previous regime only enabled the Special Administrator to transfer the appointment and assets of a failing water company onto one or more new owners. The changes enable the Special Administrator to pursue the goal of rescuing the Regulated Company as a going concern if this is reasonably practicable.

There can be no assurance that any Transfer Scheme in the context of a Special Administration regime could be achieved on terms that would enable creditors to recover amounts due to them in full.

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, the WIA restricts a Regulated Company’s ability to dispose of interests in (or create a charge or mortgage over) Protected Land (as explained in Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*” under “*Protected Land*”). Accordingly, a licence restricts a Regulated Company’s ability to create a charge or mortgage over Protected Land. In the case of SWS, the Issuer estimates that the vast majority of SWS’s assets by value are tangible property which is Protected Land and cannot therefore be effectively secured. This necessarily affects the ability of SWS to create a floating charge over the whole or substantially the whole of its business. Furthermore, in any event, there is no right of a floating charge holder under the WIA to block the appointment of a Special Administrator.

The Secretary of State and Ofwat have rights under the WIA to appoint a Special Administrator in certain circumstances in respect of SWS and its business. The appointment of a Special Administrator effectively places a moratorium upon any holder of security from enforcing that security (See the section “*Special Administration*” above).

There are also certain legal restrictions which arise under the WIA and SWS’s Licence affecting the enforcement of the security created under the Security Agreement. For example, such enforcement is prohibited unless the person enforcing the security has first given 14 days’ notice to Ofwat or the Secretary of

State, giving them time to petition for the appointment of a Special Administrator (see Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales — Security*”).

Accordingly, the security provided over the assets of SWS in favour of the Security Trustee in respect of the Issuer’s obligations under the Bonds affords significantly less protection to the Security Trustee (and, therefore, the Bondholders) than would be the case if SWS were not a Regulated Company subject to the provisions of the WIA and its Licence.

The considerations described above do not apply to the fixed and floating charges created under the Security Agreement by SWSGH, SWSH and the Issuer. The enforcement of the security granted under the Security Agreement over the shares in any company in the SWS Financing Group (other than the Issuer), including any holding company of SWS, would not be subject to the moratorium set out in the WIA nor would it be an event which would itself result in the making of the Special Administration Order. Notwithstanding this, given Ofwat’s general duties under the WIA to exercise its powers to ensure that the functions of a Regulated Company are properly carried out, the Issuer anticipates that any intended enforcement of the Security granted by SWSH or SWSGH over, and subsequently any planned disposal to a third party purchaser of, the shares in SWS would involve consultation with Ofwat. In addition, it is anticipated that any intended enforcement of the security created by SWSH or SWSGH under the Security Agreement, to the extent that such enforcement would amount to a relevant merger situation for the purposes of the Enterprise Act or a concentration with a Community dimension for the purposes of the European Merger Regulation, would require consultation with Ofwat and would be reviewable by the Office of Fair Trading (“**OFT**”) or the European Commission.

Notice of the creation of the Security by SWS has not been and will not be given to SWS’s customers or to SWS’s contractual counterparties in respect of its contracts (other than certain material contracts). Also, any security over any amounts due from customers that constitute statutory receivables may be limited by law. In addition, if SWS were to acquire any land that was not Protected Land the charge over that land granted by the Security Agreement would take effect in equity only. Accordingly, until any such assignment is perfected, registration effected with HM Land Registry in respect of registered land or certain other action is taken in respect of unregistered land, any such assignment or charge may be or become subject to prior equities arising (such as rights of set-off).

Changes to the risk weighted asset framework

Bondholders should consult their own advisers as to the consequences to and effect on them of the application of the EU Capital Requirements Directive (Directive numbers 2006/48/EC and 2006/49/EEU, as amended (“**CRD**”)), as implemented by their own regulator, to their holding of any Class of Bonds. The recent amendments to the CRD could lead to certain investors being subject to additional regulatory obligations. These regulatory obligations would vary depending on the type of investor and the jurisdiction in which they are regulated. Investors should be aware that such regulatory obligations may adversely affect their own holding of the Bonds (if they fall within one of the relevant categories of regulated investors) and may adversely affect the price for which they can sell the Bonds or their ability to sell the Bonds at all. The investor should make its own determination as to such treatment, conduct appropriate due diligence and/or seek professional advice and, where relevant, consult its regulator. The Issuer is not responsible for informing Bondholders of the effects of the changes to risk-weighting which will result for investors from the adoption of CRD by their own regulator.

Environmental

SWS’s water supply and sewerage operations are subject to a number of EU and UK laws and regulations relating to the protection of the environment and human health, enforced primarily by the DWI and the EA as described in Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*” under “*Drinking Water and Environmental Regulation*”. These laws establish, amongst other things, standards for drinking water, abstraction, and the discharge of wastewater and other polluting discharges into the environment, and procedures governing operational development.

It is possible that SWS and other Regulated Companies will incur significant costs in the future in order to comply with requirements imposed under existing or future environmental laws and regulations (including nature conservation legislation). Although the costs arising from such changes in legal requirements may, in certain cases, be eligible for the purposes of the IDOK provisions or fall to be considered as part of a Periodic Review, there can be no certainty as to how and whether future environmental laws and regulations will impact the business and financial condition of SWS and/or the interests of the Bondholders. It is possible that Ofwat may determine that the cost of fulfilling certain obligations is likely to be less than the cost actually incurred by SWS in fulfilling such obligations. In such circumstances, the funding allowed by Ofwat may not totally cover the actual costs and SWS would bear this additional element. In practice, the funding allowed by Ofwat is set for a package of obligations and some will cost more and some less.

SWS is under a duty to supply water that is wholesome at the time of supply. “Wholesomeness” is defined by reference to standards and other requirements set out in the Water Quality Regulations. Under the WIA, the DWI is required to take enforcement action against SWS for any breach of quality standards, or of monitoring, treatment, record keeping and/or information requirements of the Water Quality Regulations, unless the breach is trivial or unlikely to recur, or SWS has taken immediate remedial action, or has submitted a legally binding programme of work in the form of a Section 19 Undertaking to achieve compliance within an acceptable timescale. If there has been such a breach and SWS does not give a Section 19 Undertaking or fails to comply with its terms, the DWI may make a provisional or final Enforcement Order to secure compliance. In addition, SWS may be prosecuted and fined if it supplies water that is unfit for human consumption under section 70 of the WIA. Section 19 Undertakings, enforcement action and prosecutions could materially affect the way that SWS operates, prejudice its reputation and result in the imposition of substantial penalties or other costs and/or requirements to clean up or otherwise deal with the effects of contamination and/or operational requirements to upgrade plant and equipment, each of which could adversely affect SWS’ business, results of operations, profitability or financial position. Pollution or drinking water quality incidents may also give rise to breaches of any operational Environmental Permits held by SWS, which could result in penalties and/or termination.

Drinking water quality standards may be more rigorously enforced over time and may become more stringent and new drinking water requirements may be introduced (for instance, mandatory fluoridation – see Chapter 5 “*Description of the SWS Financing Group*” under “*Fluoride Dosing*”). Each of these factors could increase SWS’ operating and/or capital costs. These costs may be wholly or partly recoverable through the mechanisms referred to in Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*” or future Periodic Reviews, but, in the event that such recovery is not possible, such costs could adversely affect SWS’ business, results of operations, profitability or financial position.

As a large consumer of energy, SWS is likely to incur increased costs directly and indirectly by carbon trading schemes. Most electricity generators will be required to purchase all of their carbon allowances in phase III of the EU Emissions Trading Scheme (2013–2020) as there is to be no free allocation except in limited circumstances. This is likely to lead to an increase in electricity costs for SWS. Further impact on electricity prices in the short to mid-term can also be expected following implementation of the Electricity Market Reform (see further Chapter 6 “*Regulation of the Water and Waste Water Industry in England and Wales*” — “*Climate Change*”). In addition, SWS is a registered participant of the UK’s Carbon Reduction Commitment Energy Efficiency Scheme (“**CRC**”) (a scheme initiated by Defra), which requires large consumers of electricity to purchase allowances to cover their carbon dioxide emissions, commencing with allowances for the year ending 31 March 2012. The impact of the CRC on SWS includes the costs associated with improving energy efficiency, the net cost of purchasing allowances and the administrative costs of participating in the CRC.

The environmental legislation governing SWS’s business means that SWS is at risk of enforcement action, prosecution, substantial fines, requirements to deal with the effects of contamination and/or upgrade plant and equipment, in the event of incidents such as the escape of sewage or a breach of water quality standards. This could materially and adversely affect SWS’s reputation and/or financial position.

Funding Risks in relation to the Defined Benefits under SWPS

The two pension schemes which operate predominantly for SWS employees are the SWPS and a CSP (together, the “**Pension Schemes**”). The SWPS is a funded defined benefit arrangement and the CSP is a defined contribution scheme.

The funding level of the SWPS is a net FRS 17 deficit of £96.3 million before deferred tax as at 31 March 2012. This deficit has arisen mainly due to continued turbulence in the stock market, low interest rates and reduced actuarial mortality rates.

The primary liability for funding the SWPS rests with SWS. By virtue of legislation including the Pensions Act 2004, there will be risks for SWS Financing Group arising from the operation of SWPS. Many of these are generic risks associated with the operation of UK defined benefit pension schemes generally.

In summary, the main risk factors are:

- (a) The Pensions Act 2004 allows the UK pensions regulatory body (the “**Pensions Regulator**”) to impose a scheme funding target and employer contribution rate if those matters cannot be agreed between the scheme trustees and the employers and may result in more onerous funding requirements for employers.
- (b) The trustees of the SWPS have power to wind up the relevant scheme in certain circumstances (e.g. if they think it unlikely that sufficient funding will be available to provide all benefits in full). Winding up the schemes would result in a statutory obligation on the various participating employers to fund deficits in the schemes by reference to a “buy-out basis”. Additionally, regulations provide that a similar statutory debt may be triggered in certain circumstances if SWS went into liquidation.
- (c) The Pensions Act 2004 gives powers to the Pensions Regulator to require funding or funding guarantees for defined benefit pension schemes from any company that is connected or associated with the participating employers. This applies regardless of whether the companies sought to be made liable have any employees in the pension schemes concerned.
- (d) The trustees of the SWPS have control over the investment of the relevant scheme’s assets and could (having taken appropriate investment advice and consulted with the employers) alter the investment profile of the schemes. For example, they could exchange equity investments for bonds, which would typically increase the employer funding obligations in relation to the schemes because of the lower rate of return expected from lower risk bonds.

The foregoing risks are linked to the funding level of the schemes, which can be adversely affected by a number of factors including:

- (i) reducing bond yields (low yields mean a pension obligation is assessed as having a high value);
- (ii) increasing life expectancy (which will make pensions payable for longer and, therefore, more expensive to provide);
- (iii) investment returns below expectation;
- (iv) actual and expected price inflation (many benefits are linked to price inflation and, ignoring any compensating change in the value of assets and future expected investment returns, an increase in inflation will result in higher benefits being paid);
- (v) funding volatility as a result of the mismatch between the assets held and the assets by reference to which the scheme liabilities are calculated; and
- (vi) other events occurring which make past service benefits more expensive than anticipated in the actuarial assumptions by reference to which past pension contributions were assessed, including unanticipated changes to legislation or tax laws.

Employer obligations to their pension schemes (including any statutory debt) generally rank as unsecured and non-preferential obligations of the employer, with some limited exceptions.

In the 2009 Final Determination, some allowance was made for anticipated future pensions contributions and a proportion of existing pension scheme deficits are recoverable through the price limits established by Ofwat, although Ofwat may seek not to make such allowances in future Periodic Review Periods. Furthermore, a schedule of deficit annual contributions were agreed with the trustees (please see further Chapter 4 “*Financing Structure – Management and Employees of SWS – Pensions*”). If such deficits were not so recoverable in future, SWS’s business, results of operations, profitability or financial condition could be adversely affected.

Any requirement to contribute additional funds into the SWPS to cover any additional deficits could have a material adverse effect on SWS’s overall financial position.

CHAPTER 4 FINANCING STRUCTURE

History and Background

Greensands Holdings Limited is the ultimate parent company of the SWS Financing Group, and there are no minority shareholdings within this group of companies.

On 15 October 2007, SWC was acquired by Greensands Investments Limited.

Greensands Investments Limited is indirectly owned by a consortium of investors including:

- IIF Int'l SW UK Investment Limited (an independent infrastructure investments company advised by J.P. Morgan Investment Management Inc.), having a 29.3 per cent. equity stake in the Greensands Companies;
- A Future Fund investment company having a 23.4 per cent. equity stake in the Greensands Companies;
- UBS International Infrastructure Fund (managed by UBS Global Asset Management (UK) Limited) having a 15.6 per cent. equity stake in the Greensands Companies); and
- six Australasian superannuation funds that together form a governance bloc within Southern Water with a combined shareholding of 15.7 per cent. (but individual shareholdings of less than 5 per cent.).

The remainder of the shares in Greensands Holdings Limited is held by investors, none of which has an equity stake of greater than 5 per cent.

SWC, a wholly owned subsidiary within the Greensands Holdings Limited group of companies, holds 100 per cent. of the issued ordinary share capital of SWI. SWC also owns the Class A1 Preference Shares and Class B Preference Shares and is lender under the Senior Mezzanine Facility.

Immediately before the first issue of Bonds on the Initial Issue Date, SWI implemented a corporate reorganisation to facilitate the creation of the SWS Financing Group within the Group. This involved the Issuer transferring its shares in its then immediate subsidiary, SWSG, to SWI; SWI transferring its shares in the Issuer to SWS; and SWS assuming certain existing intra-group indebtedness that SWSG incurred to the Issuer in connection with the First Aqua Acquisition.

The SWS Financing Group consists of SWSGH, SWSH, SWS, the Issuer and the Pension Companies (SWPT acts as trustee of the SWS Pension Schemes in which SWS participates. SWEPT no longer serves a function). The sole purpose for the creation of the SWS Financing Group was to facilitate the refinancing and future financing of the operating and capital requirements of SWS through the issuance of Bonds, other instruments of financial indebtedness and credit facilities, from time to time, incurred by the Issuer and SWS. The Issuer may on-lend the proceeds of Financial Indebtedness incurred by it to SWS pursuant to the Issuer/SWS Loan Agreements.

The Initial Issue Date

On the Initial Issue Date, the Issuer issued the following Sub-Classes of Bonds:

- (i) £350,000,000 Series 1 Sub-Class A1 Wrapped 6.192 per cent. Bonds due March 2029;
- (ii) £150,000,000 Series 1 Sub-Class A2a Wrapped Index-Linked Bonds due March 2034;
- (iii) £35,000,000 Series 1 Sub-Class A2b Wrapped Limited Index Bonds due March 2034;
- (iv) U.S.\$483,000,000 Series 1 Sub-Class A3 Wrapped Floating Rate Bonds due March 2007;
- (v) £350,000,000 Series 1 Sub-Class A4 Unwrapped 6.640 per cent. Bonds due March 2026;

- (vi) £150,000,000 Series 1 Sub-Class A5 Unwrapped Index-Linked Bonds due March 2023;
 - (vii) £120,000,000 Series 1 Sub-Class A6 Unwrapped Step-Up Floating Rate Bonds due March 2013; and
 - (viii) £250,000,000 Series 1 Sub-Class B1 Unwrapped Step-Up Fixed/Floating Rate Bonds due March 2038
- (together, the “**Series 1 Bonds**”).

The Issuer applied the proceeds of the Series 1 Bonds, the Mezzanine Facilities and the Initial Term Facility to settle certain termination payments under existing hedging contracts terminated on or prior to the Initial Issue Date and to make advances to SWS under the Initial Issuer/SWS Loan Agreement to enable SWS to repay on the Initial Issue Date all existing intercompany indebtedness owed by it to the Issuer. The Issuer applied the repayment proceeds of the existing intercompany indebtedness owed to it by SWS among other things (i) to repay its then existing indebtedness to SWI, (ii) to pay all amounts outstanding under the term facility of the Bridge Facility Agreement and (iii) to meet certain transaction fees and expenses.

SWS applied the proceeds of its issue of SWS Preference Shares on the Initial Issue Date (together with any monies received under the Initial Issuer/SWS Loan Agreement and not required to be applied in repayment of existing indebtedness to the Issuer): (i) to discharge the obligations of SWS under the Bridge Facility Agreement, (ii) to fund the Capex Reserve Account and its O&M Reserve Account, (iii) to make an initial payment to the Debt Service Payment Account, (iv) to pay certain transaction fees and expenses, and (v) for general corporate purposes.

The advances made by the Issuer to SWS under the Initial Issuer/SWS Loan Agreement on the Initial Issue Date reflect the corresponding amount and terms of borrowing by the Issuer of each Sub-Class of Series 1 Bonds and each borrowing under the Mezzanine Facility Agreements and the Initial Term Facility on the Initial Issue Date and, to the extent that such borrowing was hedged under a Hedging Agreement, the terms of such Hedging Agreement.

The U.S.\$483,000,000 Series 1 Sub-Class A3 Wrapped Floating Rate Bonds due March 2007 and the £120,000,000 Series 1 Sub-Class A6 Unwrapped Step-Up Floating Rate Bonds due March 2013 were redeemed on 30 June 2005 (the “**Series 1 Redeemed Bonds**”).

The Second Issue Date

On the Second Issue Date, Artesian advanced the Second Artesian Term Facility to the Issuer.

The advance made by the Issuer to SWS under the Second Issuer/SWS Loan Agreement reflects the corresponding amount and terms of borrowing by the Issuer under the Second Artesian Term Facility, the repayment date being 30 September 2032.

The Third Issue Date

On the Third Issue Date, the Issuer issued the following Sub-Classes of Bonds:

- (i) £350,000,000 Series 2 Sub-Class A7 Wrapped 5.00 per cent. Bonds due March 2021; and
 - (ii) £150,000,000 Series 2 Sub-Class A8 Wrapped 5.00 per cent. Bonds due March 2041,
- (together, the “**Series 2 Bonds**”).

The advances made by the Issuer to SWS under the Third Issuer/SWS Loan Agreement reflect the corresponding amount and terms of borrowing by the Issuer of each Sub-Class of the Series 2 Bonds. SWS applied the advances made by the Issuer under the Third Issuer/SWS Loan Agreement to, among other things, prepay the advances made by the Issuer to SWS under the Initial Issuer/SWS Loan Agreement corresponding to the Series 1 Redeemed Bonds.

The Fourth Issue Date

On the Fourth Issue Date, the Issuer issued the £200,000,000 Series 3 Sub-Class A9 4.50 per cent. Wrapped Bonds due 2052 (the “**Series 3 Bonds**”).

The advances made by the Issuer to SWS under the Fourth Issuer/SWS Loan Agreement reflect the corresponding amount and terms of borrowing by the Issuer of the Series 3 Bonds. SWS applied the advances made by the Issuer under the Fourth Issuer/SWS Loan Agreement to general corporate purposes.

The Fifth Issue Date

On the Fifth Issue Date, the Issuer issued the £300,000,000 Series 4 Sub-Class A10 Wrapped 5.125 per cent. Bonds due September 2056 (the “**Series 4 Bonds**”).

The Advances made by the Issuer to SWS under the Fifth Issuer/SWS Loan Agreement reflect the corresponding amount and terms of borrowing by the Issuer of the Series 4 Bonds. SWS applied the advances made by the Issuer under the Fifth Issuer/SWS Loan Agreement to general corporate purposes.

The Sixth Issue Date

On the Sixth Issue Date, the Issuer issued the £300,000,000 Series 5 Sub-Class A11 Unwrapped 6.125 per cent. Bonds due March 2019 (the “**Series 5 Bonds**”).

The Advances made by the Issuer to SWS under the Sixth Issuer/SWS Loan Agreement reflect the corresponding amount and terms of borrowing by the Issuer of the Series 5 Bonds. SWS applied the advances made by the Issuer under the Sixth Issuer/SWS Loan Agreement to general corporate purposes.

FIGURE 1 – OWNERSHIP STRUCTURE

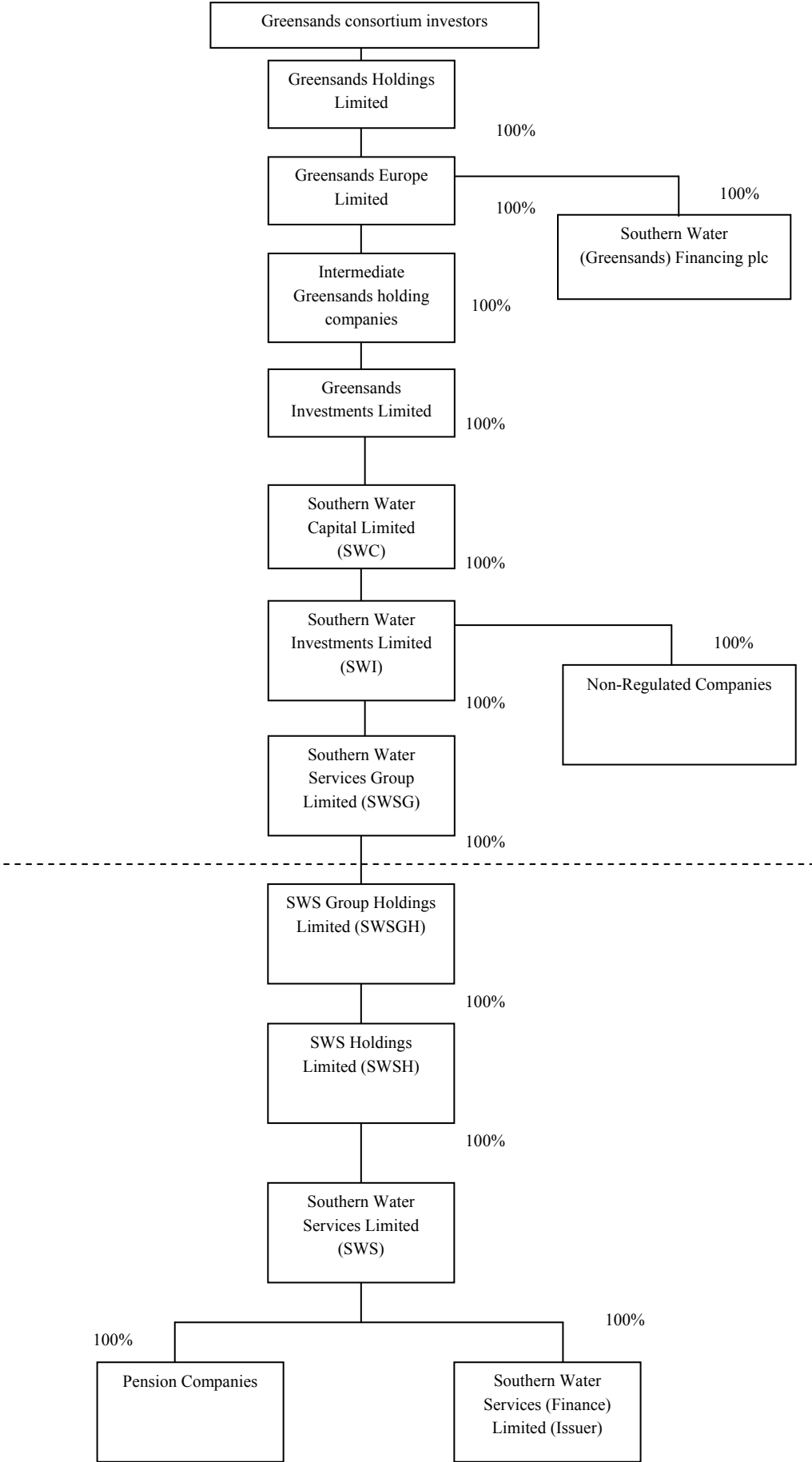
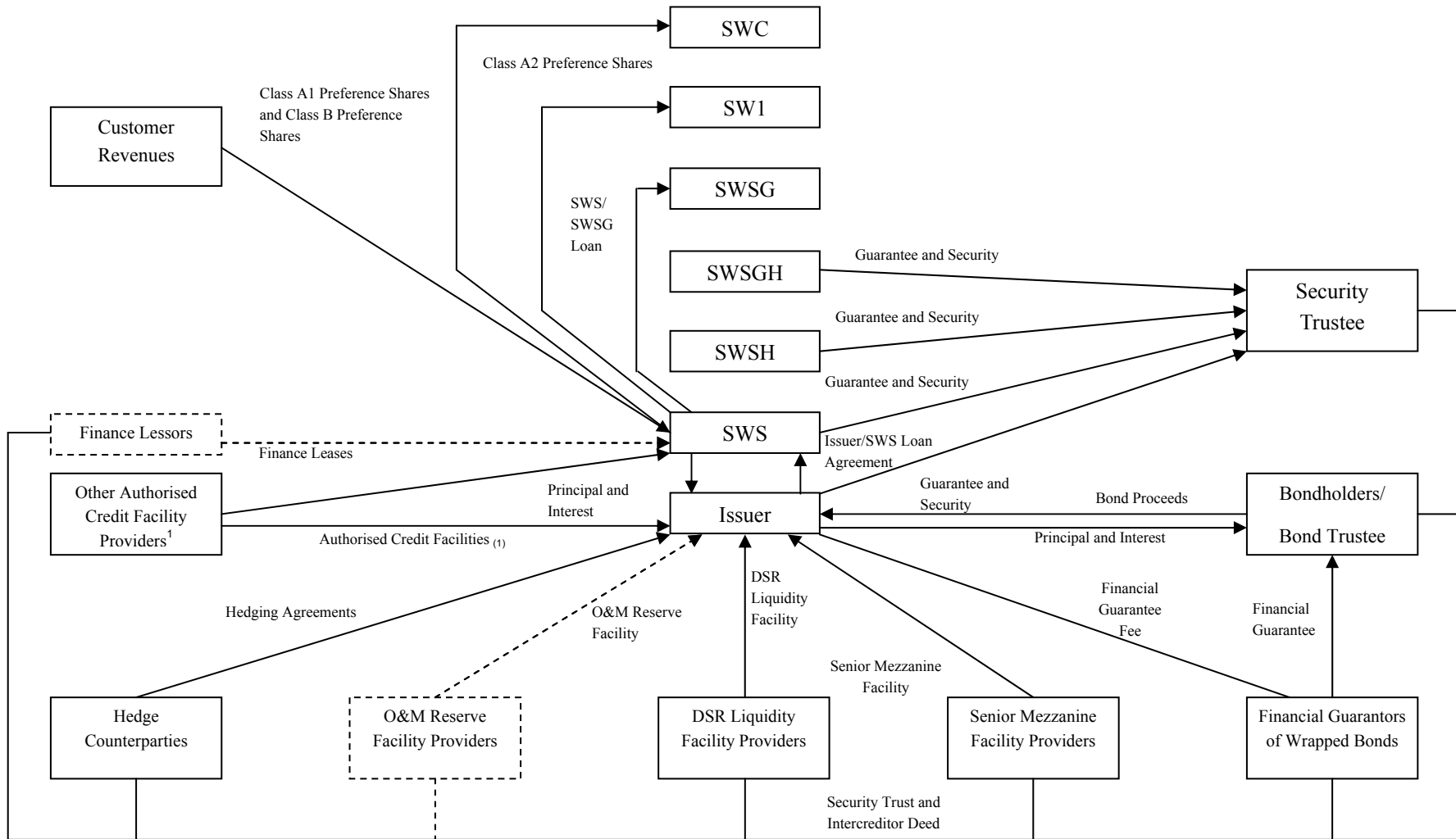


Figure 1 illustrates the simplified ownership structure of the SWS Financing Group and provides an overview of the ownership structure of the SWS Financing Group as follows:

- The Pension Companies and the Issuer are wholly owned subsidiaries of SWS.
- The entire issued ordinary share capital of SWS is held by SWSH, whose entire issued share capital is held by SWSGH.
- SWSGH is a wholly owned subsidiary of Southern Water Services Group Limited (“**SWSG**”), which is a wholly owned subsidiary of SWI.
- SWI is a wholly-owned subsidiary of SWC.
- The Greensands consortium investors, who together own the entire issued share capital of Greensands Holdings Limited, are described above.
- Each of SWSGH and SWSH is a special purpose vehicle incorporated to be the holding company of SWS and the Issuer and (in the case of SWSGH) SWSH, to enter into the Finance Documents and in particular to grant security over the shares of its respective subsidiary pursuant to the Security Agreement.

FIGURE 2 – PROGRAMME STRUCTURE



Note:

1 Including Existing RCF, NAB Facility, Initial Term Facility and Second Artesian Term Facility

Figure 2 provides an overview of the Programme, as follows:

- The Issuer may, under the Programme, issue Class A Unwrapped Bonds and Class B Unwrapped Bonds. On the Initial Issue Date, the Issuer issued the Series 1 Bonds, on the Third Issue Date the Issuer issued the Series 2 Bonds, on the Fourth Issue Date the Issuer issued the Series 3 Bonds, on the Fifth Issue Date the Issuer issued the Series 4 Bonds and on the Sixth Issue Date the Issuer issued the Series 5 Bonds.
- The Issuer and/or SWS may also borrow money from Authorised Credit Providers under Authorised Credit Facilities for funding the working capital and capital expenditure requirements of SWS, to service and repay the SWS Financing Group’s indebtedness and for the SWS Financing Group’s general corporate purposes. On the Initial Issue Date, the Issuer borrowed the Initial Term Facility. In July 2004, Artesian advanced the Second Artesian Term Facility to the Issuer. On 29 September 2011, the Issuer entered into the NAB Facility Agreement and on 24 June 2010, the Issuer entered into the Existing RCF Agreement, See Chapter 7 “*Summary of the Financing Agreements*” under “*Additional Resources Available*”.
- The Issuer may additionally borrow money from O&M Reserve Facility Providers under O&M Reserve Facility Agreements for funding the operating and maintenance expenditure of SWS.
- The Issuer, on the Initial Issue Date, borrowed the Senior Mezzanine Facility from the Initial Mezzanine Facility Providers. The Senior Mezzanine Facility has been partially repaid and the outstanding balance of the Senior Mezzanine Facility is £15,400,000 as at the date of this Prospectus. SWC is now the sole Senior Mezzanine Facility Provider.
- The Class A1 Preference Shares and the Class B Preference Shares are owned by SWC.
- Finance Lessors may provide financing of equipment to SWS.
- The terms under which the Issuer and/or SWS may incur financial indebtedness, including issuing Bonds under the Programme, are set out in the CTA.
- The Issuer is required to on-lend to SWS the proceeds of each Series of Bonds and each advance to the Issuer under each Authorised Credit Facility (other than any DSR Liquidity Facility – see below), pursuant to Issuer/SWS Loan Agreements. All indebtedness owing by SWS to the Issuer under each Issuer/SWS Loan Agreement will reflect the corresponding amount and terms of borrowing by the Issuer under the relevant Sub-Class of Bonds or the relevant Authorised Credit Facility or, where such borrowing is hedged under a Hedging Agreement, the notional amount and terms of such Hedging Agreement. Repayment by SWS of this indebtedness to the Issuer is capable of producing funds to service any payments due and payable on the Bonds and any relevant Authorised Credit Facilities.
- The Issuer is required to hedge its interest rate and currency exposure under the Bonds by entering into interest and currency swap agreements and other hedging arrangements with Hedge Counterparties in accordance with an agreed hedging policy. The economic effect of the hedging will be passed on to SWS through the relevant Issuer/SWS Loan Agreement.
- The Issuer’s obligations to repay principal and pay interest on the Bonds and the Senior Mezzanine Debt and under each Authorised Credit Facility to which it is party as borrower are intended to be met primarily from the payments of principal and interest received from SWS under the Issuer/SWS Loan Agreements. The Initial Issuer/SWS Loan Agreement, the Second Issuer/SWS Loan Agreement, the Third Issuer/SWS Loan Agreement, the Fourth Issuer/SWS Loan Agreement, the Fifth Issuer/SWS Loan Agreement and the Sixth Issuer/SWS Loan Agreement provide, and each other Issuer/SWS Loan Agreement will provide, for payments to become due from SWS 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 small profit margin.

- The Issuer may draw under any DSR Liquidity Facility provided to meet any shortfall in the amounts available to it to meet interest payments on the Class A Bonds and the Class B Bonds and certain other payments ranking in priority to or *pari passu* with the Class A Bonds and Class B Bonds of such Series (excluding any principal repayments on Class A Bonds and any principal repayments and Subordinated Coupon Amounts on Class B Bonds).
- The respective obligations of SWS and the Issuer to its Secured Creditors are guaranteed by each other in favour of the Security Trustee. SWSH and SWSGH in turn guarantee in favour of the Security Trustee the respective obligations of SWS and the Issuer and the obligations of each other.
- The obligations of each of SWS, the Issuer, SWSH and SWSGH are secured in favour of the Security Trustee under the terms of the Security Agreement.
- The guarantees and security granted by the Obligors are held by the Security Trustee for itself and on behalf of the Secured Creditors under the terms of the STID, which regulates the rights and claims of the Secured Creditors against the Obligors and the duties and discretions of the Security Trustee.

CHAPTER 5 DESCRIPTION OF THE SWS FINANCING GROUP

Introduction

SWS took over its functions as a successor to the former Southern Water Authority in respect of water supply and wastewater services on 1 September 1989 and its principal activity is the provision of water and wastewater services.

It operates under a licence which has a 25 year notice period (see Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*” under “*Termination of a licence*”). The main provisions of the Licence are described in Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*” under “*Licences*”.

A copy of the Licence and Amendments made on 14 August 2007, 5 August 2008 and 9 February 2011 can be viewed on Ofwat’s website (www.ofwat.gov.uk).

SWS is the seventh largest water and wastewater services company in England and Wales, based on turnover (source: Published Regulatory Accounts of Water Companies in England and Wales 2011/12).

For the year ended 31 March 2012, SWS had a profit before tax of £85 million on turnover of £716 million. As at 31 March 2012, the number of persons employed by SWS was 1,898. SWS’ RCV was £4,044 million as at 31 March 2012.

SWS was incorporated under the Companies Act 1985 and registered in England and Wales on 1 April 1989 with limited liability under number 02366670. The registered office of SWS is Southern House, Yeoman Road, Worthing, West Sussex BN13 3NX. SWS is a wholly-owned direct subsidiary of SWS Holdings Limited and its authorised share capital is £46,050,000 divided into 46,050,000 ordinary shares. 56,000 ordinary shares have been issued of which all have been fully paid up. The only subsidiaries of SWS are the Issuer and the Pension Companies.



The Area Served

SWS operates in an area of approximately 10,550 km² in the counties of Kent, East and West Sussex, Hampshire and the Isle of Wight, and small parts of Wiltshire, Berkshire and Surrey (the “**Region**”).

Regulation

SWS is principally regulated under the provisions of the WIA. The Secretary of State for Environment, Food and Rural Affairs (the “**Secretary of State**”) and the Water Services Regulation Authority (“**WSRA**”) are the principal regulators of SWS. (See Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*” for details on the regulation of Regulated Companies (as defined therein) including SWS).

SWS’ area of appointments can be varied in certain circumstances by way of, for example, a so-called “inset” appointment (see Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*” under “*Licences – Termination of a licence*”).

The inset appointments in SWS’ original area of appointment are:

- (i) in respect of Tidworth Army Camp (“**Tidworth**”), which is on the boundaries of both SWS’ and Wessex Water Services Limited’s areas of appointment. Operation of Tidworth’s water supply and wastewater services, previously undertaken by the Ministry of Defence, was put out to tender in 1996 and the tender was won by Thames Water Utilities Limited. A further inset appointment was then granted for the same site in June 2009 to Veolia Water Projects.
- (ii) Albion Water was appointed on 1 May 2009 to be the sewerage undertaker for a site at Knowle Village, near Fareham, Hampshire.
- (iii) SSE Water was appointed on 17 August 2010 to be the statutory sewerage undertaker for a new development at Graylingwell Park, Chichester .
- (iv) SSE Water was appointed on 16 December 2011 to be the statutory sewerage undertaker for a new development at Abbotswood, Romsey.

Water Supply

Water Supply – Approximate Base Statistics 2011/12

Description	Value
Population served.....	2.4m
Properties served.....	1.06m
Domestic premises.....	961,487
Business/non-domestic premises.....	55,079
Void account premises.....	48,358
Length of mains.....	13,715km
Number of water supply works.....	94
Number of main reservoirs	4
Number of dams and impounding reservoirs.....	4
Number of service reservoirs.....	237
Average daily supply (million litres).....	551
from groundwater	64%
from rivers	30%
from reservoirs	6%

Of the average supply of 551 million litres of water per day during the year 1 April 2011 to 31 March 2012, approximately 68 per cent. was supplied for domestic use and approximately 32 per cent. was supplied for non-domestic and industrial use.

In addition, SWS supplied approximately 21.9 million litres of water a day in aggregate (representing approximately 4 per cent. of the total water supplied by SWS) to South East Water, Wessex Water and Affinity Water (formerly Veolia Water South East which was Folkestone and Dover Water Services) under bulk supply agreements.

As of 31 March 2011, SWS supplied water to 71 large users (customers with annual water consumption in excess of 50 million litres per day) which, in the 12 month period to 31 March 2012, accounted for approximately 5.0 per cent. of the total volume of water supplied. With the recent lowering of the threshold volume for competition to 5 million litres per year, together with a further 1,117 customers using between 5 and 50 million litres per year, SWS could potentially be subject to competition in respect of these customers (see Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*”). The 1,117 customers newly eligible for competition accounted for approximately 5.0 per cent. of the total volume of water supplied in the 12 month period to 31 March 2012, meaning that our total exposure to competition stands at 1,188 customers accounting for approximately 10 per cent. of the total volume of water supplied.

As at 31 March 2012, approximately 453,028 households, or approximately 47 per cent. of total households supplied by SWS, had their water measured by meters, compared with 9.6 per cent. of households in 1992/93.

All water supplied is treated at water supply works before distribution. Water is treated at 94 water supply works and is distributed to approximately 1.1 million premises through a network of approximately 13,715 km of water mains. SWS treats water from 110 sources in the Region with approximately 64 per cent. of water supplied coming from groundwater sources (predominantly chalk), approximately 30 per cent. coming from rivers, and the remaining approximately 6 per cent. being abstracted from reservoirs. Water quality is monitored by SWS through a programme of regular sampling and analysis. Sampling of water supplies is carried out in accordance with the Water Supply (Water Quality) Regulations 2000 which sets out the number of samples to be taken depending on the volume of water produced or the population served.

SWS operates a quality assurance system approved to British Standards Institution (“BSI”) standard ISO 9002. SWS has approved procedures for the production of water up to the supply point from service reservoirs. These are used to monitor the daily activities which control water quality. These procedures are audited by the BSI on a six monthly basis.

At four of the six water supply works supplied by river sources, underground sources or storage facilities can be utilised to help provide continuity of supply if the river intake is closed due to a temporary pollution hazard

SWS owns, operates and maintains 4 impounding reservoirs which have a total storage capacity of approximately 42,390 million litres, the largest, Bewl Water Reservoir (Kent), having a gross storage capacity of 31,000 million litres.

SoSI

The Security of Supply Index (SoSI) is an Ofwat measure of companies’ water supply security. It describes whether a company is meeting its target headroom (surplus of supply over demand) under particular conditions. A company meeting its target headroom for all customers will have an index of 100. For SWS, the index is planned to be at 100 at 31 March 2015.

Leakage

Overall, about 15 per cent. of supply is lost through leakage with an estimated 12 per cent. coming from SWS’ network and the remainder from pipes and fittings owned by households and businesses. SWS met its leakage target for 2011-12. The 2011-12 leakage figure of 82 million litres a day was an improvement of 15

per cent. from the previous year, and was comfortably within the target of 93 Ml/d set by Ofwat. Southern Water remains the water and sewerage company with the lowest leakage on a per property basis.

In line with industry norms, most of SWS' mains are constructed of iron, asbestos cement and plastics, with iron being the most common material. In accordance with the 2009 Periodic Review, SWS plans that of its approximately 13,715 km of mains, 256 km (or 1.9 per cent.) will be renewed in the period 2010 to 2015 to help to maintain "stable" serviceability.

Since 1990/91, the amount of water put into supply by SWS has decreased by approximately 20 per cent. as a consequence of leakage control, metering and falling demand from domestic and commercial customers.

Any pollution or drinking water quality incident could result in criminal prosecution leading to the imposition of penalties on SWS, civil liability in damages to third parties and/or requirements to clean up or otherwise deal with the effects of contamination and/or operational requirements to upgrade plant and equipment.

During the current Periodic Review Period, SWS has agreed a £468 million investment programme for water supply with Ofwat (2007/08 prices). The principal investment targets are £122 million for the maintenance of water supply works, reservoirs and pumping stations, £156 million in maintaining the water distribution system, £27 million in drinking water quality improvements and £161 million on water resources and meeting the needs of new housing development and growth.

Water Resources

SWS has developed a water resources strategy (the "**SWS Water Resources Management Plan**") for the next 25 years, which was approved by Defra and published on 1 October 2009.

The key elements of the SWS Water Resources Management Plan are:

- (i) to meter the majority of domestic customers (486,000 new meters by 2015);
- (ii) to develop a new resource on the river Arun (completed in March 2011);
- (iii) to extend the treatment capacity at Testwood Water Supply Works up to 136 million litres per day;
- (iv) to install a strategic transfer main between the two key water supply works in Hampshire; and
- (v) leakage reduction over the next 5 year period.

This SWS Water Resources Management Plan sets out in detail how Southern Water proposes to ensure sufficient security of water supplies to meet the anticipated demands of its customers from 2010 to 2035. It includes details of levels of service, population and housing estimates, per capita consumption, water efficiency initiatives, leakage and metering. It also gives details of SWS' position with regard to the supply/demand balance and the proposed capital programme to ensure future demands are met, as well as providing key data relating to issues such as climate change and catchment abstraction management strategies for the future. These forecasts are set against the backdrop of environmental constraints and future challenges that exist in the south east of England.

SWS' water supply area borders those of eight other water companies. These are:

- Sembcorp Bournemouth Water
- Wessex Water
- Portsmouth Water
- Thames Water
- Sutton and East Surrey Water

- South East Water, which includes the area of the former Mid Kent Water
- Affinity Water (formerly Veolia Water Southeast, and before that, Folkestone and Dover Water Services)
- Cholderton and District Water.

There are a number of bulk supply agreements between these companies, which allow large volumes of water to be moved from one company's area to another's. The number of boundaries and the existing and potential future interconnections with so many water companies raises a number of opportunities for optimising the strategic use of resources across the region. However, it also adds significantly to the complexity of the planning process and the selection of a single "company-preferred" solution.

A central part of the water resources network in Kent and the eastern part of Sussex is the River Medway Scheme, incorporating the Bewl Water Reservoir, originating from a 1968 Private Act of Parliament and a subsequent agreement between SWS and South East Water. South East Water is entitled to 25 per cent. of the yield of water under this River Medway Scheme and pays a proportionate contribution to costs.

SWS also published its approved drought plan in 2013 (the "**Drought Plan**"), which detailed how it will continue, during a period of drought, to discharge its duties to supply adequate quantities of wholesome water, with as little recourse as reasonably possible to Drought Permits or Drought Orders (See Chapter 6 "*Regulation of the Water and Wastewater Industry in England and Wales - Management of Water Resources – Drought Planning*"). This followed public consultation in 2012 and approval of the Drought Plan in 2013 by Defra. The Drought Plan will help SWS provide adequate supplies of water during a drought with as minimal impact as possible on the environment and its customers. The Drought Plan (which does not form part of this Prospectus) can be viewed on SWS' website: <http://www.southernwater.co.uk/about-us/about-southern-water/our-publications/our-reports/drought-plan.asp> (which also does not form part of this Prospectus).

Fluoride Dosing

SWS does not currently add fluoride to water in any of the areas it supplies. It does however have a statutory duty to increase the fluoride content of the water it supplies (pursuant to section 87 of the WIA) if it is requested to do so by a relevant authority.

During late 2008, the NHS South Central Strategic Health Authority ("**SHA**") carried out a public consultation on proposals to add fluoride to water supplies within the Southampton Primary Care Trust area. In February 2009, the SHA board considered the findings of the public consultation and voted unanimously to proceed with the proposals. Shortly thereafter, SWS received the formal request from the SHA to add fluoride to supplies in Southampton. An initial study was carried out by SWS, to ascertain whether it was feasible to comply with the request. However, a challenge, through a judicial review, was made by opponents of the scheme on the grounds that the proposals did not meet with Government policy, as there was not a majority of affected customers in favour of a fluoridation scheme. A further challenge was sought on the grounds that the SHA board did not give sufficient consideration to the weight of arguments against the proposals. The request to fluoridate was not progressed pending the outcome of the judicial review. The judicial review process was concluded in February 2011 with the High Court finding that the SHA board decision was lawfully made.

The SHA renewed the request to fluoridate the supplies to those areas defined by the initial study. A detailed feasibility study has now been undertaken and formal discussions with SWS to agree arrangements for the installation and operation of fluoride dosing equipment. These practical arrangements are reflected within a 'model form' agreement which has been developed under the auspices of the Department of Health, and Water UK, with the intention that all new schemes will adopt identical terms (the "**Fluoridation Agreement**"). The Department of Health's view was that existing schemes with other undertakers were not well managed. The Fluoridation Agreement has not yet been finalised, but sets out the detailed obligations

upon SWS to construct, commission and operate dosing arrangements on behalf of the SHA, who in turn pay SWS for the costs associated with the scheme. From April 2013 the responsibilities of the SHA will vest in a new body called Public Health England. The Secretary of State for Health has provided a deed of indemnity to SWS, pursuant to section 90 the Water Industry Act 1991 (as amended), which indemnifies SWS for all claims in respect of death or personal injury, or loss of or damage to property, arising out of SWS's discharge of the fluoridation services it has agreed to provide to the SHA.

It is anticipated that full implementation of the Fluoridation Agreement will only take place once the full costings for capital expenditure to be undertaken by SWS have been approved by the SHA, or its successor body, Public Health England. The installation of dosing and monitoring equipment may take up to 18 months, following this approval.

Wastewater Services

Wastewater – Approximate Base Statistics 2011/12

Description	Value
Population served.....	4.42m
Properties served.....	1.90m
Domestic.....	1,730,738
Business/non-domestic premises.....	85,629
Void account premises.....	77,023
Length of sewers (excluding private sewers adopted in October 2011.....	21,959km
Estimated length of private sewers adopted in 2011.....	17,000km
Number of wastewater treatment works.....	370
Number of coastal outfalls/marine treatment works.....	1
Sewage sludge disposal:	
% vol. sludge discharged to agriculture.....	99.52
% vol. sludge discharged to landfill.....	0.48
Number of sewage pumping stations.....	2,334
Volume of wastewater treated daily.....	800Ml/d

SWS provides wastewater services to approximately 4.42 million people in Kent, Sussex, Hampshire and the Isle of Wight (the “**Wastewater Region**”). SWS collects and treats approximately 800 million litres of wastewater every day via approximately 21,959km of sewers. Approximately one half of the population in SWS' wastewater area resides in urban areas along an extensive coastline. Accordingly, the majority of SWS' sewage discharge is into estuarial or coastal waters. This includes an average volume of 19.74 million litres per day of trade effluent from approximately 1,000 industrial customers, who have permission to discharge trade effluent, subject to specific controls. These figures exclude storm flows and include any infiltration. A number of factors, including rainfall, may cause flows within SWS' wastewater network to vary from time to time.

As at 31 March 2012, SWS owned, operated and maintained 370 wastewater treatment works, 1 coastal outfall/ marine treatment works and approximately 21,959 kilometres of sewers receiving foul and surface water through a mixture of combined (foul and surface water), separate and partially separate drainage systems. In October 2011, SWS took responsibility for an estimated 17,000 kilometres of sewers and lateral drains that were previously privately owned. There are 2,334 wastewater pumping stations, which form an integral part of the wastewater system.

The wastewater system has been constructed principally of clay ware, concrete, brick and iron.

SWS has identified sewers as being either “critical” or “non-critical” based on the methodology developed by the Water Research Council. At 31 March 2012, there were some 6,721km of “critical” sewers (sewers located in places where their malfunction would cause material disruption) (constituting 30.6 per cent. of the total length of sewers) in the Wastewater Region. Over half of these “critical” sewers have been inspected by closed circuit television as part of an on-going programme to assess their structural condition. In accordance with the 2009 Periodic Review, SWS plans that 46 km (or 0.7 per cent. of the total) of “critical” sewers will be renewed or renovated during 2010-2015. At least 181 km (or 1.2 per cent. of the total) of “non-critical” sewers are planned to be replaced or renovated over the same period.

Investment in maintaining wastewater treatment works has gradually increased over the last ten years. The performance of this group of assets is determined by Ofwat using various measures and is currently reported as “Stable” for 2011-12. There is however a risk of specific factors leading to a lower performance assessment for individual services and years, with a risk of a ‘Marginal’ serviceability assessment for sewerage above ground for 2012/13.

SWS’ strategy for sludge treatment and recycling is based on environmental factors, planning constraints, the volume of sludge and unit costs. The majority of biosolids (treated sludge) is recycled for use as a fertiliser on agricultural land. The recycling of biosolids in such a manner is regulated and previous investment in sludge treatment ensures that the strict standards are met. This environmentally sustainable recycling route currently negates the regular need for other disposal methods. Alternatives, including incineration and pyrolysis, would be considered if, in the longer term, SWS were to experience increasing constraints on the use of the agricultural land bank for the recycling of biosolids.

In the 2012 bathing season the EA tested 82 designated bathing waters in the wastewater area for bacteria, physicochemical parameters, and the presence or absence of enteroviruses. In the 2012 bathing season, SWS were 100 per cent. compliant with the Mandatory Standard of the EU Bathing Water Directive.

Any pollution or drinking water quality incident could result in criminal prosecution leading to the imposition of penalties on SWS, civil liability in damages to third parties and/or requirements to clean up or otherwise deal with the effects of contamination and/or operational requirements to upgrade plant and equipment.

Ofwat are currently reviewing three cases of sewer flooding under section 94 of WIA. These cases relate to a number of properties flooded in previous years at Elmer Sands, Selsey and Riverside Mews locations. Failure to comply with the section 94 duty to “effectually drain the sewer network” may result in Ofwat directing the company to take specific action to comply with the obligation.

During the current Periodic Review Period, SWS has agreed a £1,284 million (2007/08 prices) investment programme with Ofwat. The principal investment targets for sewerage services include £288 million for the maintenance of wastewater treatment works and pumping stations, £150 million in maintaining the sewer system, £576 million towards environmental quality improvements defined by the EA, £95 million in IT, £83 million to meet demands from growth and new housing development and £36 million to reduce flooding from sewers and enhance service levels.

Environmental certification

SWS achieved ISO14001 certification for its environmental management system (“EMS”) in July 2008. The EMS applies to activities that interact with the environment and over which the company has control and can be expected to have an influence. The standard is applicable to any organisation that wishes to:

- implement, maintain and improve an EMS to manage environmental risk
- assure itself of its conformance with its own stated environmental policy
- demonstrate conformance with the international ISO14001 standard

- ensure compliance with environmental laws, regulations and relevant codes of practice
- seek certification of its environmental management system by an external third party organisation

In July 2011 SWS achieved ISO14001 re-certification for its EMS.

The SWS environmental management plan 2011-2012 is available to all employees who have responsibility for assisting in its delivery and in contributing to company environmental performance.

SWS achieved ISO 9001:2008 recertification in July 2010 for the operation of its quality management system for the collecting, checking and reporting of non-financial data for regulatory reporting purposes.

Rates and Billings

Water supply and wastewater services are charged separately and, therefore, charges are set (within the overall level set by Ofwat) so as to reflect the average costs of providing each service for each class of customers. Each year, SWS submits a pricing structure to Ofwat (within the overall limit set by Ofwat) for approval by Ofwat. The average SWS household bill for water supply and wastewater services for the 2012/13 year is £416, comprising £149 for water supply and £267 for wastewater services. During the year ended 31 March 2012, approximately 51 per cent. of turnover in respect of water and wastewater customers relates to supplies to unmetered customers, and approximately 49 per cent. to customers who pay by meter.

Charges for customers with unmetered water supplies are based on either the rateable value of their premises or an assessed charge, together with a standing charge, for both water supply and wastewater services. Charges are billed in advance on an annual basis with payment annually, half-yearly or (with the agreement of SWS) by instalments.

Charges for customers with metered water supplies are based on the measured volume of water supplied, together with a standing charge generally according to the size of the meter, for both water supply and wastewater services. Wastewater charges include a fixed or assessed allowance against volume to reflect water supplied that is not discharged to a sewer. Charges for small meters are billed half-yearly, and more frequently for larger meters.

No direct charge can be made to highway authorities for highway drainage connected to wastewater infrastructure, the cost of which is recovered through wastewater standing charges to customers as a whole. Wastewater standing charges also include charges for surface water drainage. Customers may claim a rebate for this element of the wastewater standing charge where rainwater falling on their property does not enter the sewerage system.

Domestic Customers

As at 31 March 2012, 53 per cent. of SWS domestic customers were unmetered. Although the domestic rating system was discontinued in 1990 (under the provisions of the UK Local Government Finance Act 1988), water companies were originally allowed to continue to use rateable values (as at 31 March 1990) for charging until 1 April 2000 under the WIA. Following a review of water and wastewater charges in England and Wales, the Government decided to allow companies to continue using the system after that date.

Domestic customers can have a free meter installed, where this is practicable and can be done at a reasonable cost to SWS, and can revert to an unmetered basis of charging within 12 months of such installation, unless their property is then within an area that will be metered under SWS' Universal Metering Programme ("UMP") in that financial year.

In 2007 the Government consulted on water metering in areas of serious water stress and new regulations came into force on 1 October 2007. Under Regulation 4(1) of the amended Water Industry (Prescribed Conditions) Regulations 1999 the Secretary of State may, after consulting the Environment Agency, determine the whole or any part of a water undertaker's area to be an area of serious water stress. On 28

November 2007 the Secretary of State notified SWS that the whole of its water supply area had been determined to be an area of serious water stress for the purposes of the Regulations.

By virtue of Regulation 2(d) of the amended Water Industry (Prescribed Conditions) Regulations 1999, SWS is not restricted in its power to fix charges for household premises by reference to volume and to install a meter for charging purposes, provided that those premises are subject to a programme for the fixing of charges by reference to volume, as specified in the water undertaker's final water resources management plan. The UMP is included in the SWS Water Resources Management Plan and 92 per cent. of its water supply customers are expected to have a meter installed by March 2015.

In addition, provisions of the WIA:

- prevent disconnection of domestic customers and other protected premises for non-payment;
- empower the Secretary of State to make provisions which protect vulnerable customers with high essential water use, who live in homes with meters, from higher than average bills; and
- prevent charges schemes from taking effect until approved by Ofwat and give Ofwat a duty to take into account guidance from the Secretary of State.

SWS provides three special tariffs to assist domestic customers with metered charges:

- **WaterSure Tariff:** This is an industry-wide social tariff under the WIA 99. To qualify for the tariff, the customer must be paying metered charges and be in receipt of defined state benefits. In addition, they must either have three or more children in their household, or suffer from a defined medical condition that requires them to use large amounts of water. The WaterSure tariff caps metered charges at the level of the average household bill for SWS' area;
- **Changeover Tariff:** Customers subject to SWS' UMP who are concerned that their bills will increase following their switch to metered charges can choose to pay its Changeover Tariff. This tariff introduces metered charges in steps over the first two years of metered charging; and
- **Support Tariff:** Customers subject to SWS' UMP who are unable to afford the increase in charges they experience as a direct result of their switch to metered charges can qualify for its Support Tariff. This tariff caps their metered charges at the level of the equivalent rateable value bill.

In calculating the wastewater charges of metered domestic customers, the volume of clean water supplied is used as the basis of the charge less a fixed allowance of 7.5 per cent. of such volume made in respect of water not discharged to a sewer (for example, water used outside the home for garden watering and washing cars).

The FWM Act enables water companies to introduce ‘social’ tariffs, to provide assistance to those customers who struggle to afford their water and sewerage bills. The FWM Act explicitly allows water companies to introduce cross-subsidy between customers. Before such tariffs could be introduced the FWM Act required Defra to provide guidance on the factors to be taken into account in deciding whether one group of customers should subsidise another through such tariffs. On 22 June 2012, Defra published this guidance. Under the guidance, water companies are required to consult customers and customer organisations, such as the Consumer Council for Water before introducing a social tariff. During its consultation, the water company will need to be clear on what level of cross-subsidy is proposed, who will need to pay and the effect the subsidy will have on the bills of households which receive assistance under the tariff. Factors which a water company should consider when deciding whether one group should subsidise another include the level of water stress in the area and the need to incentivise water efficiency. Water companies should assess the level and nature of any social tariff based on local circumstances. Both metered and unmetered customers should be considered as being eligible for social tariffs. Water companies are required to strike a balance between the need to support customers with payment difficulties and the interests of customers paying the subsidies.

Non-domestic customers

Most industrial and other non-domestic customers are metered. In calculating the wastewater charges of industrial and commercial metered customers, the volume of clean water supplied is used as the basis of the charge less a fixed allowance of 5 per cent. of such volume made in respect of water not discharged to a sewer. Certain industrial and commercial metered customers receive a higher allowance where a significantly higher volume of water supplied is not discharged to a sewer. Trade effluent is normally charged separately on a formula basis taking account of the volume of effluent, its strength and costs of removal and treatment.

Collections

SWS’ collection methods include full payment or instalments using direct debit, standing orders, BACS, the internet, post office, plastic payment cards, PayPoint, debit/credit cards or direct payment to SWS, through to doorstep collections, debt collection agencies, the Department for Work and Pensions and recourse to court procedures in appropriate circumstances. Disconnection of domestic customers from the water supply network for failure to pay charges is prohibited following the introduction of the WIA 99. Industrial and commercial customers are subject to a range of actions, including disconnection and court proceedings where failure to settle charges occurs.

SWS reviewed collection performance across AMP4 in 2010 and concluded that the accrual for unbilled measured revenue should be reduced by approximately £23m and bad debts charges substantially increased relative to the year ended 31 March 2010. These two amounts were charged in the year to 31 March 2011 and reflect a change to estimation techniques.

The Customer Engagement Directorate is responsible for SWS’ billing, collections and customer contact. It achieved ISO 9001:2008 accreditation in December 2010 for the operation of its quality management system.

Revenue Deviations from Ofwat’s Projections

In the 2009 Periodic Review, Ofwat introduced a revenue correction mechanism concept covering the AMP5 Period. Ofwat indicated that, under the mechanism, the revenue requirements for the next Periodic Review Period will be reduced or increased by the amount of any under-recovery or over-recovery of revenues from charges in the tariff basket between 2010/11 and 2014/15. It will also include an adjustment so that companies have an incentive to maintain accurate billing records. This incentive would operate principally by increasing or decreasing the revenue correction by an “efficient billing factor” (being the cost that an efficient company incurs in finding and billing an additional property) for every property actually found and billed by the company above or below the number that Ofwat expects.

Since actual out-turn revenues are used as the basis for the setting of price limits for the subsequent five-year period, any deviation from revenue projections in the previous five-year period may be reflected in such price

limits. However, there is no certainty that the Revenue Correction Mechanism will result in SWS being fully compensated.

In certain circumstances, SWS may apply for an IDOK as described in Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*” under “*Economic Regulation – Interim Determinations of K*”.

For SWS, a shortfall in revenues of £24.5 million was recognised in 2010/11, and approximately £27 million in 2011/12, and SWS believes it will remain at or above these levels for the whole of the five year period. It is expected this shortfall can be recovered under the Revenue Correction Mechanism. SWS held discussions with Ofwat during 2011/12 regarding smoothing the effect a recovery may have on customer bills for 2015/16, by recovering part of the revenues in the current five year period and part in the next five year period, which would require an Interim Determination of K (IDOK). SWS concluded that given the prevailing economic climate and level of prevailing inflation (plus K factors), it would not be appropriate for customers to face higher bills.

Capital Investment Programme

The Final Determination for the five year period starting on 1 April 2010 (the “**AMP 5 Period**”) sets out a level of investment for capital projects (both new projects and asset maintenance) of £1,752 million (at 2007/8 prices). This amount has been taken into account by Ofwat in determining SWS’ RCV over the course of the AMP 5 Period, and SWS will be permitted to recover in respect of such amount through customer charges its depreciation costs and an allowed return intended to compensate it for financing costs and provide a permitted return of capital. Ofwat also defines the obligations associated with that investment and sets out target implementation dates. Approximately £1,284 million of this expenditure relates to wastewater services, with the balance relating to water supply projects.

The following table summarises the levels of capital expenditure over the period 2010 to 2015 as set by Ofwat.

	Capital expenditure (net)		
	Five-year total		
	Water	Sewerage	Total
	<i>(£m)</i>		
Expenditure			
Base service – Infrastructure renewals expenditure	151	110	261
Base service – Non-infrastructure capital maintenance	143	557	700
Supply/demand balance	151	89	240
Quality enhancements	23	504	527
Enhanced service levels	0	24	24
Total	468	1,284	1,752
£ per property per year	69	179	248

The three significant categories of construction works contracts under which work is being performed pursuant to the Final Determination for the AMP5 Period are the Single Entity Contract AMP5, the Multi Services Framework Contracts and the B&H Contract (each as defined below).

The “**Single Entity Contract AMP5**” is the contract under which SWS outsources some of its key capital investment programme work to 4Delivery Limited (“**4D**”), a joint venture vehicle owned ultimately by Veolia Water UK Plc (40 per cent.) (such stake owned by United Utilities Capital Delivery Limited prior to a sale on 9 November 2010 to Veolia Water UK Plc), Costain (40 per cent.) and MWH (20 per cent.). Although United Utilities Capital Delivery Limited has sold its stake in 4D to Veolia Water UK Plc, the transfer of a parent company guarantee given by Veolia Water UK Plc to United Utilities is still under negotiation.

Under the Single Entity Contract AMP5, 4D is required to manage, design and deliver schemes, which are all stand-alone construction projects for the modification or extension of existing water mains, sewers, water supply works and wastewater treatment works. Most of the schemes have an individual value of between £1 million and £5 million each, although a small number of schemes have greater values, the maximum being up to £27 million. The total value of the Single Entity Contract AMP5 is approximately £366 million.

The Single Entity Contract AMP5 follows on from the “**Single Entity Contract PR04**” which was used for the delivery of works in AMP4 although there still remains some work from AMP4 to be concluded under the Single Entity Contract PR04. The Single Entity Contract AMP5 is constituted by a supplemental deed to the original contract dated 4 April 2005, as amended or varied on 6 May 2008, 13 November 2008 and 7 July 2009 (defined in the supplemental deed as the “**Existing PR04 Contract**”) setting out the terms and conditions upon which such Existing PR04 Contract had been varied in order to incorporate certain principles of agreement and to extending the Single Entity Contract AMP5 until 2015.

The “**Multi Services Framework Contracts**” or “**MSFCs**” comprise a number of contracts for small scale civil works, including construction works and associated management activities.

The contracts, which account for approximately £647 million of the capital expenditure for the AMP5 Period, currently include:

- water distribution – Clancy Docwra (approximately £22million per year). Under the relevant MSFC, pipe-laying, construction and some meter installation activities are outsourced;
- sewerage – Clancy Docwra (approximately £42 million per year). Under the relevant MSFC, pipe-laying and construction activities are outsourced; and
- mechanical and electrical maintenance and renewals – Morrison Utility Services (approximately £45 million per year). Barhale Trant Utilities LLP (approximately £45 million per year) and Clancy Docwra (approximately £2 million per year).

SWS’ expected expenditure in respect of MSFCs for the financial year 2012/13 will be £160 million. SWS manages and controls the MSFCs through dedicated contract management teams and retains authority for all works.

Brighton and Hove Waste Water Treatment Works and Sludge Recycling Centre

The Brighton and Hove Contract (the “**B&H Contract**”) is based on the I Chem E Form of Contract for Target Cost Contracts (Burgundy Book First Edition 2003) (“**Burgundy Book**”).

- The contracting entity is Brighton and Hove 4Delivery Limited (“**B&H4D**”) which is a special purpose vehicle whose only purpose is to deliver the B&H Contract. The B&H Contract requires each parent company of B&H4D to furnish a parent company guarantee (a “**PCG**”). There are two PCGs provided from each of United Utilities Plc and Costain Group Plc (the “**Parents**”). Although, United Utilities Capital Delivery Limited sold its stake in B&H4D to Veolia Water UK Plc on 9 November 2010, the transfer of the PCG to Veolia Water UK Plc is still under negotiation.
- The PCG guarantees the full obligations of B&H4D under the B&H Contract for up to 7.5% (total 15%) of the Initial Target Cost up to 6 years from Take-Over (as defined in the B&H Contract).

In the event that the credit rating of a Parent is impaired resulting from a change of control of such Parent, B&H4D can be required to provide a performance bond as an alternative to the PCG.

The key milestones for completion under the Burgundy Book are substantial completion and Take-Over. These milestones have been modified in the B&H Contract in recognition of SWS' overriding requirement that the Plant (as defined in the B&H Contract) demonstrates its ability to process effluent in compliance with the discharge consent by 31 March 2013.

The B&H Contract contains a target cost formula whereby B&H4D is reimbursed for its actual costs in carrying out the works prescribed under the B&H Contract, subject to the application of a formula which allows B&H4D to share in savings made ("gain share") or to contribute towards additional costs incurred ("pain share").

The Initial Target Cost of £225m was established at the date of the B&H Contract and may be adjusted only in accordance with the provisions of the B&H Contract. In summary, the Initial Target Cost is increased or decreased to take into account the effect of any variations under the B&H Contract and other limited situations specified under the B&H Contract, including any additional contractor expenses due to: (i) acts, omissions or defaults of the purchaser or the project manager; (ii) suspension orders (not resulting from contractor default); and (iii) reviewing and correcting documents supplied by the purchaser (e.g. specifications or designs). B&H4D is also entitled to an adjustment to the Target Cost to reflect its on-site costs incurred as a result of a force majeure.

The Actual Cost is the sum of costs and expenses incurred by the contractor in performing the B&H Contract, valued and charged to the purchaser in accordance with Schedule 18.

At the current time, the Bright & Hove Wastewater Treatment Works and Sludge Recycling Centre is being commissioned and undergoing compliance testing, with an expected takeover date of 31 May 2013.

Reduction of RCV by Ofwat

If SWS does not incur the expenditure necessary to complete the delivery of a defined obligation during the relevant Periodic Review Period, Ofwat would be entitled to reduce SWS' RCV to reflect this. Such reduction may be implemented by Ofwat by way of an IDOK (if the amount of expenditure which has not been incurred is material), or otherwise at the next Periodic Review. If appropriate, Ofwat would then include the relevant defined obligation (and associated capital expenditure) as part of its determination of the level of investment and associated defined obligations for the subsequent Periodic Review Period. In addition to any RCV reduction, Ofwat would be entitled to claw back any benefit received by SWS in the original Periodic Review Period in relation to the defined obligations which have not been fulfilled.

SWS' ability to fulfil defined obligations, and the level of associated expenditure, can be affected by circumstances and third parties (such as planning authorities) beyond SWS' control.

Asset Condition and Serviceability

The Licence requires SWS to produce and provide to Ofwat an Underground Asset Management Plan which, among other things, shows the expenditure necessary in each year to ensure that asset condition is maintained in an appropriate state, and tracks the condition of SWS' assets over time (in practice, Ofwat requires information in respect of both above ground assets and below ground assets).

The latest reported performance of SWS' assets, for 2011-12, shows "stable" performance for both water and sewerage underground and above ground water service assets. SWS management is committed to target maintaining "Stable" serviceability for the period 2010-2015 for all asset categories, but there is however a risk of a lower performance assessment for individual services and years, with a risk of a 'Marginal' serviceability assessment for sewerage above ground for 2012/13.

Business Process Outsourcing

As part of its drive for greater efficiency, SWS has set up outsourcing framework agreements for back-office processing work to leading organisations with offshore capabilities in India (the current annual value of such business process outsourcing is approximately £15 million). Wipro, Tata Consultancy Services, Tech Mahindra, RR Donnelly, Atkins, Mott MacDonald and Black & Veatch are engaged from 2011 until at least 2015 to provide a range of services including accounting, customer correspondence, engineering design services data & reporting, asset management, HR and IT managed services.

Information Technology

The focus over the AMP5 period is to make IT investments that enhances customer service, reduces operational risk and supports the improvement plans for asset management assessment. A major component of operational risk management is to ensure the existing IT estate is regularly refreshed and maintained. Delivery of key business initiatives such as the Universal Metering Programme, Asset Planning & Maintenance and Unit Costing are all utilising IT solutions.

By rationalising business applications and tools onto corporate technology platforms, application support costs will be optimised and the estate simplified whilst maximising the end-to-end benefits of a single ERP platform. From an organisational perspective, SWS continues to utilise an offshore delivery model, and continues to align services models to ITIL V3 best practice and ISO270001 for IT security.

The IT operating and delivery model recently introduced engagement managers that will work closely with other business units to ensure business requirements are captured and that technology investments are made against a measurable business case.

In terms of technology, AMP4 saw significant investment into Data Centre environments, storage and virtualisation technology. During AMP5, information technology will further enhance SWS' technology infrastructure, focusing on Telephony, Mobility and Security technologies.

Property

SWS' property interests consist substantially of freehold interests, and there are estimated to be between 3,000 and 4,000 separate titles (excluding pipeline interests). As a result of the reorganisations of local government and water-related services in 1974 and privatisation of the water industry in 1989, SWS inherited many of its sites, and for some, it is unable to deduce full legal title to all of its real property. Those properties where this is true fall into the following broad categories:

- properties in respect of which SWS is believed to have legal title but does not possess full documentary evidence to prove such title (the deeds having been lost or destroyed or never provided by the previous title holder); and/or
- properties in respect of which SWS has acquired or could acquire the necessary rights by compulsory purchase, or claim prescriptive rights or adverse possession.

SWS is not involved in any ongoing disputes, in relation to title to property, of a material nature. SWS has undertaken a programme of voluntary first registration at HM Land Registry of its current unregistered titles and most of its titles have now been registered.

Insurance

SWS maintains insurance cover which is consistent with the minimum insurance requirements of the CTA. Insurance cover for 2012-13 includes the following: £100 million limit with a £0.25 million deductible for Property Damage & Business Interruption; £50 million limit for Employers Liability; £150 million limit with a £0.25 million deductible for Public/Products Liability. Third Party motor insurance; £15 millions limit with a £0.25 million deductible for Crime insurance; Directors & Officers liability - effected in accordance with Good Industry Practice.

Litigation/Actions

In common with other companies in the water and wastewater industry, SWS is frequently involved in, or is the subject of, civil and criminal proceedings, but, SWS is not, and has not been, involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which SWS is aware) during the 12 months preceding the date of this Prospectus which may have or have had in the recent past significant effects on the financial position or profitability of SWS.

Non-regulated Activities

SWS' non-regulated businesses are not material to the group, generating £5.6 million annual turnover and other operating income and £3.6 million operating profit (1 per cent. of the total) for the year ending 31 March 2012. In addition, SWS has a residual non-core property portfolio that is being realised over time (£0.9 million profit on disposals of fixed assets for year ending 31 March 2012).

Activity	Turnover and other Operating Income	Operating Profit
Accommodation services	1.0	0.6
Property services	2.6	1.8
Other	2.0	1.2
Total	5.6	3.6

Ring Fencing and the SWS Financing Group

As part of its obligations as a Regulated Company, SWS is subject to certain ring-fencing restrictions under its current Licence. Modifications were made to SWS' licence in September 2008 to strengthen the ring-fence, following the acquisition of SWS by the Greensands consortium investors. See the section "*Regulatory Ring-fencing*" below, which sets out the current Licence provisions including the additional conditions which came into effect on 5 August 2008.

In addition, to reduce SWS' exposure to credit and event risk of companies in the Greensands Group, a "ring-fenced" financing group has been created (the "**SWS Financing Group**"). These measures also reflect the requirements of the covenant and security package as summarised in Chapter 7 "*Overview of the Financing Agreements*".

The ring-fencing measures are intended to ensure (i) that SWS has the means to conduct its Appointed Business separately from the Greensands Group, and (ii) that all dealings between the Greensands Group and the SWS Financing Group are on an arm's length basis. The ownership structure of the SWS Financing Group is set out in Chapter 4 "*Summary Financing Structure*".

The main elements comprising the regulatory and structural ring-fencing of the SWS Financing Group from the Greensands Group companies are set out below.

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 the Licence, SWS must ensure that transactions between it and its associated companies are on an arm's length basis, to prevent cross-subsidisation of activities. Failure to comply with the Licence may in certain circumstances give rise to a breach of the Licence and possibly the Competition Act 1998 as described in Chapter 6 "*Regulation of the Water and Wastewater Industry in England and Wales*". Under Licence Condition K.3.1, SWS must ensure at all times, so far as reasonably practicable, that, if a Special Administration Order was made in respect of it, SWS 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 Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*” under “*Licences – Special Administration Orders*”.

Current ring-fencing provisions in SWS’ Licence

The ring-fencing provisions contained in SWS’ Licence are broadly similar to those contained in the licences of all other Regulated Companies. The most important provisions are:

- (a) Transactions between SWS and its associated companies: Any transaction between SWS and its associated companies (being its subsidiaries and any affiliated companies) must be conducted at arm’s length, such that there is no cross-subsidy of the associated company by SWS (or vice versa).
- (b) Restrictions on Dividend Payments: SWS is required to only pay dividends in accordance with a policy that complies with the following principles: (i) such payments will not impair the ability to finance its Appointed Business; and (ii) the payment of such dividends is to reward efficiency and the management of economic risk.
- (c) Limits on the transfer of certain assets to associated companies: Save with the express consent of Ofwat, SWS is not permitted to transfer certain rights or assets (being those which a Special Administrator would require if a Special Administration Order were made in order to operate the Appointed Business) to an associated company.
- (d) Adequate Resources: SWS is required at all times to act in a manner “best calculated” to ensure that it has adequate financial resources and facilities and also management resources to carry out its Regulated Activities (“**Regulated Activities**” being the functions of a water undertaker or, as the case may be, a sewerage undertaker) (including necessary investment programmes). The directors of SWS are required to certify on an annual basis that this requirement will continue to be met for the subsequent 12 month period. The basis on which such a view is formed must also be disclosed to Ofwat. As soon as the directors become aware of a reason why SWS cannot be expected to comply with this obligation, they are obliged to file a report to this effect to Ofwat in accordance with the provisions of the Licence.
- (e) Restrictions on other transactions: Save with the express consent of Ofwat, SWS must not (i) give any guarantee of any liability of any associated company, (ii) make to any associated company a loan, or (iii) enter into an agreement or incur a commitment incorporating a cross default obligation (whether with an associated company or otherwise). Condition F.6.11(1B) sets out a limited exception as regards situations where liability under a cross-default obligation would arise only on a default of a subsidiary company of SWS, in which case SWS may permit that cross-default obligation to remain in effect for the period for which it was fixed by the instrument which created it, so long as its potential liability is not changed.
- (f) Publishing of financial information: SWS is required to publish such information about its annual and interim financial results as is required by the UKLA listing rules as if SWS were listed on the London Stock Exchange.
- (g) Maintenance of a financial instrument listed on the London Stock Exchange: SWS is required to maintain a financial instrument and shall use all reasonable endeavours to retain its listing on the London Stock Exchange.
- (h) Investment grade credit rating: SWS (or any associated company) will be required to maintain an investment grade issuer credit rating. The issuer rating will reflect the financial capacity of the Appointed Business and therefore its ability to raise capital or maintain access to liquidity in the

future. Any significant adverse changes to the rating will act as an early signal that the ability of the Appointed Business to raise future finance is at risk.

- (i) Conducting the Appointed Business of SWS: SWS (and its directors) is required to operate the Appointed Business as though it were substantially SWS' sole business and SWS was a separate public limited company. In particular, SWS should:
 - (i) have a board of directors which will act independently of the parent company/controlling shareholders and exclusively in the interests of SWS;
 - (ii) ensure that all directors disclose any conflicts of interest both to SWS and Ofwat, and that SWS' articles of association prohibit a director from voting in any matter in which they have an interest;
 - (iii) ensure that, where a potential conflict between SWS and its corporate group arises, SWS and its board of directors have exclusive regard to SWS' interests as a regulated water and sewerage undertaker;
 - (iv) notify Ofwat of all changes in board membership and responsibilities/functions of the directors;
 - (v) have regard to the Principles of Good Governance and Code of Best Practice required by the UKLA listing rules from time to time; and
 - (vi) have regard to, when conducting the Appointed Business, the dividend policy to be adopted by the board of directors.

Recent modifications to SWS' Licence

In addition to the above conditions, on 5 August 2008, Ofwat modified SWS' Licence Condition F. The amended Condition F came into effect on 5 August 2008, with the introduction of, among others, the following conditions:

- (a) Adequate systems of planning and internal controls: SWS must, at all times, act in a manner best calculated to ensure that it has adequate systems of planning and internal control to enable it to secure the carrying out of the Appointed Business. Such systems of planning and internal control are to comply with such guidance as Ofwat may specify from time to time. Further, the modified Licence Condition F also provides that compliance with the requirement for adequate resources, systems of planning and internal control, must not be dependent on the discharge by any other person of any obligation under, or arising from, any agreement or arrangement under which that other person has agreed to provide any services to SWS in its capacity as a Regulated Company. As SWS is required to do in relation to its financial and management resources, SWS' directors will be required to certify to Ofwat on an annual basis that this new requirement will continue to be met for the subsequent 12 month period.
- (b) Cash lock-up: A cash lock-up provision was introduced into Licence Condition F which prohibits, subject to certain limited exceptions, save with the express consent of Ofwat, the transfer, lease, licence or loan of any sum of cash or other assets to an associated company when SWS (i) no longer holds an investment grade rating, or (ii) holds a rating at the minimum investment grade level and that rating has been put under review for possible downgrade or is assigned a negative outlook.

At the same time Ofwat also modified Licence Condition P which relates to undertakings by parent companies. The amended Licence Condition P (which also came into effect on 5 August 2008) requires that SWS secures legally enforceable undertakings from its Ultimate Controller (as defined below) and, when such Ultimate Controller is not a UK holding company, from its UK holding company, that it (and each of its subsidiaries, other than SWS and SWS' subsidiaries) will:

- (a) give SWS all such information as may be necessary to enable SWS to comply with the Licence;
- (b) refrain from any action which might cause SWS to breach any of its obligations under the WIA or the Licence; and
- (c) ensure that the board of directors of SWS contains not less than three independent non-executive directors, who must be persons of standing with relevant experience and who collectively have connections with and knowledge of the areas within which SWS provides water and sewerage services and an understanding of the interests of the customers of SWS and how these can be respected and protected.

SWS must inform Ofwat immediately in writing if it becomes aware that the undertakings have ceased to be legally enforceable, or that there has been any breach of their terms. Further, save with the written consent of Ofwat, SWS must not enter (directly or indirectly) into any contract or arrangement with its Ultimate Controller or any associated company (other than subsidiaries of SWS) at a time when no such undertaking exists or there is an unremedied breach of such undertaking.

For the purposes of the amended Condition P, “Ultimate Controller” means any person (including, without limitation, a corporate body) who or which (alone or jointly with others and whether directly or indirectly) is (in the reasonable opinion of Ofwat) in a position to control, or to exercise material influence over, the policy or affairs of the Appointed Business or of any holding company of the Appointed Business.

Ofwat has been provided with copies of the Condition P undertakings provided to SWS by each of IIF Int’l SW UK Parent Co Ltd and UBS Global Asset Management (UK) Limited as joint Ultimate Controller and by Greensands Europe Limited as its UK holding company.

On 9 February 2011, Ofwat modified SWS’ Licence to allow it to increase prices in 2011-12 by 1.4% above the K factor. This was to compensate SWS for revenue that would be lost through the provision of new transitional and social tariffs for the UMP. SWS at the same time provided an undertaking to Ofwat that (i) it would offer such tariffs to all customers metered under its UMP, (ii) it would not recover more income through the price adjustment than it lost by offering the tariffs, (iii) it would offer similar tariffs to its sewerage only customers who were metered under water supply companies’ metering programmes, and (iv) it would provide all necessary information to Ofwat to allow it to assess the extent of any over or under-recovery. The Licence modification also allows for a further adjustment in prices in 2013-14 and 2014-15 if the revenue losses incurred as a result of offering these tariffs is less than that recovered through the initial 1.4 per cent. adjustment. Due to an over-recovery the company will be abating the K factor by 1.2 per cent. in 2013-2014.

Structural Ring-fencing

The regulatory ring-fencing measures described above have been enhanced by the separation of SWS from non-regulated companies and the establishment of the SWS Financing Group, as described in Chapter 4 “*Summary Financing Structure*”. The composition of each of the boards of directors for the companies within the SWS Financing Group is described below.

Security and Covenant Packages

In connection with the Programme, the SWS Financing Group provides 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 Chapter 7 “*Overview of the Financing Agreements*”), dividends, management fees (if any), debt service relating to and repayments under certain intra-group debt, and other such distributions are only permitted if 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. The security package and the covenant-based ring-fencing restrictions placed on the SWS Financing Group are set out in Chapter 7 “*Overview of the Financing Agreements*”.

Business Separation

All new debt relating to the Appointed Business will be issued by entities within the SWS Financing Group.

Pursuant to the ring-fencing arrangements, SWS employs all employees required to run the Appointed Business.

All transactions entered into by the SWS Financing Group with third parties (including Greensands Companies) are entered into on an arm’s length basis. Any transaction between SWS and the Greensands Companies is formally reviewed to ensure compliance with the Licence and procurement regulations. In addition, SWS is required to comply with additional requirements that Ofwat introduced into the Licence on 5 August 2008 regarding systems of planning and internal control. See the section “*Regulatory Ring-fencing*” above.

As part of the ring-fencing arrangements, SWS must conduct the Appointed Business as if it were substantially SWS’ sole business. SWS’ management has retained some Permitted Non-Appointed Business and assets within permitted *de minimis* levels. Under the covenant package, the Security Trustee may permit SWS to enter into limited joint ventures in areas outside the regulated water and wastewater business subject to certain limitations on the aggregate value of all Permitted Non-Appointed Business. See Chapter 7 “*Overview of the Financing Agreements*”.

Under the covenant package, SWS is 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 Chapter 7 “*Overview of the Financing Agreements*” under “*Common Terms Agreement – Covenants – General Covenants*”.

Management and Employees of SWS

Directors and Secretary of SWS

The SWS board currently consists of nine individuals.

There are no actual conflicts of interest between any duties to SWS of its directors and alternate directors and their private interests or other duties. Save as disclosed in relation to Colin Hood, who is also Chairman of Greensands Holdings Limited, Paul Moy, who is also a director of SWC and an alternate director of the Greensands Companies, Bronte Somes, who is also director of the Greensands Companies, Peter Antolik, who is also a director of the Greensands Companies and SWC and Kevin Hall, who is also company secretary of the Greensands Companies and SWC, no director or alternate director has any potential conflict of interest between his duties to, SWS and his private interests or other duties.

The directors, the alternate directors and secretary of SWS are set out below, each of whose business address is Southern House, Yeoman Road, Worthing, West Sussex BN13 3NX.

Colin Hood – Chairman

Appointed Chairman in February 2012, Colin Hood joined the board as a Non-executive Director in February 2011. He is a former Chief Operating Officer of Scottish and Southern Energy (SSE), which he joined in 2001 as Power Systems Director. Before this, he was Director of Distribution for Southern Electric, having joined the industry with the North of Scotland Hydro Electric Board in 1977. Colin is an Independent Director on the board of the Glasgow 2014 Commonwealth Games and a Non-executive Director of First Group and High Speed 1 (the Channel Tunnel Rail Link). He is a graduate of Strathclyde University, where he studied Electrical Engineering. He is also Chairman of Greensands Holdings Limited, which may have conflicting interests with those of SWS.

Matthew Wright – Chief Executive Officer

Appointed in February 2011, Matthew Wright joined SWS from United Utilities where he was Managing Director of Asset Management and Delivery. Prior to that he was Managing Director of Operations at United Utilities and his role included management of the operations, maintenance and customer service activities of United Utilities' regulated water and wastewater business as well as oversight of the company's external contracts with Dwr Cymru Welsh Water, Scottish PFI projects and other industrial customers. Matthew Wright has more than 25 years' experience of utility management in both UK and international markets. He joined United Utilities in 2007 from Scottish Power's US operation, where he was Executive Vice President of PacifiCorp's transmission, distribution and customer service division. He has also held senior management positions in operations, regulation, corporate strategy and commercial utility functions. He is also a director of the Issuer, SWI, SWSG, SWSGH and SWSH.

Mick Carmedy – Chief Financial Officer

Appointed in November 2011, Mick Carmedy joined Southern Water from United Utilities where he was previously the Group Controller and Finance Director at United Utilities Water Plc. He joined United Utilities in January 2008 from Thames Water where he worked for 17 years in various financial, commercial and regulatory roles based in both the UK and the US. Immediately prior to joining United Utilities, he was Thames Water Group Financial Controller, a role he took up following his return from the US where he spent four years with Thames Water Americas, including two years as Vice President Regulation, American Water. He is also a director of the Issuer, SWI, SWSG, SWSGH and SWSH

In addition, there are six non-executive directors

Paul Moy – Non-executive Director

Paul Moy was appointed a director of SWS in February 2010. He is the Global Head and Chief Investment Officer for UBS Infrastructure and Private Equity, a division of UBS Global Asset Management. He has extensive principal investment, investment banking and advisory experience in the infrastructure sector across a broad range of asset types, including electricity generation, transmission and distribution, gas, water, toll roads, ports, rail, telecommunications and waste management. He also has previous experience as a non-executive director and is currently a Non-executive Director of Northern Star Generation, CWF Holdings, Njord Gas Infrastructure. He holds a BA and PhD in Economics. He is also a director of SWC and an alternate director of the Greensands Companies. The Greensands Companies and SWC may have conflicting interests with those of SWS.

Surinder Toor – Non-executive Director

Surinder Toor was initially appointed a director of SWS in January 2010 until February 2011. He was re-appointed in February 2012. He is a Managing Director at JP Morgan Asset Management and the global head of asset management for JP Morgan's Infrastructure Investments Group. In addition to Southern Water, he holds directorships in Electricity North West and Noatum Ports Holdings. Previously, he was the Chief Financial Officer at Scotia Gas Networks plc and prior to that he was Managing Director of American Electric Power's European operations. He has also held positions with Arthur Andersen, PowerGen plc and at PricewaterhouseCoopers, where he started his career. He holds an MA in Engineering, Economics and Management from the University of Oxford and he is a Chartered Accountant.

David Golden – Independent Non-executive Director

David Golden was appointed a director of SWS in November 2003. He heads the MPSL Group of companies, is chairman of CPC group and is a director of Payzone plc. He was previously Contracts Director at British Nuclear Fuels plc and Director of Purchasing at North West Water Limited.

Robert Armstrong OBE – Independent Non-executive Director

Robert Armstrong was appointed a director of SWS in May 2008. He was previously Managing Director of United Utilities Customer Sales and a Director of United Utilities Water plc. He is a former chairman of

Water UK and is currently a director of several utility pension companies. He was awarded the OBE for services to the water industry in 2006.

Cheryl Black – Independent Non-executive Director

Cheryl Black was appointed a director of SWS in May 2008. She spent 2006 to 2011 as Customer Service Director on the Telefonica O2 UK Board. She has previously held Customer Service Director roles at Scottish Water and NTL, as well as a range of senior customer focussed positions at Orange, Cable & Wireless and EDF. She is a member of the Advisory Board of TRG SATMAP inc., as well as being a Vice President of the Institute of Customer Service, special advisor to the Customer Contact Association (CCA) and a Director of Telefonica O2 Pension Trustee Ltd.

Robert Jennings CBE – Independent Non-executive Director

Robert Jennings was appointed to the SWS Board in July 2012. He is the Department for Transport's representative on the Board of Crossrail and oversaw the restructuring of Eurostar and sale of High Speed 1, the (Channel Tunnel Rail Link), during his time as Corporate Finance Director for London & Continental Railways. He joined SG Warburg & Co in 1986 and remained with the organisation until February 2009 where for many years he had been head/joint head of the bank's infrastructure group. During this period, he was also seconded to HM Treasury on two occasions. He became a Chartered Accountant in 1979 and, in 2005, was made a CBE in recognition of his services to the transport sector and finance industry.

Alternate Directors

Peter Antolik is alternate for Surinder Toor. He is an Executive Director at JP Morgan Asset Management. He is currently a Director of the Greensands Companies and SWC, which may have conflicting interests with those of SWS.

Bronte Somes is alternate for Paul Moy. She is an Infrastructure Investment Executive at UBS Infrastructure Asset Management. She is currently a Director of the Greensands Companies, which may have conflicting interests with those of SWS.

Kevin Hall – Company Secretary

Kevin Hall is company secretary of SWS. He has worked for SWS for the past 37 years, and is also company secretary of each other member of the SWS Financing Group, the Pension Companies, the Greensands Companies, SWI, SWSG and SWC, which may have overlapping conflicting interests with those of SWS. He is also a director of SWI, SWSG, SWSGH, SWSH and SWEPST.

Pensions

Pensions for SWS employees are currently provided through two arrangements, the Southern Water Pension Scheme (“**SWPS**”), which is a funded defined contribution arrangement, and a Company Stakeholder Plan (“**CSP**”) which is a defined contribution scheme.

As at 31 March 2012 there were 856 active members, 1758 deferred members and 1891 retired members of the SWPS, 257 active members of the CSP, and approximately 785 SWS employees who are not members of either scheme. Employees on fixed term contracts are offered access to the CSP.

Pensions management services and secretarial support are currently provided by Capita Hartshead for the SWPS and by Standard Life for the CSP.

The funding level of the SWPS is a net FRS 17 deficit of £96.3 million before deferred tax as at 31 March 2012. The deficit is present mainly as a result of continued turbulence in the stock market, low interest rates and reduced actuarial mortality rates.

The SWPS was closed to new members from 1 April 2005. Certain terms of the schemes were changed from July 2005 when members were given the option to contribute an extra 3 per cent. of salary to continue at existing accrual rates. They were also given the option to continue to pay the current contribution rate but

build up benefits at a lower rate. Other minor changes to the SWPS were made because of legislative changes under the 2004 Finance Act and a salary sacrifice scheme (PensionSWise) was introduced in November 2009.

The company is currently making arrangements to cap future increases in Pensionable Pay to the lesser of 2.5 per cent. and the annual increase in the Retail Price Index to reduce the cost of the SWPS, address the current deficit and make the scheme more sustainable. They are also working with the Trustee to better manage the financing risks within SWPS to further reduce ongoing volatility and funding costs.

Ofwat has indicated a general willingness, subject to certain conditions, to take into account pension deficit contributions as allowable operating expenditure when determining K for Regulated Companies. For the 2009 Periodic Review Period this amounted to £10.2 million per annum. A schedule of deficit annual contributions to 2025 has been agreed with the trustees based on the triennial valuation as at 31 March 2010. This schedule of deficit contributions commenced 31 March 2010, for which a lump sum deficit contribution of £56.1 million was paid on 31 March 2010. The next scheduled payment is due 31 March 2015. The next triennial valuation effective at 1 April 2013 is due for completion by the end of that year.

SWSGH

SWSGH is incorporated under the Companies Act 1985 and registered in England and Wales. The registered office of SWSGH is Southern House, Yeoman Road, Worthing, West Sussex, BN13 3NX. SWSGH is a wholly-owned direct subsidiary of SWSG and its authorised share capital is £101,000 divided into 101,000 ordinary shares. 100,100 ordinary shares have been issued of which all have been fully paid up. SWSGH's subsidiaries are SWSH, SWS, the Issuer, SWEPST and SWPT.

Directors and Company Secretary

The directors and company secretary of SWSGH are set out below, each of whose business address is Southern House, Yeoman Road, Worthing, West Sussex, BN13 3NX.

The Directors of SWSGH are Matthew Wright, Mick Carmedy and Kevin Hall. Descriptions of their principal activities outside the SWS Financing Group can be found above under "*Management and Employees of SWS – Directors and Secretary of SWS*".

Save as disclosed above under "*Management and Employees of SWS – Directors and Secretary of SWS*" in relation to Matthew Wright and Mick Carmedy, no director has any actual or potential conflict of interest between his duties to SWSGH and his private interests or other duties.

Kevin Hall is company secretary of SWSGH.

SWSH

SWSH is incorporated under the Companies Act 1985 and registered in England and Wales. The registered office of SWSH is Southern House, Yeoman Road, Worthing, West Sussex, BN13 3NX. SWSH is a wholly-owned direct subsidiary of SWSGH and its authorised share capital is £101,000 divided into 101,000 ordinary shares. 100,100 ordinary shares have been issued of which all have been fully paid up. SWSH's subsidiaries are SWS, the Issuer, SWEPST and SWPT.

Directors and Company Secretary

The directors and company secretary of SWSH are set out below, each of whose business address is Southern House, Yeoman Road, Worthing, West Sussex, BN13 3NX.

The Directors of SWSH are Matthew Wright, Mick Carmedy and Kevin Hall. Descriptions of their principal activities outside the SWS Financing Group can be found above under "*Management and Employees of SWS – Directors and Secretary of SWS*".

Save as disclosed above under "*Management and Employees of SWS – Directors and Secretary of SWS*" in relation to Matthew Wright, Mick Carmedy and Kevin Hall, no director has any actual or potential conflict of interest between his duties to SWSH and his private interests or other duties.

Kevin Hall is company secretary of SWSH.

The Issuer

The Issuer is incorporated and registered in the Cayman Islands. The registered office of the Issuer is c/o Maples Corporate Services Limited, PO Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands. The Issuer is a wholly-owned direct subsidiary of SWS and has no subsidiaries. The authorised share capital is £25,000 divided into 25,000 ordinary shares of £1 each, of which 1,000 such shares are in issue and are fully paid up.

Directors and Company Secretary

The directors and company secretary of the Issuer are set out below, each of whose business address is Southern House, Yeoman Road, Worthing, West Sussex BN13 3NX.

The Directors of the Issuer are Matthew Wright, and Mick Carmedy. Descriptions of their principal activities outside the SWS Financing Group can be found above under “*Management and Employees of SWS – Directors and Secretary of SWS*”.

Save as disclosed above under “*Management and Employees of SWS – Directors and Secretary of SWS*” in relation to Matthew Wright, Mick Carmedy and Kevin Hall, no director has any actual or potential conflict of interest between his duties to the Issuer and his private interests or other duties.

Kevin Hall is the company secretary of the Issuer.

CHAPTER 6

REGULATION OF THE WATER AND WASTEWATER INDUSTRY IN ENGLAND AND WALES

Water and Wastewater Regulation Generally

Background

The current structure of the water and wastewater industry in England and Wales dates from 1989, when the Water Act 1989 was enacted. Before this, as a consequence of the Water Act 1973, there were 10 regional public sector water authorities supplying water and wastewater 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 wastewater services, together with the majority of the water authorities' property, rights and liabilities, were transferred to 10 companies appointed as water and sewerage undertakers in England and Wales. The industry is now (following recent acquisitions and licence unifications) made up of the 10 water and sewerage companies and 10 water only companies which are all subject to the same regulatory regime. In addition, there are six new entrants with licences to operate as a water and wastewater undertaker as a result of inset appointments having been made by Ofwat (together, the “**Regulated Companies**”, but unless otherwise expressly stated, references to a “**Regulated Company**” in this Chapter 6 are references to that company in its capacity as a water and sewerage undertaker or, as the case may be, a water undertaker). Further, under the water supply licensing regime, seven water supply licence holders have been appointed to supply certain specific sites within England and Wales. The provisions of the Water Act 1989 are now contained mainly in the consolidating WIA which itself has been substantially amended by the Water Industry Act 1999, the Water Act 2003, the FWM Act and to a lesser extent by various other statutory provisions. References in this Chapter 6 to statutes are to the WIA, as amended, unless otherwise stated.

Regulatory Framework

The activities of Regulated Companies are principally regulated by the provisions (as amended) of the WIA, the WRA and regulations made under these Acts and the conditions of their licences (also referred to as “Instruments of Appointment”). 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 to Ofwat.

The economic regulator for the water and wastewater industry is Ofwat. Ofwat is responsible for, among other things, 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 (the DWI is appointed by the Secretary of State for the Environment, Food and Rural Affairs) and the EA. The DWI's principal task is to ensure that Regulated Companies 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 the Department of Environment, Food and Rural Affairs (“**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 undertaker; 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 regulatory and EU requirements. The EA was established under the Environment Act 1995 and is responsible, in England and Wales, for the protection and improvement of the environment in delivering schemes to improve water quality. The EA's duties include the regulation of abstractions from, and discharges to, controlled waters (which include coastal waters, territorial waters extending three miles from shore, inland freshwaters and groundwater).

There are also specific requirements for development, and requirements for the protection and management of nationally and internationally important wildlife and natural habitats (either on land owned by SWS or on land affected by SWS's wider operations) regulated by Natural England, Defra and the EA.

The description given in this document relates to the structure and regulations that apply in England. Although the structure of the water and wastewater industry is the same in Wales, different regulations sometimes apply. There are different structures and different regulatory frameworks for water and wastewater services in the remainder of the United Kingdom (Scotland and Northern Ireland).

Ofwat and the Secretary of State

Each of the Secretary of State and Ofwat has a primary duty under the WIA to exercise and perform its powers and duties under the WIA in the manner it considers best calculated to:

- further the consumer objective;
- secure that the functions of Regulated Companies are properly carried out throughout England and Wales;
- secure that Regulated Companies are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of those functions; and
- secure that the activities authorised by the licence of a licensed water supplier and any statutory functions imposed on it are properly carried out.

The consumer objective is to protect the interests of consumers wherever appropriate by promoting competition between persons engaged in, or in commercial activities connected with, the provision of water and sewerage services. For the purpose of the consumer objective, the “interests of consumers” requires Ofwat to take into account the interests of all consumers. However, Ofwat must have regard in particular to consumers who are disabled or chronically sick, of pensionable age, with low incomes or residing in rural areas as well as customers of Regulated Companies whose premises are not eligible to be supplied by a licensed water supplier. In addition, the Secretary of State and Ofwat have the power, in exercising any function in relation to water and sewerage services, to have regard to any interests of consumers of gas, electricity and telecommunications services that are affected by the carrying out of that function.

Subject to these primary duties, each of the Secretary of State and Ofwat is required to exercise and perform its powers and duties in the manner it considers best calculated to:

- promote economy and efficiency on the part of Regulated Companies;
- secure that there is no undue preference or discrimination in the fixing of charges;
- protect the interests of customers of Regulated Companies (and companies connected with them) in respect of non-regulated activities 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; and
- contribute to the achievement of sustainable development.

There is also a power for the Secretary of State to issue statutory guidance to Ofwat concerning how Ofwat might contribute to social and environmental policies. There is also a duty on Defra to encourage water conservation and on all public authorities, as defined, to take into account, where relevant, the desirability of conserving water supplied or to be supplied to premises.

Licences

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 that relate to limits on charges, information reporting requirements, various codes of practice, and other matters. In addition to the conditions regulating price limits (see the section “*Economic Regulation*” below), each 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 each 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 Ofwat; provision of combined and wholesale water supplies; and payments to customers for supply interruptions because of drought. Ofwat is responsible for monitoring compliance with licence conditions and, where necessary, enforcing compliance through procedures laid down in the WIA.

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:

- a Regulated Company could consent to the making of a replacement appointment or variation, which changes its appointed area, in which case Ofwat has the authority to appoint a new licence holder;
- under condition O of a licence, where the Secretary of State has given the Regulated Company at least 25 years’ notice and that period of notice has expired;
- under the provisions of the Special Administration regime, the Special Administrator may transfer the business and licence to a successor (see the section “*Special Administration Orders*” below); or
- by the granting of an “inset” appointment over part of a Regulated Company’s existing appointed area to another Regulated Company (see “*Competition in the Water Industry*” below).

Before making an appointment or variation replacing a Regulated Company, Ofwat or the Secretary of State must consider any representations or objections made. In making an appointment or variation replacing a Regulated Company and, where the Secretary of State or Ofwat makes such an appointment or variation, in determining what provision should be made for the fixing of charges by the new Regulated Company, it is the duty of the Secretary of State or Ofwat 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 regards 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 wastewater services on an unserved site, or to a large user of water and/or wastewater 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 50 million litres 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. The inset mechanism continues alongside the introduction of the new regime for licensing new entrants under the Water Act. New entrants have been able to apply for a water supply licence since 1 August 2005. As at January 2013, seven companies hold water supply licences. The new water supply licensing regime is described in more detail in the section “*Competition in the Water Industry – The Water Act*” below.

Modification of a Licence

(a) *Regulatory landscape*

Conditions of a licence may be modified in accordance with the procedures laid down in the WIA. Subject to a power of veto by the Secretary of State of certain proposed modifications, Ofwat may modify the conditions in the licence with the consent of the Regulated Company concerned. Before making the modifications, Ofwat must publish the proposed modifications as part of a consultation process, giving third parties the opportunity to make representations and objections which Ofwat must consider. In the absence of consent, the only means by which Ofwat can normally 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, among other things, 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 Ofwat.

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, Ofwat must then make such modifications to the licence as appear to it 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.

If it appears to the Competition Commission that the proposed modifications are not requisite for the purpose of remedying or preventing the adverse effects specified in its report, the Competition Commission has the power to substitute its own modifications which are requisite for the purpose.

When the FWM Act was at the bill stage (see section "*Competition in the Water Industry – General*" below), there was a proposal to include a collective modification regime whereby Ofwat could make changes to all standard conditions of appointment of Regulated Companies where a certain proportion of the companies (to be specified in an order) agree to the change. These provisions did not make it into the FWM Act which received Royal Assent on 8 April 2010, but may be included in future legislation. In the Draft Water Bill (published in July 2012) clause 23 would allow Ofwat to modify the conditions of Regulated Companies and licensees where that was considered necessary or expedient as a consequence of amendments made by the Draft Water Bill.

The Competition Commission (and the Secretary of State in certain circumstances) now also has, among others, the power to modify the conditions of the licence after an investigation under its merger or market investigation powers under the Enterprise Act if it is concluded that matters investigated in relation to water or wastewater services broadly were anti-competitive or, in certain circumstances, against the public interest.

(b) *Proposed Instrument of Appointment modifications*

In December 2011 Ofwat issued a notice to modify the conditions of appointment of water companies (the "**December 2011 Notice**" under section 13 of the WIA, stating that it wanted to make water companies' licences more flexible in terms of the way price limits are set. (For details of the current price control regime, see "*Economic Regulation*" below). The notice proposed more flexibility in determining the number, form, nature and length of controls at each price determination. In particular, the price adjustment formula of RPI + K would be removed.

The December 2011 Notice invited water companies to indicate their acceptance or otherwise of the proposed modifications. SWS responded on 29 February 2012, stating that it did not accept the proposed amendment to its conditions of appointment. All other water companies refused to accept the December 2011 Notice.

Ofwat subsequently extended its consultation period and, in a notice in August 2012 (the “**Information Notice**”), confirmed that the consultation period with water companies would continue into October 2012. The Information Notice set out five principles which Ofwat would apply in making modifications (i) protecting the financing of wholesale activities; (ii) flexibility to enable price controls to meet future challenges; (iii) a materiality test to ensure that changes are consistent with the first principle of protecting the financing of wholesale activities; (iv) certainty for all stakeholders about the price setting process; and (v) transparency to make sure that the changes and price setting process can be clearly understood.

During the consultation period, Ofwat was in discussion with the water companies in various forums, including through the industry group Water UK, working groups made up of representatives of UK water companies and by meeting with water company CEOs.

On 26 October 2012 Ofwat published a further section 13 notice (the “**October 2012 Notice**”). Ofwat stated in the October 2012 Notice that it had listened to stakeholders’ concerns and made substantial changes to the proposals contained in the December 2011 Notice. It claimed that the revised proposals represented a modest and evolutionary change and built in safeguards to protect the interest of all stakeholders.

In summary, the October 2012 Notice proposed to:

- (i) retain a link between RPI and the price control for capital-intensive wholesale activities;
- (ii) allow separate price controls for retail and wholesale activities;
- (iii) remove specific detail on how retail activities will be regulated;
- (iv) allow Ofwat to set one or more price controls in addition to the RPI-linked wholesale price-control, each of the “appropriate nature, form and level” and each of the appropriate length, for different parts of the Appointed Business;
- (v) designate activities representing up to 20% of total appointed revenues (on an industry wide basis) as “Non-Material Activities”, which will not be subject to the wholesale price control, in any Periodic Review Period;
- (vi) allow Non-Material Activities to amount to up to 40% of total appointed revenues (on an industry wide basis) on a cumulative basis across multiple control periods;
- (vii) allow Ofwat to designate, at any time during a price control period, activities as “Retail Activities” or “Non-Material Activities”;
- (viii) allow Ofwat to designate, at any time during a price control period, any Retail Activity or Non-Material Activity as not being subject to any price controls; and
- (ix) allow the duration of price controls to depart from the five year Periodic Review system currently in use after the 2014 Periodic Review, permitting shorter or longer periods.

On 21 November 2012, Ofwat published a document providing clarification on certain aspects of the October 2012 Notice. Amongst other things, Ofwat explained that certain activities could only be moved out of the RPI + K price control if particular value thresholds were met. However monopoly water distribution and sewage collection and transport activities would always remain with the RPI-linked price control. Ofwat also provided further information on the regulatory safeguards that would remain applicable. It stated that, despite the proposals to grant it greater flexibility in setting price controls, it would still operate in accordance with its statutory duty to ensure that efficient companies are able to carry out the proper financing of their functions.

Ofwat also stressed that companies would still be able to appeal the nature, form, duration or level of any future price control.

The consultation period on the October 2012 Notice closed on 23 November 2012. Out of 24 written responses, Ofwat received eight acceptances and 16 rejections. On 21 December 2012, Ofwat published a third section 13 notice (the “**December 2012 Notice**”), which Ofwat said reflected the comments received from stakeholders in response to the October 2012 Notice. In particular, Ofwat noted that stakeholders had raised concerns about the uncertainty introduced by the extent of the activities which Ofwat could move out of the main wholesale control (see (iv) to (vii) above). The December 2012 Notice noted the importance of consulting on a revised section 13 notice promptly, in order to deliver certainty and facilitate the 2014 Periodic Review. (See “*Periodic Reviews of K*” below for more information on the 2014 Periodic Reviews). The December 2012 Notice proposed the following key changes with respect to the October 2012 Notice:

- (i) The proposals now clarify that there would be two wholesale controls (one for water and one for sewerage).
- (ii) The licence would now specify that all wholesale activities would be subject to the overall wholesale water and sewerage controls, which would remain subject to the RPI + K formula.
- (iii) The duration of the wholesale controls would be fixed at five years and retail controls would be specified as lasting up to a maximum of five years.
- (iv) Ofwat would not have the ability to set new price controls during the Periodic Review Period.
- (v) The licence would include a clause committing companies to use “all reasonable endeavours” to work with Ofwat “in a constructive and cooperative manner” on the development of price controls.

The other key elements of the October 2012 Notice have been retained, including the ability for Ofwat to set separate price controls for retail and wholesale activities, flexibility as to the number and form of retail controls, a generic description of retail activities, and the ability to move activities between wholesale and retail controls during a Periodic Review Period.

In the December 2012 Notice, Ofwat states that, even if its proposed changes are accepted, it will need to adapt its regulation further “to meet future challenges” and that additional modifications to the licence provisions governing price controls will be required perhaps early in the next Periodic Review Period. If the proposals in the December 2012 Notice are implemented, companies will be required to “use all reasonable endeavours” to cooperate with Ofwat in developing future price controls so that they might be appropriately targeted or operated more effectively in respect of specific activities undertaken as part of the Appointed Business (see (v) above).

The deadline for responses to the December 2012 Notice elapsed on 23 January 2013. All 20 Regulated Companies which responded accepted Ofwat’s proposals. However many of the respondents requested further clarification regarding the “all reasonable endeavours” obligation to co-operate with Ofwat (see above). SWS responded to Ofwat on 17 January 2013. It consented to the proposed amendments, subject to the specific wording of Ofwat’s modifications. It also requested further clarity from Ofwat as to how it could positively demonstrate compliance with the proposed “all reasonable endeavours” obligation.

Ofwat stated on 24 January 2013 that all respondents had accepted the changes proposed in the December 2013 Notice and that it will now amend Regulated Companies’ licences in line with these proposals. As yet, no further clarification has been provided regarding the “all reasonable endeavours” obligation.

Water Supply

Each Regulated Company which is a water undertaker has a general duty as such 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 a duty to comply with a water

main requisition provided certain conditions are met, 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. These duties must be carried out, so far as reasonably possible, with the aim of furthering the conservation and enhancement of natural beauty and the conservation of flora, fauna and physical features of special interest, and of maintaining freedom of access to places of natural beauty, buildings, sites and objects of archaeological, architectural and historical interest and providing access and recreation to the public. In addition, it may be required in certain very limited circumstances to connect premises outside its appointed area to one of its water mains and to supply water to those premises. Each Regulated Company is under a duty to promote the efficient use of water by its customers.

Water supplied for domestic purposes or food production purposes must be wholesome at the time of supply, which entails compliance with the Water Supply 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 or apply for an authorised departure to the Secretary of State detailing steps designed to secure or facilitate compliance with those standards. The Secretary of State is not required to take enforcement action for breaches of the Water Quality Regulations if satisfied with the undertakings, or if satisfied that the breaches are of a trivial nature, or if general duties preclude taking enforcement action. The Secretary of State has stated that, except in certain very limited circumstances, it is unlikely that enforcement action will be taken against Regulated Companies which are complying with the terms of their undertakings. Under the WIA, it is a criminal offence for a Regulated Company to supply water which is unfit for human consumption.

Wastewater Services

Each Regulated Company which is a sewerage undertaker has a general duty as such 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 provided certain conditions are met, 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.

Under the Environmental Permitting (England and Wales) Regulations 2010 (“**EP Regulations 2010**”), it is a criminal offence for a person to cause or knowingly permit any poisonous, noxious or polluting matter or trade or sewage effluent to enter controlled waters (including most rivers and other inland and coastal waters) other than in accordance with the terms of an environmental permit. The principal prosecuting body is the EA.

The terms of the environmental permit will depend largely on the type of discharge and when the permit was granted. The EA has discretion as to the terms on which Environmental Permits are granted or existing are altered. The disposal of wastewater sludge from wastewater treatment works is also controlled.

Service Standards

Ofwat makes annual assessments of the serviceability of Regulated Companies’ water and wastewater assets based on data submitted in companies’ annual returns. Ofwat considers four asset categories (water infrastructure, water non-infrastructure, sewerage infrastructure and sewerage non-infrastructure) and assesses each against key performance measures to assess annually whether each category is “improving”, “stable”, “marginal” or “deteriorating”.

Regulated Companies are required to report to Ofwat 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 Ofwat’s guaranteed standards scheme, they may be required to pay compensation to customers.

Under the Water Act, Regulated Companies are required to disclose whether or not they link the remuneration of their directors to levels of customer service attained and to give details of how any links affect remuneration.

Enforcement Powers

The general duties of Regulated Companies as water or sewerage undertakers are enforceable by the Secretary of State or Ofwat or both. The conditions of the licence (and other duties) are enforceable by Ofwat alone whilst other duties, including those relating to water quality, are enforceable by the DWI. Other duties, such as those in respect of water abstractions and discharges, are enforceable by the EA.

Where the Secretary of State (via the DWI) or Ofwat is satisfied that a Regulated Company is contravening, or has contravened and is likely to do so again, or is likely to contravene, its licence or a relevant statutory or other requirement, either the Secretary of State or Ofwat (whichever is the appropriate enforcement authority) must make a final enforcement order to secure compliance with that condition or requirement, save that, where it appears to the Secretary of State or Ofwat 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 Ofwat 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 Ofwat 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 that is in breach. There are exemptions from the Secretary of State's and Ofwat'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, a Section 19 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.

Section 19 Undertakings create obligations that are capable of direct enforcement under section 18 of the WIA. Accordingly, the main implication of a Regulated Company assuming such an undertaking is that any future breach of the specific commitments contained in the undertaking is enforceable in its own right (without the need for further grounding on general statutory or licence provisions).

The WIA also confers powers on Ofwat or the Secretary of State to impose financial penalties on Regulated Companies and the licensees introduced by the Water Act. In certain circumstances, Ofwat and the Secretary of State have the power to fine such a company up to 10 per cent. of its turnover from the preceding 12 months. These circumstances include a failure to comply with licence conditions, standards of performance or other obligations. The penalty must also be reasonable in all the circumstances. In 2007, Ofwat imposed a penalty of £8.5 million on United Utilities Water Plc for non-compliant trading arrangements with associate companies in breach of condition F of its licence. In February 2008, Ofwat penalised SWS a total of £20.3 million for breaching Condition J and/or M of the Licence in respect of regulatory reporting. In April 2008, Ofwat imposed a penalty on Severn Trent Water of 3 per cent. of its turnover (£35.8 million) for breaching the same conditions of its licence. In that same month it also imposed a penalty on Thames Water Utilities Limited of 0.7 per cent. of its turnover (£9.7 million), again for breaching the same conditions of its licence. In October 2008, Ofwat penalised Tendring Hundred Water Services £42,000 for breaching condition M of its licence by submitting unreliable, inaccurate and incomplete information to Ofwat. In March 2010, Ofwat accepted undertakings under section 19(1)(b) of the WIA in relation to South West Water Limited's contravention of Condition J and/or M and failure to meet the standards of performance prescribed by the Water Supply and Sewerage Services (Customer Service Standards) Regulations 1989 (as amended). South West Water Limited gave Ofwat a formal undertaking to improve (at shareholders' expense) its systems and processes by March 2011. In October 2011, Ofwat accepted an undertaking from SWS under s19(1)(b) of the WIA following SWS's breach of its leakage targets in 2009-2010 and 2010-2011. SWS committed to achieve its leakage reduction targets for the following four years. Ofwat also required SWS to return £5 million to its customers at its shareholders' expense.

The Water Act also provides for situations where a new licensee has caused or contributed to a breach of a Regulated Company's licence or caused or contributed to a Regulated Company contravening a statutory or other requirement, or where a Regulated Company has caused or contributed to the breach of a new licensee's licence or caused or contributed to the breach of the latter's statutory or other requirements. In those cases, Ofwat may impose an appropriate remedy. A Regulated Company may appeal a penalty order to the court (the "Court"). The Court may cancel or reduce the penalty or extend the time-scale to pay. The requirement to pay the penalty is suspended until the case is determined. A financial penalty may not be imposed under this provision for an infringement if it is more appropriate to proceed under the Competition Act.

Special Administration Orders

(a) *Circumstances*

The WIA contains provisions enabling the Secretary of State, or Ofwat with the consent of the Secretary of State, to secure the general continuity of water supply and wastewater services. In certain specified circumstances, the Court may, on the application of the Secretary of State or, with his consent, Ofwat, 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 wastewater 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 124 of the Insolvency 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 to adequately participate in arrangements certified by the Secretary of State or Ofwat 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.

(b) *Special Administration Petition Period*

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, 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 modifications: 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 the section "*Restrictions on the Enforcement of Security*" below.

(c) *Special Administrator powers and the Transfer Scheme*

A Special Administrator has extensive powers similar to those of an administrator under the Insolvency Act, but with certain important differences. He is appointed only for the purposes of transferring to one or more different Regulated Companies as much of the business of the Regulated Company as is necessary for the proper carrying out of its water supply or sewerage functions as the case may be and, pending the transfer, of carrying out those functions. During the period of the order, the Regulated Company is managed for the achievement of the purposes of the order and in a manner which protects the respective interests of members and creditors. However, the effect of other provisions of the WIA is ultimately to subordinate members' and creditors' rights to the achievement of the purposes of the Special Administration Order.

Were a Special Administration Order to be made, it is for the Special Administrator to agree the terms of the transfer on behalf of the existing appointee, subject to the provisions of the WIA. 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 Ofwat, as well as the power to exercise any right the Regulated Company may have to seek a review by Ofwat of the Regulated Company's charges pursuant to an IDOK or a Shipwreck Clause. To take effect, the Transfer Scheme must be approved by the Secretary of State or Ofwat. In addition, the Secretary of State and Ofwat 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 Her Majesty's 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.

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 wastewater 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 equally 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 Ofwat) of Protected Land required for carrying out the Appointed Business. In addition, Ofwat can impose conditions on disposals of Protected Land including conditions 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 and the restrictions on enforcement of security thereunder) and of condition K of its licence, a Regulated Company would not expect to obtain the consent of the Secretary of State or Ofwat to the creation of any security over its Protected Land.

Security

(a) 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, the WIA restricts a Regulated Company's ability to dispose of Protected Land (as explained in the section "*Protected Land*" above). Accordingly, its licence restricts a Regulated Company's ability to create a charge or mortgage over Protected Land. In the case of SWS, management believes that the vast majority of SWS's assets by value is tangible property which is Protected Land and cannot therefore be effectively secured.

In addition, provisions in a Regulated Company's licence require the Regulated Company at all times:

- (a) 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 an order could be achieved; and
- (b) to act in the manner best calculated to ensure that it has adequate: (a) financial resources and facilities; and (b) management resources, to enable it to carry out its regulated activities.

These provisions further limit the ability of a Regulated Company to grant security over its assets, in particular assets required for carrying out the Appointed Business, and limit in practice the ability to enforce such security.

(b) 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 Ofwat. If a petition for Special Administration has been presented, leave of the Court is required before such security is enforceable or any receiver can be appointed (or, if a 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 the section "*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, among other persons, the Secretary of State, Ofwat and the creditors of the company. The creditors’ approval of 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.

Enforcement of Security over Shares in Regulated Companies

Under the WIA, the enforcement of security over, and the subsequent sale of, directly or indirectly, the shares in a Regulated Company would not be subject to the restrictions described above in relation to the security over a Regulated Company’s business and assets. Notwithstanding this, given Ofwat’s general duties under the WIA to exercise and perform its powers and duties, among other things, to ensure that the functions of a Regulated Company are properly carried out, the expectation is that any intended enforcement either directly or indirectly of security over, and subsequently any planned disposal of, the shares in a Regulated Company to a third party purchaser would require consultation with Ofwat. In addition, depending on the circumstances, the merger control provisions could apply in respect of any such disposal.

Economic Regulation

General

Economic regulation of the water industry in England and Wales is based on a system of five-year price caps (determined by the Periodic Reviews) 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. The current five-year period is the AMP5 Period spanning 1 April 2010 to 31 March 2015. The framework for setting the price limits for the AMP5 Period is set out below. Ofwat is now consulting on a proposed framework for setting price limits after that date (see “*Ofwat’s Future Price Limits Framework*” below).

The current system of economic regulation is described below. See “*Modification of a Licence – Proposed Instrument of Appointment Modifications*” above for details of Ofwat’s proposed amendments to the price control regime.

K Price Limitation Formula

The main instrument of economic regulation is 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 wastewater

services. The weighted average charges increase is limited to the sum of the percentage movement in the RPI plus K, a company specific adjustment factor. The size of a Regulated Company's K factor (which can be positive, negative or zero) reflects the scale of its capital investment programme, its cost of capital as determined by Ofwat, and its operational and environmental obligations, together with Ofwat's judgment as to the scope for it to improve its efficiency. As such, it may be a different number in different years.

Regulatory Capital Value

Under the methodology developed by Ofwat, the regulatory capital value of Regulated Companies is a critical parameter underlying price limits set at Periodic Reviews, being the value of the capital base of the relevant Regulated Company for the purposes of calculating the return on capital element of the determination of K. The value of the regulatory capital value to investors and lenders is protected against inflation by adjusting the value each year by RPI. In addition, Ofwat's projections of regulatory capital value takes account of the assumed net capital expenditure in each year of a Periodic Review Period.

For the 2009 Periodic Review, Ofwat introduced the Capital Expenditure Incentive Scheme ("CIS"). Under the CIS, the RCV is adjusted at the subsequent price review to reflect the actual level of net capital expenditure. Under or over performance against the final determination assumptions is reflected in a revenue penalty or reward. For the purposes of these comparisons, SWS expects the allowed capital expenditure to be adjusted for differences between the assumed Construction Output Prices Index and the actual level. For these purposes, Ofwat makes an assumption regarding the relationship between movements in the RPI and movements in COPI. At the 2009 Periodic Review, SWS's RCV was adjusted by, amongst other things, substituting the actual movement in COPI for that assumed in 2004. An adjustment may also be made to the RCV to reflect differences between the level of land sales assumed by Ofwat in setting prices and the actual levels achieved.

Revenue Correction Mechanism

The primary purpose of the Revenue Correction Mechanism is to remove the scope of a company to either over or under-recover tariff basket revenue relative to assumptions made at the Periodic Review. Actual turnover will be driven primarily by key physical factors such as metered volumes, metering programmes and new property growth. These will depend on external factors such as the weather, economic growth and customer behaviour. The Revenue Correction Mechanism makes an adjustment in the next AMP Period, based on actual turnover compared to the Final Determination turnover assumption (adjusted for inflation).

Under or over-recovery of revenue is calculated for each year of the current AMP Period, with the cumulative impact being adjusted in K over each year of the next AMP Period.

Bulk Supply Charges

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 January 2008 Ofwat published a consultation, on its proposed strategy for future charges and its updated charging principles entitled "*Our Future Strategy for Customer Charges for Water and Sewerage Services*". The conclusion of that consultation which was published in April 2008, confirmed Ofwat's general approach that prices should be cost-reflective and based on the principles of fairness and equity, affordability, simplicity and transparency and should incentivise suppliers and consumers to promote efficient usage and sustainable development. In March 2010, Ofwat set out its proposed principles in relation to the assessment of bulk supply pricing, namely that prices should reflect the costs reasonably associated with the provision of the service, facilitate the efficient use of resources and effective competition, and be consistent

with the duties and obligations of the supplier. Its conclusions following consultation were published in February 2011 and contained these principles.

Periodic Reviews of K

K factors are currently re-determined by Periodic Review every five years. Following the last Periodic Review, new price limits took effect from 1 April 2010 and were set for the AMP5 Period subject to interim determinations. The industry average price limit for 2012-13 is 1.6% (2011-12 0.3%). The average price limit for water and sewerage companies for 2012-13 is 1.7% (2011-12 0.2%).

Interim Determinations of K

(a) *Notified Item*

A Notified Item is any item formally notified by Ofwat to the Regulated Company as not having been allowed for (either in full or at all) in K, provided that there has been no Periodic Review subsequent to that notification. Notified Items put forward by Ofwat in the determination of price limits for the Regulated Companies in the AMP5 Period are: (i) increases in household bad debt and debt management costs resulting from worsening economic circumstances in a company's operating area; (ii) increases in the environmental improvement unit charge component of abstraction charges above the retail price index to cover the compensation costs of the Environment Agency's Restoring Sustainable Abstraction programme; (iii) increased costs necessary to balance water supply and demand, based on companies' application of the UK Climate Projections data published by the UK Climate Impacts Programme on 18 June 2009 and appropriate analytical tools and processes; and (iv) costs associated with the impact of the introduction of permit schemes made pursuant to the Traffic Management Act.

(b) *Relevant Changes of Circumstances*

Relevant Changes of Circumstance are defined in the licences. Such changes include: (i) 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 wastewater undertaker); (ii) any difference in value between actual or anticipated proceeds of disposals of Protected Land and those allowed for at the last Periodic Review or IDOK; (iii) 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 (a) 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 (b) the stated purpose has not otherwise been achieved; and (in some licences) (iv) movements in construction prices so as to differ from those assumed in the determination.

An IDOK 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 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 wastewater 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 Ofwat is required to apply.

(c) ***Shipwreck Clause***

In addition, under the substantial effects clause, in the licence of a Regulated Company, the Regulated Company or Ofwat is permitted to request price limits to be reset if its Appointed 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 except that the 10 per cent. threshold is replaced by a 20 per cent. threshold.

Other Restrictions on Charging

Under the WIA, Regulated Companies must charge for water supplied, or wastewater services provided, to dwellings in accordance with a charges scheme which cannot take effect unless approved by Ofwat 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.

References to the Competition Commission

If Ofwat fails within specified periods to make a determination at a Periodic Review or in respect of an IDOK or if the Regulated Company disputes its determination, the Regulated Company may require Ofwat to refer the matter to the Competition Commission for determination by it after making an investigation. 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 Ofwat. The decisions of the Competition Commission are binding on Ofwat. Bristol Water was the only Regulated Company to dispute the Final Determination for the AMP5 Period.

Other Restrictions on Charging

Under the WIA, Regulated Companies must charge for water supplied, or wastewater services provided, to dwellings in accordance with a charges scheme which cannot take effect unless approved by Ofwat 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.

The Walker Review of charging for household water and sewerage services

In February 2008 Defra launched an independent review of charging for household water and sewerage services (“**Walker Review**”). The Walker Review, announced in “*Future Water – the Government’s Water Strategy for England*” published on 7 February 2008 includes the examination of the current system of charging for households for water and sewerage services in response to the more acute pressure on supply and demand, a greater awareness of wider environmental impacts and the increasing concerns about fairness and affordability in the existing system. It will include consideration of social, economic and environmental concerns and will make recommendations which could include changes to current legislation and guidance.

The final report was published on 8 December 2009. It set out findings and 70 recommendations, including the following key areas:

Costs and Charging

- (a) The EA and Ofwat should continue to work on methods of valuing water in a way that reflects its full future value.
- (b) The basis of water charges should continue to move away from the current system of a mixture of rateable value and volume consumed, towards a system based on volume consumed only. The speed at which this can be achieved depends on the costs of metering and the affordability of such a transition.
- (c) The Government should consider transferring existing highway drainage charges from sewerage customers to local highway authorities.

Capital Expenditure Incentive Scheme

Ofwat has also introduced the CIS, a new incentive mechanism for capital expenditure. Under the CIS, Regulated Companies recover their actual capital expenditure, plus or minus revenue rewards or penalties that depend on how closely their expenditure forecasts compare to their actual expenditure.

The CIS allows for symmetric treatment of capital expenditure over-spends and under-spends. If a Regulated Company under- or over-spends, compared to the allowed capital expenditure within the AMP, the RCV is corrected within the next price review to reflect the actual expenditure which occurred. In addition to the correction of the RCV, such Regulated Company's revenues are also adjusted to give a reward/penalty for the performance in the previous AMP, as per the CIS mechanism.

Drinking Water and Environmental Regulation

EU Law Generally

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. It should be noted that many of the EU Directives which outline standards for the aquatic environment and therefore affect Regulated Companies have cyclical review cycles, usually of four to six years. The transposition into UK law and interpretation of these EU Directives by the EA and Defra also remain under review. Investment consequences for Regulated Companies of either EU wide or UK focused reviews are taken into account in the Periodic Review process, principally through their inclusion in the EA's National Environment Programme ("NEP").

The investment consequences for the AMP5 Period of the Directives listed below have been discussed and agreed with the EA as part of the 2010-15 Periodic Review process. Further details of these were outlined in the Final Business Plan and Ofwat has subsequently approved the funding of a suite of schemes to deliver the requirements of these Directives with one exception which will be the subject of a Change Protocol request.

SWS maintains a 'Legal Register' which lists legislation relevant to the ISO 14001 certification of its environmental management system.

Water Framework Directive

Directive 2000/60/EC establishing a framework for community action in the field of water policy (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 and improvement of ground, inland and coastal waters from hazardous substances and to promote sustainable water consumption. The Water Framework Directive was transposed into English and Welsh law by the Water Environment (Water Framework Directive) (England and Wales) Regulations 2003 which came into force on 2 January 2004. The Directive is set out over three 'six year' cycles, the first of which commenced in December 2009 with the publication of River Basin Management Plans. These plans included programmes of measures that Regulated Companies and other parties will need to

undertake to achieve the objectives of the Water Framework Directive. These require specific actions on the part of Regulated Companies, to be undertaken within defined timescales. These actions include improving sewage works at various locations, and working with the EA to modify abstraction licences for certain areas to achieve more sustainable levels of abstraction. These programmes of measure are likely to cause Regulated Companies to incur material expenditure. However, these measures were captured in the NEP and subsequently received funding approval through the Periodic Review process. Spreadsheets showing the full programmes of measures and detailing the involvement of individual Regulated Companies for each River Basin Management Plan can be viewed on the EA website (<http://www.environment-agency.gov.uk>). To comply with the Water Framework Directive, Member States will have to ensure all their waters achieve at least “good status” by 2015, or set out alternative standards and/or a timetable for the achievement of these by no later than 2027. The Water Framework Directive is expected to have a significant impact on Regulated Companies in the longer term, particularly post-2015.

It is noteworthy that many of the investments driven by the Water Framework Directive will also increase the level of carbon emissions of Regulated Companies. Targets set by the Government in this regard will need to be addressed by other means like the Carbon Reduction Commitment (CRC), which are likely to incur additional costs or penalties.

On 17 June 2008, the European Parliament and Council reached agreement on the text for a new directive on environmental quality standards for water. This directive (the Priority Substances Directive (2008/105/EC)) entered into force on 13 January 2009 and has been transposed into UK law through the River Basin Districts Typology, Standards and Groundwater Threshold Values (Water Framework Directive) (England and Wales) Direction 2010 (the “**Typology Direction**”) and the River Basin Districts Surface Water and Groundwater Classification (Water Framework Directive) (England and Wales) Direction 2009. The Priority Substances Directive replaces five existing directives, and sets harmonised quality standards for “priority” substances (those which are most harmful to the aquatic environment, such as mercury), thereby translating the concept of “good status” into transparent numerical values.

A programme of investment for the AMP5 Period was agreed with the EA and was detailed in the Final Business Plan which was submitted to Ofwat. This programme sets out further investigations that Regulated Companies must undertake. These studies will inform what, if any, material investment could follow in the AMP6 Period to ensure compliance with the Water Framework Directive.

Groundwater Directive

A new groundwater directive (Directive 2006/118/EC) (the “**Groundwater Directive**”) was adopted in December 2006. Under the Groundwater Directive, Member States are required to monitor and assess groundwater quality on the basis of common criteria and to identify and reverse trends in groundwater pollution. If groundwater quality is improved, Regulated Companies may benefit from reduced costs in cleaning abstracted water. However, there is also a possibility that Regulated Companies may have to bear part of the costs of complying with the new Directive. Member States had until 16 January 2009 to bring into force laws, regulations and administrative provisions to implement the new Directive. The UK implemented the Groundwater Directive as the Groundwater (England and Wales) Regulations 2009 (the “**Groundwater Regulations**”) which came into force on 30 October 2009. However, these regulations have now been repealed and replaced by the EP Regulations 2010. This regime may generate compliance costs to meet the requirements to protect, enhance and restore groundwater bodies and to reverse any significant upward trends of pollutants. Investment schemes and an investigation have received funding approval from Ofwat within the Periodic Review process to address these issues during the AMP5 period.

Urban Waste Water Treatment Directive

The Urban Waste Water Treatment Directive (91/271/EEC) (“**UWWTD**”) relates to the collection, treatment and discharge of urban wastewater. The UWWTD lays down minimum requirements for the treatment of municipal wastewater and for the disposal of sewage sludges which arise from the treatment process and aims

to control the discharge of industrial wastewaters. Receiving waters are classified according to their “sensitivity” to nutrient enrichment, with “sensitive” waters being subject to more stringent treatment requirements. Pursuant to the European Commission commencing infraction proceedings against the UK, alleging that it had failed to implement the UWWTD correctly by inaccurately designating “sensitive” waters, the case was referred to the ECJ, judgement was handed down on 10 December 2009, with the ECJ finding that the UK was not in breach of the UWWTD in respect of certain coastal and estuarial waters since the four criteria for eutrophication established by EU case law were not met. This is a significant decision for Regulated Companies since, had the ECJ found the UK was in breach of its obligations, Regulated Companies may have been required to make material investment in further treatment processes which would in due course be expected to be funded through the normal Ofwat price setting mechanism.

However, in June 2010 the EC commenced infraction proceedings against the Government for its implementation of the UWWTD in relation to untreated waste water discharges at combined sewer overflows (CSOs) in four specific localities (Whitburn, Beckton, Crossness and Mogden). The case has been referred to the ECJ where it was heard on 10 November 2011. The final judgment has not yet been issued, however, a non-binding opinion in favour of the EC was delivered on 26 January 2012 by one of the ECJ’s Advocate-Generals. Whilst the localities concerned do not fall within SWS’s catchment area, there is a possibility that a clarified test relating to untreated discharges may lead to further regulations being introduced to regulate all CSOs, which would be likely to require material investment. However, it would be expected that this would be funded either through an IDOK or through the normal Ofwat price setting mechanism.

The UWWTD has been transposed into UK legislation by the Urban Waste Water Treatment Regulations 1994 (as amended) as further described below (“*Discharge into Controlled Water*”). Schemes to address this driver have received funding approval from Ofwat within the Periodic Review process for delivery during the AMP5 Period, with one exception which SWS will address via the Change Protocol process.

Bathing Waters Directive

The Bathing Waters Directive (2006/7/EC) was adopted and published early in 2006 and has now been transposed into UK law by the Bathing Water Regulations 2008, which came into force on 14 May 2008.

The main objective of this directive is to improve public health protection, while taking account of changes in science and technology and bathing water management since the original 1976 Directive was adopted. The revised directive sets four new standards of water quality (excellent, good, sufficient and poor) and all bathing waters shall be expected to achieve at least the “sufficient” classification by 2015, with limited exceptions. Key aspects of the new directive include an obligation to meet a much tighter minimum bathing water quality standard, rationalisation of the water quality parameters to be monitored, new rules for the frequency of sampling and improved provision of information to the public concerning bathing water quality. SWS has investigations with funding approval for delivery during the AMP5 Period which focus on those sites which are ‘at risk’ of not achieving the ‘sufficient’ classification. These investigations may recommend further capital investment in the AMP6 Period.

Water Quality Directive

The EU’s Directive on the Quality of Water intended for Human Consumption (98/83/EC) (the “**Drinking Water Directive**”) sets standards for water intended for drinking, food preparation or other domestic purposes and has been implemented by the Water Quality Regulations, which came into force in full on 1 January 2004. The Water Quality Regulations were amended in 2007 introducing the requirement for wider catchment risk assessments and a Drinking Water Safety Plan (“**DWSP**”) approach to safeguarding the quality of drinking water supplies. A revision to the Drinking Water Directive is also being considered to bring a DWSP approach to European legislation.

Habitats and Birds Directives

Directive 92/43/EEC on the conservation of natural habitats and wild flora and fauna (“**Habitats Directive**”) and Directive 2009/147/EC on the conservation of wild birds (“**Birds Directive**”) (the codified version of its predecessor Directive 79/409/EEC) establish a network of areas protected by designation across Europe called “Natura 2000” to conserve endangered habitats classified as special protection areas (“**SPA**”) under the Birds Directive and Special Areas of Conservation (“**SAC**”) under the Habitats Directive. Once a site is designated, Member States must take steps to avoid the deterioration of habitats and disturbance of species. This has involved a review of any existing abstraction consent and Environmental Permits that are likely to impact upon a protected area. Regulated Companies are likely to have sites located within or adjacent to SPAs or SACs, which could materially affect operations and the ability to abstract water in or adjacent to such designated areas. The designation of SPAs and SACs, pursuant to the Habitats Directive, may negatively impact upon a Regulated Company’s plans for future sites or operations. This risk is significantly increased by the effects of climate change, such as the increasing risk of drought. Schemes to address this driver have received funding approval from Ofwat within the Periodic Review process for delivery during the AMP5 Period, with one exception which SWS will address via the Change Protocol process.

Freshwater Fish Directive

The Directive (2006/44/EC) (as amended by Regulation (EC) No 1137/2008) on the quality of fresh waters needing protection or improvement in order to support fish life (“**Fish Directive**”) aims to encourage healthy fish populations by protecting and improving the quality of rivers and lakes. It sets water quality standards and monitoring requirements for areas of water which are designated by Defra as significant bodies of water which are capable of supporting fish populations. In the UK, the Fish Directive is implemented through the Surface Waters (Fishlife) (Classification) Regulations 1997 (as amended). A total of 34,500km of rivers and canals and more than 200 still waters are designated under the directive. The list of designated waters is held on the Defra website in a series of Schedules. In 2013, the Fish Directive will be repealed. Waters currently designated as Fish Directive waters will become protected areas under the Water Framework Directive (2000/60/EC) (as amended). Schemes to address compliance with the Fish Directive are driving investment in the AMP5 Period and have received funding approval from Ofwat within the Periodic Review process.

Shellfish Waters Directive

The Directive (2006/113/EC) (as amended by Regulation (EC) No 1137/2008) on the quality required of shellfish waters (“**Shellfish Directive**”) aims to protect shellfish populations, by maintaining the high quality of shellfish in waters. It sets the standard for water quality in estuaries and other areas where shellfish grow and reproduce. Under the Shellfish Directive, waters that are inhabited by shellfish need to be monitored for certain substances, which are threatening their survival, inhibiting their growth, or making them too expensive to treat before they can be used as a food source. For each of these substances, the Shellfish Directive specifies the minimum number of samples to be taken and the percentage of samples that must meet these standards. In the UK the Shellfish Directive is implemented through the Surface Waters (Shellfish) (Classification) Regulations 1997 (as amended) and the Surface Waters (Shellfish) Directions 2010. The Shellfish Directive will be repealed in 2013 by the Water Framework Directive (2000/60/EC) (as amended) and shellfish waters will be classified as protected areas. Schemes to address compliance with the Shellfish Directive are driving investment in the AMP5 Period and have received funding approval from Ofwat within the Periodic Review process.

Environmental Liability Directive

In April 2004, a European Directive (2004/35/EC) on “environmental liability with regard to the prevention and remedying of environmental damage” (the “**Environmental Liability Directive**”) came into effect. It aims to both prevent and remedy environmental damage, including water pollution, damage to biodiversity and land contamination, which causes serious harm to human health. Under the Environmental Liability Directive, operators responsible for certain prescribed activities (for example, abstraction and discharge activity that requires authorisation) 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 repair the damage. Member States had until 30 April 2007 to implement the Environmental Liability Directive into national law, which was completed in England with the enactment of the Environmental Damage (Prevention and Remediation) Regulations 2009 which came into force on 1 March 2009. Although the Regulations only apply to post-1 March 2009 environmental damage, the Directive may well have a significant impact on Regulated Companies whose operations cause damage to the environment and biodiversity that goes beyond damage already covered by existing statutory regimes.

Strategic Environmental Assessment Directive

Directive 2001/42/EC on the assessment of the effects of certain plans and programmes (“**SEA Directive**”) states that its objective is “to provide for a high level of protection of the environment and to contribute to the integration of environmental considerations into the preparation and adoption of plans and programmes with a view to promoting sustainable development”. The SEA Directive has been transposed in England by the Environmental Assessment of Plans and Programmes Regulations 2004, which came into force on 20 July 2004. It requires an “environmental assessment” of certain plans and programmes. The SEA Directive defines “environmental assessment” as a procedure comprising:

- (i) preparing an Environmental Report on the likely significant effects of the draft plan or programme;
- (ii) carrying out consultation on the draft plan or programme and the accompanying Environmental Report;
- (iii) taking into account the Environmental Report and the results of consultation in decision making; and
- (iv) providing information when the plan or programme is adopted and showing how the results of the environmental assessment have been taken into account.

Water Resources Management Plans may fall within the scope of the SEA Directive, if their preparation began on or after 21 July 2004. This means that affected Regulated Companies may have to prepare a report on the likely significant environmental effects of their plans, consult environmental authorities and the public, and take the report and the results of the consultation into account during the plan preparation process and before the plan is adopted. A strategic environmental assessment was undertaken on SWS’ draft Water Resources Management Plan published in April 2008 for consultation. The strategic environmental assessment was updated in line with the final SWS Water Resources Management Plan published in December 2009.

Pollution Prevention and Control and Sludge Directive

The EC Integrated Pollution Prevention and Control Directive (96/61/EC codified and recast as 2008/1/EC) (the “**IPPC Directive**”) establishes the integrated Pollution Prevention and Control Regime (“**PPC Regime**”) implemented in England through the EP Regulations 2010, which aims to achieve a high level of protection of the environment as a whole by providing an integrated approach to pollution control. Under the PPC Regime, there is a basic prohibition on operating certain prescribed industrial “installations” except under, and to the extent authorised by, a specific permit. The Commission launched a review of the IPPC Directive in November 2005 which culminated in the publication on 21 December 2007 of the Commission’s proposal for a Directive on industrial emissions (integrated pollution, prevention and control) (recast) (the “**Industrial Emissions Directive**”), which proposes to consolidate seven existing Directives regarding industrial emissions including the Waste Incineration Directive (2000/76/EC) and includes a number of changes regarding new and existing activities. This new Industrial Emissions Directive (Directive 2010/75/EU) has now been approved and will replace the IPPC Directive and the Waste Incineration Directive from 7 January 2014.

Recycling treated sludge to agricultural land as a fertiliser and soil conditioner is the major outlet for this material. Current controls of this activity are based on the EU Directive on the Protection of the Environment, and, in particular, of the Soil, when Sewage Sludge is used in Agriculture (86/278/EEC) (as amended) (the “**Sludge Directive**”). Among other things, the Sludge Directive sets out limits for concentrations of heavy metals and prohibits the use of sludge on certain crops.

Incineration of sewage sludge with energy recovery is regulated under the PPC Regime and certain permit conditions applying to incineration are set in accordance with the Waste Incineration Directive (2000/76/EC) (implemented through the permitting requirements of the EP Regulations 2010).

Responsibility for monitoring the condition of the environment is increasingly being transferred by legislation from the EA to the industry: REACH

Regulation (EC) 1907/2006 concerning the registration, evaluation, authorisation and restriction of chemicals (“**REACH**”) came into force on 1 June 2007, and is the EU’s main chemicals legislation. It places responsibility on the industry (rather than the authorities) to manage the risks posed by chemicals to human health and the environment. The main obligation on EU manufacturers and importers of chemicals (from outside the EEA) is registration of data about the relevant chemicals with the European Chemicals Agency. When REACH came into force, it required manufacturers or importers of chemicals to pre-register the basic details about these chemicals by 1 December 2008, in order to avail of a series of phased in deadlines for full registration of detailed chemical data. Failure to pre-register a substance by this date (or within 6 months of first manufacturing or importing over 1 tonne per annum) means that the substance cannot be manufactured, imported or put on the EU market until the full registration process is completed. Downstream users of chemicals have an obligation under REACH to ensure that suppliers are aware of the uses and exposure scenarios relating to their business and ensure that these are reflected in safety data sheets and registration dossiers. Under REACH, Regulated Companies are likely to be downstream users of chemicals (though may also be importers) and are required to ensure their suppliers have registered the chemicals used at water and wastewater treatment works, and other operations. There is no requirement under REACH to pre-register substances that Regulated Companies manufacture, such as ozone, as these are defined as intermediates and are generated and used in site without ever being isolated. The European Chemicals Agency released guidance on 4 May 2010 (which was updated in December 2010) regarding the definition of “intermediates” under REACH.

REACH may impact upon the compliance costs of Regulated Companies, which are likely to be downstream users of chemicals, even if they do not have registration obligations as manufacturers or importers.

SWS has assessed all of its on-site chemical “production” processes and determined whether it was required to pre-register under REACH by 1 December 2008. All of SWS’ processes were either not captured by REACH or are exempt. SWS has written to all of its major chemical suppliers requesting details of their pre-registration process. SWS’ supply chain will not be affected by its suppliers failing to pre-register. SWS has complied with Article 35 of REACH to ensure that the most up to date safety data sheet information is available to all employees via the intranet and that health and safety and environmental risk assessments can be made from the data sheets.

United Kingdom Law Generally

The water industry is subject to numerous regulatory requirements concerning human health and safety and the protection of the environment. Non-compliance with many of these requirements may potentially constitute a criminal offence. However, the Regulatory Enforcement and Sanctions Act 2008 (“**RESA**”) allows the Secretary of State to confer powers on the regulators to impose civil penalties (such as fixed monetary penalties) on businesses as an alternative to criminal prosecution in relation to a number of environmental offences. Through the Environmental Civil Sanctions (England) Order 2010 the Secretary of State conferred these powers on the Environment Agency and Natural England. If a civil sanction is imposed, any potential criminal liability falls away. The criminal burden of proof of “beyond reasonable doubt” is used rather than the civil burden of “balance of probabilities”. The introduction of these powers will mean that minor environmental offences cases will be dealt with outside the criminal system by the regulators with appeals being handled by a tribunal, and only the most serious cases going to the criminal courts. This will give the Environment Agency more flexibility, and is expected to result in more enforcement activity for relatively minor offences. Whilst the risk that adverse publicity related to court hearings may therefore be lessened, the Environment Agency will be required to publish details of any sanctions imposed.

Abstraction Licensing

Under the WRA, water abstractions must be carried out in accordance with a licence granted by the EA. It is a criminal offence to abstract water without a licence or in breach of the conditions of an abstraction licence. The maximum penalty is an unlimited fine. The Water Act amends the abstraction licensing system in England and Wales to ensure the sustainable use of water. The EA may revoke abstraction licences in the interests of environmental protection where a licence has not been used for four years. No compensation would be available for any loss suffered as a consequence of any such amendment or revocation. Existing abstraction licences may be revoked or varied where the Secretary of State believes that revocation or variation is necessary to protect any waters or underground strata, or any flora and fauna dependent on them, from serious damage and from 15 July 2012 such variations and revocations can be made without compensation being payable. Defra consulted on this right to vary or revoke in February 2012 and confirmed that the EA will assess each licence against a set of principles before recommending to the Secretary of State whether the modification or revocation is needed to protect the environment from serious damage. Also included in the Water Act is a provision requiring all new abstraction licences to be time-limited (and the Government has previously indicated that it expects most existing licences to be converted to a time-limited basis over time) and a provision creating a new right for third parties to claim damages against an abstractor for loss or damage due to water abstraction. Any new licence with a duration of more than 12 years must contain a “curtailment condition” which allows the EA to give the licence holder 6 years’ notice of the abstraction licence changing to a lower authorised quantity without compensation being paid.

Following its publication of the Water White Paper “*Water for life*” on 8 December 2011, Defra published the Draft Water Bill for pre-legislative scrutiny on 10 July 2012. The Draft Water Bill includes measures to strengthen the water sector’s ability to respond to the challenges of a growing population and less certain water supplies. The Government wants to put in place a more flexible abstraction regime which will enable abstractors to respond to variations in water availability as the climate changes. This is a significant programme of reform, which may involve modifying over 30,000 abstraction licences, and which creates risks and uncertainty for abstractors. The Government are currently working closely with abstractors in order to inform the shape of the new regime and will formally consult on detailed proposals for abstraction reform by the end of 2013. Implementation is expected to be phased to minimise disruption to abstractors and allow the reforms to be tailored to the circumstances of different catchment areas. The capital cost of replacing any deployable output lost as a result of the non-renewal, revocation or modification of any abstraction licences is likely to be material.

Since the Water White Paper was published, the Government has been preparing for a transition to a new regime and Ofwat has also confirmed in its report “*Future price limits – statement of principles*” its proposal to disincentivise environmentally damaging abstraction through the Abstraction Incentive Mechanism (AIM). Ofwat also published an independent report on 2 October 2012 confirming that AIM can be applied in practice and plans to use the findings of its report to inform its development of AIM. As the reforms to the abstraction framework as set out in the Water White Paper and the Draft Water Bill are implemented, the need for this mechanism should fall away.

Changes to the charges levied by the EA in connection with abstraction licences for 2008-2009 became effective from 1 April 2008, arising from compensation payments for environmental improvements under the Restoring Sustainable Abstraction programme. Ofwat has recognised that the new charging scheme has the potential to increase charges to water undertakers but in its Final Determination in November 2009 has not allowed the increase in charges to be recoverable from customers. In any event, the increase in water abstraction charges is unlikely to have a material effect on the financial position of SWS.

In April 2001, the EA launched the Catchment Abstraction Management Strategies (“*CAMS*”) process which is a part of the Government’s plans to reform water resources licensing. For the purposes of managing water resources, the EA has divided England and Wales into catchment areas and has formulated a local strategy for each catchment area based upon sustainable use of water resources. The strategy gives details of the water

resource availability in the catchment area and informs the EA's abstraction licensing policies for that area. CAMS are also the vehicle for reviewing time-limited abstraction licences and determining whether and on what terms they should be renewed.

If an abstraction licence potentially affects a site designated under the Conservation (Natural Habitats &c.) Regulations 1994 (as amended), the licence must be reviewed in accordance with those Regulations, a process called "appropriate assessment". All licences, including abstraction licences, were reviewed by the EA to ensure that they do not adversely affect sites designated under the Habitats Regulations between 2000 and March 2010 (the "**Review of Consents**"). The capital cost of replacing any deployable output lost as a result of the nonrenewal revocation or modification of any abstraction licences is likely to be material.

Water rights trading has also been considered by the EA as part of the implementation of the Water Act. At present, licences may be transferred from one abstractor to another subject to approval by the EA but the circumstances in which this is possible are limited. The EA's proposals address the procedural changes brought about by the Water Act's changes to the rights needed to apply for a licence, the need to advertise applications and the requirement to specify land on most licences. The ability to trade water rights without needing to specify land to which they apply is the key change and is expected to foster the creation of a true market in the rights. The EA published its consultation document on the proposals in June 2003 ("*Trading Water Rights - a consultation document*") and responses to that consultation in March 2004. The EA and Ofwat undertook a joint project in 2008 to explore the barriers to abstraction licence trading and published a final report in February 2009 making recommendations to encourage future water rights trading. SWS does expect to engage in trading in the water rights market. It would be likely to trade with a limited number of licence holders, namely other water companies, large industrial abstractors or farmers. Instances of such trading would be few. Furthermore, SWS would not wish to reduce through long-term trades the licensed quantities of water it would have available for sale to its customers. Consequently, the impact of the new framework for water rights trading on SWS might present future opportunities.

Water Quality

The DWI can take enforcement action in the event that a Regulated Company 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 Chief Inspector of Drinking Water for the offence of supplying water "unfit for human consumption", for example if discoloured or foul-tasting water is supplied to customers. The Public Bodies Act 2011 allows charges to be imposed on water undertakers and licensed water suppliers for functions performed by inspectors appointed under the WIA, namely the DWI.

Pollution Prevention and Control

There are separate legislative controls over discharges to water courses from certain environmentally hazardous processes under the Pollution Prevention and Control Regime (the "**PPC Regime**") which was introduced in the UK by the Pollution Prevention and Control Act 1999 (and the Pollution Prevention and Control Regulations 2000 made under that Act, the "**PPC Regulations**"). On 6 April 2008, the Environmental Permitting Regulations 2007 came into force, replacing the PPC Regulations and combining PPC and waste management licensing, bringing in a new regime (the "**Environmental Permitting Regime**"). The Environmental Permitting Regulations 2007 have now been replaced by the Environmental Permitting (England and Wales) Regulations 2010 (as amended) (the "**EP Regulations 2010**"). Since the introduction of the Environmental Permitting Regime, PPC Permits are now known as "environmental permits" in the UK. The aim of the Environmental Permitting Regime is to protect the environment from the potentially harmful effects of industrial installations: operators of certain such installations are required to be authorised by the EA (or local authority) under an environmental permit and are 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, certain water company activities can be subject to the Environmental Permitting Regime. As the application of the Environmental Permitting Regime to SWS' current operations

requires bespoke environmental permits for certain sites where combustion of sludge gas (biogas) occurs, SWS holds permits for the following sites:

- (a) Budds Farm – Combined heat and power (“CHP”) installation with thermal input of more than 3 megawatts;
- (b) Millbrook – CHP installation with thermal input of more than 3 megawatts;
- (c) Ashford – sludge dryer and CHP installation with thermal input of more than 3 megawatts;
- (d) Hastings – sludge dryer with thermal input of more than 3 megawatts; and
- (e) Ford – sludge dryer with thermal input of more than 3 megawatts.

The 2009 Periodic Review business plan recognises future implications of the Environmental Permitting Regulations and includes capital expenditure and operating expenditure requirements that will ensure that future compliance will be achieved.

The case of *United Utilities Water v Environment Agency* [2007] All ER (D)234, extended the application of the Environmental Permitting Regime to include treatment operations at wastewater treatment works which produce sludge. On appeal, the House of Lords in its judgment in October 2007 confirmed that wastewater treatment works carrying out intermediate wastewater treatment are covered by the PPC Regulations (as replaced by the EP Regulations 2010), even though final treatment and disposal takes place elsewhere. Pursuant to legislation passed on 10 March 2010, ground water authorisations and discharge consents were included in the Environmental Permitting Regime with effect from 6 April 2010 pursuant to the EP Regulations 2010 coming into force.

The EA continues to attempt to simplify and rationalise the regulatory regime, including that relating to the PPC Regime. These “better regulation” initiatives intend to transfer monitoring responsibilities from the EA to the relevant companies. The Draft Water Bill (published in July 2012) also extends the scope of the Environmental Permitting Regime to include water abstraction and impounding licences and flood defence consents in order to reduce the administrative burden for companies and further simplify the regime.

The EA introduced an Operational Risk Appraisal (“OPRA”) system and Operator Self Monitoring (“OSM”) system to the regulation of discharges to water from Regulated Companies in April 2009. This allows the EA to assess pollution hazards and to determine how many site visits a site should receive and what an operator should pay in fees and charges. As the responsibility, and therefore the cost, of monitoring passes to operators, the EA has announced its intention to reduce subsistence charges to cover the extra costs associated with OSM and also to reward good management through reduced OPRA scores and subsistence charges. The EA 2012/13 subsistence charge applicable from April 2012 depends on four factors: the maximum daily volume of discharge permitted; the content of the discharge; the type of receiving water; and the annual financial factor (currently set at £684).

Sewage Sludge

The recycling of sewage sludge by using it on agricultural land as a fertiliser and soil conditioner is recognised by the European Parliament and the European Commission as the Best Practicable Environmental Option for such material. Such recycling must be in accordance with the Sludge (Use in Agriculture) Regulations 1989 (as amended and supported by a Code of Practice for Agricultural Use of Sewage Sludge (DoE 1996)) (the “**Sludge Regulations**”). The Government is currently amending these Regulations, but the water and wastewater industry has already invested for, and is complying with, the forthcoming amendments in advance of them coming into force. These amendments will give statutory effect to the water and wastewater industry’s voluntary agreement with the British Retail Consortium under the Safe Sludge Matrix. The European Commission is currently considering proposals to amend the EU’s 1986 Sludge Directive (86/278/EEC). There may be some tightening of metals and organic limits, in addition to following the UK approach on pathogen

standards. However, the use of treated sludge in agriculture is recognised as important by the Commission, and they have a stated objective “to increase the quantity of sludge that is used on land in a sustainable manner”.

It should be noted that sludge use in agriculture is subject to both market forces and legislation. Significant changes to markets or legislation could cause Regulated Companies to incur material expenditure. Changes in legislation would potentially represent “Relevant Changes of Circumstance” by Ofwat in relation to licences of Regulated Companies.

Some sewage sludge is also used to generate renewable energy through anaerobic digestion facilities which in turn reduces energy costs.

Climate Change

Energy use in water and wastewater treatment processes results in emissions of greenhouse gases and constitutes a significant environmental impact resulting from a Regulated Company’s activities. Regulated Companies are significant energy users and subject to the climate change levy.

In December 2010 the Government undertook a review of the climate change levy with the aim of giving more certainty and support to the carbon price. In its 2012 Budget, the Government announced that the climate change levy discount on electricity for participants in climate change agreements will be increased to 90 per cent. from April 2013, to continue to support energy intensive businesses exposed to international competition. The Climate Change Agreement scheme has been extended until 2023. The Government consulted on simplification of this scheme and implemented its changes through the Climate Change Agreements (Administration) Regulations 2012, which came in to force on 1 October 2012. Under the new simplified scheme the EA will be appointed as administrator and the Government has aligned the timing of the administration of the scheme with both the CRC and the EU ETS. The Regulations also set out what a scheme participant will have to pay if they have failed their target (through a buy-out mechanism) and include details of the proposed new penalty regime which the EA can impose for non-compliance under the scheme.

SWS may incur increased costs in the future due to increased electricity prices to account for carbon trading schemes applicable to electricity generators. There will be tighter caps on emissions and full auctioning of allowances to most electricity generators in Phase III of the EU Emissions Trading Scheme (“**EU ETS**”) that will run from 2013 to 2020. This is likely to give rise to a restriction on supply resulting in higher prices for carbon that are expected to be passed on by the generators to consumers in the price of electricity. The UK Government’s recent introduction of a carbon price floor for electricity generation, which will apply from 1 April 2013, is also likely to affect electricity prices in the future. This is likely to lead to increased costs for electricity consumers such as SWS. Further impact on electricity prices can also be expected following the Government’s implementation of its plans to reform the UK’s electricity market (“**Electricity Market Reform**”). In this context, on 12 July 2011 the Government published ‘Planning our electric future: a White Paper for secure, affordable and low-carbon electricity’ and a Technical Update in December 2011 as part of its Electricity Market Reform package. Following these commitments, the Draft Energy Bill was introduced to Parliament on 29 November 2012 and contains provisions intended to incentivise investment in low carbon generation. Implicit throughout the publications on Electricity Market Reform is the fact that whilst the Government will aim to ensure that the costs of a low-carbon transition are as low as possible for electricity consumers, such costs will inevitably rise in the short to mid-term.

Separately, in November 2008, Parliament enacted the Climate Change Act 2008, which includes a framework for the adoption of environmental trading schemes. In January 2011, under the Climate Change Act 2008, SWS submitted a Climate Change Adaptation Report to Defra to report on the current and predicted impact of climate change on its functions and its proposals and policies for adapting to climate change. SWS must also comply with any guidance or directions made by the Secretary of State under the Act.

The Climate Change Act 2008 also requires that the Government must regulate for mandatory carbon reporting on greenhouse gas emissions by April 2012 or explain to Parliament why no such regulations have been made.

On 20 June 2012, plans to introduce mandatory carbon reporting from April 2013 for all UK incorporated companies whose share capital is listed on the Main Market of the London Stock Exchange or in an EEA state or is admitted to either the New York Stock Exchange or the Nasdaq were announced and draft regulations have been published for consultation. Relevant companies will be required to report on the same organisational basis as for financial reporting. SWS will not currently fall within such mandatory carbon reporting requirements, however, the Government plan to revise the regime in 2015 to take a decision on whether to extend the reporting requirement to all large companies.

As large consumers of electricity, Regulated Companies are affected by the UK Carbon Reduction Commitment Energy Efficiency Scheme (the “**CRC**”). The CRC Energy Efficiency Scheme Order (the “**CRC Order**”) entered into force on 22 March 2010. The CRC is a mandatory cap and trade scheme, which commenced on 1 April 2010 and which is applicable to organisations whose half-hourly metered electricity consumption is greater than 6000MWh in the qualification period (which for the first phase of the CRC is the calendar year 2008). This is intended to capture organisations with annual electricity bills across all sites in the region of £1 million or more. To determine whether this threshold is exceeded, the half hourly metered UK electricity consumption of all subsidiaries within a corporate group as at the end of the qualification period (31 December 2008 for the first phase) are aggregated and the highest UK parent company assumes the obligations under the CRC on behalf of the whole group. Emissions that are covered under the EU Emissions Trading Scheme or by climate change agreements are typically exempt from the CRC. The scheme started in April 2010 with an introductory phase in which allowances will be sold from April of each year. Initially, the first phase was intended to run to April 2013, but it will now be extended to April 2014 by the CRC Energy Efficiency Scheme (Amendment) Order 2011. In the first phase, the sale of allowances is retrospective and commenced in April 2012 in respect of the 2011-2012 compliance period, (the first year of the Scheme was a reporting year only). Under the current CRC Order, the Government will impose a cap on the number of allowances available in Phase 2 and these will be auctioned to participants. Allowances with respect to 2012/13 emissions will be £12 per tonne of carbon dioxide (tCO₂). Participants are currently ranked according to their performance in the CRC in a league table that is publicly available to provide a reputational driver to the CRC. Following an announcement in the Government Spending Review in October 2010, funds raised from the sale/auction of allowances will no longer be recycled to participants but will be used to support the public finances, including spending on the environment.

On 10 December 2012, the Government published a response to its March 2012 consultation on simplifying the CRC in order to reduce the administrative and regulatory burden on participants. The Government has confirmed that from 2014 onwards the CRC will be simplified, including the abolition of the performance league table and reducing the number of fuels covered by the CRC from 29 to 2 (electricity and gas used for heating). In the December 2012 Autumn Statement, the Government indicated that the price of CRC allowances will be £16/tCO₂ in 2014/15 and from 2015/16 onwards the price will be increased in line with RPI. Potential impacts of the CRC on Regulated Companies include the costs associated with improving energy efficiency, the net costs of purchasing allowances (which will increase with RPI), and the administrative costs of participating in the scheme. The net cost to Regulated Companies depends on their ability to implement energy efficiency improvements during the term of the CRC.

The water and wastewater industry has also made a commitment to a 20 per cent. target for renewable energy by 2020 and to research how it might better manage non-CO₂ greenhouse gas emissions from wastewater treatment.

Climate change appears to have been a main driver in the Government’s new water strategy. On launching the strategy in February 2008, the Government stressed the need to reduce carbon dioxide emissions from water undertakers, to improve efficiency and to reduce demand and wastage. Some of the strategy’s proposals that may have the potential to impact Regulated Companies in the future include: (i) an independent review into water charging to advise on the role of metering and charging in the future and whether there is a need to move beyond the current system where companies in seriously water stressed areas may introduce mandatory

metering where there is a clear case for doing so; (ii) new proposals to tackle surface water drainage; and (iii) proposals to make the abstraction licensing system more able to cope with climate change in order to maintain a balance between demand for essential supplies and protection of wildlife and aquatic environments. Social and Environmental Guidance was issued to Ofwat in 2008. This Guidance together with the Statement of Obligations (a compendium of the key environmental and drinking water statutory obligations that was sent to all water and sewerage undertakers on 21 December 2007) were Defra's first contribution to the 2009 Periodic Review of water price limits by Ofwat. Defra has subsequently published a Water White Paper "*Water for life*" on 8 December 2011 followed by the Draft Water Bill on 10 July 2012. The Water White Paper focussed on the future challenges facing the water industry and aimed to provide a clear direction and policy framework for the future (see further "*Abstraction Licensing*" above).

By nature, Regulated Companies are exposed to the risk of increasing drought and consequent loss of abstraction resources resulting from the effects of climate change. It is likely that the use of such resources will become increasingly regulated as governments work to comply with their international obligations pertaining to the environment and as such resources become scarce. As a consequence and in order for Regulated Companies to comply with such increasing regulation and to adapt to and mitigate the risk of decreasing abstraction resources, it is likely that this will be a future area of investment for these companies. To the extent that such investment is not allowed by Ofwat for whatever reason, this may constitute a material liability for the relevant company.

Contaminated Land

Part 2A of the EPA, together with certain implementing regulations and statutory guidance, establishes a legal regime to address the remediation of contaminated land (including controlled waters). Current and future impacts may be dealt with under other pollution control laws instead (for example, if the contamination arises out of an activity regulated under the Environmental Permitting Regime). Under Part 2A, 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 it is causing, or there is a significant possibility of it causing, significant pollution of controlled waters. The higher threshold of "significant" pollution of controlled waters was introduced in 2012 and has been effective since 6 April 2012. 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. 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 and liability for contamination may also rest with a Regulated Company where the contamination emanating from its land arose as a result of the activities of one of its statutory predecessors. In practice, remediation of contaminated land is most likely to be triggered on the cessation of regulated activities or the redevelopment of land. Updated statutory guidance on Part 2 of the EPA was issued by Defra in April 2012. The guidance has been split between non-radioactive contamination but (apart from bringing in a higher threshold for water pollution) no major changes have been made to the regime.

The Environmental Damage (Prevention and Remediation) Regulations 2009 also give the EA and local authorities the power to order remediation by companies in instances where their activities cause damage to the environment or biodiversity, and where such damage is not within the scope of existing statutory regimes.

Asbestos

The Control of Asbestos Regulations 2012 impose a duty on those who own or control commercial premises to carry out detailed assessments for the presence of asbestos, record its condition and proactively manage the associated risks.

Trade Effluent Discharge

Regulated Companies are responsible under the WIA for regulating discharges of trade effluent into their sewers. Industrial and trade sources of wastewater to sewers arise from a wide range of industries, such as food

manufacturers, car washes and laundries. Regulated Companies regulate these discharges to protect their operations and the environment.

Under section 118 of the WIA, an owner or occupier of premises who wishes to discharge trade effluent into public sewers must apply to the relevant Regulated Company for consent to do so. In considering whether or not to grant such a consent, the Regulated Company will usually have regard to the effect that receiving the effluent will have on the performance of its wastewater treatment works and associated discharges. Such a consent may be subject to conditions imposed by the Regulated Company. These conditions can stipulate treatment to be undertaken to minimise the polluting effects of the discharge, as well as charges to be paid in respect of the trade effluent discharge. Under the Trade Effluents (Prescribed Processes and Substances) Regulations 1989 (SI 1156) (as amended), when trade effluent contains prescribed substances, or more than a prescribed quantity of such substances, or derives from a stipulated process (that is “**special category effluent**”), the Regulated Company must refer to the EA any application to make such a discharge. The EA must then determine whether, and if so upon what conditions, the Regulated Company may accept the discharge. The Regulated Company cannot consent to the discharges to which the reference relates until the EA serves notice on the Regulated Company of its determination on the reference. Any person aggrieved by the refusal of a Regulated Company to give consent or by conditions imposed in a consent can appeal to Ofwat.

The Regulated Company may review the terms of any consent from time to time and vary those terms by notice. However, this power is subject to restrictions. In addition, in certain circumstances, the EA has the power to review discharges of special category effluent, and may require the termination or variation of the relevant discharge. Again, this power is subject to restrictions, unless the review is required to enable compliance with EU obligations or international agreements, or for the protection of the environment.

A Regulated Company may enter into an agreement with the owner or occupier of trade premises for the reception and disposal of trade effluent, instead of granting a consent. If the trade effluent which is to be the subject of an agreement is special category effluent, the Regulated Company must refer to the EA the question of whether the relevant operations should be prohibited or made subject to conditions. The Regulated Company cannot enter into any agreement regarding special category effluent until the EA serves notice on the Regulated Company of its determination in this regard.

It is an offence to discharge trade effluent from trade premises without a consent from, or an agreement with, the relevant Regulated Company, or to fail to comply with the conditions in a consent, and in both cases the maximum penalty is an unlimited fine.

Discharge consents are also subject to the Review of Consents undertaken by the EA under the Habitats Directive as referred to above, which could lead to modification or revocation of the same. The implementation of the Water Framework Directive and subsequent relevant directives will also drive trade effluent consent reviews, tightening trade effluent consent limits.

Sewer Flooding

When a “combined” sewerage system, which carries both sewage and surface water run-off, reaches its capacity during heavy rainfall, a mixture of surface run-off and sewage overflows into rivers or out of external or internal drains. Section 94 of the WIA places a duty on every Regulated Company to ensure its area is properly drained via an adequate sewerage system. This duty is enforceable by the Secretary of State or Ofwat who, under section 18 of the WIA, may make an Enforcement Order securing compliance. Householders can bring proceedings against the Regulated Company in respect of its failure to comply with such an Enforcement Order. However, where such an order has not been made, the only remedy available to such householders is to request that the Secretary of State or Ofwat makes an order and, if one is not forthcoming, to pursue judicial review proceedings against either the Secretary of State or Ofwat on the grounds of their failure to act. Householders do not have the right directly to enforce section 94 against Regulated Companies. This was confirmed by the House of Lords’ decision in *Marcic v Thames Water Utilities* [2003] UKHL 66.

In *Environment Agency v Thames Water Utilities Limited* [2008] EWHC 1763 (QB), the EA prosecuted Thames Water Utilities Limited for a number of offences alleged to have occurred in 2003, including the deposit of untreated sewage constituting “controlled waste” without a waste management licence (now an environmental permit) contrary to section 33(1)(a) of the EPA. A preliminary point of law was referred by the Divisional Court to the ECJ (Case C-252/05) as to whether or not sewage escaping from a sewer governed by the UWWTD and the WIA falls within the scope of domestic waste controls implementing the Waste Framework Directive 75/442/EEC (as amended by Directive 91/156/EEC and eventually replaced by Directive 2008/98/EC). The ECJ ruled that wastewater which escapes from a sewerage network maintained by a statutory wastewater undertaker pursuant to Council Directive 91/271/EEC of 21 May 1991, constitutes waste within the meaning of the Waste Framework Directive. The ECJ also ruled that it falls to the national court to ascertain whether national rules outside of those implementing the Waste Framework Directive may be regarded as “other legislation” containing precise provisions organising the management of the waste in question, and if they are such as to ensure a level of protection of the environment equivalent to that guaranteed by the Waste Framework Directive. On 28 July 2008, the Divisional Court held that sewage escaping from pipes maintained by a statutory undertaker is “controlled waste” within the meaning of section 33 of the EPA, and thus falls within the UK’s waste management regime (now Environmental Permitting Regime) and is subject to the enforcement authority of the EA. This decision may result in significant and costly changes to the operational practices of sewerage undertakers.

The FWM Act contains provisions requiring the Secretary of State to set national standards for sustainable drainage and for prohibiting the construction of certain new drainage systems without approval of (generally) a local authority. The FWM Act’s requirements on local authorities to adopt and maintain sustainable drainage systems (SUDS) and on developers to demonstrate that they have met national standards for sustainable drainage before they can connect any residual surface water drainage to a public sewer (amending section 106 of the WIA) is expected to result in less water reaching sewerage treatment works, reduced maintenance work for sewerage companies and a reduced risk of flooding from overflows. The Draft Flood and Water Management Bill also contained a provision to give Regulated Companies the right to tackle misconnections with sewers directly, instead of through local authorities, making this process cheaper, quicker and more efficient and reducing pollution which can cause sewer overloading. This provision was not included in the FWM Act but may be legislated for at a later date.

The UK has experienced prolonged periods of rain during 2012 which has put pressure on combined sewerage systems and the EA has issued numerous flood alerts and flood warnings throughout the year. In order to address flooding risks SWS has carried out a £1.5 million scheme to create storage ponds to hold water during heavy rain at Hoo St Werburgh in Kent and has completed a £4.7 million scheme to reduce the risk of sewer flooding at Brambridge in Hampshire. SWS has commenced construction in Portsmouth of a £20 million scheme to separate rain from wastewater and provide flood protection for Southsea.

Combined Sewer Overflows (“CSOs”)

The development of urban drainage systems has evolved over time. Sewage systems are designed to cope with the combined flow of sewage and storm water up to a particular level, which is consented to by the EA (the “**Consented Discharge**”). Where, during heavy rains, the level of sewage and storm water exceeds the level that the sewerage systems are designed to cope with, the Consented Discharge is allowed to flow into the relevant watercourse in order to prevent flooding in the surrounding area. The drainage systems vary considerably in their age, design, and hydraulic performance and the EA regulate and monitor the impact of these discharges on the aquatic environment. Any discharges which are considered to be unsatisfactory may be required to be improved through the investment programme agreed as part of the Periodic Review process.

It is a requirement of the UWWTD that Member States limit the pollution of receiving waters by untreated sewage discharge. To meet this requirement, the EA uses performance criteria to assess the impact of CSOs and to determine whether they should be regarded as “satisfactory” or “unsatisfactory”. CSOs will be regarded as unsatisfactory if, for example, they cause a breach of water quality standards or other EC directives, they cause

or significantly contribute to a deterioration in river chemical or biological quality/class, or they cause a significant visual or aesthetic impact due to solids or sewage fungus and have a history of justified public complaint. See further “*Urban Waste Water Treatment Directive*” above.

Discharge into Controlled Waters

If Regulated Companies wish to discharge polluting matter into controlled waters, whether from continuous or intermittent (Storm/CSO) outfalls, they must seek an environmental permit from the EA. Since 1 April 2010, applications are made under EP Regulations 2010 (although consents under the WIA may be required for works carried out at reservoirs, wells or boreholes where discharges are made through pipes of a certain size). The EA has the power to grant or refuse permits, to impose conditions, or to modify, vary or revoke such permits. Permit conditions may control the quantity of a discharge or the concentrations of particular substances in it, or impose broader controls on the nature of a discharge. They are based on objectives set by the EA for the quality of the relevant receiving water as well as any relevant water quality standards in EU Directives.

Non-compliance

The EP Regulations 2010 provide for a number of water pollution offences which include causing or knowingly permitting any poisonous, noxious or polluting matter or any trade or sewage effluent to enter controlled waters unless the relevant discharge is made under and in accordance with a regulatory consent (including an environmental permit), and failing to comply with the conditions in an environmental permit. The maximum penalty for these offences is an unlimited fine or five years’ imprisonment, or both.

Under the EP Regulations 2010, a Regulated Company will be regarded as responsible for a discharge of sewage effluent if it was bound to receive into its sewers the matter included in that discharge. However, a Regulated Company will not be guilty of an offence under the EP Regulations 2010 if the offending discharge is attributable to a discharge into a sewer by a third party which the Regulated Company was not bound to receive and could not reasonably have been expected to prevent.

Groundwater

Activities that could lead to the contamination of groundwater such as direct and indirect discharges of pollutants to groundwater, are regulated under the EP Regulations 2010. The definition of a pollutant includes substances harmful to human health or the quality of aquatic ecosystems. The EP Regulations 2010 require a permit for such discharges. Direct discharges, which are those ones which enter, without percolation, straight into groundwater, are controlled under the Environmental Permitting Regime. Any permits granted must be consistent with the requirements of the EP Regulations 2010. Indirect discharges, which are those which enter groundwater following percolation through ground or subsoil, may arise from the disposal or tipping for the purposes of disposal to land of pollutants, and applications for permits for them will also be made to the EA under the EP Regulations 2010. The EA also has the power under the EP Regulations 2010 to issue prohibition notices to stop activities which may cause a direct or indirect discharge of pollutants to groundwater, for example, oil from underground storage tanks. Before issuing such notices, the EA must take account of any code of practice issued for the purposes of the EP Regulations 2010.

Hazardous Substances

Regulated Companies operate facilities which house hazardous substances (e.g. oil, polychlorinated biphenyls (“PCBs”)) and which therefore could be subject to the following regulatory requirements: (i) the Control of Pollution (Oil Storage) (England) Regulations 2001 (as amended), which require that all new and existing above ground storage facilities holding more than 200 litres of oil have minimum design standards to prevent spilt or leaking oil from entering controlled waters; (ii) the Environmental Protection (Disposal of Polychlorinated Biphenyls and other Dangerous Substances) (England and Wales) Regulations 2000 (as amended), which regulate electrical equipment that contains PCBs (for example, since 31 December 2000, holding PCBs or equipment containing PCBs has been prohibited); and (iii) the Control of Major Accident Hazards Regulations 1999 (as amended) (“**COMAH Regulations**”) which give effect to a safety regime for the prevention and mitigation of major accidents at establishments where named dangerous substances or

dangerous substances falling within certain generic categories are present in specified quantities. The COMAH Regulations apply at two thresholds, the lower tier and the top tier, depending upon the quantities of dangerous substances that are present. Operators must comply with lower tier duties (such as taking all measures necessary to prevent major accidents and limit their consequences) and operators that have quantities of dangerous substances over the higher threshold are subject to the additional top tier duties (such as preparation of a safety report).

Management of Water Resources

Water Resources Planning

The Water Act amends the WIA to provide that Regulated Companies are under a duty to further water conservation when they formulate or consider any proposal relating to their functions and has placed water resources management plans on a statutory footing: Regulated Companies are now under a duty to produce Water Resources Management Plans and publish and consult upon them. These plans will set out how the Regulated Company will manage and develop water resources so as to be able, and continue to be able, to meet its water supply duties under the WIA. It must address, amongst other things, the Regulated Company's estimate of water it will need to meet its duties, and the measures it intends to take to manage and develop resources. The planning period is 25 years. Plans will be subject to an annual review (the conclusion of which must be sent to the Secretary of State) and will have to be revised every five years, or in any case where the annual review indicates a material change in circumstances, or the Secretary of State directs that a revised draft should be prepared. In the past, Regulated Companies have produced Water Resources Management Plans on a voluntary basis every five years and produced an annual review for the EA each subsequent year.

As described above, Water Resources Management Plans are likely to fall within the scope of the Strategic Environmental Assessment Directive (2001/42/EC), if their preparation began on or after 21 July 2004. In addition, the plans will need to take account of the Habitats Directive (92/43/EEC) and the likely effect of any measures on protected habitats.

Drought Planning

There are various water restriction options available to Regulated Companies in times of drought, which could be applied, in the order set out below, depending on the severity of the drought situation and the approval of either Defra or the EA.

- Voluntary water restrictions which generally involve press campaigns to encourage customers to voluntarily restrict their use of water.
- Hosepipe ban which prohibits such activities as the watering of parks, gardens and landscaping, ornamental fountains, the filling of swimming pools and the washing of buildings and private boats. Watering gardens with watering cans or using buckets to wash cars is permitted. These restrictions were empowered by the WIA (as amended by the FWM Act). They can be implemented following express notice and do not require Defra or EA consent.
- An Ordinary Drought Order is granted by Defra and allows a Regulated Company to stop or limit the use of water for a range of purposes specified in the Drought Direction 1991 (made by the Secretary of State), such as: watering of parks and sport or recreation grounds; ornamental fountains; cleaning the exteriors of buildings; and washing of road vehicles, railway rolling stock, aircraft (other than for safety/hygiene). An Ordinary Drought Order lasts for up to six months, but can be extended up to a year.
- A Drought Permit is granted by the EA and allows a Regulated Company to take water from new sources, or increase the amount of water taken from existing sources. A Drought Permit lasts for up to six months, but can be extended up to a year.

- An Emergency Drought Order is granted by Defra and allows a Regulated Company to limit usage “for such purposes as it thinks fit”, and to set up standpipes or water tanks to provide water during rota cuts. Emergency Drought Orders can last for up to three months, but can be extended up to five months.

The necessary powers for an Ordinary Drought Order, a Drought Permit and an Emergency Drought Order are provided under the WRA.

Regulated Companies are under a statutory duty to consult on, prepare and maintain a drought plan. This plan should prescribe how the Regulated Company will continue during a period of drought to discharge its duties to supply adequate quantities of wholesome water with as little recourse as reasonably practicable to Drought Orders or Drought Permits.

The plan must include measures that the Regulated Company might need to take to restrain the demand for water in its water region and those it might need to take to obtain extra water from other sources. The Secretary of State may issue directions as to the content of the plan. Drought plans must be reviewed within three years of the date they were published and should be revised or reviewed if there is any material change of circumstances or if the Secretary of State directs. SWS’s final drought plan was approved by Defra and published by SWS in September 2008. An updated version of the drought plan was published in draft by SWS in February 2012. Following the consultation period, a statement of response was published in May 2012 and SWS will publish an updated drought plan incorporating relevant stakeholder responses in 2013 unless the Secretary of State directs otherwise.

The Draft Water Bill changes the statutory timeframe for drought plans to a 5 yearly maximum cycle to align with other water planning cycles such as Ofwat’s price reviews. However, the Secretary of State will retain the discretionary power to compel companies to prepare drought plans more frequently if circumstances require it.

Sustainability Reductions

The management of water resources by Regulated Companies is subject to a number of challenges, including: dry weather conditions; climate change; increasing demands for water; rises in leakage rates; aquifer contamination from industrial and agricultural pollution; and reductions in abstraction required to ensure sustainable river systems. In relation to the latter, the EA has been instructed by Defra to use its powers to revoke damaging abstraction licences. The Restoring Sustainable Abstraction Programme was set up by the EA in 1999 with the purpose of investigating and, where appropriate, resolving the impacts of abstraction on sites designated by statutory drivers (for example, the Habitats Regulations) and undesignated sites of concern to local communities.

In previous years, funding for environmental sustainability reductions has been provided through the Periodic Review with the solution chosen to achieve the abstraction reduction (such as use of an alternative water supply source) being funded prior to its implementation. This funding mechanism is no longer available for the AMP5 Period and subsequent AMP Periods. Licence reductions will now be funded through the payment of compensation by the EA, with the money being paid after the licence reduction. The EA plans to raise the funds through the abstraction charges scheme, the majority of which charges are paid for by Regulated Companies. In its Final Determination in November 2009, Ofwat has not allowed for increases in abstraction licence charges to fund the sustainability changes through an environmental improvement unit charge, although Ofwat has included this increase in abstraction licence charges as a Notified Item. From 2012, the EA has the power to lower the authorised quantity of existing abstraction licences without paying compensation, so long as it gives six years’ prior notice. At this time, a funding route for sustainability reductions will need to be found, and it is possible that the Periodic Review mechanism will be used again.

Planning and Environmental Impact Assessment

All development carried out by Regulated Companies requires either planning permission from the relevant local planning authority, or, if the proposed development is categorised as a Nationally Significant Infrastructure Project (“NSIP”), the grant of a development consent under the Planning Act 2008. Where a

development requiring planning permission is considered to be permitted development under the Town and Country Planning (General Permitted Development Order) 1995, planning permission for it is granted by the development order without any application being made.

The relevant local planning authority will consider applications for planning permission against the backdrop of the development plan compiled for its area, which sets out objectives, policies and proposals for the use of land. Major projects, such as the development of new pipelines or reservoirs, or the construction of or extensions to wastewater or water supply works, may also be subject to an environmental impact assessment (“EIA”) under the Town and Country Planning (Environmental Impact Assessment) (England and Wales) Regulations 2011 (the “EIA Regulations”). An EIA is a procedure for drawing together in a systematic way a project’s likely significant environmental effects. Projects falling within Schedule 1 of the EIA Regulations (for example, a wastewater treatment works with a capacity exceeding 150,000 population equivalent) will require an environmental impact assessment in every case. Projects falling within Schedule 2 of the EIA Regulations (for example a wastewater treatment works which does not fall within Schedule 1) will require an assessment only if they are judged likely to give rise to significant environmental effects.

The main part of the assessment is the environmental statement which contains: a description of the development, a description of measures to be taken to mitigate environmental effects, the data necessary to identify and assess the main environmental effects, an outline of the main alternatives to the development and a non-technical summary. The environmental statement will generally accompany the planning application that is submitted to the local authority. The EIA Regulations require that the statement be publicised: public authorities with relevant environmental responsibilities and the public must be given an opportunity to give their views about the project and the statement. The local planning authority is under a duty to take into account the environmental statement, together with any representations made on it, in determining the planning application.

Applicants have the right to appeal against a decision to refuse an application for permission. Appeals from a decision of the local planning authority are normally dealt with by the Planning Inspectorate on behalf of the Secretary of State.

The Government is undertaking a radical reform of the planning regime in England and Wales. A national planning framework was published in 2012 which sets out in a concise form the Government’s planning policies aimed at encouraging growth. The framework includes a policy that there is a presumption in favour of granting planning permission for sustainable development. The Localism Act 2011 contains a number of provisions affecting planning including: the abolition of regional planning; changes to the local plan approval process designed to speed this process up; allowing neighbourhoods the opportunity to have a much greater say on the developments carried out in their area; changes to the planning appeal and enforcement procedures; and changes to the procedures for determining applications for development consent for NSIPs.

Under the Planning Act 2008, any development defined as a NSIP, which includes the construction or extension of a dam/reservoir, development relating to the transfer of water resources and the construction of waste water treatment plants (where these developments are of the scale prescribed in the legislation), must be granted development consent pursuant to the new regime set out in the 2008 Act. A developer seeking development consent is required to follow a detailed pre-application procedure which will involve both publicity and consultation. Following the changes made to the Planning Act 2008 development consent regime by the Localism Act 2011, applications for development consent are processed by the Planning Inspectorate which will appoint an Inspector or panel of Inspectors to act as Examining Authority to examine the application. An Examining Authority is under a statutory duty to complete its examination within six months and must prepare a report on the application for the relevant Secretary of State charged with determining the application within three months of the end of the examination. The report must contain a recommendation to the Secretary of State who must determine the application within three months. It is possible to challenge a decision to refuse or grant development consent by Judicial Review, which must be brought in the High Court within 6 weeks. The intention of the legislation is that major planning applications will be dealt with more efficiently and quickly. EIAs will need to be conducted as part of development consent applications.

Rather than planning permission being granted against the backdrop of the local development plan the Examining Authority and the Secretary of State must have regard to any national policy statement (“NPS”), which has been designated and is relevant to the NSIP for which development consent is sought. NPSs are statements prepared by the Government following consultation, which set out the national planning agenda on such matters as water and waste requirements and incorporate social, economic and environmental policies. NPSs must be the subject of parliamentary scrutiny and require the approval of the House of Commons before they can be designated. The NPS for waste water was designated in March 2012 after it had been the subject of public consultation and parliamentary scrutiny. No draft of an NPS relating to water supply has yet been published.

Another effect of the Planning Act 2008 is the introduction of a community infrastructure levy (“CIL”) which is a charge payable by the developer/owner to fund local infrastructure. The regulations to implement CIL came into force on 6 April 2010. Before they can charge CIL, local planning authorities have to prepare charging schedules. CIL will be charged on new development which increases floor space.

Competition in the Water Industry

General

Each Regulated Company effectively holds a geographic monopoly within its appointed area for the provision of water and wastewater services although there is some limited competition. Ofwat has stated that it will use its 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:

- (i) inset appointments which allow one company to replace another as the statutory undertaker for water or wastewater services in a specified geographical area within the other Regulated Company’s appointed territory. Insets can be granted for sites which do not already receive public water and/or sewerage services, sites on which premises use more than a given quantity of water per annum (currently 50 million litres), or where the incumbent undertaker consents to an inset appointment;
- (ii) facilitating developers, or their contractors, to provide new water mains and service pipes instead of asking Regulated Companies to do the work (“**self-lay**”). The Water Act introduced a statutory framework for self-lay (see below);
- (iii) water supply licence (retail) – when a water supply licensee purchases wholesale supplies of water from the existing water undertaker and supplies water to a customer’s eligible premises (i.e. using more than 5 megalitres per annum). The Water Act introduced a statutory framework for such licences. Regulated Companies have published indicative access prices, based on the “costs principle” which indicate the approximate scale of discount they would offer to licensees. The threshold was recently reduced from 50 megalitres per annum (see “*Regulatory Developments*” below);
- (iv) water supply licence (combined) – when a water supply licensee introduces water into the supply system and supplies water to its customer’s eligible premises using a Regulated Company’s network (referred to as “**common carriage**”). All Regulated Companies maintain access codes which set out the conditions, including indicative access prices, under which licensees may introduce water into their networks;
- (v) cross-border supplies (raw/treated and sewage/sludge) 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
- (vi) private suppliers or private sewers including on-site water and effluent treatment.

The Water Act

The Water Act contained provisions aimed at increasing the opportunities for competition in the supply of water services to non-household high-volume users. The eligibility threshold for such users is set currently at 5 megalitres per year (having been reduced from 50 megalitres per year by the Water Supply (Amendment to the Threshold Requirement) Regulations 2011), though there are proposals to abolish the threshold altogether (see “Water Supply (Amendment to the Threshold Requirement) Regulations 2011” below).

The Water Act introduced a system to license new water suppliers either under a “retail licence” or a “combined licence”. The new licensing system commenced on 1 December 2005. A “retail licence” enables the holder to purchase water from the Regulated Company to supply to its customers through a wholesale agreement with the Regulated Company. Retail services could range from simply contracting with the customer to provide a supply and billing for the supply, to a much wider range of services including water efficiency planning, metering and providing tailored customer services. A “combined licence” is a retail licence with a supplementary authorisation to allow the holder to introduce water into the supply system (“**common carriage**”) in connection with a supply to customers’ premises in accordance with its retail authorisation. Such a licensee may have its own water sources or it may purchase water from a neighbouring Regulated Company to import into the “local” Regulated Company’s supply system. This introduction must be done through an access agreement with the relevant Regulated Company. Before a combined licence is granted, the Secretary of State must be consulted so that the DWI can give its assessment as to the applicant’s suitability to introduce water into the public supply network. Regulated Companies are excluded from holding a retail or combined licence but an associated company of a Regulated Company may do so.

Before a Regulated Company is required to provide a wholesale supply of water to a licensee in respect of customers in the Regulated Company’s appointed area, certain conditions must be satisfied. Where a request is made for such a wholesale supply, the Regulated Company is under a duty to take steps to enable the supply to be made and to provide that supply in accordance with terms agreed with the supplier or determined by Ofwat, for example, connecting a new customer to the main. However, there are certain circumstances in which the duty on a Regulated Company to supply a licensee does not apply.

Equally, certain conditions apply when Regulated Companies are required to allow licensees with a combined licence to introduce water to their supply systems. The duty on Regulated Companies to allow licensees to introduce water is limited to where a request is in connection with a specific supply to a customer under the licensee’s retail authorisation. The Regulated Company will also be under this duty where it has agreed (outside the competition provisions in these clauses) to treat a licensee’s water so that it can be introduced into the supply system and, in connection with that introduction, the licensee requests that the Regulated Company permit the licensee to then introduce water into the supply system for the supply of its customers. The Regulated Company that receives a request to introduce water to its supply system must take steps to permit this in accordance with the terms agreed with the licensee or determined by Ofwat. Such steps may include laying a pipe to connect the licensee’s treatment works with the Regulated Company’s supply system. However, there are certain circumstances in which the duty on the Regulated Company to allow the licensee to introduce water to its supply system does not apply.

A licensee may seek a determination from Ofwat as to whether a refusal on the part of the Regulated Company to provide a wholesale supply or to permit water to be introduced was justified. Where the terms cannot be agreed with the Regulated Company for such an arrangement, Ofwat will determine the terms and conditions and, if the licensee agrees, these will form the contract. The charges payable by the licensee under the agreement or determination must be fixed in accordance with the costs principle.

The costs principle, as set out in section 66E of the WIA (introduced by section 56 of the Water Act), is that Regulated Companies are to recover from licensees two elements of cost to the extent that those sums exceed any financial benefits the Regulated Companies receive as a result of the licensee using the system:

- (i) the direct costs of providing any wholesale supply to a licensee or permitting the introduction of water into the supply system; and
- (ii) an appropriate amount of qualifying expenses (those incurred in performing statutory functions) together with a reasonable return on that amount, where the appropriate amount is defined as the expenses which the Regulated Company would have ordinarily recovered from its customers if they had not been supplied by the licensee which cannot be reduced or avoided or recovered in some other way (other than from other customers of the undertaker).

The Draft Water Bill proposes to replace the costs principle with a transparent wholesale access pricing scheme.

Under the Water Act, it is an offence to use a Regulated Company's system to supply the premises of a customer unless the supply is made by a Regulated Company or a licensee in pursuance of its licence. It is also an offence to introduce water into a Regulated Company's supply system except for the introduction by a licensee in pursuance of its licence or by another Regulated Company under an agreement with the Regulated Company in question or under a bulk supply agreement. The Secretary of State may, however, by statutory instrument grant exemptions to the above offences.

The Water Act also sets out a statutory framework for self-lay and adoption of water mains and service pipes including the steps to be taken and the agreement that must be entered into by a developer or self-lay organisation proposing to construct water mains or service pipes which are to be vested in the Regulated Company. It provides that the main must be built in accordance with the agreement of the Regulated Company to enable it to be adopted on completion and Regulated Companies may not connect new mains or service pipes to their public networks unless they are adopted in this way. There are certain situations, however, when appeals can be made to Ofwat if the Regulated Company refuses to enter into an adoption agreement on reasonable terms. The Water Act also sets out that the person who enters into the adoption agreement relating to a water main must pay the Regulated Company's reasonable costs of incorporating the water main within its existing water mains network. It also provides for an offset payment to be made by the Regulated Company to the developer or self-lay organisation equivalent to the discounted estimated sum of the water charges for the first 12 years in respect of the premises expected to be connected to the new main. In October 2010 Ofwat withdrew its guidance called "*Guidance on financial arrangements for self-lay and requisitioning agreements*" because Ofwat had changed its position on charges that can be made by Regulated Companies in relation to self-lay work, the security that can be required by Regulated Companies and the calculation of the 'asset payment' payable to developers in respect of self-lay schemes. In November 2011 Ofwat also withdrew its guidance called "*Competition in providing new water mains and service pipes: Guidance to Companies – version 3.0*" and consulted on its policy principles for charging for new connections. To date no further guidance has been published.

The Competition Act 1998

The Competition Act came into force in March 2000 and introduced 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 market position which may affect trade within the UK.

Ofwat has concurrent powers with the OFT to apply and enforce the Competition Act 1998 to deal with anti-competitive agreements or abuses of dominance relating to the water and wastewater sector, including the power to enforce directions to bring an infringement to an end and to impose penalties of up to 10 per cent. of worldwide group-wide turnover of a Regulated Company for the infringement. 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.

The EA consultation document on the facilitation of trading of water abstraction licences (*“Trading Water Rights – A Consultation Document”* June 2003) considered the possibility of abuse by licence holders in a dominant position of an area who may seek to buy up all water rights available in that area to prevent competitors acquiring water rights. The EA considered that this potential problem could be dealt with by the EA assessing all trading applications in terms of reasonable need and for consistency with competition principles, and by Ofwat or the OFT as part of their statutory roles. As such it does not represent a change to the legal framework governing competition in the water industry.

Merger Regime

The OFT has a duty to refer to the Competition Commission mergers or proposed mergers between two or more water enterprises where the value of the turnover of the water enterprise being taken over, or the value of the turnover of each of the water enterprises belonging to the person making the takeover, exceeds £10 million. In determining whether such a merger operates, or may be expected to operate, against the public interest, the Competition Commission must assess whether the merger prejudices Ofwat’s ability to make comparisons between different water companies. If the Competition Commission decides there is a prejudicial outcome (i.e. that the merger has prejudiced, or may be expected to prejudice, the ability of Ofwat to make comparisons), it must decide whether action should be taken to remedy, mitigate or prevent that prejudice and, if so, what action. Remedies may be structural (total or partial prohibition of a proposed merger; total or partial divestiture of a completed acquisition) or behavioural, such as amendments to a Regulated Company’s licence (for instance regarding the provision of information) or a requirement to maintain separate management. In deciding on remedies, the Competition Commission has regard to any relevant customer benefits (in the form of lower prices, higher quality, greater choice or innovation) of the merger under consideration. The Competition Commission takes the final decision on remedial action, and this decision can be appealed to the CAT by any person sufficiently affected by the decision. Depending on the size of the parties involved, such mergers may require notification to the European Commission under the EU merger regime, although the Competition Commission may (protecting a national “legitimate interest”) still investigate the effect on the comparator principle.

In cases of an acquisition of a Regulated Company by a company which is not already a Regulated Company or where the special water merger regime does not otherwise apply, general merger control rules apply. These may call for discussion with the OFT as well as Ofwat. The OFT has the power to investigate any merger within the jurisdiction of the United Kingdom. The OFT must refer the transaction to the Competition Commission for further investigation if the arrangement could be expected to result in a substantial lessening of competition within any market or markets in the UK for goods or services. In its investigations, the OFT will consult with Ofwat.

The Secretary of State, in certain limited circumstances, may also refer a merger to the Competition Commission to investigate whether the arrangement could be expected to operate against the public interest. Depending on the size of the parties involved, such mergers may require notification to the European Commission under the EU’s merger regime.

In July 2012, the Draft Water Bill proposed amendments to the water special merger regime. The Draft Water Bill would introduce a two-tier referral system allowing water companies seeking to acquire other water companies to make undertakings to the OFT in lieu of the current mandatory referral, where the merger satisfies the current £10m turnover threshold, to the Competition Commission. The OFT may decide not to make a reference if it believes that (1) the merger arrangements are not sufficiently advanced or likely to proceed to justify the making of a reference; (2) the merger is not likely to prejudice Ofwat’s ability in carrying out its functions, to make comparisons between water enterprises or (3) the merger is likely to prejudice Ofwat’s ability to make comparisons but the prejudice is outweighed by relevant customer benefits relating to

the merger. The introduction to the Draft Water Bill also notes that the special merger regime's threshold of £10m (the turnover of the acquired or acquiring water company must reach or exceed threshold of £10m) will be kept under review by the OFT and may be increased to £70m, as proposed in the Water White Paper.

Market Investigation Regime

The Enterprise Act contains the power for the Competition Commission to investigate markets where the OFT (or, in some circumstances, a minister or Ofwat) has reasonable grounds for believing that competition in that market is not effective. The reference by the OFT, the relevant minister or Ofwat will describe the goods or services and will indicate the feature(s) that relate to such goods or services that it believes have adverse effects on competition. The Competition Commission will be responsible for remedies (which may include structural break up). However, where there are public interest considerations, the Secretary of State may intervene and may remedy any adverse effects in the public interest.

OFT Study into Organic Waste Markets

The OFT published its market study, "Organic Waste" on 21 September 2011. In its study, the OFT makes recommendations to Ofwat with a view to increasing competition in the market for the treatment of organic waste, including sewage sludge. Ofwat is currently considering the OFT's recommendations, including changes to economic regulation to enable the creation of a market in the treatment of organic waste. This may lead to opportunities for SWS to increase its business treating sewage sludge. However, if SWS's business in treating sewage sludge decreases, it could affect SWS's turnover, which could adversely affect SWS's business, operational performance, profitability or financial condition.

Regulatory Developments

Water White Paper

On 8 December 2011, the Government published a White Paper, "Water for Life" (the "**Water White Paper**").

One of the key themes of the Water White Paper was to increase competition in the water sector. Proposals for achieving this centred on increasing choice for non-household consumers through both the extension of the WSL regime (see "*Water Supply (Amendment to the Threshold Requirement) Regulations 2011*" below), and a proposal to introduce self-supply licences enabling "suitably qualified" large customers to purchase water in the wholesale market. To further increase competition, proposals set out in the Water White Paper also centred on facilitating the entry of new market participants by reforming existing pricing rules for new entrants, harmonising regulation to create unified codes for operating standards and aligning these to create a market with Scotland and introducing licences for the provision of network services (such as water treatment and sewerage). However, the Government has stated that it "does not believe there is a case in the foreseeable future for opening up the household market to competition".

The Water White Paper also includes proposals to reform the abstraction licence regime and use of water resources (including interconnection between undertakers and the trading of bulk supplies) and address water efficiency, quality and affordability.

The Water White Paper deviates in places from Martin Cave's recommendations in his review, "Independent Review of Competition and Innovation in Water Markets", recognising the clear imperative for the water sector to "remain an attractive prospect for long-term investors if the cost of capital, and the cost to customers, is to remain affordable". In particular, the Government has "decided not to take forward the proposal for separation of the retail businesses of water companies that was proposed by the Cave review", as the Government does not want to "introduce changes that risk unsettling investor confidence".

On 5 July 2012, the Environment, Food and Rural Affairs Committee published its report (the "**Committee Report**") on the Water White Paper. The Committee Report considered the proposals regarding abstraction reform and metering and welcomed the plans to open the water market to new entrants and increased competition.

Draft Water Bill

On 10 July 2012, the Government published a draft Water Bill (the “**Draft Water Bill**”) for pre-legislative scrutiny. The Draft Water Bill aims to implement the legislative changes set out in the Water White Paper to strengthen the water sector’s ability to respond to the challenges of a growing population and less certain water supplies and also to offer consumers more choice by enabling them to switch water and sewage suppliers easily through the removal of existing regulatory barriers for new entrants to the market.

The Draft Water Bill is intended to modernise Ofwat’s regulatory powers to allow it to continue to regulate the industry in the interests of consumers and will extend the scope of the Environmental Permitting regime to include water abstraction and impounding licences and align the frequency of drought planning to a five year cycle so it aligns with other water planning cycles.

The measures in the Draft Water Bill are designed, among other things, to introduce greater clarity within the special merger regime, amend legislation in order to remove barriers to effective competition, reform the handling of new appointees and of existing appointees involved in the inset process, improve Ofwat’s existing enforcement tools and to reduce the bureaucracy around water companies’ charges scheme to promote greater innovation.

On 1 February 2013, the House of Commons Environment, Food and Rural Affairs Committee (the “**Committee**”) published a report on the Draft Water Bill. In its report, the Committee welcomed the overall aim of the reforms set out in the Draft Water Bill. However, it was critical of certain aspects of the government’s proposals and made a number of recommendations, the most important of which are set out below.

- (i) The Committee noted that the Draft Water Bill provides that Ofwat would be responsible for drafting detailed rules relating to the operation of the competitive market, such as the rules on charges that new entrants would pay to receive a wholesale supply of water from an incumbent. Under the Draft Water Bill, the Secretary of State and the Welsh ministers may issue guidance on the contents of those charging rules. The Committee recommended that the Draft Water Bill should be amended to clarify that such guidance be laid before Parliament for scrutiny and subject to the affirmative resolution procedure. In addition, the guidance should be published alongside the Draft Water Bill itself to inform debate on the bill.
- (ii) The Committee noted that vertically-integrated incumbent water companies would be able to ensure that their retail arms receive a wholesale supply on favourable terms. Therefore, the Committee recommended that the Draft Water Bill “level the playing field” by including a requirement for the functional separation of incumbent companies’ retail and wholesale arms, as suggested by the Cave review (this proposal had previously been dismissed by Defra in the Water White Paper, see *Water White Paper* above). Whereas previously the government had asked Ofwat to police non-discrimination via regulatory means, the Committee suggested that a non-discrimination principle be included on the face of the Draft Water Bill.
- (iii) The Committee recommended that the Draft Water Bill should allow incumbent companies to exit the retail market. This would allow incumbents with less efficient retail arms to focus on their upstream business, if it was in their interests to do so.
- (iv) The Committee welcomed the government’s commitment to opening the non-household retail market to competition by 2017. It noted that Defra had established a “High Level Group” to drive reforms; however it recommended that the government set out the steps it is taking “to provide the necessary direction and oversight of the High Level Group”.
- (v) The Committee expressed concerns about the levels of uncertainty in the proposals for reform of the upstream markets. It recommended that Defra revisit the issue of how to introduce upstream reforms in a way that preserves investor confidence, ensures that customers do not face increased bills and

maintains resilience in the sector. Defra should begin inviting evidence from the industry, consumer groups and other interested parties immediately.

- (vi) The Committee suggested that the abolition of the “costs principle” (see *The Water Act* above) should not lead to household customers subsidising competition in the non-household sector and recommended that the Draft Water Bill should be amended to reflect this principle.
- (vii) The Committee recommended that the Draft Water Bill set target dates for the final decision on the form and scope of upstream reforms, and the opening of the upstream market.

Defra will now consider the Committee’s recommendations. It is not clear when the Draft Water Bill will come before Parliament, however the Committee’s report stated that the Draft Water Bill was “unlikely to become law before the end of 2013”.

Water Supply (Amendment to the Threshold Requirement) Regulations 2011

As part of the Government’s plans to increase the size of the water supply licensing market, on 15 December 2011, the Water Supply (Amendment to the Threshold Requirement) Regulations 2011 came into force. These reduced the non-household consumer threshold in the water supply licensing regime from 50 megalitres per annum to 5 megalitres per annum. This means that holders of water supply licences are now permitted to supply customers using in excess of 5 megalitres per annum. This change in threshold represents an increase in the size of the market within SWS’s region from approximately 250 to 2,200 consumers.

In the Water White Paper, the Government has stated it will “deregulate further in a future Water Bill by reducing the threshold to zero so that any non-household customer can tender their water and sewerage services”. This statement also represents a further proposed widening of the WSL regime in the Water White Paper, by extending it to include sewerage services and on 10 July 2012, the Draft Water Bill was published to enact these measures into legislation.

Ofwat’s Future Price Limits Framework

On 23 November 2011, Ofwat published “Future Price Limits – a consultation on the framework” as part of its proposed framework for setting price limits.

In the consultation, Ofwat stated that its overall aims in the Future Price Limits consultation are to streamline the Periodic Review process, making companies more accountable for their actions and increasing their choice through a lighter-touch regulation.

Following the consultation, in May 2012, Ofwat published the “Future Price Limits – statement of principles” (“**FPL Principles**”), which set out high-level principles which will guide how it sets price limits for the 2014 Periodic Review and in the longer term. Ofwat said in the FPL Principles that there continue to be a number of questions to be addressed (for example as regards the precise scope and form of the separate wholesale and retail price controls). Ofwat proposes to continue to engage with stakeholders in respect of these outstanding issues and will publish its proposed methodology for setting price limits in early 2013. Following consultation on these proposals, it intends to publish its final methodology in the summer of 2013, before making draft determinations in the spring of 2014 and making final determinations in the autumn of 2014. The new price limits will come into force on 1 April 2015. The 2014 Periodic Review will run parallel to any further consultations on Ofwat’s proposed amendments to the price control regime (see “*Modification of a Licence – Proposed Instrument of Appointment Modifications*” above).

The FPL Principles indicate that future Periodic Reviews will:

- (i) set two separate price controls for retail and wholesale, rather than a single price control and both price controls will be for a period of five years from April 2015;
- (ii) set a separate sub-price limit within the wholesale control, but excluding water resources. Ofwat has indicated that this will be “non-binding” for the 2014 Periodic Review;

- (iii) regulate outcomes with appropriate measures of success and incentives, rather than outputs. This would prioritise the longer-term results which companies deliver, when monitoring their performance, ensuring that the issues of greatest importance to customers are taken into account;
- (iv) have greater customer engagement, with Ofwat expecting companies to engage with their customers in setting the outcomes to be achieved;
- (v) use a total expenditure (“totex”) approach for cost assessment, cost recovery and incentives for the wholesale price control, rather than maintaining the current distinction between capex and opex;
- (vi) introduce incentives to abstract water sustainably and increase water trading; and
- (vii) introduce incentives to optimise the operation of the water network.

On 28 January 2013, Ofwat published a consultation paper detailing its proposed methodology for setting price controls for the five year period from 2015 to 2020. Ofwat’s proposals include:

- (i) the introduction of two different retail price controls: one for water and sewerage services to household customers and another for water and sewerage services to business customers;
- (ii) the introduction of two different wholesale price controls: one for water services and another for sewerage services;
- (iii) the wholesale price controls will continue to be based on the RPI + K framework, with some changes, such as the use of the “totex” approach (see (v) above);
- (iv) Ofwat’s decisions relating to the how retail and wholesale activities are defined; and
- (v) Ofwat’s proposed approach to incentives, risk, financeability and delivering outcomes which benefit customers.

The deadline for response to the consultation by companies and other stakeholders is 26 March 2013.

Priority Substances Directive

The Priority Substances Directive (“Environmental Quality Standards Directive”, 2008/105/EC) was adopted and transposed too late for site-specific investment to be identified for PR09, but a comprehensive investigation of the prevalence of the regulated parameters at a range of STWs was agreed and is nearing completion. The investigation (known as the “Chemical Investigation Programme”) is intended to provide the technical basis to inform UK policy decisions regarding implementation of 2008/105/EC; the requirements of this Directive are not absolute but subject to a test of disproportionate cost. The extent of potential investment is further complicated by the proposed revision of this Directive, currently under discussion in Europe. If the revisions as currently proposed are adopted, it will potentially represent a step change in investment needs, as some of the parameters it seeks to regulate are pharmaceutical residues. There is no clear means to regulate these substances before disposal to sewer and hence if they require removal, the only option is to do so by treatment at the STW. However, conventional treatment processes are insufficient to ensure adequate removal and additional processes – in essence, those used to produce potable water – will need to be deployed.

Customers’ Interests

General

Ofwat is responsible for protecting the interests of customers. It monitors the performance and level of service of Regulated Companies and the implementation of a “guaranteed standards” scheme in respect of customer care.

Consumer Council for Water

The Water Act introduced a new independent consumer council for water consumers (known as “**CC Water**”) whose role is to provide information of use to consumers and to promote the interests of all water consumers. CC Water, which came into being on 1 October 2005, replaced WaterVoice, which had previously fulfilled a similar role. CC Water operates through five regional consumer council committees, which typically meet monthly and comprise a chair and about ten members. The council comprises the national chair (currently Dame Yve Buckland), five members who chair CC Water committees, four non-executive members and the chief executive (currently Tony Smith).

Service Incentive Mechanism

Ofwat introduced a performance assessment called the service incentive mechanism (“**SIM**”) which replaced its overall performance assessment (“**OPA**”) measure. The SIM is designed to focus on the quality of customer service and the customer experience of contact with companies.

Ofwat began to measure SIM from 1 April 2010, when new price limits took effect, although the results from 2010/11 will not be used to derive financial incentives. This is to allow sufficient time to ensure comparisons are robust.

Ofwat will calculate incentives at the next Periodic Review based on average performance over the years 2011/12, 2012/13 and 2013/14.

Guaranteed Standards

The guaranteed standards scheme is underpinned by regulations made under sections 38(2) to (4), 95(2) to (4) and section 213 of the WIA, which prescribe standards of performance 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 dealing with flooding from sewers.

If a Regulated Company does not meet any of the prescribed standards, the customer is entitled to compensation, normally in the region of £20 for domestic customers and £20 or £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.

Currently the guaranteed standards scheme applies only to services provided by Regulated Companies. However, under the Draft Water Bill supply licensees would also have to comply with prescribed minimum standards of service.

CHAPTER 7 OVERVIEW OF THE FINANCING AGREEMENTS

Please note that any references to Wrapped Bonds in this overview are for informational purposes only. For the avoidance of doubt, the Issuer shall not issue any Wrapped Bonds pursuant to this Prospectus.

Security Trust and Intercreditor Deed

General

The intercreditor arrangements in respect of the SWS 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 Obligors.

The Secured Creditors include the Class A Debt Providers, the Class B Debt Providers and the Senior Mezzanine Facility Provider. Any new Authorised Credit Provider (or in respect of Bondholders, the Bond Trustee) will be required to accede to the STID and the CTA as a Class A Debt Provider, a Class B Debt Provider, a Senior Mezzanine Facility Provider or a provider of Subordinated Debt.

Unsecured creditors are not and 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 Financial Indebtedness is restricted under the Common Terms Agreement.

The purpose of the Intercreditor Arrangements is to regulate, among other things: (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 “*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 claims among the SWS Financing Group (other than claims in respect of the Issuer/SWS Loan Agreements funded through the raising of Class A Debt, Class B Debt and Mezzanine Debt).

Undertakings of Secured Creditors

Pursuant to the terms of the STID, each Secured Creditor (other than the Security Trustee) undertakes that it will not, except as expressly contemplated in the CTA, unless the Majority Creditors or, where applicable, the Super Majority Creditors otherwise agree:

- (a) permit or require any Obligor to discharge any of the Secured Liabilities owed to it, save to the extent permitted by the STID, including (i) the Payment Priorities and (ii) in the case of the Mezzanine Debt and prepayments of other Financial Indebtedness (other than out of the proceeds of Permitted Financial Indebtedness) the Restricted Payment Condition;
- (b) 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 or the STID including pursuant to a Permitted Lease Termination or a Permitted Hedge Termination, pursuant to a provision for prepayment upon illegality or, in the case of Mezzanine Debt and prepayments of other Financial Indebtedness (other than out of the proceeds of Permitted Financial Indebtedness), if the Restricted Payment Condition is satisfied;
- (c) 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 Financial Guarantees or pursuant to the terms of the Finance Documents;

- (d) 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 (other than set-off in relation to amounts in the Operating Accounts which are owed to the Account Bank or in relation to Standby Drawings owed to a Liquidity Facility Provider under a Liquidity Facility Agreement), the whole or any part of the Secured Liabilities owed to it, save to the extent permitted by the CTA or the STID; or
- (e) except as described in “*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.

Undertakings of Obligors

Pursuant to the terms of the STID, each Obligor undertakes that it will not, unless the Majority Creditors or, where applicable, the Super-Majority Creditors otherwise agree:

- (i) discharge any of the Secured Liabilities owed by it, save to the extent contemplated in paragraph (a) of “*Undertakings of Secured Creditors*” above;
- (ii) pay, prepay, repay, redeem, purchase, early or voluntarily terminate or otherwise acquire any of the Secured Liabilities owed by it, save to the extent contemplated in paragraph (b) of “*Undertakings of Secured Creditors*” above;
- (iii) 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 Financial Guarantees or pursuant to the terms of the Finance Documents;
- (iv) (except as referred to in paragraph (d) of “*Undertakings of Secured Creditors*” above) 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 or the STID;
- (v) without the consent of the Security Trustee or, where applicable, each relevant Secured Creditor (as described in “*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
- (vi) take or omit to take any action whereby any subordination contemplated by the STID may be impaired.

Ranking of Secured Liabilities

The underlying principle of the Intercreditor Arrangements is that at all times the Class A Debt ranks in point of payment prior to any payment in respect of the Class B Debt and the Mezzanine Debt, the Class B Debt ranks in point of payment prior to the Mezzanine Debt and the Senior Mezzanine Debt ranks in point of payment prior to the Junior Mezzanine Debt (including in each case both prior to and during any Standstill Period, after acceleration of the Secured Liabilities and upon any enforcement of the Security), see Chapter 3 “*Risk Factors*” under “*Subordination of the Class B Bonds*” for further details. Prior to a Standstill Period payment dates for Class A Debt, Class B Debt and Mezzanine Debt may fall on different dates.

Modifications, Consents and Waivers

Subject to the Entrenched Rights and Reserved Matters (see “*Entrenched Rights and Reserved Matters*” below), 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 or, in certain cases, Super-Majority Creditors. Not all proposals which require the consent of the Majority Creditors or, as the case may be, Super-Majority Creditors will be sent to all Secured Creditors (or their Secured Creditor Representatives, as the case may be).

Subject to the Entrenched Rights and Reserved Matters (see “*Entrenched Rights and Reserved Matters*” below), 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.

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 prior to repayment in full of the Class A Debt, only the Qualifying Class A Debt Providers are eligible to exercise the rights of the Majority Creditors and, where appropriate, Super-Majority Creditors. Decisions of the Majority Creditors and, where applicable, Super-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 “*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 is comprised of the following representatives (each, a “**Class A DIG Representative**”):

- (a) in respect of each Sub-Class of Class A Wrapped Bonds or other Class A Wrapped Debt (if no FG Event of Default has occurred and is continuing in respect of the relevant Financial Guarantor), such Financial Guarantor;
- (b) in respect of each Sub-Class 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 Sub-Class of Class A Unwrapped Bonds, the Bond Trustee;
- (c) in respect of the Existing RCF Agreement, the Existing RCF Agent, in respect of the Initial Term Facility, Artesian II and, in respect of the Second Artesian Term Facility, Financial Security Assurance (U.K.) Limited; and
- (d) in respect of any other Secured Liabilities of the type referred to in paragraphs (a) to (c) above (excluding liabilities in respect of any Hedging Agreements or Liquidity Facilities) 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 STID or the relevant Accession Memorandum to the STID and the CTA as the Class A DIG Representative.

Each Class A DIG Representative is 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 and no Emergency Instruction Notice has been served (see “*Emergency Instruction Procedure*” below), the Bond Trustee shall not be entitled to convene a meeting of holders of any Series, Class or Sub-Class of Bonds to consider any proposal to be voted on by the Class A DIG except where such proposal is the subject of an Entrenched Right or a Reserved Matter in respect of such Series, Class or Sub-Class.

Decisions of the Majority Creditors and, where appropriate, Super-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 or, as the case may be, Super-Majority Creditors of those Class A DIG Representatives which have actually voted by the specified date for voting, which date must be not less than 10 business days (or in certain circumstances five business days) after the date the STID Directions Request is deemed to be given (or, where the Bond Trustee is a DIG Representative and a Default Situation is continuing (subject to the Emergency Instruction Procedure – see “*Emergency Instruction Procedure*” below), such later date (not later than two 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, Class or Sub-Class of Bondholders to seek directions) or, if earlier, as soon as Class A DIG Representatives in respect of more than 50 per cent. (or 66⅔ per cent. for Super-Majority Creditor decisions) of the Qualifying Class A Debt have voted in favour of the relevant proposal.

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 and, where appropriate, Super-Majority Creditors. After repayment in full of the Class A Debt, decisions of such Majority Creditors or, as the case may be, Super-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 “*Entrenched Rights and Reserved Matters*” below.

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**”):

- (a) in respect of each Sub-Class of Class B Wrapped Bonds (if no FG Event of Default has occurred and is continuing in respect of the relevant Financial Guarantor), such Financial Guarantor;
- (b) in respect of each Sub-Class 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 Sub-Class of Class B Unwrapped Bonds, the Bond Trustee;
- (c) in respect of the NAB Facility Agreement, the NAB Facility Provider; and
- (d) in respect of any other Secured Liabilities of the type referred to in paragraphs (a) and (c) above (excluding liabilities in respect of any Currency Hedging Agreements in relation to Class B Debt) 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 to the STID as the Class B DIG Representative.

Each Class B DIG Representative is 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 no Emergency Instruction Notice has been served (see “*Emergency Instruction Procedure*” below) and is continuing, the Bond Trustee is not entitled to convene a meeting of holders of any Series, Class or Sub-Class of Bonds to consider any proposal to be voted on by the Class B DIG except where such proposal is the subject of an Entrenched Right or a Reserved Matter in respect of such Series, Class or Sub-Class.

Decisions of the Majority Creditors and, where appropriate, Super-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 or, as the case may be, Super-Majority Creditors of those Class B DIG Representatives which have actually voted by the specified date for voting, which date must be not less than 10 business days (or in certain circumstances five business days) after the date the STID Directions Request is deemed to be given (or, where the Bond Trustee is a DIG Representative and a Default Situation is continuing (subject to the Emergency Instruction Procedure – see “*Emergency Instruction Procedure*” below), such later date (not later than two 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, Class or Sub-Class of Bondholders to seek directions) or, if earlier, as soon as Class B DIG Representatives in respect of more than 50 per cent. (or 66⅔ per cent. for Super-Majority Creditor decisions) of the Qualifying Class B Debt have voted in favour of the relevant proposal.

Senior Mezzanine Debt Instructing Group

Following repayment in full of the Class A Debt and the Class B Debt, the Senior Mezzanine Debt Providers will be eligible to exercise the rights of the Majority Creditors and, where appropriate, the Super-Majority Creditors.

Voting by the Bond Trustee as DIG Representative of the Bondholders

Where the Bond Trustee acts as the DIG Representative of some or all of the Wrapped Bondholders (following the occurrence of an FG Event of Default which is continuing in respect of the relevant Financial Guarantor of those Wrapped Bonds) and/or the Unwrapped 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 aggregate Outstanding Principal Amount of some or all of such Sub-Classes of Bonds, but shall not, prior to a Default Situation, be entitled to convene a meeting of any Series, Class or Sub-Class of Bondholders to seek directions (except in respect of an Entrenched Right or Reserved Matter of such Series, Class or Sub-Class of Bondholders).

Additionally whilst a Default Situation is continuing, where the Bond Trustee acts as the DIG Representative in respect of Bonds, the Bond Trustee shall not be entitled to convene a meeting of the Bondholders to direct the Security Trustee in accordance with an extraordinary resolution of the relevant Sub-Class of Bonds after the presentation of a valid Emergency Instruction Notice pursuant to the terms of the STID. See “*Emergency Instruction Procedure*” below.

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 the EIN Signatories’ reasonable opinion, unless such action is taken within the timeframe specified in the Emergency Instruction Notice, the interests of the EIN Signatories would be materially prejudiced.

Hedge Counterparties

Each Hedge Counterparty is or will be a Secured Creditor party to the STID and the CTA and each Hedging Agreement to hedge the currency of any Class A Debt or to hedge interest rates constitutes or will constitute Class A Debt or, if entered into to hedge the currency of any Class B Debt, Class B Debt.

The Hedge Counterparties will not form part of the Class A DIG or, in the case of any Currency Hedging Agreement in relation to Class B Debt, the Class B DIG. However, except in relation to certain amounts payable by the Issuer under any Currency Hedging Agreement in relation to Class B Debt, all fees, interest and principal payable by the Issuer to the Hedge Counterparties will rank in the Payment Priorities senior to or *pari passu* with interest or principal payments on the Class A Bonds. See “*Cash Management*” and “*Hedging Agreements*” below.

Liquidity Facility Providers

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

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

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.

Amounts due and payable under the Finance Leases are dealt with in “*Cash Management*” below.

Standstill

The STID provides for an automatic standstill of the claims of the Secured Creditors against SWS and the Issuer (the “**Standstill**”) immediately following notification to the Security Trustee of an Event of Default (other than an Event of Default under any Hedging Agreement with respect to a Hedge Counterparty under such Hedging Agreement) and for so long as any Class A Debt and/or Class B Debt is outstanding.

The Standstill is designed to reduce or postpone the likelihood of a Special Administration Order being made against SWS 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 enable SWS to continue as a going concern and to allow time for the financial condition of SWS to be restored.

During the Standstill Period:

- (a) 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 SWS;
- (b) the Security granted by SWSGH and SWSH may be enforced at any time by the Security Trustee at the direction of the Majority Creditors except in the case of a Standstill Period which has commenced as a result of the occurrence of the Event of Default pursuant to a rating downgrade of the Bonds (no other Event of Default having occurred and being outstanding), in which case such Security may only be enforced at any time following the date which is three months from the date of commencement of the Standstill Period provided that such Event of Default is continuing at such time;
- (c) save as provided in paragraphs (a) and (b) above, no Enforcement Action may be taken by any Secured Creditor; and
- (d) any monies received by SWS or the Issuer will be applied in accordance with the cash management provisions contained in the CTA (see “*Cash Management*” below) and in accordance with the Payments Priorities (see “*Cash Management – Debt Service Payment Account*” below).

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 SWSH and SWSGH under the Security Documents.

The period of the Standstill in respect of any Event of Default relating to SWS and/or the Issuer (the “**Standstill Period**”) will be 18 months unless the Standstill Period is extended beyond 18 months (see “*Standstill Extension*” below) or any of the following occur prior to the expiry of the relevant Standstill Period:

- (a) an order is made for the Special Administration of SWS or any steps are taken to commence insolvency proceedings against the Issuer or SWS other than proceedings that are commenced by the Security Trustee;
- (b) (during the first 18 months of the Standstill Period) Class A DIG Representatives in respect of 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) Class B DIG Representatives in respect of 66⅔ 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 “*Standstill Extension*” below);

- (c) the waiver or remedy of the relevant Event of Default giving rise to the Standstill Period; or
- (d) the Security Trustee notifies SWS and each Secured Creditor (or its DIG Representative) that notice by any Secured Creditor of the occurrence of the relevant Event of Default has been revoked.

The occurrence of a Standstill will not of itself prevent the Issuer drawing under the Liquidity Facilities.

Upon termination of a Standstill Period (except by virtue of the matters referred to in paragraphs (c) and (d) above), each Secured Creditor will be entitled to exercise all rights which may be available to it under any Finance Document to which it is a party (other than any Security Document) including directing the Security Trustee to take Enforcement Action.

Standstill Extension

The Standstill Period shall automatically be extended beyond 18 months:

- (a) 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;
- (b) following the period referred to in paragraph (a) above, for a further 60 days unless Class A DIG Representatives in respect of 33 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
- (c) following the period referred to in paragraph (b) above, 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 Sub-Class of Class A Wrapped Bonds (following the occurrence of an FG Event of Default which is continuing in respect of the relevant Financial Guarantor of such Sub-Class of Class A Wrapped Bonds) or Class A Unwrapped Bonds or (ii) in writing by Bondholders holding not less than 25 per cent. of the Outstanding Principal Amount of the relevant Sub-Class of Class A 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.

The period of Standstill in respect of any Event of Default other than an Event of Default relating to SWS and/or the Issuer will terminate upon the earlier of (a) the date of the waiver or remedy of the relevant Event of Default giving rise to the Standstill Period and (b) the date on which the Security Trustee notifies SWS and each Secured Creditor (or its DIG Representative) that notice by any Secured Creditor of the occurrence of the relevant Event of Default has been revoked.

Enforcement

Following an Event of Default and for so long as it is continuing, the Majority Creditors may direct the Security Trustee to enforce the Security created by SWSGH and SWSH; following the termination of a

Standstill Period (except under paragraph (c) or (d) of “*Standstill*” above), the Majority Creditors may direct the Security Trustee to enforce the Security created by SWS and the Issuer.

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 (excluding monies credited to the Excluded Accounts) will be applied by the Security Trustee in accordance with the Payment Priorities (see “*Debt Service Payment Account*” below).

The holders of the SWS Preference Shares and the Mezzanine Facility Providers are subject to certain call option arrangements under which they will be required (subject to certain conditions) to sell their SWS Preference Shares (other than the Class A2 Preference Shares) or, as the case may be, their Mezzanine Debt in the event that the Security Trustee or any receiver appointed by it sells the ordinary shares in SWSH or SWS following the enforcement of the Security created by SWSGH or SWSH. In this event, the holders of the SWS Preference Shares will be required to sell their shares (other than the Class A2 Preference Shares) to the person that acquires the ordinary shares in SWSH or SWS on an enforcement of the Security created by SWSGH or SWSH (or to any nominee of such person) for a price to be determined in accordance with the SWS Preference Share Deed (see “*SWS Preference Shares*” below) and the Mezzanine Facility Providers will be required, if any of their Mezzanine Debt remains outstanding following the application of the proceeds of such enforcement of Security pursuant to the Payment Priorities, to sell their debt at its market value (likely to be a nominal amount). There is no Junior Mezzanine Debt outstanding. The rights of the holders of the Class A2 Preference Shares shall be deferred upon any sale of the other SWS Preference Shares pursuant to these call option arrangements.

Excluded Accounts

Although the Issuer has pursuant to the Security Agreement created first fixed charges over the Excluded Accounts in favour of the Security Trustee, the Security Documents provide that, on and following an Acceleration of Liabilities (other than a Permitted Lease Termination, Permitted Hedge Termination or Permitted Share Pledge Acceleration), all monies held in the Issuer’s O&M Reserve Account and the Debt Service Reserve Account will be held by the Security Trustee on trust for the relevant Liquidity Facility Providers whose commitments have been drawn to fund the Issuer’s O&M Reserve Account or, as the case may be, the Debt Service Reserve Account and in the proportions that their respective drawn amounts under the relevant O&M Reserve Facility Agreement or, as the case may be, DSR Liquidity Facility Agreement bear to the balance on the O&M Reserve Account or, as the case may be, the Debt Service Reserve Account.

Accession of Additional Secured Creditors

The STID requires that, to the extent that SWS 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) 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 action without the consent of the Majority Creditors or, where appropriate, the Super-Majority Creditors. The STID provides that on or before the relevant Accession Date, a proposed Additional Secured Creditor must deliver to the Security Trustee (among other things) a legal opinion as to (i) due incorporation, capacity and authorisation of such Additional Secured Creditor and (ii) the binding effect of the STID, the Accession Memorandum and any Supplemental Deed on such proposed Additional Secured Creditor. This does not apply to any regulated financial or credit institution, who, in lieu of providing a legal opinion, is required to make representations and warranties covering (i) the same matters as the legal opinion and (ii) that it is a regulated entity. Holders of SWS Preference Shares who, by virtue of the terms of the SWS Preference Shares, become holders of Subordinated Debt upon the conversion of the SWS Preference Shares into Subordinated Debt may elect to accede to (or cause its trustee to accede to) the terms of the STID and the CTA as a Secured Creditor for the reasons described immediately above.

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, where appropriate, the Super-Majority Creditors or, in particular cases, other specified parties and in accordance with the provisions of the STID.

Super-Majority Creditor Decisions

Whilst most of the decisions relating to any waiver, consent or modification under or in respect of a Finance Document require the approval of the Majority Creditors (subject always to the Entrenched Rights and Reserved Matters of Secured Creditors), the STID provides that a limited number of decisions (relating to the ability of the Obligors to raise further Financial Indebtedness or create Security Interests) require the approval of the Super-Majority Creditors.

Entrenched Rights and Reserved Matters

Modifications, consents and waivers will be agreed by the Security Trustee, in accordance with votes of the Majority Creditors or, where appropriate, Super-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 SWS (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 relevant ratings set out in the definition of Rating Requirement (in relation to the Class A Bonds) and the ratings ascribed to the Class B Bonds at the time of their issue have been affirmed by all Rating Agencies then rating the Class A Bonds and/or the Class B Bonds as applicable.

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

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 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:

- (a) 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 under or in connection with the STID or any other Finance Document;
- (b) (i) 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 (ii) 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;

- (c) would change or would relate to the Payment Priorities;
- (d) 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;
- (e) would change or would relate to (i) the definitions of "Class A DIG", "Class A DIG Representatives", "DIG Proposal", "DIG Directions Request", "Majority Creditors", "Restricted Payment", "Restricted Payment Condition", "Qualifying Class A Debt", "Super-Majority Creditors" or "Voted Qualifying Class A Debt", (ii) those matters expressly requiring the consent, approval or agreement of, or directions or instructions from, or waiver by the Majority Creditors, Super-Majority Creditors or the Security Trustee or (iii) the percentages of aggregate Outstanding Principal Amount of Qualifying Class A Debt required to terminate a Standstill;
- (f) 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;
- (g) 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;
- (h) 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;
- (i) 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);
- (j) (subject to paragraph (k) below) would change any Event of Default or any Trigger Event relating to financial ratios or credit rating downgrade;
- (k) would relate to the waiver of the non-payment Event of Default in respect of any Obligor or Events of Default or Trigger Events relating to non-payment, credit rating downgrade or financial ratios or the making of Restricted Payments (see "*Common Terms Agreement – Trigger Events*" and "*Events of Default*" below);
- (l) 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, Taxes, 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); or
- (m) 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.

The Entrenched Rights of the Class B Debt Providers 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:

- (a) 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 under or in connection with the STID or any other Finance Document;

- (b) (i) 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 (ii) 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;
- (c) would change or would relate to the Payment Priorities;
- (d) 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;
- (e) would change or would relate to (i) the definitions of "Class B DIG", "Class B DIG Representatives", "DIG Proposal", "DIG Directions Request", "Majority Creditors", "Restricted Payment", "Restricted Payment Condition", "Super-Majority Creditors", "Qualifying Class B Debt" or "Voted Qualifying Class B Debt", (ii) 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 (iii) the percentages of aggregate Outstanding Principal Amount of Qualifying Class B Debt required to terminate a Standstill;
- (f) 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;
- (g) 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;
- (h) 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;
- (i) 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);
- (j) (subject to paragraph (k) below) would change any Event of Default or any Trigger Event relating to financial ratios or credit rating downgrade;
- (k) would relate to the waiver of the non-payment Event of Default in respect of any Obligor or Events of Default or Trigger Events relating to non-payment, credit rating downgrade or financial ratios or the making of Restricted Payments (see "*Common Terms Agreement – Trigger Events*" and "*Events of Default*" below);
- (l) 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, Taxes, 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); or
- (m) 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:

- (a) any sale, transfer or other disposal (whether deemed or otherwise) of any of the Equipment;
- (b) the affixing of any Equipment to any land or building to which SWS or the Issuer (as applicable) does not have an interest in such land for the purposes of the Capital Allowances Act 2001;
- (c) the creation or subsistence of any encumbrance, lien, mortgage or other Security Interest over any Equipment;
- (d) any of the covenants or representations and warranties set out in the Finance Documents which relate to the maintenance or condition of the Equipment;
- (e) any provision(s) contained in the Finance Documents pertaining to any damage, destruction or total loss of any of the Equipment;
- (f) any elections filed with HM Revenue & Customs by SWS 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;
- (g) the provisions relating to the calculation of rental payments and/or sums due upon termination of the leasing of any Equipment; and
- (h) any changes to the Entrenched Rights of the Finance Lessors set out in paragraphs (a) to (g) above.

Entrenched Rights of the Mezzanine Facility Providers

The Mezzanine Facility Providers enjoy some of the same Entrenched Rights as apply to the Class B Debt Providers insofar as is necessary to protect the fundamental terms of their investment. In addition:

- (a) for so long as no Default has occurred and is continuing, no modification can be made which would have the effect of changing or supplementing any of the provisions contained in Paragraph 37 (*Restricted Payments*) of Part 3 of Schedule 5 (*Covenants*) to the Common Terms Agreement; any of the Trigger Events contained in Part 1 of Schedule 6 (*Trigger Events*) to the Common Terms Agreement; any of the remedies to Trigger Events contained in Part 3 of Schedule 6 (*Trigger Events*) to the Common Terms Agreement; or any of the Events of Default set out in Schedule 7 (*Events of Default*) to the Common Terms Agreement, in each case where the effect of such change or supplement would or might reasonably be expected to be adverse to the interests of a Mezzanine Facility Provider; or
- (b) unless and until (i) an Event of Default has occurred and is continuing or (ii) a Trigger Event has occurred and is continuing and a Remedial Plan has concluded that the failure to raise new Financial Indebtedness would or could reasonably be expected to lead to an Event of Default and provided that the Security Trustee has received an Entrenched Rights or Reserved Matters Notice from any Mezzanine Facility Provider (or its Secured Creditor Representative), no modification to, or consent or waiver under or in respect of, any term of the STID and/or any other Finance Document will be effective if the proposed modification, consent or waiver would permit the raising of new Financial Indebtedness by the SWS Financing Group to the extent that, as a result, the aggregate of the Senior Net Indebtedness and any other net indebtedness ranking in point of priority senior to the Senior Mezzanine Debt would exceed 90 per cent. of RCV,

unless the Security Trustee has received written consent to such modification, consent or waiver from at least 66⅔ per cent. by value of Mezzanine Facility Providers of the Senior Mezzanine Facility (or from its Secured Creditor Representative).

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

The Bond Trustee, the Security Trustee, the Hedge Counterparties and the Financial Guarantors 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.

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 each Secured Creditor reserves to itself to decide are each and every right, power, authority and discretion of, or exercisable by, each such Secured Creditor at any time:

- (a) 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 Authorised Credit Facility to which it is a party (as permitted under the CTA);
- (b) to make determinations of and require the making of payments due and payable to it under the provisions of the Authorised Credit Facilities to which it is a party (as permitted under the CTA);
- (c) to exercise the rights vested in it or permitted to be exercised by it under and pursuant to the CTA and the STID;
- (d) to receive notices, certificates, communications or other documents or information under the Finance Documents or otherwise;
- (e) to assign its rights or transfer any of its rights and obligations under any Authorised Credit Facility subject always to the requirement of the assignee or transferee to accede to the CTA and the STID as a Secured Creditor;
- (f) 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;
- (g) in the case of each Hedge Counterparty, to terminate the relevant Hedging Agreement provided such termination is a Permitted Hedge Termination; and
- (h) 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 SWSGH and SWSH pursuant to the terms of the Security Documents.

The Bond Trustee, the Security Trustee, the Senior Mezzanine Facility Lenders, the Hedge Counterparties and the Financial Guarantors each have certain additional Reserved Matters which each has reserved to itself to decide. For the Bond Trustee and each Financial Guarantor, these include rights vested in it pursuant to the terms of the Bond Trust Deed and the Financial Guarantee. 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 (xiv) to (xix) below, in relation to any Sub-Class of Class A Unwrapped Bonds or Class B Unwrapped Bonds and (where an FG Event of Default has occurred and is continuing in respect of the Financial Guarantor of such Sub-Class of Wrapped Bonds) any such Sub-Class of 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:

- (i) to make any determination contemplated or required under the 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;
- (ii) 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 Financial Guarantee;
- (iii) to make any claim under, or enforce any provision of, any Financial Guarantee;
- (iv) 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;
- (v) 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;
- (vi) to receive any amounts owing to it for its own account in accordance with the provisions of the Finance Documents;
- (vii) to determine the amount of sums due in relation to expenses and stamp duties pursuant to the Finance Documents;
- (viii) to make a claim for expenses under the Finance Documents;
- (ix) to receive notices, certificates, communications or other documents or information under the Finance Documents or otherwise;
- (x) 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);
- (xi) against or in relation to the relevant Bondholders;
- (xii) under the Fourth Schedule (*Provisions for Meetings of Bondholders*) of the Bond Trust Deed;
- (xiii) the right to appoint a co-trustee or to retire under, as the case may be, Clause 24 (*New Bond Trustee*) and Clause 25 (*Bond Trustee's Retirement and Removal*) of the Bond Trust Deed;
- (xiv) the publication of an Interest Rate or Interest Amount, as the case may be, in accordance with Condition 6(h) (*Determination and Publication of Interest Rates, Interest Amounts, Redemption Amounts and Instalment Amounts*);
- (xv) the determination of amounts in accordance with Condition 6(h) (*Determination and Publication of Interest Rates, Interest Amounts, Redemption Amounts and Instalment Amounts*);
- (xvi) the selection of or made by an Indexation Adviser in accordance with Condition 7(a) (*Definitions*) and 7(c)(ii) (*Changes in Circumstances Affecting the Index – Delay in publication of Index*);
- (xvii) the consideration and approval in relation to a substitute index figure in accordance with Conditions 7(e)(i) to (iii) inclusive (*Cessation of or Fundamental Changes to the Index*);
- (xviii) the variation, termination and appointment of Agents in accordance with Condition 9(e) (*Appointment of the Agents*); and
- (xix) to consent to any proposed amendment to, as the case may be, the 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 (*Modification, Consent and Waiver*) of the Bond Trust Deed will be subject to the directions of the Majority Creditors).

Those Reserved Matters which each 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 Financial Guarantee (except if an FG Event of Default in respect of such Financial Guarantor is continuing) in relation to:

- (a) the publication of an Interest Rate or Interest Amount in accordance with Condition 6(h) (*Determination and Publication of Interest Rates, Interest Amounts, Redemption Amounts and Instalment Amounts*);
- (b) the determination of amounts in accordance with Condition 6(h) (*Determination and Publication of Interest Rates, Interest Amounts, Redemption Amounts and Instalment Amounts*);
- (c) the selection of or made by an Indexation Adviser in accordance with Condition 7(a) (*Definitions*) and 7(c)(ii) (*Changes in Circumstances Affecting the Index – Delay in publication of Index*);
- (d) the consideration and approval in relation to a substitute index figure in accordance with Condition 7(e)(i) to (iii) inclusive (*Cessation of or Fundamental Changes to the Index*); and
- (e) the variation, termination and appointment of Agents in accordance with Condition 9(e) (*Appointment of the Agents*).

Each Financial Guarantor of Wrapped Debt (other than Wrapped Bonds) has and will have similar matters reserved to it in respect of the determination of interest, interest amounts and repayment amounts, the selection of an indexation adviser, approval of substitute index figure, variation, termination and appointment of Agents under the Authorised Credit Facility under which such Wrapped Debt is incurred by SWS or the Issuer in addition to any amendment to Part C (*Financial Guarantor Reserved Matters*) of Schedule 3 to 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:

- (i) pursuant to the STID;
- (ii) 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;
- (iii) 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;
- (iv) except as otherwise specifically provided in the STID, to apply any of the sums referred to in Clause 15 (*Activities of the Security Trustee*) of the STID in accordance with such Clause;
- (v) 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 (subject to the disclosure of information provisions of the CTA) any other party, or, where applicable, to determine the form and content of any notice, certificate, communication or other document;
- (vi) 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);

- (vii) 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;
- (viii) 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
- (ix) 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 8.2 (*Procedures for Modifications, Consents and Waivers*) of the STID.

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. The implementation of any such proposal is an Entrenched Right of the Bond Trustee and each Financial Guarantor.

Intercompany Loan Arrangements

Issuer/SWS Loan Agreements

All Financial Indebtedness raised by the Issuer from time to time (whether through the issue of Bonds or raising of debt under Authorised Credit Facilities) is and will be backed by an aggregate matching debt obligation owed by SWS to the Issuer under a loan agreement (each an “**Issuer/SWS Loan Agreement**”). As such, the Issuer/SWS Loan Agreements are a source of funds capable of servicing any payments due and payable on the Bonds.

In the case of the initial Issuer/SWS Loan Agreement entered into on the Initial Issue Date (the “**Initial Issuer/SWS Loan**”), the aggregate nominal amount of all Financial Indebtedness raised through the issue of Bonds and the raising of Mezzanine Debt and the Initial Term Facility on the Initial Issue Date was lent by the Issuer to SWS under the Initial Issuer/SWS Loan Agreement on the Initial Issue Date. Each advance under the Initial Issuer/SWS Loan Agreement corresponds to the principal amount of the relevant Sub-Class of Bonds issued on the Initial Issue Date, the principal amount of the Senior Mezzanine Debt and the Junior Mezzanine Debt or, as the case may be, other debt under the Initial Term Facility raised by the Issuer on the Initial Issue Date.

The Issuer advanced the proceeds of the Second Artesian Term Facility to SWS under an Issuer/SWS Loan Agreement dated 5 July 2004 (the “**Second Issuer/SWS Loan Agreement**”). The advance under the Second Issuer/SWS Loan Agreement is equal to the principal amount of the Second Artesian Term Facility.

The Issuer advanced to SWS the proceeds of each Sub-Class of Series 2 Bonds under an Issuer/SWS Loan Agreement dated 27 May 2005 (the “**Third Issuer/SWS Loan Agreement**”). Each advance under the Third Issuer/SWS Loan Agreement is equal to the principal amount of the corresponding Sub-Class of Series 2 Bonds.

The Issuer advanced to SWS the proceeds of the Series 3 Bonds under an Issuer/SWS Loan Agreement dated 18 October 2006 (the “**Fourth Issuer/SWS Loan Agreement**”). The advance under the Fourth Issuer/SWS Loan Agreement is equal to the principal amount of the Series 3 Bonds.

The Issuer advanced to SWS the proceeds of the Series 4 Bonds under an Issuer/SWS Loan Agreement dated 17 July 2007 (the “**Fifth Issuer/SWS Loan Agreement**”). The advance under the Fifth Issuer/SWS Loan Agreement is equal to the principal amount of the Sub-Class of Series 4 Bonds.

The Issuer advanced to SWS the proceeds of the Series 5 Bonds under and Issuer/SWS Loan Agreement dated 27 February 2009 (the “**Sixth Issuer/SWS Loan Agreement**”). The advance under the Sixth Issuer/SWS Loan Agreement is equal to the principal amount of the Sub-Class of Series 5 Bonds.

The proceeds of all Financial Indebtedness raised by the Issuer through the further issue of Bonds or raising of debt under any Authorised Credit Facility (other than the DSR Liquidity Facilities) will be lent to SWS under further Issuer/SWS Loan Agreements in order that such Financial Indebtedness will be backed by a debt obligation owed to the Issuer under such Issuer/SWS Loan Agreement. Such debt will be subdivided into advances such that each advance corresponds to the principal amounts of the relevant Tranche, Sub-Class or Class of Bonds issued or the principal amount of debt raised under the relevant Authorised Credit Facility or Facilities by the Issuer.

All advances made or to be made by the Issuer under the Issuer/SWS Loan Agreements are or will be in Sterling and in amounts and at rates of interest set out in the relevant Final Terms or Authorised Credit Facility or, if hedged in accordance with the Hedging Policy (see “*Hedging Agreements*” below), at the hedged rate plus, in each case, a small margin and will have interest payment dates on the same dates as the related Bonds or advance under the relevant Authorised Credit Facility. Interest on each advance made under an Issuer/SWS Loan Agreement will accrue from the date of such advance. In addition, each advance will be repayable on the same date as the related Bonds or advance under the relevant Authorised Credit Facility.

The obligations of SWS under each Issuer/SWS Loan Agreement are or will be secured pursuant to the Security Agreement, and such obligations are or will be guaranteed by SWSH and SWSGH in favour of the Security Trustee, who holds or will hold the benefit of such security on trust for the Secured Creditors (including the Issuer) on the terms of the STID.

The Issuer’s obligations to repay principal and pay interest on the Bonds are intended to be met primarily from the payments of principal and interest received from SWS under each Issuer/SWS Loan Agreement.

SWS agrees to make payments free and clear of any withholding on account of tax unless it is required by law to do so – in such circumstances SWS will gross-up such payments.

In the Common Terms Agreement, SWS makes certain representations and warranties (as more fully set out under “*Common Terms Agreement – Representations*” below) to each Finance Party (which includes the Issuer as lender under an Authorised Credit Facility).

Each Issuer/SWS Loan Agreement is or will be governed by English law and subject to the exclusive jurisdiction of the English courts (except that the Issuer alone may commence proceedings in any other court with jurisdiction).

Fees Generally

The Issuer is responsible for paying the fees and expenses of the Bond Trustee, the Security Trustee, the Paying Agents, the Registrar, the Transfer Agents, the Agent Bank, the Issuer’s legal advisers, accountants and auditors, certain fees due to Financial Guarantors of Wrapped Debt and to liquidity providers.

SWS, by way of facility fees under the Issuer/SWS Loan Agreements, pays to the Issuer amounts equal to the amounts required by the Issuer to pay its ongoing fees and expenses.

Common Terms Agreement

General

Each of the Initial Hedge Counterparties, the Security Trustee, the Cash Manager, the Standstill Cash Manager, the Liquidity Facility Providers, the Initial Term Facility Provider, each Obligor, the Initial Mezzanine Facility Providers, the Bond Trustee, the Initial Financial Guarantors, the Principal Paying Agent, the Transfer Agent, the Registrar and others entered into a common terms agreement dated 23 July 2003 (as amended from time to time) (the “**Common Terms Agreement**” or “**CTA**”). The Common Terms Agreement sets out the

representations, covenants (positive, negative and financial), Trigger Events and Events of Default which apply to each Authorised Credit Facility (including, for the avoidance of doubt, the Issuer/SWS Loan Agreements, Hedging Agreements and any other document entered into in connection with an Authorised Credit Facility).

It is 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 and any other Common Agreement and any other exception expressly set out in the CTA will be unenforceable (save for limited exceptions which, among other things, include covenants relating to indemnities, covenants to pay, covenants relating to remuneration, costs and expenses, representations and covenants in each Class or Sub-Class of Bonds and certain provisions under the Hedging Agreements and the Finance Leases). The Common Terms Agreement allows SWS (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 relevant ratings set out in the definition of Rating Requirement (in relation to the Class A Bonds) and the ratings ascribed to the Class B Bonds at the time of their issue have been affirmed by all Rating Agencies then rating the Class A Bonds and/or Class B Bonds as applicable.

The Common Terms Agreement also sets out the cash management arrangements to apply to the SWS Financing Group (see "*Cash Management*" below). It is a requirement of the Common Terms Agreement that future providers of Authorised Credit Facilities must also accede to the Common Terms Agreement and the STID.

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

Representations

On the Initial Issue Date each Obligor made a number of representations in respect of itself to each Finance Party. These representations 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 (or, in the case of SWS, its material assets), its constitutional documents or any material applicable law (save in the case of SWS and the Instrument of Appointment to the extent such conflict has been waived by Ofwat to the reasonable satisfaction of the Security Trustee);
- (iv) the preparation of its financial statements in accordance with Applicable Accounting Principles and that such financial statements give a true and fair view of its financial condition;
- (v) no event having occurred or circumstance having arisen since the date of the last financial statements which has a Material Adverse Effect (except for any announcement of K from time to time);
- (vi) except as disclosed in its financial statements, it not being subject to any contingent liabilities or commitments that would be reasonably likely to have a Material Adverse Effect;
- (vii) the validity and admissibility in evidence of the Finance Documents in any proceedings in the jurisdiction of its incorporation;
- (viii) 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 a Permitted Security Interest);

- (ix) the conduct of its business not violating any judgment, law or regulation, which if enforced would have a Material Adverse Effect;
- (x) no Default or Potential Trigger Event being outstanding or will result from entry into and performance under the Transaction Documents;
- (xi) the obtaining by it prior to the Initial Issue Date of all consents and approvals necessary for the conduct of SWS's business and the transactions in the Finance Documents which if not obtained or complied with, or which if revoked or terminated, would either (i) have a Material Adverse Effect or (ii) not be in the normal course of business and Good Industry Practice generally;
- (xii) 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;
- (xiii) insurances required to be maintained under any Finance Document being in full force and effect where failure to maintain would be reasonably likely to have a Material Adverse Effect;
- (xiv) there being no insolvency event in relation to it;
- (xv) the ownership structure of the SWS Financing Group;
- (xvi) the due payment of all its taxes (save to the extent any tax payment is being disputed in good faith) and the due filing in all material respects of any tax returns and there being no material claims being asserted against it with respect to taxes which are not being disputed in good faith);
- (xvii) under the laws of its jurisdiction of incorporation and tax residence in force on the Initial Issue Date, it not (other than as disclosed) being required to make any deduction or withholding from any payment of interest under the Finance Documents in circumstances where, under current United Kingdom law, no United Kingdom withholding tax would be imposed on the payment;
- (xviii) the claims of Secured Creditors secured pursuant to a Security Agreement ranking prior to the claims of its other unsecured and unsubordinated creditors;
- (xix) no Security Interest having been created, or allowed to exist, other than Permitted Security Interests and no indebtedness incurred other than Permitted Financial Indebtedness and Permitted Volume Trading Arrangements;
- (xx) 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;
- (xxi) no litigation or other proceedings current, or to its knowledge pending or threatened against it or its assets which, if adversely determined, are reasonably likely to have a Material Adverse Effect;
- (xxii) limits on its powers not being exceeded as a result of the borrowing, leasing, granting of security or giving or guarantees contemplated by the Finance Documents;
- (xxiii) compliance with environmental laws and having obtained all Environmental Permits necessary for conduct of its business and no Environmental Claim having been commenced;
- (xxiv) no loans made by any Obligor being outstanding to other persons immediately following the issue of Bonds on the Initial Issue Date other than pursuant to Finance Documents, under any Permitted Volume Trading Arrangements and the SWS/SWSG Loan Agreement;
- (xxv) no Treasury Transactions being outstanding immediately following the issue of Bonds on the Initial Issue Date other than the Initial Hedging Agreements;
- (xxvi) all arrangements or contracts with any person being on arm's length basis and, other than in respect of contracts entered into by SWS and under which payments to be made would fall within paragraph (a) of

the exclusions in the definition of Distribution, 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 Associate, except: (1) contracts entered into by SWS and under which payments to be made would fall within paragraph (c) of the exclusion in the definition of Distribution; (2) as permitted under the Finance Documents; or (3) as a result of a Permitted Emergency Action; and

(xxvii) on the Initial Issue Date, no member of the SWS 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 Class A Debt, Class B Debt or Mezzanine Debt, the providers of which have executed the CTA and the STID, the SWS Preference Shares, the initial holders of which will have executed the SWS Preference Share Deed, or Permitted Financial Indebtedness falling within the categories listed in paragraphs (a), (b), (d) or (e) of the definition of Permitted Financial Indebtedness.

Also, on each Issue Date and on each date on which any Financial Guarantee or any other new Authorised Credit Facility is issued or entered into under the Programme, each Obligor will repeat certain of such representations (excluding those representations contained in paragraphs (x), (xxv) and (xxvii) above on each Issue Date and excluding the representation contained in paragraph (xx) on each date on which any Financial Guarantee or any other new Authorised Credit Facility is issued or entered into under the Programme) in relation only to the Bonds or Financial Guarantee then being issued or the new Authorised Credit Facility then being entered into (the “**Initial Date Representations**”).

On each Payment Date, on each date of a request for a borrowing, on the first date of each borrowing and on each date for payment of a Restricted Payment, each Obligor shall make certain representations (including those contained in paragraphs (i), (ii), (iv), (v), (vi), (xiii), (ix), (xxi), (xxii) and (xxiii) above) (the “**Repeated Representations**”). Each Obligor shall also make the Repeated Representations on each date on which SWS enters into any new Material Agreement, but only in relation to such new Material Agreement.

Additionally, SWS has made and will make (subject, in some cases, to agreed exceptions and qualifications as to materiality and reservations of law) representations including:

- (i) (on the date of each Initial Date Representation and each Repeated Representation) to the best of its knowledge, it has the right to use Intellectual Property Rights necessary to conduct its Business;
- (ii) (on the date of each Initial Date Representation) 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) (on the date of each Initial Date Representation) assumptions used in respect of financial ratio calculations and projections having been made in good faith, after due and careful consideration and being consistent with Applicable Accounting Principles and Good Industry Practice;
- (iv) (on the date of each Initial Date Representation and each Repeated Representation) it is not aware of any Special Administration Order having been made in respect of it; and
- (v) (on the date of each Initial Date Representation) the accuracy (in all material respects) of certain written information provided by SWS and the accuracy of this Prospectus.

Additionally, each of SWSH, SWSGH and the Issuer represents that its activities have been limited to the First Aqua Acquisition, the financing and refinancing thereof following the acquisition by SWI of the Issuer in May 2003 the holding of shares in its subsidiaries, implementing the corporate reorganisation of SWI and its subsidiaries on the Initial Issue Date, the declaration and payments of dividends, and its entry into and performance of documents relating thereto and envisaged by the Transaction Documents.

Covenants

The Common Terms Agreement contains certain covenants from each of the Obligors. A summary of the covenants which are (amongst others) 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 “*Information – Covenants*”, “*Covenants – General*” and “*Financial Covenants*”.

Information – Covenants

- (i) So far as permitted by any applicable law or any binding confidentiality obligation, SWS has undertaken to supply to the Security Trustee, each Rating Agency rating the Bonds at that time and, in certain cases, each Financial Guarantor 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 SWS 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 SWS 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 SWS;
 - (e) copies of all certificates and responses provided by SWS or any member of the SWS 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 SWS or SWS’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 materially adverse in relation to the creditworthiness of SWS or to SWS’s ability to perform its duties under the Instrument of Appointment;
 - (g) a semi-annual Investors Report; and
 - (h) such material information about the business and financial condition of SWS 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).
- (ii) SWS has further agreed to provide information regarding certain changes of control of SWSGH to the Security Trustee, each Financial Guarantor and the Rating Agencies as soon as it becomes aware of any such proposal and to use all reasonable endeavours to procure that the Security Trustee and each Financial Guarantor have been given a reasonable opportunity to express views on the identity and role of any such proposed new Controlling person under any such changes of control.
- (iii) SWS has further agreed to provide information in relation to any announcement of K which has or might reasonably have a Material Adverse Effect.
- (iv) SWS has further agreed 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, SWS must provide the required information as soon as reasonably practicable. This is subject to action SWS reasonably believes is consistent with prudent management as part of negotiations with the Director General.

- (v) Additionally, each Obligor has undertaken to supply to the Security Trustee within a certain timeframe:
 - (a) its audited financial statements for each of its financial years and, in the case of SWS, its unaudited 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 (to the extent that such documents would be sent to its shareholders if such Obligor were a listed company) or creditors generally;
 - (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 SWS 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 SWS's annual charges scheme, a summary of SWS's strategic business plan at each Periodic Review, SWS's current Procurement Plan (if any), SWS's annual drinking water quality report, SWS's annual environmental report and SWS's annual conservation and access report);
 - (C) promptly upon coming aware of them, details concerning any Obligor placed on credit watch with negative implications;
 - (D) any event which could reasonably be expected to give rise to an insurance claim in excess of £4,000,000 (indexed from the Initial Issue Date);
 - (E) any Material Entity Event (see "*Material Entity Events*" below) and/or Emergency which would be reasonably likely to have a Material Adverse Effect;
 - (F) any non-compliance with any law or regulation which would be reasonably likely to have a Material Adverse Effect;
 - (G) any other event which would be reasonably likely to have a Material Adverse Effect;
 - (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).
- (vi) Additionally, each of SWS and the Issuer has undertaken, among other things:
 - (a) to supply a compliance certificate signed by two authorised signatories of the Issuer and two directors of SWS; such compliance certificate to be accompanied by a statement as to what the historical and forward-looking financial ratios which are required to be calculated under the Common Terms Agreement are and a copy of the computations made in respect of such historical and forward-looking financial ratios;
 - (b) to permit the Security Trustee to investigate the calculations contained in any compliance certificate and to call for other substantiating evidence if it certifies to SWS or the Issuer that it has reason to believe that the historical or forward-looking ratios (or confirmation of compliance with the financial ratios) as set out in the statement are incorrect or misleading or in the event that there is a deterioration in the historical 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 (b) if a Default or Potential Trigger Event is outstanding, specifying the Default or Potential Trigger Event and the steps (if any) taken or proposed to be taken to remedy such event.

- (vii) 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 five 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.

Covenants – General

- (i) Each Obligor has undertaken, among other things:
- (a) to do all such things as are necessary to maintain its corporate status where failure to do so 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 secured claims of Secured Creditors against it under the Finance Documents will rank (subject to certain reservations as to matters of law) prior to 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 and the Finance Documents and, in the case of SWS, the Instrument of Appointment, the WIA and Good Industry Practice (taking its Business as a whole);
 - (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 in accordance with Good Industry Practice;
 - (g) to ensure that, save as otherwise agreed by the Security Trustee and each Financial Guarantor and save for any Permitted Acquisitions or Permitted Disposals, the corporate ownership structure of the SWS Financing Group (other than the ownership or Control of SWSGH and the ownership of the SWS Preference Shares) 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 Issuer/SWS Loan Agreements 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 acknowledgements 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 SWS, Permitted Volume Trading Arrangements;
- (k) not to enter into any amalgamation, demerger, merger, consolidation or reconstruction other than as agreed by the Security Trustee and each Financial Guarantor (other than, in the case of SWS, a Permitted Disposal or Permitted Acquisition);
- (l) not to acquire or invest, other than Permitted Acquisitions and Authorised Investments;
- (m) not 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) any credit or indemnity provided under any Finance Document; (B) any loan made under the Issuer/SWS Loan Agreements; (C) any loan provided to SWS subordinated to the Authorised Credit Facilities on terms acceptable to the Security Trustee; (D) any guarantee in the Finance Documents; (E) the SWS/SWSG Loan; (F) single loans by SWS to employees of less than £250,000 (indexed from the Initial Issue Date) or loans by SWS to employees in aggregate less than £750,000 (indexed from the Initial Issue Date); (G) in the case of SWS, Permitted Volume Trading Arrangements; (H) any loan made as a Permitted Post Closing Event; (I) other loans by SWS in aggregate of less than £500,000 (indexed from the Initial Issue Date) not falling in (A) to (H) above; provided (other than in the case of (B) and except where a Default is continuing (F)) 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 without the prior written consent of the Security Trustee (provided that SWS may change its memorandum or articles of association or other constitutional documents without the Security Trustee's consent where such change is not in relation to the SWS Preference Shares and would not be reasonably likely to have a Material Adverse Effect or otherwise prejudice the Security Interests created pursuant to the Security Documents);
- (o) not to enter into any Treasury Transaction other than Hedging Agreements;
- (p) 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 or pursuant to the Finance Documents) relating to Tax;
- (q) 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;
- (r) (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;
- (s) to maintain separate bank accounts;

- (t) to pay all Taxes for which an Obligor is primarily liable 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;
 - (u) 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, nor create or enter into any restriction or prohibition on the creation or granting of, any Security Interest on any of its assets except as permitted by the Finance Documents, nor create or permit to exist any further Security Interest over all or any of its present and future revenues, equipment or assets as security for any Permitted Financial Indebtedness other than in favour of the Security Trustee to be held upon the terms of the STID;
 - (v) 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 any Associate other than (in the case of the Issuer or SWS) 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 respect of SWS only), 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 and exceeds an amount equal to 0.13 per cent. of RCV in aggregate at any time;
 - (w) not to dispose of all or any part of the Equipment or its undertaking, revenues, business or assets other than a Permitted Disposal or pursuant to the creation of a Permitted Security Interest;
 - (x) not to change its tax residence from the United Kingdom;
 - (y) 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) after the Initial Issue Date, issue any share capital to any person, other than where any such action or transaction: (i) is in respect of the SWS Preference Shares (subject, in certain circumstances, to the Restricted Payment Condition); (ii) is in furtherance of a Restricted Payment and the amount of the Restricted Payment is permitted to be paid pursuant to the Finance Documents; (iii) is expressly permitted under the Finance Documents; or (iv) has received the prior written consent of the Security Trustee and each Financial Guarantor;
 - (z) other than as a result of Permitted Emergency Action (in which case SWS shall use reasonable endeavours to ensure that all contracts entered into will be on an arm's length basis, although SWS will not be required to obtain alternative competitive quotes) or in respect of contracts entered into by SWS under paragraph (c) of the definition of Distributions, 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; and
 - (aa) other than SWS except with the consent of the Security Trustee and each Financial Guarantor, no Obligor shall participate in a scheme in respect of retirement benefit arrangements with companies other than the other Obligors. SWS may participate in subject to paragraphs (iv) and (v) below, the Permitted Existing Pension Schemes.
- (ii) Additionally, each of SWSH and SWSGH has undertaken:

- (a) not to: (A) carry on or transact any business or other activity other than (i) ownership of the shares in members of the SWS Financing Group held by it on the Initial Issue Date; (ii) the giving of guarantees in accordance with the Finance Documents; and (iii) performance of obligations required under the Finance Documents; (B) own any asset or incur any liabilities except for the purposes of carrying on that business in accordance with the Finance Documents; (C) suspend, abandon or cease to carry on its business; (D) declare, make or pay Restricted Payments otherwise than as permitted under the Finance Documents; or (E) take any steps to enforce any claims it may have against any other Obligor without the prior written consent of the Security Trustee; and
 - (b) not to make any Restricted Payments otherwise than out of monies received by it, directly or indirectly, from SWS which have been properly paid by SWS as a Distribution or as set out under the Common Terms Agreement.
- (iii) Save as otherwise approved by the Security Trustee, SWS has further undertaken to maintain on its board of directors at least three non-executive directors who are not employees or directors of any Associate (subject to temporary vacancies arising out of exceptional circumstances).
- (iv) Additionally, SWS has undertaken among other things:
- (a) to ensure that the nature of its business is limited to the Business;
 - (b) to conduct its Appointed Business in the name of SWS only and to ensure that separation from the Group or Associates is maintained at all times by holding SWS 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 Appointed Business unless such suspension or abandonment is in accordance with its Instrument of Appointment;
 - (d) if it exceeds the Permitted Non-Appointed Business Limits, to dispose of or reduce all or part of its Permitted Non-Appointed Business within six months so that the Permitted Non-Appointed Business Limits are complied with on the next Calculation Date;
 - (e) to comply in all material respects with the Instrument of Appointment save to the extent Ofwat has waived or approved such non-compliance to the reasonable satisfaction of the Security Trustee;
 - (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;
 - (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 required under 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) other than in respect of contracts entered into by SWS and under which payments to be made would fall within paragraphs (a) or (c) of the exclusions in the definition of Distribution, to comply with the Outsourcing Policy, which became effective on and from the Initial Issue Date and applies to each Outsourcing Agreement and Capex Contract entered into by SWS (other than any Excluded Agreements) on and from the Initial Issue Date; (B) subject to (A), to procure that any Outsourcing Agreement or Capex Contract entered into on and from the Initial Issue Date complies with the Public Procurement Rules (if such Outsourcing Agreement or Capex Contract would be an agreement to which the Public Procurement Rules would apply) and the Outsourcing Policy; (C) where an Emergency is continuing, to use its best endeavours to rectify such Emergency as soon as is reasonably practicable (for the avoidance of doubt, any Permitted Emergency Action will not constitute a breach of the Outsourcing Policy); (D) each time an Excluded Agreement expires in accordance with its terms or is terminated early, any agreement entered into by SWS in place of such Excluded Agreement shall comply with the Outsourcing Policy (to the extent required by the terms of the Outsourcing Policy); (E) not to amend, modify or alter any material provision or agree to renew or extend (or agree to exercise any option to renew or extend) any Excluded Agreement without the consent of the Security Trustee and each Financial Guarantor; and (F) to at all times use Good Industry Practice in exercising its rights and performing its obligations under any Excluded Agreement. In March 2005 SWS obtained a waiver from the Majority Creditors in relation to certain aspects of the Single Entity Contract PR04 described in Chapter 5 “*Description of the SWS Financing Group – Capital Investment Programme*” that do not comply with the Outsourcing Policy – see “*Events of Default*” below;
- (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 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, SWS must use its reasonable endeavours to ensure that subject to its obligations under the WIA: (A) a Transfer Scheme is agreed between SWS, the transferee and the Director General by a date no less than two 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 SWS 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) other than in respect of the SWS Preference Shares, 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 SWSH, the right (whether conditional or otherwise) to call for the issue or allotment of any share (or equivalent) loan note or loan capital of SWS (including an option or right of pre-emption or conversion);
- (q) to make an SWS/SWSG Debt Service Distribution quarterly each year and then only provided that certain conditions are met, including each of the following:
 - (i) no Event of Default is subsisting or will result from the payment;

- (ii) no event of default has occurred and is continuing under the SWS/SWSG Loan Agreement and SWSG is not in default of its obligations under the SW Tax Deed of Covenant;
 - (iii) all dividends declared by SWS, SWSH and SWSGH are validly declared;
 - (iv) all payments in respect of a Permitted Tax Loss Transaction comply fully with the SW Tax Deed of Covenant and the CTA; and
 - (v) such SWS/SWSG Debt Service Distribution is made against irrevocable payment instructions directing the Account Bank to remit the proceeds thereof on receipt by SWSG to the relevant account of SWS for same day value;
- (r) to comply with the obligations to provide information under any Surveillance Letter or any Authorised Credit Facility;
 - (s) 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), in all circumstances which are appropriate in accordance with Good Industry Practice provided that any such application is consistent with prudent management;
 - (t) 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 SWS to meet its operational, investment and financial obligations on a timely basis under the Instrument of Appointment and its obligations in respect of Financial Indebtedness;
 - (u) 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; and
 - (v) to (i) procure that the nature of the business of its Pension Companies is limited to the business and functions of a trustee of an occupational pension scheme (as defined in section 1 of the Pension Schemes Act 1993) in respect of SWS Pension Schemes only and (ii) procure that the Pension Companies do not incur any Financial Indebtedness or permit security to be taken over their assets or shares other than where such Security is taken in accordance with the Security Agreement.
- (v) Additionally, SWS and the Issuer have undertaken among other things:
 - (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) only to:
 - (A) pay Customer Rebates at a time when no Event of Default is subsisting;
 - (B) other than in the case of Permitted Post Closing Events, any SWS/SWSG Debt Service Distribution, any Subordinated Debt Replacement Event and any SWS Preference Share Conversion Event, pay any Distribution or make any payment under the Subordinated Debt or SWS Preference Shares if:
 - (i) in the case of Distributions or dividends under the SWS Preference Shares, the payment is made after a duly constituted board meeting has been held approving the declaration of such Distribution or dividend;
 - (ii) the amount of the Distribution, payment under the Subordinated Debt and/or payment under the SWS Preference Shares that may be paid is limited to an amount equal to the Proposed Payment Amount (as defined below);

- (iii) on the date of such payment:
 - (a) no drawings are outstanding under the Liquidity Facilities, other than Standby Drawings;
 - (b) save in the case of the first scheduled payment under the Subordinated Debt and the SWS Preference Shares, the Senior RAR, as certified by the Issuer and SWS in the Compliance Certificate most recently delivered to the Security Trustee and each Rating Agency, is less than or equal to 0.850:1 for each Test Period (after deducting an amount equal to the aggregate of any proposed Customer Rebates, proposed Distribution, proposed payment on the Subordinated Debt and proposed payment on the SWS Preference Shares (the “**Proposed Payment Amount**”) from available cash); and
 - (c) no Default subsists or might reasonably be expected to result from the payment and the Repeated Representations 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 as defined in Schedule 2 of the WIA or other satisfactory security has been established that will not be materially prejudicial to the interests of the Class A Debt Providers or the Class B Debt Providers (as the case may be); and
- (iv) in the case of a payment under the SWS Preference Shares or any Subordinated Debt into which the SWS Preference Shares have converted, at the time of such payment there is no amount which has fallen due under the Subordinated Debt which has not been paid or would, but for any deferral of unpaid amounts, have fallen due,

and SWS shall be treated as having made to each Secured Creditor in respect of Class A Debt and Class B Debt a representation on the date of any Restricted Payment that each of the conditions necessary to be satisfied in relation to such Restricted Payment has been satisfied.

In addition to the restrictions on payment of Restricted Payments described above, a Restricted Payment will not be permitted if certain changes of control of SWSGH result in a downgrade of the shadow rating of the Class A Wrapped Debt to or below BBB+ (S&P), Baa1 (Moody’s) and BBB+ (Fitch) and such ratings have not been restored;

- (c) 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;
- (d) 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;
- (e) 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;

- (f) to inform the Security Trustee of any change to the Auditors, as soon as reasonably practicable;
 - (g) 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;
 - (h) 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 SWS 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 SWS; and
 - (i) to ensure that it will not enter into any Authorised Credit Facility (other than in respect of any Subordinated Debt) unless following such entry into of such Authorised Credit Facility: (a) its aggregate nominal outstanding Financial Indebtedness which has an expected maturity falling within any period of 24 consecutive months shall not exceed 20 per cent. of SWS's RCV for the time being, and (b) the aggregate nominal outstanding Financial Indebtedness which has an expected maturity falling within the period from one Periodic Review to the next Periodic Review shall not exceed 40 per cent. of SWS's RCV for the time being (adjusted and increased proportionately to the extent that the period from one Periodic Review to the next Periodic Review is greater than five years).
- (vi) Additionally, the Issuer has undertaken, among other things:
- (a) not to (A) carry on any business other than the raising of funds to provide debt financing to SWS for the purposes of its Business in accordance with the Finance Documents or any Hedging Agreement 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 hedging arrangements contemplated in the Hedging Policy, in accordance with the terms of the Hedging Policy;
 - (c) prior to any refinancing of any Class B Debt with any Class A Debt, to obtain confirmation from all Rating Agencies then rating the Bonds that the Rating Requirement is met and will not cease to be met as a result of such refinancing;
 - (d) to use all reasonable endeavours to procure the admission of all listed Bonds for trading on the Market or the PSM, or such other stock exchange approved by the Dealers 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 SWS 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 FSMA of such notice as an investment advertisement (as therein defined));

- (g) to 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 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 8(c) (*Redemption for Index Event, Taxation or Other Reasons*) or 8(b) (*Optional Redemption*), to 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 SWS 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 amendments 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) any request for consent from the Security Trustee and each Financial Guarantor under any Finance Document (other than the STID) in relation to any matter or act which would be automatically treated as permitted by such Finance Document upon the giving of consent by the Security Trustee and each Financial Guarantor; (C) the Bonds of any Sub-Class being repaid in full; (D) the termination of the appointment of the Cash Manager; (E) the appointment of a replacement Bond Trustee or Security Trustee or the appointment of any new or replacement Agents; (F) any Default; (G) the taking of Enforcement Action; (H) the occurrence of any SWS Change of Control or certain changes of control of SWSGH; or (I) the acquisition of any Permitted Subsidiary pursuant to a Permitted Acquisition, in each case, promptly after the Issuer or SWS becoming aware of the same;
- (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, if any Registered Bonds are outstanding, to procure that the Registrar maintains the Register and to 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 (unless the Bond Trustee otherwise agrees) to enter into a deed supplemental to the Bond Trust Deed, so that the relevant Condition shall make reference to that other or additional territory; and

- (p) to notify the Bond Trustee of any amendment to the Dealership Agreement.

Financial Covenants

- (i) SWS has undertaken, among other things:

- (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 copy of the computations made in respect of the calculation of such ratios:

- (A) the Class A ICR for each Test Period;
- (B) the Senior Adjusted ICR for each Test Period;
- (C) the Class A Adjusted ICR for each Test Period;
- (D) the Senior Average Adjusted ICR;
- (E) the Class A Average Adjusted ICR;
- (F) the Senior RAR as at such Calculation Date and, in the case of forward-looking ratios, the 31 March falling in each Test Period;
- (G) the Class A RAR as at such Calculation Date and, in the case of forward-looking ratios, the 31 March falling in each Test Period; and
- (H) the ratio of Net Cash Flow minus Capital Maintenance Expenditure to Class A Debt Interest for the 12 month period ending on such Calculation Date,

and to calculate (x) the historical ratios using the audited financial statements (or unaudited financial statements if audited financial statements are not available on such date) delivered with such Compliance Certificate and (y) the forward-looking ratios using the SWS Business Financial Model which shall be prepared on a consistent basis and using assumptions from the most recently available relevant information and the most recently delivered financial statements; and

- (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 SWS 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 from at least two of the Rating Agencies.

- (ii) The Issuer has further undertaken to maintain:

- (a) a DSR Liquidity Facility 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 Account) is 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 (after taking into account the impact on interest rates of such Class A Debt and Class B Debt of any Hedging Agreements then in place); and
- (b) an O&M Reserve and/or O&M Reserve Facility available for drawing which together (including the value of any Authorised Investments funded from the balance on any 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 SWS Business Financial Model.

Trigger Events

The Common Terms Agreement also sets out certain Trigger Events. The specific Trigger Events and the consequences which flow from the occurrence of those events are set out 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 (each a “**Trigger Event Ratio Level**”) as at the most recently occurring Calculation Date:

- (a) the Senior RAR as at such Calculation Date or, in the case of forward-looking ratios, as at 31 March falling in any Test Period is or is estimated to be more than 0.900:1;
- (b) the Class A RAR as at such Calculation Date or, in the case of forward-looking ratios, as at 31 March falling in any Test Period is or is estimated to be more than 0.750:1;
- (c) the Senior Adjusted ICR for any Test Period is or is estimated to be less than 1.10:1;
- (d) the Class A Adjusted ICR for any Test Period is or is estimated to be less than 1.30:1;
- (e) the Senior Average Adjusted ICR is or is estimated to be less than 1.20:1; or
- (f) the Class A Average Adjusted ICR is or is estimated to be less than 1.40:1.

(ii) Credit Rating Downgrade

- (a) The long-term shadow credit rating of any Class A Wrapped Debt given by any two of the Rating Agencies falls to BBB (S&P), Baa2 (Moody’s) or BBB (Fitch) or below;
- (b) the long-term credit rating of any Class A Unwrapped Debt by any two of the Rating Agencies falls to BBB (S&P), Baa2 (Moody’s) or BBB (Fitch) or below;
- (c) the long-term shadow credit rating of the Class B Wrapped Debt by any two of the Rating Agencies falls below Investment Grade; or
- (d) the long-term credit rating of the Class B Unwrapped Debt by any two of the Rating Agencies falls below Investment Grade.

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

(iii) Debt Service Payment Account Shortfall

The failure by SWS to pay the Monthly Payment Amount within five Business Days following the date on which such payment was scheduled to be made.

(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, including variances in real construction prices from assumed construction prices, and deducting capital expenditure incurred or to be incurred in respect of items for which SWS is entitled to make an application for an IDOK) in respect of SWS by 10 per cent. or more.

(v) Liquidity for Capital Expenditure and Working Capital

If, as at any Calculation Date, the aggregate of (i) SWS's operating cash flows including monies standing to the credit of the Operating Accounts 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 is less than the aggregate of SWS's (a) forecast Capital Expenditure projected for the next 12 month period; (b) forecast working capital requirements projected for the next 12 month period; (c) the maximum total amount of interest in respect of Class A Debt and Class B Debt which is or is projected to fall due and payable during the next succeeding 12 month period; (d) all amounts which are or are projected to fall due and payable during the next succeeding 12 month period in respect of Financial Indebtedness which falls within paragraph (e) of the definition of Permitted Financial Indebtedness; and (e) the amount the Issuer estimates, in its reasonable opinion, is equal to the net amount payable by the Issuer to a Hedge Counterparty following the exercise of an option to terminate a Treasury Transaction as permitted by the Hedging Policy.

(vi) Drawdown on DSR Liquidity Facilities and O&M Reserve Facility

If, at any time, the aggregate of all amounts available for drawing under the DSR Liquidity Facilities and all amounts standing to the credit of the Debt Service Reserve Account is less than the Required Balance (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 three Business Days without such repayment being funded by a further drawing under a DSR Liquidity Facility).

The Issuer draws down under an O&M Reserve Facility or either the Issuer or SWS withdraws funds from either O&M Reserve Account, in either case to pay SWS's operating or maintenance expenditure (excluding any drawing or repayment of any Standby Drawing in relation to the Issuer's O&M Reserve Facility).

(vii) Enforcement Order

An Enforcement Order (as defined under the WIA) is issued under Part II, Chapter 11 of the WIA against SWS 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 SWS 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 SWS.

(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 Material Entity Event occurs in relation to a Material Agreement or a Contractor and/or SWS under a Material Agreement and which continues unremedied for 60 days (other than (i) a Material Entity Event in relation to a Contractor's failure to pay (see paragraph (a) of "*Material Entity Events*" below) which continues unremedied for 45 days or (ii) a Material Entity Event in relation to a misrepresentation or breach of obligation which is capable of remedy (see paragraphs (b) and (c) of "*Material Entity Events*" below) which continues unremedied for 30 days) from the date from which SWS could be reasonably

expected to become aware of such Material Entity Event unless the relevant Contractor has been replaced in accordance with the Outsourcing Policy or SWS has terminated the appointment of the relevant Contractor and assumed the obligations of the Contractor under the relevant Material Agreement.

(xii) Referral

A referral is made under sub-paragraph 14.3 of Condition B in Schedule 2 (*Shipwreck Clause*) 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 SWS 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 SWS.

(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) if such legislation could (if enacted) reasonably be expected to lead to a breach of the financial ratios referred to in "*Financial Ratios*" above or cause a material deviation as set out in "*Material Deviations in Projections*" above, in each case taking into account any actions available to SWS to mitigate the same.

(xv) Modification or Replacement of Instrument of Appointment

If 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, SWS 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-Appointed Business Limits are breached.

(xvii) Breach of Outsourcing Policy

SWS fails duly to perform or comply with its material 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 SWS becoming aware of such breach. (In March 2005 SWS obtained a waiver from the Majority Creditors in relation to certain aspects of the Single Entity Contract PR04 described in Chapter 5 "*Description of the SWS Financing Group – Capital Investment Programme*" that do not comply with the Outsourcing Policy.)

(xviii) Adverse Final Determination of K

A final determination of K by Ofwat which is reasonably likely to have a Material Adverse Effect.

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 "*Trigger Events Remedies*" below) or otherwise remedied to the satisfaction of the Security Trustee, the following consequences ("**Trigger Event Consequences**") 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, SWS must stop their implementation and must not declare any Customer Rebates.

(ii) Further Information and Remedial Plan

- (a) SWS must provide such information as to the relevant Trigger Event (including its causes and effects) as may be requested by the Security Trustee.
- (b) SWS must discuss with the Security Trustee its plans for appropriate remedial action and the timetable for implementation of such action. SWS 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 Remedial Plan must then be implemented by SWS.

(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 SWS 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 Plan 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 SWS may agree in a Remedial Plan, the Security Trustee will be entitled to procure the appointment of further non-executive directors to the board of SWS (in addition to those already on the board of SWS) in such numbers as would allow it, following such appointments, to have appointed a maximum of 20 per cent. of the board by number.

(vi) Payments under Outsourcing Agreements and Capex Contracts with Associates

All payments made by SWS under Outsourcing Agreements and/or Capex Contracts with Associates (excluding, for the avoidance of doubt, contracts which fall within paragraphs (a) and (c) of the definition of Distribution) which do not comply with the Outsourcing Policy in all material respects, shall be made as Distributions where such non-compliance has remained unremedied for a period in excess of 365 days from the date on which SWS became aware of such non-compliance.

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 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.

Trigger Event Remedies

At any time when the Issuer or SWS (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 five Business Days of receipt of such notice from the Issuer or SWS (as the case may be)) 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 (each, a “**Trigger Event Remedy**”):

(i) Financial Ratios

The breach of a Trigger Event Ratio Level shall be remedied if such ratio or ratios come within the relevant level or levels specified below in relation to the most recently occurring Calculation Date:

- (a) the Senior RAR as at such Calculation Date and, in the case of any forward-looking ratios, as at the 31 March falling in each Test Period relating to such Calculation Date is or is estimated to be less than 0.900:1;
- (b) the Class A RAR as at such Calculation Date and, in the case of any forward-looking ratios, as at the 31 March falling in each Test Period relating to such Calculation Date is or is estimated to be less than 0.750:1;
- (c) the Senior Adjusted ICR for each Test Period relating to such Calculation Date is or is estimated to be greater than 1.10:1;
- (d) the Class A Adjusted ICR for each Test Period relating to such Calculation Date is or is estimated to be greater than 1.30:1;
- (e) the Senior Average Adjusted ICR is or is estimated to be greater than 1.20:1; or
- (f) the Class A Average Adjusted ICR is or is estimated to be greater than 1.40:1.

(ii) Credit Rating Downgrade

The occurrence of a Trigger Event in relation to a credit rating downgrade (see paragraph (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.

(iii) Debt Service Required Payment Shortfall

The occurrence of a Trigger Event in relation to the non-payment of the Monthly Payment Amount into the Debt Service Payment Account (see paragraph (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 in relation to material deviations in projections (see paragraph (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. of the figure assumed by the Director General in the last Periodic Review (adjusted to take account of any subsequent IDOK and Out-turn Inflation) or, if a different figure is subsequently agreed by Ofwat and SWS, the deviations are less than 10 per cent. of the subsequently agreed figure, as the case may be.

(v) Liquidity for Capital Expenditure and Working Capital

The occurrence of a Trigger Event in relation to liquidity for capital expenditure and working capital (see paragraph (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 (e) of that paragraph.

(vi) Drawdown on DSR Liquidity Facilities and O&M Reserve Facility

- (a) The occurrence of a Trigger Event in relation to drawdowns under the DSR Liquidity Facility (see paragraph (vi) of “*Trigger Events*” above) will be remedied if the amount available for drawing under the DSR Liquidity Facilities when aggregated with all amounts standing to the credit of the Debt Service Reserve Account is restored to at least the Required Balance.
- (b) The occurrence of a Trigger Event in relation to a drawing under the O&M Reserve Liquidity Facility (see paragraph (vi) of “*Trigger Events*” above) will be remedied if the amount available for drawing under the O&M Reserve Facility, when aggregated with the O&M Reserve, is at least equal to the O&M Reserve Required Amount.

(vii) Enforcement Order

The occurrence of a Trigger Event in relation to an Enforcement Order (as set out in paragraph (vii) of “*Trigger Events*” above) will be remedied if SWS 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 in relation to circumstances leading to a Special Administration Order (as set out in paragraph (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 SWS.

(ix) Termination of Instrument of Appointment

The occurrence of a Trigger Event in relation to termination of the Instrument of Appointment (as set out in paragraph (ix) of “*Trigger Events*” above) will be remedied by agreement by SWS to the extent that a Transfer Scheme reasonably satisfactory to the Security Trustee is implemented prior to the termination of the Instrument of Appointment.

(x) Event of Default

The occurrence of a Trigger Event in relation to an Event of Default (as set out in paragraph (x) of “*Trigger Events*” above) will be remedied if the Event of Default is waived or revoked in accordance with the STID or is remedied to the reasonable satisfaction of the Security Trustee.

(xi) Material Entity Event

The occurrence of a Material Entity Event in relation to a Trigger Event (as set out in paragraph (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 if SWS has terminated the appointment of the relevant Contractor and assumed the obligations of that Contractor as prescribed under the relevant Material Agreement; 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 in relation to a referral under the Instrument of Appointment (as set out in paragraph (xii) of “*Trigger Events*” above) will be remedied if:

- (a) in the absence of any determination or forecast of the determination of the Director General the financial ratios set out above come within the relevant level or levels specified in paragraph (i) of “*Trigger Event Remedies*” in relation to the most recently occurring Calculation Date; or
- (b) the Director General has made a determination that restores the financial ratios specified in paragraph (i) of “*Trigger Events*” above to at least the Trigger Event Ratio Levels.

(xiii) Audit Qualification

The occurrence of a Trigger Event in relation to an audit qualification (as set out in paragraph (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 if SWS produces a further set of Statutory Accounts upon which the auditors’ report is not qualified.

(xiv) Adverse Governmental Legislation

The occurrence of the Trigger Event in relation to adverse Governmental legislation (as set out in paragraph (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 is reasonably likely not to cause a breach of the financial ratios set out in paragraph (i) of “*Trigger Events*” above or such financial ratios are otherwise reinstated to the Trigger Event Ratio Levels or the Director General has confirmed that the Capital Expenditure which would otherwise have led to a material deviation as referred to in paragraph (iv) of “*Trigger Events*” above is allowable under adjustments to the RCV and, when taking such adjustment into account, such financial ratios would meet the Trigger Event Ratio Levels.

(xv) Modification or Replacement of Instrument of Appointment

The occurrence of a Trigger Event in relation to the modification or replacement of the Instrument of Appointment (as set out in paragraph (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 SWS will or do contain equivalent terms which permit SWS to carry on its water and sewerage business substantially as carried on as of the Initial Issue Date taking into account any changes in the regulatory environment since the Initial Issue 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 (i) of “*Trigger Events*” above.

(xvi) Conduct of Business

Within six months of the date of the occurrence of the Trigger Event in relation to the conduct of business (as set out in paragraph (xvi) of “*Trigger Events*” above), SWS disposes of all or part of the Permitted Non-Appointed Business so that the Permitted Non-Appointed Business Limits will be complied with during the current Test Period excluding (for the purpose of calculating such ratio) the aggregate Non-Appointed Expenses of the former Permitted Non-Appointed Business which has been disposed of by SWS during such Test Period.

(xvii) Breach of Outsourcing Policy

The occurrence of the Trigger Event in relation to a breach of the Outsourcing Policy (as set out in paragraph (xvii) of “*Trigger Events*” above) will be remedied and the Trigger Event Consequence set out in paragraph (vi) of “*Trigger Event Consequences*” above will be disappplied if SWS takes such action as is necessary so that it is in compliance with the Outsourcing Policy.

(xviii) Adverse Final Determination of K

The occurrence of the Trigger Event in relation to an adverse final determination of K (as set out in paragraph (xviii) of “*Trigger Events*” above) will be remedied if the financial ratios set out above ‘come within the relevant level or levels specified in paragraph (i) of “*Trigger Event Remedies*” in relation to the most recently occurring Calculation Date.

In respect of any of the Trigger Event Remedies 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.

Events of Default

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

- (a) non-payment of amounts payable under the Finance Documents within three Business Days of the due date;
- (b) non-compliance with certain other obligations under the Finance Documents (other than the Tax Deeds of Covenant) or the occurrence of a TDC Breach which is continuing;
- (c) material misrepresentation;
- (d) 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;
- (e) an Insolvency Event or Insolvency Proceedings occur(s) in relation to the Obligors other than SWS or, in relation to SWS, an insolvency event or insolvency proceedings as set out further in the CTA occur(s) in relation to SWS;
- (f) SWS transferring the Instrument of Appointment without the Security Trustee’s consent or SWS 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 two years prior to the expiration of such notice;
- (g) 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 Initial Issue Date;
- (h) insufficient liquidity (from operating cash flows, the Authorised Credit Facilities and the Capex Reserve Account) to meet SWS’s forecast Capital Maintenance Expenditure and working capital requirements projected for the next six month period;
- (i) attachment, sequestration, distress or execution involving sums in excess of £500,000 (indexed) and if not discharged within 30 days;

- (j) any Obligor repudiating a Finance Document or it becoming unlawful or ineffective for any Obligor to perform its material obligations under any Finance Document;
- (k) an SWS Change of Control occurs;
- (l) any of the Security ceasing to be in full force and effect;
- (m) certain governmental action (including nationalisation) which would be reasonably likely to have a Material Adverse Effect;
- (n) a member of the SWS Financing Group failing to comply with a judgment involving sums in excess of £500,000 (indexed) in aggregate at any time except where such judgement is being appealed in good faith to a higher court;
- (o) 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;
- (p) SWS failing to comply with its obligations under the Outsourcing Policy (and such failure has a Material Adverse Effect);
- (q) an Obligor other than SWS ceasing or threatening to cease to carry on its business (or any substantial part of its business) it carries on as at the date of the CTA or as contemplated by the Finance Documents or SWS ceasing or threatening to cease to carry on the Appointed Business (or any substantial part of the Appointed Business) it carries on at the date of the CTA or which is contemplated by the Finance Documents other than as permitted by the Finance Documents;
- (r) 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;
- (s) 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;
- (t) the Class A ICR being less than 1.60:1, the Senior RAR being more than 0.950:1 and/or the ratio of Net Cash Flow minus Capital Maintenance Expenditure to Class A Debt Interest for the immediately preceding 12 month period is less than 1.00:1;
- (u) an Obligor (other than SWS) amending its memorandum or articles of association or SWS amending its memorandum or articles, if such amendment relates to the terms of the SWS Preference Shares or is in a manner which is reasonably likely to have a Material Adverse Effect or diminish the value of any Security Interest granted in favour of the Security Trustee, unless the Security Trustee has previously given its prior written consent to such amendment;
- (v) a Material Entity Event (as described in “Material Entity Events” below) occurring which has a Material Adverse Effect.

In March 2005 SWS obtained a waiver from the Majority Creditors in relation to certain aspects of the Single Entity Contract PR04 described in Chapter 5 “*Description of the SWS Financing Group – Capital Investment Programme*” that do not comply with the Outsourcing Policy.

In December 2005, SWS obtained a waiver from the Majority Creditors in relation to the opening of two new bank accounts required in order to implement a counter payment network service administered by PayPoint Network Limited and PayPoint Collections Limited, which provides SWS with the facility to collect cash payments for water bills through PayPoint terminals located in the convenience retail sector.

SWS has obtained waivers from the Majority Creditors in respect of the requirement to produce consolidated accounts for SWS for the years ending 31 March 2005, 31 March 2006, 31 March 2007, 31 March 2008, 31 March 2009 and 31 March 2010. SWS will seek similar waivers in the future.

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 “*Entrenched Rights and Reserved Matters*” above)) act in accordance with the instructions of the Majority Creditors in accordance with the STID (see “*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 “*Security Trust and Intercreditor Deed – Standstill*” above).

Material Entity Events

The Common Terms Agreement provides (subject, in some cases to certain exceptions, reservations of law and grace periods) 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, SWS, to the extent that such event would be reasonably likely to have a Material Adverse Effect:

- (a) any amount due from the Contractor or SWS is not paid 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;
- (b) any representation or statement made or deemed to be made by a Contractor or SWS in any Material Agreement is or proves to have been incorrect or misleading in any respect when made or deemed to be made and such failure, if capable of remedy, is not remedied by the Contractor or SWS within 30 days of it becoming aware that such representation was incorrect or misleading in any respect;
- (c) the Contractor or SWS 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 SWS, as the case may be, within 30 days of becoming aware of such breach;
- (d) 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;
- (e) an Insolvency Event or equivalent event occurs in relation to a Contractor to a Material Agreement;
- (f) 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 at any time except where such judgment is being appealed in good faith to a higher court;
- (g) any Material Agreement to which the Contractor and SWS is a party or any obligation purported to be contained therein or the security or credit enhancement intended to be effected in relation to such Material Agreement is repudiated by the Contractor or SWS 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 SWS or the Contractor is a party or the security or credit enhancement related there to or any such 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 the Contractor or SWS or on behalf of the Contractor or SWS; and

- (h) the Contractor, SWS or any provider of security or credit enhancement therefor does not have the legal power to perform any of its obligations under the Material Agreements or, as the case may be, such security or credit enhancement or to own any assets or to carry on any part of its business or at any time it is or becomes unlawful for the Contractor, SWS or any provider of security or credit enhancement therefor to perform or comply with any of its obligations under any Material Agreement or any of the obligations of the Contractor or any provider of security or credit enhancement thereunder are not or cease to be legal, valid, binding and enforceable.

Conditions Precedent

The conditions precedent to, among other things, the release of Financial Guarantees and to the issue of Bonds are set out in a conditions precedent agreement dated 23 July 2003 (the “**CP Agreement**”) between, among others, the Bond Trustee, the Security Trustee and the Obligor.

Cash Management

Accounts

In accordance with the Common Terms Agreement, SWS has opened and maintains the following Accounts with the Account Bank:

- (a) each Operating Account;
- (b) an O&M Reserve Account; and
- (c) the Capex Reserve Account.

The Issuer has also opened or (in the case of the O&M Reserve Account) shall open and maintain the following Accounts with the Account Bank:

- (a) the Debt Service Payment Account;
- (b) the Debt Service Reserve Account; and
- (c) in the event the Issuer becomes a borrower under an O&M Reserve Facility, an O&M Reserve Account.

SWSGH and SWSH have each opened and maintain one chequing account only with the Account Bank.

Each of the above accounts together with any other bank account of any Obligor are collectively referred to as the “**Accounts**”. Each of the Accounts is held with the Account Bank pursuant to the Account Bank Agreement. Each Obligor agreed in the Common Terms Agreement to comply with the Account Bank Agreement and the provisions of the Common Terms Agreement applying to its Accounts.

Operating Accounts

Under the Common Terms Agreement, SWS must ensure that all of its revenues (other than any interest or Income which is credited to the Account from which the Authorised Investment was made) will be paid into an operating account.

For those revenues of SWS which are received into existing collection accounts of SWS with a bank other than the Account Bank, SWS must ensure the balance on such collection accounts is transferred into an Operating Account at least once a week and, following a downgrade of the short term unsecured unsubordinated debt rating of such bank (excluding for this purpose Alliance & Leicester Commercial Bank plc (formerly Girobank and now part of the Santander Group)) below the Minimum Short-term Rating, on close of business of each Business Day.

The Operating Accounts are the principal current accounts of SWS through which all operating and Capital Expenditure or any Taxes incurred by SWS and (subject to the terms of the Finance Documents) payments in respect of the Financial Indebtedness of the SWS Financing Group which are not permitted to be satisfied out

of monies credited to the Debt Service Payment Account are cleared. SWS may make transfers at any time from one Operating Account to another, in its sole discretion.

All operating expenditure of SWS is funded (a) through payments made directly into the Operating Accounts and (b) through drawings made by the Issuer or SWS under any Authorised Credit Facility or other Permitted Financial Indebtedness and, in the case of drawings made by the Issuer (except under any DSR Liquidity Facility), on lent to SWS under an Issuer/SWS Loan Agreement, as and when required and permitted by the Finance Documents. Capital Expenditure is funded out of monies standing to the credit of the Operating Accounts, out of cash transfers made from the Capex Reserve Account to the Operating Accounts and/or (in relation to Capital Maintenance Expenditure), to the extent that the sums standing to the credit of the Operating Accounts and the Capex Reserve Account are insufficient, SWS's O&M Reserve Account.

All Distributions, payments under the SWS Preference Shares (or, following an SWS Preference Share Conversion Event, the relevant Subordinated Debt into which the SWS Preference Shares are converted) and Permitted Post-Closing Events have been or will be funded (directly or indirectly) out of monies standing to the credit of the Operating Accounts subject always to the satisfaction of all of the conditions set out in the Common Terms Agreement for the making of such payments.

Annually on 31 March of each year (or, if such day is not a Business Day, the immediately preceding Business Day) SWS calculates the Annual Finance Charge for the period of 12 months commencing on the immediately following 1 April, and details of such calculation are included in the next following Investors Report.

Under the Common Terms Agreement, SWS on the opening of business on the first Business Day of each month until the Discharge Date transfers to the Issuer from the Operating Accounts an amount (the "**Monthly Payment Amount**") equal to $1/12^{\text{th}}$ of SWS's Annual Finance Charge for the relevant 12 month period to the Debt Service Payment Account provided that the aggregate of any interest accruing on and credited to the Debt Service Payment Account is treated as a prepayment of future Monthly Payment Amounts payable during the relevant 12 month period. Accordingly, the Monthly Payment Amounts due for the remaining months of such 12 month period shall be reduced pro rata to reflect such prepayment.

SWS recalculates the Annual Finance Charge and the Monthly Payment Amount, as applicable if, during the course of any relevant 12 month 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 reduction in the rate of applicable interest, 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) in the Annual Finance Charge and adjusts the Monthly Payment Amount for the remaining months in the relevant 12 month period, and details are included in the next following Investors Report.

Capex Reserve Account

As at 31 January 2012 approximately £22.9 million was standing to the credit of the Capex Reserve Account.

SWS may not withdraw any monies from the Capex Reserve Account unless such withdrawal is for the purpose of funding a transfer to the Operating Account on account of SWS's capital expenditure requirements or as contemplated below in relation to the application of insurance proceeds.

SWS must ensure that the proceeds of any advance to it under any Authorised Credit Facility for the purpose of funding its capital expenditure is paid directly into the Capex Reserve Account or an Operating Account.

SWS must also ensure that all proceeds of any property damage insurance claim (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 Capex Reserve Account.

SWS may withdraw the proceeds of property damage insurance claims from the Capex Reserve Account 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, where any Permitted Lease Termination has arisen as a consequence of the loss of such asset, in payment of any Class A Debt falling due on the date of that Permitted Lease Termination arising as a consequence of the loss of such asset.

If SWS has paid sums to reinstate, restore or replace assets or effects lost or damaged or to meet claims by third parties out of moneys withdrawn from the Operating Accounts, then SWS may pay the relevant insurance amounts received directly into an Operating Account. If the reinstatement, restoration or replacement cost of any damaged property is less than the property damage insurance proceeds received by it in relation to such property, SWS may pay the difference into an Operating Account.

SWS's O&M Reserve Account

As at 31 March 2012 approximately £46.3 million was standing to the credit of the O&M Reserve Account.

SWS may not withdraw any monies from its O&M Reserve Account unless (i) such withdrawal is for the purpose of funding a transfer to an Operating Account on account of operating and capital expenditure requirements that cannot be met from existing balances in the Operating Accounts and additionally, in the case of any capital expenditure requirement, the Capex Reserve Account (ii) such withdrawal is for the purpose of transferring into an Operating Account any interest income earned from time to time on the O&M Reserve (including Income from any related Authorised Investments) or (iii) prior to making a withdrawal, SWS delivers a certificate to the Security Trustee and the Account Bank certifying that, following such proposed withdrawal, the aggregate of the O&M Reserve and all amounts then available for drawing under any O&M Reserve Facility are at least equal to the O&M Reserve Required Amount on the date of such withdrawal. As at the date of this Prospectus, SWS has not withdrawn any monies from its O&M Reserve Account.

SWS must ensure that the proceeds of any drawing by the Issuer under any O&M Reserve Facility Agreement (other than a Standby Drawing) are lent by the Issuer to SWS under an Issuer/SWS Loan Agreement and are paid directly into SWS's O&M Reserve Account or an Operating Account.

Debt Service Payment Account

As at 31 March 2012 approximately £127.6 million was standing to the credit of the Debt Service Payment Account.

SWS must ensure that each transfer of or in respect of the Monthly Payment Amount from the Operating Account, is made to the Issuer directly into the Debt Service Payment Account.

The Common Terms Agreement provides that, on each Payment Date, monies credited to the Debt Service Payment Account must be applied by the Issuer in the following order for the purpose of enabling the following payments (“**Permitted Payments**”) to be made in the following order of priority (the “**Payment Priorities**”) without double counting:

- (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 of the SWS Financing Group's operating costs (except to the extent falling due under the Finance Documents) and maintenance costs;
- (ii) *second*, pro rata, according to the respective amounts thereof in or towards satisfaction of the remuneration, costs and expenses of the Security Trustee and the Bond Trustee;
- (iii) *third*, pro rata, according to the respective amounts thereof in or towards satisfaction of, on a pro rata basis: (a) the remuneration, costs and expenses of each Agent, the Account Bank under the Account Bank Agreement, each DSR Liquidity Facility Provider under the relevant DSR Liquidity Facility Agreement, each O&M Reserve Facility Provider under the relevant O&M Reserve Facility Agreement, each facility agent under the relevant Authorised Credit Facility and the Standstill Cash Manager; and (b) the remuneration, costs and expenses of and fees of each Financial Guarantor pursuant to the relevant G&R Deed;

- (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 DSR Liquidity Facility Provider under the relevant DSR Liquidity Facility Agreement; (b) all amounts of fees, interest and principal (other than Subordinated Liquidity Facility Amounts) due or overdue to each O&M Reserve Facility Provider under the relevant O&M Reserve Facility Agreement; 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;
- (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), recurring fees and commitment commissions due or overdue in respect of the Class A Debt (other than any Subordinated Coupon Amounts and Subordinated Authorised Loan Amounts); (b) any unscheduled amounts (including termination amounts) due and payable to each Hedge Counterparty under any Interest Rate Hedging Agreement (except to the extent required to be paid at paragraph (xvi) below); (c) all scheduled amounts (other than principal exchange amounts) payable to each Hedge Counterparty under any Currency Hedging Agreement in respect of Class A Debt and (subject to paragraph (xvi) below and following termination of a Standstill Period other than due to remedy or waiver by the Majority Creditors of, or the revocation of, the Event of Default giving rise to the Standstill Period) all amounts payable to each Hedge Counterparty under any Currency Hedging Agreement in respect of Class A Debt; (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 G&R Deed in respect of payments of interest on any Class A Wrapped Debt 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 in respect of Class A Debt; (c) any termination amounts or other unscheduled sums due and payable to each Hedge Counterparty under any Currency Hedging Agreement in respect of Class A Debt (except to the extent required to be paid at paragraph (xvi) below); and (d) all reimbursement sums (if any) owed to each Financial Guarantor under the relevant G&R Deed in respect of payments of principal on any Class A Wrapped Debt guaranteed by such Financial Guarantor;
- (viii) *eighth*, in or towards satisfaction of any Make-Whole Amount due and payable on the Class A Debt;
- (ix) *ninth*, 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;
- (x) *tenth*, in payment to the Debt Service Reserve Account until the sum of the balance thereon and the aggregate available commitments under the DSR Liquidity Facility Agreements is equal to the Class A Required Balance;
- (xi) *eleventh*, in payment to the Issuer's O&M Reserve Account until the sum of the O&M Reserve and the aggregate of amounts available to be drawn under O&M Reserve Facilities is equal to the O&M Reserve Required Amount;

- (xii) *twelfth*, 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 due or overdue in respect of any Class B Bonds and Subordinated Authorised Loan Amounts);
 - (b) all amounts of underwriting commissions due or overdue in respect of the Class B Debt;
 - (c) except to the extent required to be paid at paragraph (xvi) below, all scheduled amounts (other than principal exchange amounts) payable to each Hedge Counterparty under any Currency Hedging Agreement in respect of Class B Debt and (following termination of a Standstill Period other than due to remedy or waiver by the Majority Creditors of, or revocation of, the Event of Default giving rise to the Standstill Period) all amounts payable to each Hedge Counterparty under any Currency Hedging Agreement in respect of Class B Debt; and
 - (d) all reimbursement sums (if any) owed to each Financial Guarantor under the relevant G&R Deed in respect of payments of interest on any Class B Wrapped Debt guaranteed by such Financial Guarantor;
- (xiii) *thirteenth*, 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;
 - (b) all principal exchange amounts due and payable to each Hedge Counterparty under any Currency Hedging Agreement in respect of Class B Debt;
 - (c) except to the extent required to be paid at paragraph (xvi) below, any termination amounts or other unscheduled sums due and payable to each Hedge Counterparty under any Currency Hedging Agreement in respect of Class B Debt; and
 - (d) all reimbursement sums (if any) owed to each Financial Guarantor under the relevant G&R Deed in respect of payments of principal on any Class B Wrapped Debt guaranteed by such Financial Guarantor;
- (xiv) *fourteenth*, 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;
- (xv) *fifteenth*, in payment to the Debt Service Reserve Account until the sum of the balance thereon and the aggregate available commitments under the DSR Liquidity Facilities is equal to the sum of the Class A Required Balance and the Class B Required Balance;
- (xvi) *sixteenth*, 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 (other than any amount attributable to the return of collateral or any premium or other upfront payment paid to the Issuer to enter into a transaction to replace a Hedging Agreement (in whole or in part)) shall be applied first in payment of amounts due to the Hedge Counterparty in respect of that Hedging Agreement;
- (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 Liquidity Facility Agreements;
 - (b) 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;
 - (c) any other indemnified amounts due or overdue to each Financial Guarantor under the relevant G&R Deed in respect of any Class A Wrapped Debt guaranteed by such Financial Guarantor; and
 - (d) any amounts payable in respect of Class A Debt not referred to in other sub-paragraphs of the Payment Priorities;
- (xviii) *eighteenth*, pro rata according to the respective amounts thereof, in or towards satisfaction of:
 - (a) 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;
 - (b) any other indemnified amounts due or overdue to each Financial Guarantor under the relevant G&R Deed in respect of any Class B Wrapped Debt guaranteed by such Financial Guarantor; and
 - (c) any amounts payable in respect of Class B Debt not referred to in any other sub-paragraphs of the Payment Priorities;

- (xix) *nineteenth*, 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 B Bonds;
- (xx) *twentieth*, subject always to the satisfaction of the Restricted Payment Condition, pro rata according to the respective amounts thereof, in or towards satisfaction of all amounts of interest due or overdue in respect of the Senior Mezzanine Debt;
- (xxi) *twenty-first*, subject always to the satisfaction of the Restricted Payment Condition, pro rata according to the respective amounts thereof, in or towards satisfaction of all amounts of principal due or overdue in respect of the Senior Mezzanine Debt;
- (xxii) *twenty-second*, subject always to the satisfaction of the Restricted Payment Condition, pro rata according to the respective amounts thereof, in or towards satisfaction of any other sums due or overdue in respect of the Senior Mezzanine Debt;
- (xxiii) *twenty-third*, subject always to the satisfaction of the Restricted Payment Condition, pro rata according to the respective amounts thereof, in or towards satisfaction of all amounts of interest due or overdue in respect of the Junior Mezzanine Debt;
- (xxiv) *twenty-fourth*, subject always to the satisfaction of the Restricted Payment Condition, pro rata according to the respective amounts thereof, in or towards satisfaction of all amounts of principal due or overdue in respect of the Junior Mezzanine Debt;
- (xxv) *twenty-fifth*, subject always to the satisfaction of the Restricted Payment Condition, pro rata according to the respective amounts thereof, in or towards satisfaction of any other sums due or overdue in respect of the Junior Mezzanine Debt;
- (xxvi) *twenty-sixth*, subject always to the satisfaction of the Restricted Payment Condition, in or towards satisfaction of all sums due or overdue in respect of any Subordinated Debt into which the SWS Preference Shares have converted upon an SWS Preference Share Conversion Event where the holder of such Subordinated Debt has acceded to the STID as a Secured Creditor; and
- (xxvii) *twenty-seventh*, (to the extent required in the Common Terms Agreement) the balance shall remain in the Debt Service Payment Account.

Any payment made by the Issuer to a Secured Creditor pursuant to the Payment Priorities on account of a liability in respect of which SWS is the principal debtor is treated as having discharged SWS's obligation to make such payment to that Secured Creditor. SWS is also treated as having discharged its related payment obligation to the Issuer under the relevant Issuer/SWS Loan Agreement upon (and to the extent of) the Issuer making a payment pursuant to the Payment Priorities to a Secured Creditor in respect of which the Issuer is the principal debtor.

The Payment Priorities set out in paragraphs (i) to (xxvi) inclusive do not apply to (a) the proceeds of any further borrowing of Permitted Financial Indebtedness which are required by the terms of such borrowing to be applied (i) in repayment or prepayment of any existing Financial Indebtedness of the SWS Financing Group (including Subordinated Debt) or (ii) in redeeming the SWS Preference Shares, in each case, to the extent permitted by the CTA or (b) any return of collateral or premium or up front payment in relation to a Hedging Agreement contemplated in paragraph (xvi) above which will be paid to the relevant Hedge Counterparty directly. In no circumstance is the Issuer entitled to apply monies represented by the Monthly Payment Amount in or towards making a Restricted Payment.

For so long as no Standstill Event is continuing, SWS must, 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 of all amounts referred to in paragraphs (i) to (xix) inclusive of the Payment Priorities which fall due and payable on such Payment Date taking account of any receipts due from any Hedge Counterparty under any Hedging Agreement on such

Payment Date (such aggregate amount, “**Scheduled Debt Service**”). If the balance on the Debt Service Payment Account on a Determination Date is less than the amount of Scheduled Debt Service falling due on the following Payment Date, then SWS will promptly transfer to the Debt Service Payment Account an amount equal to the shortfall from sums standing to the credit of the Operating Accounts. No amounts may be so transferred to the extent that to do so would cause the aggregate net balance of the Operating Accounts to fall below the then current aggregate net overdraft limit on the Operating Accounts or cause the balance on any Operating Account to fall below the then current gross overdraft limit in respect of such Operating Account. If after making any required transfers from the Operating Accounts the balance on the Debt Service Payment Account would be insufficient to pay any Scheduled Debt Service falling due for payment at items (i) to (vi), (ix) or (xii) of the Payment Priorities (excluding any termination payments under any Hedging Agreements), the Issuer must promptly request a drawing under the DSR Liquidity Facility for payment on the following Payment Date in an amount equal to the shortfall (subject to any limitations in the DSR Liquidity Facility Agreements on drawings applicable to shortfalls relating to Class B Debt).

Until such time as a Standstill commences and is continuing, all amounts payable on any Payment Date must be paid strictly in the order referred to above, to the intent that no amounts falling to be paid under any paragraph may be paid until such time as the amounts falling to be paid on the same date or earlier under each preceding paragraph have been paid in full.

Debt Service Reserve Account and Issuer’s O&M Reserve Account

The Issuer will be required to drawdown the whole of a Liquidity Facility Provider’s commitment if that Liquidity Facility Provider (i) ceases to have the Liquidity Facility Requisite Rating or (ii) fails to renew its commitment at the end of the term of the relevant Liquidity Facility and whose commitment is not replaced by another Liquidity Facility Provider. The Issuer must deposit the proceeds of each such drawdown into the Debt Service Reserve Account (in the case of a drawdown under a DSR Liquidity Facility Agreement) or the Issuer’s O&M Reserve Account (in the case of a drawdown under any O&M Reserve Facility). No monies may be withdrawn from the Debt Service Reserve Account or the O&M Reserve Account except as permitted by the relevant Liquidity Facility Agreement (see the “*Liquidity Facilities*” below) or the Issuer delivers, prior to any withdrawal, a certificate to the Security Trustee and the Account Bank that following the making of such withdrawal (a) in the case of the Debt Service Reserve Account, the aggregate of the amounts standing to the credit of the Debt Service Reserve Account and available for drawing under the DSR Liquidity Facilities is at least equal to the Required Balance and (b) in the case of the Issuer’s O&M Reserve Account, the aggregate of the O&M Reserve and amounts available for drawing under the O&M Facilities is at least equal to the O&M Required Amount.

SWS has agreed to procure that on any Payment Date (save for any date upon which a drawing is to be made under a DSR Liquidity Facility or out of the Debt Service Reserve Account to make a payment into the Debt Service Payment Account):

- (a) the aggregate of (i) all amounts available for drawing under the DSR Liquidity Facilities; and (ii) all amounts standing to the credit of the Debt Service Reserve Account (including the value of any Authorised Investments) are equal to the next 12 months’ interest forecast to be due on the Class A Debt of the SWS Financing Group (the “**Class A Required Balance**”); and
- (b) the aggregate of (i) all amounts available for drawing in respect of Class B Debt under the DSR Liquidity Facilities; and (ii) all amounts standing to the credit of the Debt Service Reserve Account (including the value of any Authorised Investments) (after deducting all amounts required in order to satisfy the Class A Required Balance) are equal to the next 12 months’ interest forecast to be due on the Class B Debt (other than in respect of any Subordinated Coupon Amounts) of the SWS Financing Group (the “**Class B Required Balance**” and, together with the Class A Required Balance, the “**Required Balance**”).

Authorised Investments

The Common Terms Agreement allows SWS 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.

Cash Management during a Standstill Period

The arrangements described in “*Debt Service Payment Account*” above continue to apply until the commencement of a Standstill Period. The Common Terms Agreement provides that, so long as a Standstill Period continues unremedied, and provided no Enforcement Action (other than a Permitted Share Pledge Acceleration) has occurred, SWS shall cease to be the Cash Manager and will be replaced by the Standstill Cash Manager, who 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 the forecast revenues are insufficient (after paying all relevant operating expenditure) to pay the aggregate of all payments falling to be made during the next 12 months, the Standstill Cash Manager shall notionally apply those forecast revenues to each category in accordance with the Payment Priorities until the revenue that is forecast to be available is insufficient to meet all of the payments falling to be made within such 12 month period in any paragraph of the Payment Priorities (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, 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 Payment Priorities) 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 Payment Priorities. In circumstances where such enforcement occurs during a Standstill Period or following termination of a Standstill the proceeds of enforcement will be applied in accordance with the above Payment Priorities but excluding in these circumstances payments under paragraphs (i), (x), (xi) and (xv) thereof.

Security Agreement

Security

Each Obligor entered into the security agreement (the “**Security Agreement**”) with the Security Trustee on the Initial Issue Date pursuant to which SWSH and SWSGH guarantee the obligations of each other Obligor under the Finance Documents and SWS and the Issuer guarantee the obligations of each other under the Finance Documents, in each case to the Security Trustee as security trustee for the Secured Creditors. Each Obligor has secured its property, assets and undertakings to the Security Trustee as trustee for the Secured Creditors. However, in respect of SWS, the creation, perfection and enforcement of such security is subject to the WIA, the Instrument of Appointment and requirements thereunder. As a result of the restrictions placed upon SWS 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 SWS is severely limited (see Chapter 3 “*Risk Factors*” and Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*” of this Prospectus for a more detailed discussion of these issues).

The Security Agreement incorporates, to the extent applicable, the provisions of the Common Terms Agreement and is subject to the STID.

The security constituted by the Security Agreement is expressed to include:

- (i) first fixed charges over:
 - (a) the ordinary shares in SWS, SWSH, the Pension Companies 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 from the Initial Issue Date)); and
 - (B) the proceeds of disposal of any land (including Protected Land);
 - (c) all present and future plant, machinery, office equipment, computers, vehicles and other chattels;
 - (d) all moneys standing to the credit of each Obligor's accounts and the debts represented thereby;
 - (e) any Intellectual Property Rights owned by each Obligor (excluding information technology licence agreements);
 - (f) any present and future goodwill and any present and future uncalled capital and rights in relation to such uncalled capital;
 - (g) each Authorised 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;
 - (j) all benefit in respect of Insurances taken out by any Obligor and all claims and returns of premiums in respect thereof; and
- (ii) an assignment of each Obligor's right in respect of Insurances taken out by any Obligor and in respect of its 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, directors and officers liability insurance, pension fund trustee 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; and
 - (c) all damages, compensation, remuneration, profit, rent or income derived from information technology licence agreements; 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 does not include any security over Protected Land (see Chapter 6 "*Regulation of the Water and Wastewater Industry in England and Wales*" under "*Protected Land*") or any of SWS'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 is 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 SWS to grant security and certain limitations and restrictions on the security purported to be granted, see Chapter 3 "*Risk Factors – Certain Legal*

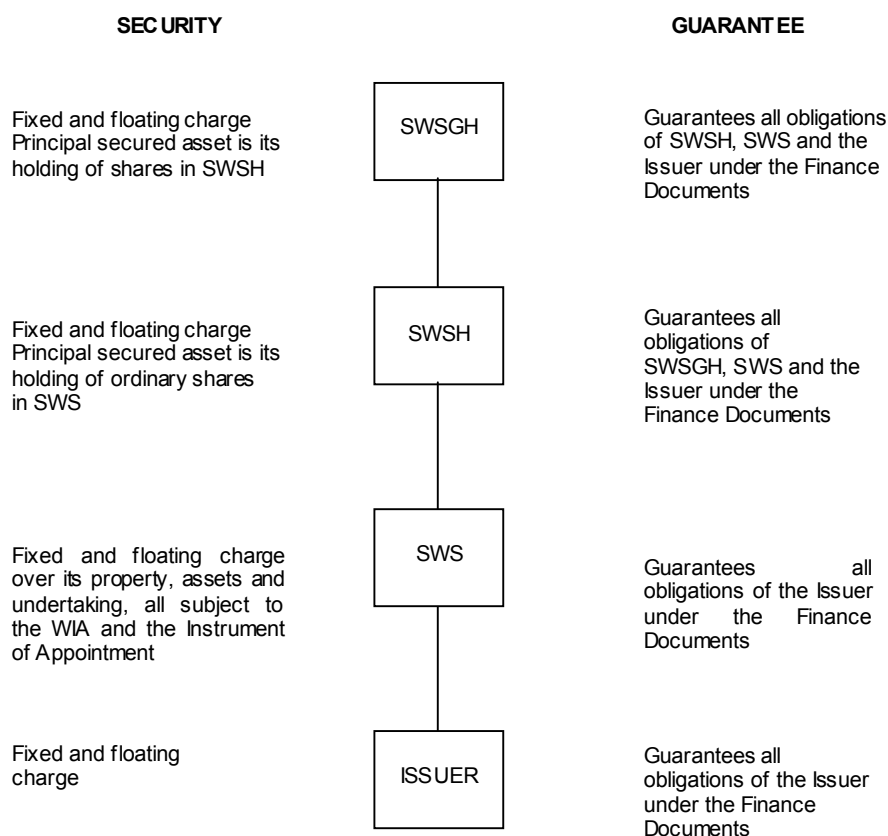
Considerations – Security” and Chapter 6 *“Regulation of the Water and Wastewater Industry in England and Wales – Restrictions on the granting of security”*.

Notice of the creation of the Security has not been and 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 has taken 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.

Neither SWSGH nor SWSH has any significant assets other than the shares in its respective subsidiary.

Security Structure

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



Financial Guarantor Documents

The Financial Guarantees of Wrapped Bonds

MBIA Assurance S.A., MBIA UK and Assured Guaranty (Europe) have each in the past issued Financial Guarantees in respect of Wrapped Bonds. (A decision of the Comité des Entreprises d’Assurance (the French insurance regulator) on 27 December 2007 approved the transfer of the business of MBIA Assurance S.A. to MBIA UK Insurance Limited with effect from 28 December 2007 pursuant to article L.324-1 of the French Insurance Code; MBIA UK Insurance Limited has, therefore, assumed all rights and obligations of MBIA

Assurance S.A. under the Transaction Documents as if it were the Initial Financial Guarantor of the Series of Wrapped Bonds issued on 23 July 2003 and 27 May 2005.)

Upon an early redemption of the relevant Class A Wrapped Bonds or an acceleration of the relevant Class A Wrapped Bonds, the relevant Financial Guarantor's obligations in relation to outstanding Class A Wrapped Bonds issued prior to the date of this Prospectus will continue to be to pay the Guaranteed Amounts as they fall Due for Payment (as defined in the relevant Financial Guarantee) on each Payment Date. Such Guaranteed Amounts are the Issuer's obligations: (1) to repay on their respective maturity date the outstanding nominal amount of the relevant Class A Wrapped Bonds, as reduced by each amount of principal repaid or prepaid by the Issuer, excluding any additional amount relating to premium, prepayment, early redemption, broken funding indemnities or penalties; and (2) on each Interest Payment Date, to pay the regularly scheduled interest under the relevant Class A Wrapped Bonds due on such Interest Payment Date, excluding any amount relating to prepayment, early redemption, broken-funding indemnities, penalties or default interest or (for Floating Rate Bonds only) any amounts by which the margin on the coupon on such Class A Wrapped Bonds exceeds the initial margin on the coupon as at the date on which such Class A Wrapped Bonds were issued. The relevant Financial Guarantor will not be obliged under any circumstances to accelerate payment under its Financial Guarantees. However, if it does so, it may do so in its absolute discretion in whole or in part, and the amount payable by the relevant Financial Guarantor 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 the relevant Financial Guarantor under any of the Financial Guarantees.

The Bond Trustee alone has the right to enforce the terms of Financial Guarantees issued in respect of Wrapped Bonds, and any right of any other person to do so is expressly excluded.

Guarantee and Reimbursement Deeds

On each relevant Issue Date, the Issuer and SWS entered into a guarantee and reimbursement deed (each a "G&R Deed") with the relevant Financial Guarantor, pursuant to which the Issuer is obliged, among other things, to reimburse such Financial Guarantor in respect of the payments made by it under the relevant Financial Guarantee and to pay, among other things, any financial guarantee fee and fees and expenses of such Financial Guarantor in respect of the provision of the relevant Financial Guarantee. Insofar as a Financial Guarantor makes payment under the relevant Financial Guarantee in respect of Guaranteed Amounts (as defined in such Financial Guarantee), it will be subrogated to the present and future rights of the relevant Wrapped Bondholders or relevant holders of other Wrapped Debt against the Issuer in respect of any payments made.

On the Initial Issue Date and on 27 May 2005, the Issuer and SWS entered into a G&R Deed with MBIA Assurance S.A. in respect of the Class A Wrapped Bonds issued on the Initial Issue Date and 27 May 2005, respectively. (A decision of the Comité des Entreprises d'Assurance (the French insurance regulator) on 27 December 2007 approved the transfer of the business of MBIA Assurance S.A. to MBIA UK Insurance Limited with effect from 28 December 2007 pursuant to article L.324-1 of the French Insurance Code; MBIA UK Insurance Limited has, therefore, assumed all rights and obligations of MBIA Assurance S.A. under the Transaction Documents as if it were the Initial Financial Guarantor of the Series of Wrapped Bonds issued on 23 July 2003 and 27 May 2005.)

On the Fourth Issue Date, the Issuer and SWS entered into a G&R Deed with MBIA UK in respect of the Sub-Class A9 Wrapped Bonds issued on the Fourth Issue Date.

On the Fifth Issue Date, the Issuer and SWS entered into a G&R Deed with Assured Guaranty (Europe) in respect of the Sub-Class A10 Wrapped Bonds issued on the Fifth Issue Date.

For the avoidance of doubt, the Issuer shall not issue any Wrapped Bonds pursuant to this Prospectus.

Additional Resources Available

Authorised Credit Facilities

SWS has entered into various bilateral and syndicated bank facilities, which incorporate and are subject to the terms of the STID and the CTA.

Existing Authorised Credit Facilities. On 24 June 2010, SWS entered into a facility agreement (the “**Existing RCF Agreement**”) with an aggregate facility amount of £200,000,000 with RBS (the “**Existing RCF**”). Under this facility agreement a £60,000,000 revolving credit facility is available to SWS for working capital requirements and a £140,000,000 revolving credit facility is available to SWS for capital expenditure requirements (in respect of capital expenditure which will qualify for an addition to RCV) from 9 July 2010 until 24 June 2015.

Drawings under the revolving credit facilities are subject to various conditions precedent as set out in the related facility agreement, including that no Event of Default or Potential Event of Default is subsisting, and in the case of a roll-over advance no Event of Default is subsisting, and each Repeating Representation is correct at the time of requesting and making the drawing. In the event of a Standstill, any outstanding Advances under the revolving credit facilities shall convert into a term loan repayable on the earliest of (i) the termination of the Standstill; (ii) the final Maturity Date and (iii) the date of any acceleration under, and as permitted by, the STID.

Interest accrues on any drawing under the revolving credit facilities calculated at a daily rate by reference to applicable sterling LIBOR plus a margin and mandatory costs. SWS also pays certain agency and arrangement and a commitment fee which accrues on any undrawn portion of the commitment under the revolving credit facilities.

SWS entered into a facility agreement (the “**NAB Facility Agreement**”) on 29 September 2011 with an aggregate facility amount of £100,000,000 (the “**NAB Facility**”) with National Australia Bank Limited as lender who acceded to the terms of the STID and the CTA on 29 September 2011. The NAB Facility constitutes Class B Debt. The NAB Facility must be used for refinancing in full the principal amount of the £50,000,000 term facility dated 5 June 2009 between, amongst others, National Australia Bank Limited as lender and SWS as borrower and for the general corporate purposes of SWS. Utilisation of the NAB Facility is subject to various conditions precedent as set out in the NAB Facility Agreement, including that no Event of Default or Potential Event of Default is continuing or results from the proposed utilisation, each Repeating Representation is correct at the time of requesting and making the utilisation and no Standstill has occurred or is continuing. Interest accrues on any drawing at a daily rate by reference to applicable sterling LIBOR plus a margin and mandatory costs.

The Issuer has also entered into a separate facility agreement with RBS under which RBS advanced to the Issuer a £165,000,000 index-linked term facility (the “**Initial Term Facility**”). RBS has transferred its rights and obligations in respect of the Initial Term Facility to Artesian Finance II plc (“**Artesian II**”). The advance under the Initial Term Facility has similar terms to Indexed Bonds in terms of interest accrual and payment, with a final repayment date in September 2033. The Issuer applied the proceeds of such advance in making an index-linked advance to SWS under the Initial Issuer/SWS Loan Agreement. Certain of the Issuer’s payment obligations under the Initial Term Facility Agreement in respect of the advance under the Initial Term Facility are guaranteed by Assured Guaranty (Europe) Limited (“**Assured Guaranty (Europe)**”), a Financial Guarantor. The Issuer has given certain indemnities to Artesian II in connection with its funding of the Initial Term Facility.

The Issuer has also entered into a separate facility agreement dated 5 July 2004 (the “**Second Artesian Term Facility Agreement**”) with RBS under which RBS advanced to the Issuer a £156,484,023.05 index-linked term facility (the “**Second Artesian Term Facility**”). RBS has transferred its rights and obligations in respect of the Second Artesian Term Facility to Artesian Finance plc (“**Artesian**”). The advance under the Second Artesian Term Facility has similar terms to Indexed Bonds in terms of interest accrual and payment, with a final

repayment date in September 2032. The Issuer applied the proceeds of such advance in making an index-linked advance to SWS under the Second Issuer/SWS Loan Agreement. Certain of the Issuer's payment obligations in respect of the advance under the Second Artesian Term Facility are guaranteed by Assured Guaranty (Europe). The Issuer has given certain indemnities to Artesian in connection with its funding of the Second Artesian Term Facility.

The Existing RCF, the Initial Term Facility, the Second Artesian Term Facility and the NAB Facility are referred to in this Prospectus as the “**Existing Authorised Credit Facilities**”.

SWS and the Issuer make representations and warranties, covenants and undertakings to the Existing RCF Providers, Artesian II, Artesian and Assured Guaranty (Europe) on the terms set out in the Common Terms Agreement. The Existing RCF Providers, Artesian II, Artesian and Assured Guaranty (Europe) have acceded to the STID and the CTA.

The Events of Default under the Common Terms Agreement apply under the Existing Authorised Credit Facilities (see “*Common Terms Agreement*” above).

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

SWS and/or the Issuer may enter into further Authorised Credit Facilities on terms similar to those in the Existing Authorised Credit Facilities. 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.

SWS and the Issuer have entered into loan insurance and indemnity agreements with Assured Guaranty (Europe), under which: the Issuer agrees to reimburse to Assured Guaranty (Europe) amounts paid by Assured Guaranty (Europe) under Assured Guaranty (Europe)'s guarantee of amounts payable by the Issuer under the Initial Term Facility and the Second Artesian Term Facility; the Issuer agrees to pay a fee to Assured Guaranty (Europe) and to pay, and to indemnify Assured Guaranty (Europe) against, certain other of Assured Guaranty (Europe)'s costs and expenses; SWS and the Issuer made representations, warranties and covenants to Assured Guaranty (Europe) on the terms set out in the Common Terms Agreement; and SWS guarantees to Assured Guaranty (Europe) the Issuer's obligations to Assured Guaranty (Europe) under such agreements.

The Liquidity Facilities

The DSR Liquidity Facility provided by The Royal Bank of Scotland plc, Abbey National Treasury Services Plc, Barclays Bank PLC, BNP Paribas, London Branch and HSBC Bank plc (the “**Existing DSR Liquidity Facility Providers**”) is the only Liquidity Facility in place as at the date of this Prospectus. The Issuer may establish further DSR Liquidity Facilities in connection with further Bonds and other Class A Debt and Class B Debt issued or incurred.

Under the terms of the Existing DSR Liquidity Facility Agreement, the Existing DSR Liquidity Facility Providers provide a 364 day commitment (which may be renewed from time to time, and with the current scheduled renewal date being 20 June 2013 in an aggregate amount specified in the DSR Liquidity Facility Agreement to permit drawings to be made by the Issuer, in circumstances where there will be insufficient funds in the Debt Service Payment Account available on a Payment Date to pay amounts (other than principal amounts to be repaid in respect of Class A Debt and principal amounts to be repaid and any Subordinated Coupon Amounts to be paid in respect of Class B Debt or any termination payments under any Hedging Agreements) scheduled to be paid in respect of paragraphs (i) to (vi) inclusive and (ix) and, after deducting any prior ranking payments, (xii) of the Payment Priorities (a “**Liquidity Shortfall**”).

The Issuer will not be able to make a drawing in respect of a Liquidity Shortfall relating (in whole or in part) to Class B Debt unless the sum of the amount available under the DSR Liquidity Facilities and the amount

standing to the credit of the Debt Service Reserve Account (immediately after such drawing) is not less than the next 12 months interest forecast on Class A Debt.

The Issuer may also enter into an O&M Reserve Facility Agreement with one or more Liquidity Facility Providers, drawings under which will be on-lent by the Issuer to SWS to meet SWS's operating and capital maintenance expenditure requirements to the extent that SWS has insufficient funds available to it to meet these requirements. No O&M Reserve Facility Agreement has been entered into as at the date of this Prospectus.

Each Liquidity Facility Provider must be a bank which as at the relevant Issue Date has the Minimum Short-Term Rating (the "**Liquidity Facility Requisite Rating**").

Each 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 Rating and all amounts outstanding to such Liquidity Facility Provider are repaid in full.

Each Liquidity Facility Agreement does or will provide that amounts repaid by the Issuer may be redrawn.

Each Liquidity Facility Agreement does or will provide that if (i) at any time the rating of the relevant Liquidity Facility Provider falls below the Liquidity Facility Requisite Rating or (ii) the relevant Liquidity Facility Provider does not agree to renew its commitment under such Liquidity Facility prior to the expiry of the relevant availability period, the Issuer will:

- (a) use all reasonable endeavours to replace the relevant Liquidity Facility Provider with a party having the Liquidity Facility Requisite Rating; 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 Debt Service Reserve Account (in the case of a DSR Liquidity Facility) or the Issuer's O&M Reserve Account (in the case of an O&M Reserve Facility) the full amount of the relevant Liquidity Facility Provider's undrawn commitment (a "**Standby Drawing**").

A Standby Drawing will generally be repayable only if the relevant Liquidity Facility Provider is re-rated with the Liquidity Facility Requisite Rating 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.

Interest will accrue on any drawing (including a Standby Drawing) made under a Liquidity Facility provided by a Liquidity Facility Provider at a reference rate per annum plus a margin. Under the Liquidity Facility Agreements, the Issuer, in certain circumstances, will 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. The Issuer will also pay certain agency, arrangement and renewal fees as well as a commitment fee which accrue on any undrawn portion of the commitments under the Liquidity Facilities.

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.

Mezzanine Facility Agreement

The Issuer entered into a senior mezzanine facility agreement with, amongst others, The Royal Bank of Scotland plc (as agent), RBEF Limited (as arranger), Royal Bank Investments Limited as the Original Senior Mezzanine Facility Provider and the Security Trustee in an aggregate amount of £127,200,000 (the "**Senior Mezzanine Facility Agreement**") The Issuer borrowed the full amount available under the Senior Mezzanine Facility Agreement on the Initial Issue Date and lent the proceeds thereof together with the nominal principal

amount of the Bonds issued and borrowings under other Authorised Credit Facilities raised on the Initial Issue Date to SWS under the Initial Issuer/SWS Loan Agreement. SWS applied such loan proceeds, amongst other things, to repay its existing indebtedness to the Issuer, and the Issuer applied such repayment proceeds to repay all of its indebtedness under the Bridge Facility Agreement and all of its indebtedness to SWI.

The Senior Mezzanine Facility has been partially prepaid and the outstanding balance of the Senior Mezzanine Facility is £15,400,000 as at the date of this Prospectus. SWC is the sole Senior Mezzanine Facility Provider.

Interest accrues on any drawing under the Senior Mezzanine Facility at a floating rate of interest. The Issuer's obligations to pay floating rate interest are hedged in accordance with the Hedging Agreements entered into on the Initial Issue Date (see "*Hedging Agreements*" below). The Issuer pays certain agency and arrangement fees under the Senior Mezzanine Facility Agreement.

The Issuer has made representations and warranties, covenants and undertakings to the Mezzanine Facility Providers on the terms set out in the Common Terms Agreement. The Events of Default under the Common Terms Agreement apply under the Senior Mezzanine Facility Agreement (see "*Common Terms Agreement*" above).

The Issuer's payment obligations under the Senior Mezzanine Facility Agreement are backed by advances owing to the Issuer pursuant to the Initial Issuer/SWS Loan Agreement and the terms of the advance in terms of amount, interest rate, tenor and payment dates correspond with the relevant advances under the related Interest Rate Hedging Agreement.

Under the terms of the CTA, neither SWS nor the Issuer is allowed to make any payments of interest, principal or any other amounts under the Senior Mezzanine Facility Agreement or the corresponding advance under the Initial Issuer/SWS Loan Agreement (save for mandatory prepayments in the event of, amongst other things, illegality) unless the Restricted Payment Condition is satisfied or pursuant to a Subordinated Debt Replacement Event.

The claims of the Senior Mezzanine Facility Providers are secured under the terms of the Security Documents but are subordinated to the Class A Debt and the Class B Debt in accordance with the Payment Priorities. In the event of any failure to meet the Restricted Payment Condition on any payment date or if, following satisfaction of the Restricted Payment Condition, there is a shortfall in cash available to pay amounts due and payable under the Senior Mezzanine Facility Agreement, the amount of the shortfall will not be treated as due and instead shall be deferred until the payment date on which the Issuer has sufficient funds to meet such payment or the final maturity date of any outstanding senior debt. The ability of the Senior Mezzanine Facility Providers to accelerate any sums owing to them under the Senior Mezzanine Facility Agreement upon or following the occurrence of an Event of Default is postponed to the rights of the holders of the Class A Debt and the Class B Debt pursuant to the STID.

The Senior Mezzanine Facility Providers are subject to certain call option arrangements in relation to their Mezzanine Debt which may be exercised against them following enforcement of any of the security granted by SWSGH and/or SWSH (see "*Security Trust and Intercreditor Deed – Enforcement*" above).

SWS Preference Shares

SWS has issued (i) fixed dividend (£40 per share net) cumulative redeemable preference shares 2038 of £1 each in the capital of SWS (the "**Class A1 Preference Shares**"), (ii) non-voting participating cumulative redeemable preference shares 2038 of 1p each in the capital of SWS (the "**Class A2 Preference Shares**") and (iii) fixed dividend (£70 per share net) cumulative redeemable preference shares 2038 of £1 each in the capital of SWS (the "**Class B Preference Shares**" and together with the Class A1 Preference Shares and the Class A2 Preference Shares the "**SWS Preference Shares**"). The SWS Preference Shares are non-voting save in respect of certain limited matters which are specific to the rights and value of the SWS Preference Shares.

Under the terms of the CTA, SWS is not allowed to make any payments on or under the SWS Preference Shares unless the Restricted Payment Condition is satisfied (see “*Common Terms Agreement*” above).

The holders of the SWS Preference Shares enjoy certain specific and protective entrenched rights. These can be waived in accordance with the terms and conditions of the SWS Preference Shares and in addition, and amongst other things, will have no effect, and will not require SWS to obtain any consent or sanction of the SWS Preference Shareholders unless the proposed event or action would or could reasonably be expected to have a material adverse effect on the fundamental terms or value of their investment. For example, for so long as neither an Event of Default is continuing nor, if a Trigger Event has occurred and is continuing, has a Remedial Plan concluded that the failure to raise new Financial Indebtedness in the circumstances described below would lead to an Event of Default, in the circumstance where the Mezzanine Facility Providers would have an equivalent Entrenched Right (as described earlier in “*Security Trust and Intercreditor Deed – Entrenched Rights of the Mezzanine Facility Providers*”), the articles of association of SWS provide that SWS may not agree any modification to, or consent or waiver under or in respect of, any term of any Finance Document if the proposed modification, consent or waiver would permit the raising of new Financial Indebtedness by the SWS Financing Group to the extent that, as a result, the aggregate of the Senior Net Indebtedness and any other net indebtedness ranking in point of priority senior to the Senior Mezzanine Debt would exceed 90 per cent. of RCV, unless the Security Trustee has received consent from the holders of more than 50 per cent. of the aggregate nominal value of all classes of SWS Preference Shareholders or the sanction of an ordinary resolution passed at a separate general meeting of the holders of all classes of the SWS Preference Shares. Certain of these other key rights are also disapplied following an Event of Default.

The SWS Preference Shares may in certain circumstances be converted into Subordinated Debt of SWS, whereupon the holders of such Subordinated Debt will be required either to accede to the STID and the CTA for the purposes of, *inter alia*, taking the benefit of the Security and subordinating their secured claims to those of the holders of the Class A Debt, the Class B Debt and the Mezzanine Debt or to accede to the SWS Preference Share Deed (as defined below) for the purpose of, *inter alia*, restricting their right to accelerate their unsecured claims during a Standstill Period.

The initial holders of the SWS Preference Shares entered into a deed on the Initial Issue Date with the Security Trustee and the Obligors (the “**SWS Preference Share Deed**”) pursuant to which SWS agreed not to, and such holders of the SWS Preference Shares agreed not to permit or require SWS to, make any Distribution in respect of the SWS Preference Shares unless the Restricted Payment Condition is satisfied at such time and payments made in breach of the Restricted Payment Condition shall be immediately repaid to the Security Trustee and pending such repayment shall be held on trust for the Security Trustee. Under call option arrangements contained in the SWS Preference Share Deed, each holder of the SWS Preference Shares (other than the Class A2 Preference Shares) will be required to sell its SWS Preference Shares to any person who acquires the ordinary shares in SWSH or SWS following an enforcement of the Security granted by SWSGH or SWSH (or to any nominee of such person) for a consideration calculated to ensure that the price that such holder of the SWS Preference Shares receives will not be less than the price it would have received for its holding had its SWS Preference Shares been charged in favour of the Security Trustee as security for Secured Liabilities and sold as part of any disposal of the Security Assets on an enforcement of the Security granted by SWSGH and/or SWSH. In this event, the rights of the holders of the Class A2 Preference Shares will be deferred.

SWC owns the Class A1 Preference Shares and the Class B Preference Shares. SWI owns the Class A2 Preference Shares. Each of SWC and SWI has acceded to the SWS Preference Share Deed.

Hedging Agreements

Hedging Policy

The Hedging Policy provides that the SWS Financing Group must enter into Hedging Agreements in accordance with the Hedging Policy and that the only member of the SWS Financing Group that may enter into Hedging Agreements is the Issuer, provided that the Issuer may enter into back-to-back swap arrangements

with SWS in respect of Hedging Agreements entered into by the Issuer to hedge the obligations of SWS under Finance Leases or any other Authorised Credit Facility raised by SWS or which are otherwise not directly linked to the raising of new debt under an Authorised Credit Facility.

However, STID Proposals had been granted allowing SWS to enter into Hedging Agreements in connection with the Second Revolving Credit Facility.

The Hedging Policy provides, *inter alia*, that:

1. The SWS Financing Group will not enter into Treasury Transactions for the purpose of speculation, but rather only to manage risk inherent in its business or funding on a prudent basis.
2. Any change to the Hedging Policy will be subject to SWS board approval and may only be made with the approval of the Security Trustee (such approval not to be unreasonably withheld).
3. Subject to such approvals, the Hedging Policy will be reviewed from time to time by the SWS Financing Group and amended (subject to Entrenched Rights and Reserved Matters and in accordance with the provisions of the STID) as appropriate in line with market developments, regulatory developments, and Good Industry Practice.
4. The SWS Financing Group must not bear currency risk in respect of any foreign currency denominated debt instruments, or in respect of any significant foreign currency purchases.
5. The SWS Financing Group must hedge its exposure to interest rate risk on at least 85 per cent. of its total outstanding debt liabilities for the current period to the next Periodic Review and at least 70 per cent. in the next period to the subsequent Periodic Review (each to be adjusted to the extent that the period from one Periodic Review to the next Periodic Review is greater than five years) (on a rolling basis). This figure will be kept under review with respect to market conditions and developments in regulatory methodology and practice.
6. Interest rate risk on floating rate liabilities may be hedged through a combination of cash balances, Authorised Investments and instruments such as interest rate swaps entered into by the Issuer.
7. The SWS Financing Group may manage its exposure to inflation risk through the use of index-linked instruments where it is cost effective.
8. The Issuer may only enter into Treasury Transactions with counterparties whose short-term, unsecured and unsubordinated debt obligations are assigned a rating by the Rating Agencies which is no less than the Minimum Short-term Rating and whose long-term, unsecured and unsubordinated debt obligations are assigned a rating by Moody's of at least A2 (the "**Moody's Minimum Long-term Rating**"), or where a parent guarantee is provided by an institution which meets the same criteria. Each Hedging Agreement is to include a provision entitling the Issuer to terminate if there is a Hedge Counterparty Downgrade as described below.
9. Hedging Agreements must be entered into in the form, as amended by the parties thereto, of the 1992 ISDA Master Agreement (Multicurrency – Cross Border), the 2002 Master Agreement published by ISDA or any successor thereto published by ISDA unless otherwise agreed by the Security Trustee.

Hedging Agreements

The Existing Hedging Agreements

The Issuer has entered into various interest rate and currency swap transactions with the Hedge Counterparties (the "**Existing Hedging Agreements**") in conformity with the Hedging Policy.

Tax

Each Hedge Counterparty is 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, a Hedge Counterparty 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 in accordance with the relevant Hedging Agreement, the Hedge Counterparty may terminate the relevant Hedging Agreement.

Termination

The Issuer will be entitled to terminate a Hedging Agreement in certain circumstances (including a failure to pay by the Hedge Counterparty, certain insolvency events affecting the Hedge Counterparty and certain rating downgrade events affecting the Hedge Counterparty).

The Hedge Counterparty will be entitled to terminate a Hedging Agreement only in certain limited circumstances being:

- a failure by the Issuer to make payment when due;
- certain insolvency events affecting the Issuer;
- illegality affecting the Hedging Agreement;
- certain tax events (including as described above);
- redemption in whole or in part of any Sub-Class of the Bonds hedged by such Treasury Transaction;
- termination of a Standstill Period (except by virtue of remedy, revocation or waiver of the relevant Event of Default giving rise to the Standstill Period) or, if earlier, an Acceleration of any Sub-Class of the Bonds hedged by such Treasury Transaction pursuant to Condition 11 of the Bonds; and
- (subject to the provisions described below) upon the exercise of an option to terminate a Hedging Agreement on the tenth anniversary of the effective date of the relevant Hedging Transaction or at five yearly intervals thereafter.

The Issuer may enter into Treasury Transactions with Hedge Counterparties pursuant to which 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 (a) the relevant Hedge Counterparty gives the Issuer at least one year's prior notice in writing of its intention to exercise such right of termination; and (b) the aggregate notional amount and/or sterling currency amounts (as applicable) of Treasury Transactions pursuant to which Hedge Counterparties have such right of termination does not exceed 10 per cent. of RCV.

Within three months of the receipt of a notice of termination from the relevant Hedge Counterparty, the Issuer shall use all reasonable endeavours to enter into new Treasury Transaction(s) in order to replace the Treasury Transaction which is the subject of such notice of termination.

In the event that a Hedging Agreement or a Treasury Transaction is terminated, a termination payment may be due from the Issuer.

Hedge Counterparty Rating Downgrade

If a Hedge Counterparty falls below the Minimum Short-term Rating or the Moody's Minimum Long-term Rating (a "**Hedge Counterparty Downgrade**") and as a result of such Hedge Counterparty 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 or Class B Unwrapped

Bonds outstanding, the then current shadow rating of the Class B Wrapped Bonds) would be downgraded or placed under review for possible downgrade by any of the Rating Agencies (a “**Bond Downgrade**”) and the Hedge Counterparty has not, within 30 days of being notified of such Bond Downgrade, at its own cost either:

- (a) procured that its obligations with respect to the relevant Hedging Agreement are guaranteed by a third party which has a rating of no less than the relevant Minimum Short-term Rating and the Moody’s Minimum Long-term Rating; or
- (b) put in place an appropriate mark-to-market collateral agreement in accordance with the requirements specified in the relevant Hedging Agreement in support of its obligations under the relevant Hedging Agreement; or
- (c) transferred all of its rights and obligations under the Hedging Agreement to a replacement third party which is rated no less than the Minimum Short-term Rating and the Moody’s Minimum Long-term Rating; or
- (d) taken such other action as the Hedge Counterparty agrees which will result in the rating (or shadow rating, as applicable) of the relevant Bonds being restored to the level they were immediately prior to the Hedge Counterparty Downgrade,

then the Issuer shall be entitled to terminate the relevant Hedging Agreement.

Other Transaction Documents

Account Bank Agreement

Pursuant to the Account Bank Agreement, the Account Bank has agreed to hold the Accounts and operate them in accordance with the instructions of the Cash Manager or Standstill Cash Manager (as applicable). The Cash Manager or Standstill Cash Manager (as applicable) will manage the Accounts on behalf of the SWS Financing Group pursuant to the Common Terms Agreement (see “*Cash Management*” above).

Registered Office Agreement

Pursuant to a registered office agreement entered into between the Issuer and M&C Corporate Services Limited on 1 January 2002 (the “**Registered Office Agreement**”), M&C Corporate Services Limited and/or Maples and Calder provide certain corporate services to the Issuer.

SW Tax Deed of Covenant

Under the terms of the SW Tax Deed of Covenant, each Obligor has given certain representations and covenants as to its tax status and to the effect that, subject to SWS’s membership of the SWS VAT Group, 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 where that tax is primarily the liability of another person. Certain other companies including SWC and SWI have also represented and covenanted that they have not taken nor will take any steps which might reasonably be expected to give rise to a liability for tax for an Obligor where that tax is primarily the liability of another person.

With a view to preventing a liability to tax arising for an Obligor which is primarily the liability of another person, SWI (among others) will, under the SW Tax Deed of Covenant, incur certain obligations in relation to specified events and any change in tax residence of the Obligors. For example, the SW Tax Deed of Covenant provides that in certain circumstances where it is anticipated that there will be a change of control for tax purposes of SWSGH and therefore of the Obligors (say, as a result of the sale of shares in SWC or SWI), SWI can be required, as a condition of that sale, to deposit an amount in a trust account equal to the estimated tax liability (if any) arising or likely to arise in an Obligor as a result of the sale. The money deposited could then be used to pay the tax liability of the Obligor.

SWS/SWSG Loan Agreement

SWSG is indebted to SWS in the principal amount of £812,300,000 (the “**SWS/SWSG Loan**”). The terms of the SWS/SWSG Loan are set out in a loan agreement entered into between SWS and SWSG on the Initial Issue Date (the “**SWS/SWSG Loan Agreement**”). Interest accrues on the SWS/SWSG Loan at the rate of 7 per cent. per annum payable quarterly to the extent that SWSG has on such interest payment date received on such date a dividend from SWS (through SWSH and SWSGH) and/or a payment from SWS for a Permitted Tax Loss Transaction, in each case paid by SWS solely for the purpose of enabling SWSG to meet its scheduled payment obligations under the SWS/SWSG Loan (such dividend payment or payment for a Permitted Tax Loss Transaction a “**SWS/SWSG Debt Service Distribution**”). Interest will roll-up to the extent that SWSG is not put in funds to meet its scheduled payment obligations and the unpaid amount will itself accrue interest at the relevant interest rate.

The SWS/SWSG Loan is secured by a full first ranking debenture granted by SWSG in favour of SWS on the Initial Issue Date creating, *inter alia*, a first fixed charge over SWSG’s shares in SWSGH and related rights, a first fixed charge over SWSG’s bank account with the Account Bank into which any SWS/SWSG Debt Service Distribution to it is paid and a first floating charge over all of SWSG’s assets, revenues and undertakings. The security will not operate as a fetter on SWSG’s ability to dispose of the shares in SWSGH provided that the proceeds from such disposal are sufficient to enable SWSG to repay all amounts outstanding under the SWS/SWSG Loan Agreement.

No SWS/SWSG Debt Service Distribution may be made unless, among other things (a) in the case of a dividend payment, the dividend has been validly declared; (b) in the case of a payment for Permitted Tax Loss Transaction, the payment when made complies in all respects with the SW Tax Deed of Covenant and the CTA; (c) each payment is made against irrevocable payment instructions from SWSG directing the Account Bank to remit the proceeds of such payment on receipt by SWSG directly to an Operating Account of SWS for same day value; (d) no Event of Default is subsisting or would result from the payment; and (e) no event of default under the SWS/SWSG Loan Agreement has occurred and is continuing.

An event of default under the SWS/SWSG Loan Agreement will occur and the security granted by SWSG will become immediately enforceable if SWSG defaults on any of its payment obligations to pay interest or principal, breaches any warranty or covenant contained in the SWS/SWSG Loan Agreement or SWSG commits a TDC Breach (as defined in the SW Tax Deed of Covenant) which has a material adverse effect, becomes insolvent or if the security granted by SWSG becomes invalid.

CHAPTER 8 THE BONDS

Terms and Conditions of the Bonds

*The following is the text of the terms and conditions which (subject to the provisions of the relevant Final Terms (as defined below) and, save for the italicised paragraphs) will be incorporated by reference into each Global Bond (as defined below) representing Bonds (as defined below) in bearer form, Bonds in definitive form (if any) issued in exchange for the Global Bond(s) representing Bonds in bearer form, each Registered Bond (as defined below) in global form (a “**Global Bond Certificate**”) representing Bonds in registered form and each Registered Bond in definitive form (a “**Individual Bond Certificate**”) (as defined below) representing Bonds in registered form (only if such incorporation by reference is permitted by the rules of the relevant stock exchange and agreed by the Issuer). If such incorporation by reference is not so permitted and agreed, each Bond in bearer form and each Individual Bond Certificate representing Bonds in registered form will have endorsed thereon or attached thereto such text (as so completed, amended, varied or supplemented). Further information with respect to each Tranche (as defined below) of Bonds will be given in Part A of the relevant Final Terms which will provide for those aspects of these Conditions which are applicable to such Tranche (as defined below) of Bonds, including, in the case of all Sub-Classes (as defined below), the terms of the relevant advance under the relevant Issuer/SWS Loan Agreement. References in the Conditions to “Bonds” are, as the context requires, references to the Bonds of one Sub-Class only, not to all Bonds which may be issued under the Programme.*

Southern Water Services (Finance) Limited (the “**Issuer**”) has established a guaranteed bond programme (the “**Programme**”) for the issuance of up to £6,000,000,000 guaranteed bonds (the “**Bonds**”). Bonds issued under the Programme on a particular Issue Date comprise a Series (a “**Series**”), and each Series comprises one or more Classes of Bonds (each a “**Class**”). Each Class may comprise one or more sub-classes (each a “**Sub-Class**”) and each Sub-Class comprising one or more tranche (each a “**Tranche**”).

The guaranteed unwrapped bonds will be designated as “**Class A Bonds**” or “**Class B Bonds**”. Each Sub-Class will be denominated in different currencies or having different interest rates, maturity dates or other terms. Bonds of any Class may be zero coupon (“**Zero Coupon Bonds**”), fixed rate (“**Fixed Rate Bonds**”), floating rate (“**Floating Rate Bonds**”), index-linked (“**Indexed Bonds**”), dual currency bonds (“**Dual Currency Bonds**”), partly paid bonds (“**Partly Paid Bonds**”) or instalment bonds (“**Instalment Bonds**”) depending on the method of calculating interest payable in respect of such Bonds and may be denominated in sterling, euro, U.S. dollars or in other currencies subject to compliance with applicable law.

The terms and conditions applicable to any particular Sub-Class of Bonds are these terms and conditions (“**Conditions**”) completed by a set of final terms in relation to such Sub-Class (“**Final Terms**”). In the event of any inconsistency between these Conditions and the relevant Final Terms, the relevant Final Terms shall prevail.

Reference to the “**Final Terms**” is to the Final Terms (or the relevant provisions thereof) applicable to this Bond.

The Bonds are subject to and have the benefit of a trust deed dated the Initial Issue Date (as defined below) (as amended by a Deed of Amendment dated 20 May 2005, as further amended by a Second Deed of Amendment dated 13 October 2006, as further amended by a Third Deed of Amendment dated 27 February 2009 and as further amended, supplemented, restated and/or novated from time to time, the “**Bond Trust Deed**”) between, among others, the Issuer 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 Bonds have the benefit (to the extent applicable) of an agency agreement (as amended, supplemented and/or restated from time to time, the “**Agency Agreement**”) dated the Initial Issue Date (to which the Issuer, the Bond Trustee, the Principal Paying Agent and the other Paying Agents (in the case of Bearer Bonds) or the

Transfer Agents and the Registrar (in the case of Registered Bonds) are party). As used herein, each of “**Principal Paying Agent**”, “**Paying Agents**”, “**Agent Bank**”, “**Transfer Agents**” and/or “**Registrar**” means, in relation to the Bonds, the persons specified in the Agency Agreement as the Principal Paying Agent, Paying Agents, Agent Bank, Transfer Agents and/or Registrar, respectively, and, in each case, any successor to such person in such capacity. The Bonds may also have the benefit (to the extent applicable) of a calculation agency agreement (in the form or substantially in the form of Schedule 1 to the Agency Agreement, the “**Calculation Agency Agreement**”) between, inter alia, the Issuer and any calculation agent appointed by the Issuer as calculation agent (the “**Calculation Agent**”).

On 23 July 2003 (the “**Initial Issue Date**”), the Issuer entered into a security agreement (the “**Security Agreement**”) with Deutsche Trustee Company Limited as security trustee (the “**Security Trustee**”), pursuant to which the Issuer granted certain fixed and floating charge security to the Security Trustee for itself and on behalf of the other Secured Creditors (as defined below), the Bond Trustee (for itself and on behalf of the Bondholders), the Bondholders, each Financial Guarantor, the Issuer, each Liquidity Facility Provider, the Hedge Counterparties, the Initial Authorised Credit Facility Arranger, the Liquidity Facility Agents, the Initial Authorised Credit Facility Agent, the Initial Authorised Credit Provider and each Authorised Credit Provider (as defined below), each Agent, the Cash Manager (other than when the Cash Manager is SWS), the Standstill Cash Manager, any Additional Secured Creditors (each as defined therein) and the Mezzanine Finance Parties (together, the “**Secured Creditors**”). On the Initial Issue Date, the Issuer entered into a security trust and intercreditor deed (the “**STID**”) with, among others, the Security Trustee and other Secured Creditors and pursuant to which the Security Trustee holds the Security on trust for the Secured Creditors and the Secured Creditors agree to certain intercreditor arrangements.

On 27 February 2009, the Issuer entered into an amended and restated Dealership Agreement (the “**Dealership Agreement**”) with the dealers named therein (the “**Dealers**”) in respect of the Programme, pursuant to which any of the Dealers may enter into a subscription agreement in relation to each Sub-Class of Bonds issued by the Issuer, and pursuant to which the Dealers have agreed to subscribe for the relevant Sub-Class of Bonds on behalf of the Issuer. In any subscriptions agreement relating to a Sub-Class of Bonds, any of the Dealers may agree to procure subscribers to subscribe for the relevant Sub-Class of Bonds.

On the Initial Issue Date, the Issuer entered into a common terms agreement (the “**Common Terms Agreement**”) with, among others, the Security Trustee, pursuant to which the Issuer makes certain representations, warranties and covenants and which sets out in Schedule 7 thereof the Events of Default (as defined therein) in relation to the Bonds.

The Issuer has entered or may enter into liquidity facility agreements (together, the “**Liquidity Facility Agreements**”) with certain liquidity facility providers (together, the “**Liquidity Facility Providers**”) pursuant to which the Liquidity Facility Providers agree to make certain facilities available to meet liquidity shortfalls (including debt service liquidity shortfalls and shortfalls in operating and maintenance expenditure of SWS).

The Issuer has entered or may enter into certain revolving credit facilities (together, the “**Authorised Credit Facilities**”) with certain lenders (the “**Authorised Credit Providers**”), pursuant to which the Authorised Credit Providers agree to make certain facilities available to the Issuer for the purpose of funding certain working capital, capital expenditure and other expenses.

The Issuer has entered or may enter into certain currency and interest rate hedging agreements (together, the “**Hedging Agreements**”) with certain hedge counterparties (together the “**Hedge Counterparties**”) in respect of certain Sub-Classes of Bonds and Authorised Credit Facilities, pursuant to which the Issuer hedges certain of its currency and interest rate obligations.

The Bond Trust Deed, the Bonds (including the applicable Final Terms), the Security Agreement, the STID (the STID, the Security Agreement and any other documentation evidencing or creating security over any asset of an Obligor to a Secured Creditor under the Finance Documents being together the “**Security Documents**”), the Financial Guarantee Fee Letters, the Finance Lease Documents, the Agency Agreement, the Liquidity Facility

Agreements, the Hedging Agreements, the Initial Term Facility Agreement, the Initial RCF Agreement, the Second Artesian Term Facility Agreement, the Issuer/SWS Loan Agreements, the G&R Deeds, the Financial Guarantees, the Common Terms Agreement, the Mezzanine Facility Agreements, the CP Agreement, any other Authorised Credit Facilities, the master definitions agreement between, among others, the Issuer and the Security Trustee dated the Initial Issue Date and amended on 13 October 2006 (as further amended, supplemented and/or restated from time to time, the “**Master Definitions Agreement**”), the account bank agreement between, among others, the account bank, the Issuer and the Security Trustee (the “**Account Bank Agreement**”), the Tax Deeds of Covenant and the indemnification deed between, among others, the Financial Guarantor(s) and the Dealers dated 18 July 2003 (as amended from time to time) (the “**Indemnification Deed**”), the SWS Preference Share Deed, the SWS/SWSG Loan Agreement and any related security document (each, if not defined above, as defined below or in the Master Definitions Agreement) are, in relation to the Bonds, (and together with each other agreement or instrument between SWS or the Issuer (as applicable) and an Additional Secured Creditor designated as a Finance Document by SWS or the Issuer (as applicable), the Security Trustee and such Additional Secured Creditor in the Accession Memorandum of such Additional Secured Creditor) together referred to as the “**Finance Documents**”.

Terms not defined in these Conditions have the meaning set out in the Master Definitions Agreement.

Certain statements in these Conditions are summaries of the detailed provisions appearing on the face of the Bonds (which expression shall include the body thereof), in the relevant Final Terms or in the Bond Trust Deed, the Security Agreement or the STID. Copies of, inter alia, the Finance Documents are available for inspection during normal business hours at the specified offices of the Principal Paying Agent (in the case of bearer Bonds) or the specified offices of the Transfer Agents and the Registrar (in the case of registered Bonds).

The Bondholders (as defined below) are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Bond Trust Deed, the STID, the Security Agreement, the Common Terms Agreement and the relevant Final Terms and to have notice of those provisions of the Agency Agreement and the other Finance Documents applicable to them.

Any reference in these conditions to a matter being “specified” means as the same may specified in the relevant Final Terms.

1 Form, Denomination and Title

(a) Form and Denomination

The Bonds are in bearer form (“**Bearer Bonds**”) or in registered form (“**Registered Bonds**”) as specified in the applicable Final Terms and, serially numbered in the Specified Denomination(s) provided that in the case of any Bonds which are to be admitted to trading on a regulated market within the European Economic Area or offered to the public in a Member State of the European Economic Area in circumstances which require the publication of a prospectus under the Prospectus Directive, the minimum Specified Denomination shall be €100,000 (or its equivalent in any other currency as at the date of issue of the relevant Bonds). 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. References in these Conditions to “**Bonds**” include Bearer Bonds and Registered Bonds and all Sub-Classes, classes, Tranches and Series.

Interest-bearing Bearer Bonds are issued with Coupons (as defined below) (and, where appropriate, a Talon, (as defined below)) attached. After all the Coupons attached to, or issued in respect of, any Bearer Bond which was issued with a Talon have matured, a coupon sheet comprising further Coupons (other than Coupons which would be void) and (if necessary) one further Talon will be issued against presentation of the relevant Talon at the specified office of any Paying Agent. Any Bearer Bond the principal amount of which is redeemable in instalments may be issued with one or more Receipts (as

defined below) (and, where appropriate, a Talon) attached thereto. After all the Receipts attached to, or issued in respect of, any Instalment Bond which was issued with a Talon have matured, a receipt sheet comprising further Receipts (other than Receipts which would be void) and (if necessary) a further Talon will be issued against presentation of the relevant Talon at the specified office of any Paying Agent.

(b) Title

Title to Bearer Bonds, Coupons, Receipts and Talons (if any) passes by delivery. Title to Registered Bonds passes by registration in the register (the “**Register**”), which the Issuer shall procure to be kept by the Registrar.

In these Conditions, subject as provided below, each “**Bondholder**” (in relation to a Bond, Coupon, Receipt or Talon), “**holder**” and “**Holder**” means (i) in relation to a Bearer Bond, the bearer of any Bearer Bond, Coupon, Receipt or Talon (as the case may be) and (ii) in relation to Registered Bond, the person in whose name a Registered Bond is registered, as the case may be. The expressions “**Bondholder**”, “**holder**” and “**Holder**” include the holders of instalment receipts (which, in relation to Class A Bonds will be “**Class A Receipts**”, in relation to Class B Bonds, “**Class B Receipts**” and together, the “**Receipts**”) appertaining to the payment of principal by instalments (if any) attached to such Bonds in bearer form (the “**Receiptholders**”), the holders of the coupons (which, in relation to Class A Bonds will be “**Class A Coupons**”, in relation to Class B Bonds, “**Class B Coupons**” and together, the “**Coupons**”) (if any) appertaining to interest bearing Bonds in bearer form (the “**Couponholders**”), and the expression Couponholders or Receiptholders includes the holders of talons in relation to Coupons or Receipts as applicable, (which, in relation to Class A Bonds will be “**Class A Talons**”, in relation to Class B Bonds, “**Class B Talons**” and together, the “**Talons**”) (if any) for further coupons or receipts, as applicable attached to such Bonds (the “**Talontholders**”).

The bearer of any Bearer Bond, Coupon, Receipt or Talon and the registered holder of any Registered Bond will (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any interest in it, any writing on the relevant Bond, or its theft or loss or any express or constructive notice of any claim by any other person of any interest therein other than, in the case of a Registered Bond, a duly executed transfer of such Bond in the form endorsed on the Bond Certificate in respect thereof) and no person will be liable for so treating the holder.

Bonds which are represented by a Global Bond or Global Bond Certificate will be transferable only in accordance with the rules and procedures for the time being of Euroclear and Clearstream, Luxembourg, as the case may be. References to 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 Final Terms or as may otherwise be approved by the Issuer, the Principal Paying Agent and the Bond Trustee.

(c) Fungible Issues of Bonds comprising a Sub-Class

A Sub-Class of Bonds may comprise a number of issues in addition to the initial Tranche of such Sub-Class, each of which will be issued on identical terms save for the first interest payment, the Issue Date and the Issue Price. Such further issues of the same Sub-Class will be consolidated and form a Series with the prior issues of that Sub-Class.

2 Exchanges of Bearer Bonds for Registered Bonds and Transfers of Registered Bonds

(a) Exchange of Bonds

Subject to Condition 2(e) (*Closed Periods*), Bearer Bonds may, if so specified in the relevant Final Terms, be exchanged at the expense of the transferor Bondholder for the same aggregate principal amount of Registered Bonds at the request in writing of the relevant Bondholder and upon surrender of the Bearer Bond to be exchanged together with all unmatured Coupons, Receipts and Talons (if any) relating to it at the specified office of the Registrar or any Transfer Agent or Paying Agent. Where, however, a Bearer Bond is surrendered for exchange after the Record Date (as defined below) for any payment of interest or Interest Amount (as defined below), the Coupon in respect of that payment of interest or Interest Amount need not be surrendered with it Registered Bonds may not be exchanged for Bearer Bonds.

(b) Transfer of Registered Bonds

A Registered Bond may be transferred upon the surrender of the relevant Individual Bond Certificate, together with the form of transfer endorsed on it duly completed and executed, at the specified office of any Transfer Agent or the Registrar. However, a Registered Bond may not be transferred unless (i) the principal amount of Registered Bonds proposed to be transferred and (ii) the principal amount of the Registered Bonds proposed to be the principal amount of the balance of Registered Bonds to be retained by the relevant transferor are, in each case, Authorised Denominations. In the case of a transfer of part only of a holding of Registered Bonds represented by an Individual Bond Certificate, a new Individual Bond Certificate in respect of the balance not transferred will be issued to the transferor within three business days (in the place of the specified office of the Transfer Agent or the Registrar) of receipt of such form of transfer.

(c) Delivery of New Individual Bond Certificates

Each new Individual Bond Certificate to be issued upon exchange of Bearer Bonds or transfer of Registered Bonds will, within three business days (in the place of the specified office of the Transfer Agent or the Registrar) of receipt of such request for exchange or form of transfer, be available for delivery at the specified office of the Transfer Agent or the Registrar stipulated in the request for exchange or form of transfer, or be mailed at the risk of the Bondholder entitled to the Individual Bond Certificate to such address as may be specified in such request or form of transfer. For these purposes, a form of transfer or request for exchange received by the Registrar after the Record Date (as defined below) in respect of any payment due in respect of Registered Bonds shall be deemed not to be effectively received by the Registrar until the business day (as defined below) following the due date for such payment.

(d) Exchange at the Expense of Transferor Bondholder

Registration of Bonds on exchange or transfer will be effected at the expense of the transferor Bondholder by or on behalf of the Issuer, the Transfer Agent or the Registrar, and upon payment of (or the giving of such indemnity as the Transfer Agent or the Registrar may require in respect of) any tax or other governmental charges which may be imposed in relation to it.

(e) Closed Periods

No transfer of a Registered Bond may be registered, nor any exchange of a Bearer Bond for a Registered Bond may occur during the period of 15 days ending on the due date for any payment of principal, interest, Interest Amount (as defined below) or Redemption Amount (as defined below) on that Bond.

3 Status of Bonds

(a) Status of Class A Bonds

This Condition 3(a) is applicable only in relation to Bonds which are specified as being a Sub-Class of Class A Bonds.

The Class A Bonds, Class A Coupons, Class A Talons and Class A Receipts (if any) are direct and unconditional obligations of the Issuer, are secured in the manner described in Condition 4 (Security, Priority and Relationship with Secured Creditors) and rank pari passu without any preference among themselves.

(b) Status of Class B Bonds

This Condition 3(b) is applicable only in relation to Bonds which are specified as being a Sub-Class of Class B Bonds.

The Class B Bonds, Class B Coupons, Class B Talons and Class B Receipts (if any) are direct and unconditional obligations of the Issuer, are secured in the manner described in Condition 4 (Security, Priority and Relationship with Secured Creditors), are subordinated to the Class A Bonds, Class A Coupons, Class A Receipts and Class A Talons (if any) and rank pari passu without any preference among themselves.

(c) Security Trustee not responsible for monitoring compliance

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, where appropriate, the Super-Majority Creditors or, in particular cases, other specified parties and in accordance with the provisions of the STID.

The Security Trustee shall not be responsible for monitoring compliance by SWS with any of its obligations under the Finance Documents to which it is a party except by means of receipt from SWS of certificates of compliance which SWS has covenanted to deliver to the Security Trustee pursuant to the provisions of the Common Terms Agreement and which will state among other things, that no Default is outstanding. The Security Trustee shall be entitled to rely on certificates absolutely unless it is instructed otherwise by the Majority Creditors in which case it will be bound to act on such instructions in accordance with the STID. The Security Trustee is not responsible for monitoring compliance by any of the parties with their respective obligations under the Finance Documents. The Security Trustee may call for and is at liberty to accept as sufficient evidence a certificate signed by any two Authorised Signatories of any Obligor or any other party to any Finance Document to the effect that any particular dealing, transaction, step or thing is in the opinion of the persons so certifying suitable or expedient or as to any other fact or matter upon which the Security Trustee may require to be satisfied. The Security Trustee is in no way bound to call for further evidence or be responsible for any loss that may be occasioned by acting on any such certificate although the same may contain some error or is not authentic. The Security Trustee is entitled to rely upon any certificate believed by it to be genuine and will not be liable for so acting.

All Bondholders shall (on providing sufficient evidence of identity) be entitled to view a copy of the Periodic Information (as defined in the Master Definitions Agreement) as and when available to the Security Trustee pursuant to the terms of the CTA and to view a copy of the unaudited interim accounts and audited annual accounts of SWS within 60 days of 30 September and 120 days of 31 March, respectively.

In addition, each Guarantor has covenanted to provide the Security Trustee with certain additional information (as set out in Schedule 5, Part 1 “Information Covenants” of the Common Terms Agreement). Such information may be published on a website designated by the relevant Guarantor and the Security Trustee. Any Bondholder who provides sufficient evidence of identity may obtain the current password to such website upon application to the Principal Paying Agent or the Registrar (as applicable).

In the event the relevant website cannot be accessed or is infected by an electronic virus or function software for a period of five consecutive days, all such information set out above which would otherwise be available will be delivered to the Security Trustee in paper form for onward delivery to the Bond Trustee and the Agents. Copies of such information will be available for inspection at the specified office of the Agents and the Bond Trustee.

4 Security, Priority and Relationship with Secured Creditors

(a) *Guarantee and Security*

Under the Security Agreement, each of SWS Holdings Limited (“**SWSH**”) and SWS Group Holdings Limited (“**SWSGH**”) guarantees the obligations of each other Obligor under the Finance Documents and SWS and the Issuer will guarantee the obligations of each other under the Finance Documents, in each case to the Security Trustee for itself and on behalf of the Secured Creditors (including, without limitation, the Bond Trustee for itself and on behalf of the Bondholders) and secures such obligations upon the whole of its property, undertaking, rights and assets, subject to certain specified exceptions and, in the case of SWS, 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 Initial Issue Date. All Bonds issued by the Issuer under the Programme and any additional creditor of the Issuer acceding to the STID will share in the security (the “**Security**”) constituted by the Security Documents.

In these Conditions:

the “**Act**” means the United Kingdom Water Industry Act 1991 (as amended);

“**Instrument of Appointment**” means the Instrument of Appointment, dated 1989 as amended under which the Secretary of State for the Environment appointed SWS 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; and

“**Obligors**” means SWS, SWSGH, SWSH and the Issuer.

(b) *Relationship among Bondholders and with other Secured Creditors.*

The Bond Trust Deed contains provisions detailing the Bond Trustee’s obligations to consider discretions of the Bond Trustee (except where expressly provided or otherwise referred to in Condition 16 (*Bond Trustee Protections*)).

The STID provides that the Security Trustee (except in relation to its Reserved Matters and Entrenched Rights (each as defined in the Master Definitions Agreement) and subject to certain exceptions) will act on instructions of the Majority Creditors (including the Bond Trustee as trustee for and representative of the 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 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 (other than the Excluded Accounts) (each as defined in the Master Definitions Agreement) 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 Issuer has agreed to comply with the covenants as set out in Schedule 5 of the Common Terms Agreement.

The Bond Trustee shall be entitled to rely absolutely on a certificate of any director of the Issuer in relation to any matter relating to such covenants and to accept without liability any such certificate as sufficient evidence of the relevant fact or matter stated in such certificate.

6 Interest and other Calculations

(a) *Interest Rate and Accrual*

Each Bond (unless specified in the relevant Final Terms to be a Zero Coupon Bond) bears interest on its Principal Amount Outstanding as defined below (or as otherwise specified in the relevant Final Terms) from the Interest Commencement Date (as defined below) at the Interest Rate (as defined below), such interest being payable in arrear (unless otherwise specified in the relevant Final Terms) on each Interest Payment Date (as defined below). The amount of interest payable shall be determined in accordance with Condition 6(g).

Interest will cease to accrue on each Bond (or, in the case of the redemption of part only of a Bond, that part only of such Bond) on the due date for redemption unless, upon due presentation, payment of principal is improperly withheld or refused, in which event interest will continue to accrue (both before and after judgment) at the Interest Rate in the manner provided in this Condition 6 to the Relevant Date (as defined in Condition 6(i) (*Definitions*)).

In the case of interest on Class B Bonds only, if, on any Interest Payment Date, prior to the taking of Enforcement Action after the termination of a Standstill Period, there are insufficient funds available to

the Issuer (after taking into account any amounts available to be drawn under any DSR Liquidity Facility or from the Debt Service Reserve Account) to pay such accrued interest, the Issuer's liability to pay such accrued interest will be treated as not having fallen due and will be deferred until the earliest of:

- (i) the next following Interest Payment Date on which the Issuer has, in accordance with the cash management provisions of Schedule 12 of the Common Terms Agreement, sufficient funds available to pay such deferred amounts (including any interest accrued thereon);
- (ii) the date on which the Class A Debt has been paid in full; and
- (iii) an Acceleration of Liabilities (other than a Permitted Hedge Termination or a Permitted Lease Termination) and in the case of a Permitted Share Pledge Acceleration only to the extent that there would be sufficient funds available in accordance with the Payment Priorities to pay such deferred interest (including any interest accrued thereon). Interest will accrue on such deferred interest at the rate otherwise payable on unpaid principal of such Class B Bonds.

If any Maximum Interest Rate or Minimum Interest Rate is specified in the relevant Final Terms, then the Interest Rate shall in no event be greater than the maximum or be less than the minimum so specified, as the case may be.

(b) Business Day Convention

If any date referred to in these Conditions or the relevant Final Terms is specified to be subject to adjustment in accordance with a Business Day convention and would otherwise fall on a day which is not a Business Day (as defined below), then if the Business Day Convention specified in the relevant Final Terms is:

- (i) the "**Following Business Day Convention**", such date shall be postponed to the next day which is a Business Day;
- (ii) the "**Modified Following Business Day Convention**", such 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 date shall be brought forward to the immediately preceding Business Day; or
- (iii) the "**Preceding Business Day Convention**", such date shall be brought forward to the immediately preceding Business Day.

(c) Floating Rate Bonds

This Condition 6(c) is applicable only if the relevant Final Terms specify the Bonds as Floating Rate Bonds.

If "**Screen Rate Determination**" is specified in the relevant Final Terms as the manner in which the Interest Rate(s) is/are to be determined, the Interest Rate applicable to the Bonds for each Interest Period will be determined by the Agent Bank (or the Calculation Agent, if applicable) on the following basis:

- (i) if the Page (as defined below) displays a rate which is a composite quotation or customarily supplied by one entity, the Agent Bank (or the Calculation Agent, if applicable) will determine the Relevant Rate (as defined in Condition 6(i) (*Definitions*));
- (ii) in any other case, the Agent Bank (or the Calculation Agent, if applicable) will determine the arithmetic mean of the Relevant Rates (as defined below) which appear on the Page as of the Relevant Time (as defined below) on the relevant Interest Determination Date;

- (iii) if, in the case of (i) above, such rate does not appear on that Page or, in the case of (ii) above, fewer than two such rates appear on that Page or if, in either case, the Page is unavailable, the Agent Bank (or the Calculation Agent, if applicable) will:
 - (a) request the principal Relevant Financial Centre office of each of the Reference Banks (as defined in Condition 6(i) (*Definitions*)) to provide a quotation of the Relevant Rate at approximately the Relevant Time on the relevant Interest Determination Date to prime banks in the Relevant Financial Centre (as defined below) interbank market (or, if appropriate, money market) in an amount that is representative for a single transaction in that market at that time; and
 - (b) determine the arithmetic mean of such quotations; and
- (iv) if fewer than two such quotations are provided as requested in Condition 6(c)(iii), the Agent Bank (or the Calculation Agent, if applicable) will determine the arithmetic mean of the rates (being the rates nearest to the Relevant Rate as determined by the Agent Bank (or the Calculation Agent, if applicable)) quoted by the Reference Banks at approximately 11.00 a.m. (local time in the Relevant Financial Centre of the Relevant Currency) on the first day of the relevant Interest Period (as defined in Condition 6(i) (*Definitions*)) for loans in the Relevant Currency to leading European banks for a period equal to the relevant Interest Period and in the Representative Amount (as defined in Condition 6(i) (*Definitions*)).

and the Interest Rate for such Interest Period shall be the sum of the Margin and the rate or (as the case may be) the arithmetic mean so determined. However, if the Agent Bank is unable to determine a rate or (as the case may be) an arithmetic mean in accordance with the above provisions in relation to any Interest Period, the Interest Rate applicable to the Bonds during such Interest Period will be the sum of the Margin and the rate or (as the case may be) the arithmetic mean last determined in relation to the Bonds in respect of a preceding Interest Period.

If “**ISDA Determination**” is specified in the relevant Final Terms as the manner in which the Interest Rate(s) is/are to be determined, the Interest Rate(s) applicable to the Bonds for each Interest Period will be the sum of the Margin and the relevant ISDA Rate where “**ISDA Rate**” in relation to any Interest Period means a rate equal to the Floating Rate (as defined in the ISDA Definitions) that would be determined by the Agent Bank (or the Calculation Agent, if applicable) under an interest rate swap transaction if the Agent Bank (or the Calculation Agent, if applicable) were acting as calculation agent for that interest rate swap transaction under the terms of an agreement incorporating the ISDA Definitions and under which:

- (i) the Floating Rate Option (as defined in the ISDA Definitions) is as specified in the relevant Final Terms;
- (ii) the Designated Maturity (as defined in the ISDA Definitions) is the Specified Duration (as defined in Condition 6(i) (*Definitions*)); and
- (iii) the relevant Reset Date (as defined in the ISDA Definitions) is either (1) if the relevant Floating Rate Option is based on LIBOR for a currency, the first day of that Interest Period or (2) if the relevant Floating Rate Option is based on EURIBOR, the first day of that Interest Period.

(d) *Fixed Rate Bonds*

This Condition 6(d) is applicable only if the relevant Final Terms specify the Bonds as Fixed Rate Bonds.

The Interest Rate applicable to the Bonds for each Interest Period will be the rate specified in the relevant Final Terms.

(e) *Indexed Bonds*

This Condition 6(e) is applicable only if the relevant Final Terms specify the Bonds as Indexed Bonds.

Payments of principal on, and the interest payable in respect of, the Bonds will be subject to adjustment for indexation and to the extent set out in Condition 7(b) (*Application of the Index Ratio*). The Interest Rate applicable to the Bonds for each Interest Period will be at the rate specified in the relevant Final Terms.

(f) *Rounding*

For the purposes of any calculations required pursuant to these Conditions (unless otherwise specified):

- (i) all percentages resulting from such calculations will be rounded, if necessary, to the nearest one hundred-thousandth of a percentage point (with halves being rounded up);
- (ii) all figures will be rounded to seven significant figures (with halves being rounded up); and
- (iii) all currency amounts which fall due and payable will be rounded to the nearest unit of such currency (with halves being rounded up). For these purposes, “unit” means, with respect to any currency other than euro, the lowest amount of such currency which is available as legal tender in the country of such currency and, with respect to euro, means 0.01 euro.

(g) *Calculations*

The amount of interest payable per Calculation Amount (as defined in the relevant Final Terms) in respect of any Bond for each Interest Period shall be equal to the product of (1) the Interest Rate, (2) the Calculation Amount specified in the relevant Final Terms, and (3) the Day Count Fraction (as defined in Condition 6(i) (*Definitions*)) and, in the case of Indexed Bonds only, adjusted according to the indexation set out in Condition 7(b) (*Application of the Index Ratio*), unless an Interest Amount is specified in respect of such period in the relevant Final Terms, in which case the amount of interest payable per Calculation Amount in respect of such Bond for such Interest Period will equal such Interest Amount.

(h) *Determination and Publication of Interest Rates, Interest Amounts, Redemption Amounts and Instalment Amounts*

As soon as practicable after the Relevant Time on each Interest Determination Date or such other time on such date as the Agent Bank (or the Calculation Agent, if applicable) may be required to calculate any Redemption Amount or the amount of an instalment of scheduled principal (an “**Instalment Amount**”), obtain any quote or make any determination or calculation, the Agent Bank (or the Calculation Agent, if applicable) will determine the Interest Rate and calculate the amount of interest payable (the “**Interest Amounts**”) in respect of each Specified Denomination of Bonds for the relevant Interest Period (including, for the avoidance of doubt any applicable Index Ratio to be calculated in accordance with Condition 7(b) (*Application of the Index Ratio*), calculate the Redemption Amount or Instalment Amount, obtain such quote or make such determination or calculation, as the case may be, and cause the Interest Rate and the Interest Amounts for each Interest Period and the relevant Interest Payment Date and, if required to be calculated, the Redemption Amount, Principal Amount Outstanding or any Instalment Amount to be notified to, in the case of Bearer Bonds, the Paying Agents or in the case of Registered Bonds, the Registrar, and, in each case, the Bond Trustee, the Issuer, the Bondholders and the London Stock Exchange and each other listing authority, stock exchange and/or quotation system by which the relevant Bonds have then been admitted to listing, trading and/or quotation) as soon as possible after its determination but in no event later than (i) (in case of notification to the London Stock Exchange and each other listing authority, stock exchange and/or quotation system by which the relevant Bonds have then been admitted to listing, trading and/or quotation) the commencement of the relevant

Interest Period, if determined prior to such time, in the case of an Interest Rate and Interest Amount, or (ii) in all other cases, the fourth Business Day after such determination. The Interest Amounts and the Interest Payment Date so published may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without 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 Sub-Class or Class of Bonds is for the time being listed or by which it has been admitted to listing and to the Bondholders in accordance with Condition 17 (*Notices*). If the Bonds become due and payable under Condition 11 (*Events of Default*), the accrued interest and the Interest Rate payable in respect of the Bonds shall nevertheless continue to be calculated as previously provided in accordance with this Condition but no publication of the Interest Rate or the Interest Amount so calculated need be made unless otherwise required by the Bond Trustee. The determination of each Interest Rate, Interest Amount, Redemption Amount and Instalment Amount, the obtaining of each quote and the making of each determination or calculation by the Agent Bank (or the Calculation Agent, if applicable) or, as the case may be, the Bond Trustee pursuant to this Condition 6 or Condition 7 (*Indexation*), shall (in the absence of manifest error) be final and binding upon all parties.

(i) *Definitions*

In these Conditions, unless the context otherwise requires, the following defined terms shall have the meanings set out below.

“**Business Day**” means:

- (i) in relation to any sum payable in euro, a TARGET Settlement Day; and/or
- (ii) in relation to any sum payable in a currency other than euro, a day on which commercial banks and foreign exchange markets settle payments in the principal financial centre of the Relevant Currency (which in the case of a payment in Sterling shall be London) and in each (if any) additional city or cities specified in the relevant Final Terms; and/or
- (iii) 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 Final Terms.

“**Day Count Fraction**” means, in respect of the calculation of an amount of interest on any Bond for any period of time (whether or not constituting an Interest Period, the “**Calculation Period**”):

- (i) if “**Actual/Actual (ICMA)**” is specified:
 - (a) if the Calculation Period is equal to or shorter than the Determination Period during which it falls, the number of days in the Calculation Period divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Periods normally ending in any year; and
 - (b) if the Calculation Period is longer than one Determination Period, the sum of:
 - (x) the number of days in such Calculation Period falling in the Determination Period in which it begins divided by the product of (1) the number of days in such Determination Period and (2) the number of Determination Periods normally ending in any year; and
 - (y) the number of days in such Calculation Period falling in the next Determination Period divided by the product of (1) the number of days in such Determination Period and (2) the number of Determination Periods normally ending in any year,

where:

“**Determination Period**” means the period from and including a Determination Date in any year but excluding the next Determination Date; and

“**Determination Date**” means the date specified as such hereon or, if none is so specified, the Interest Payment Date;

- (ii) if “**Actual/Actual**” or “**Actual/Actual – ISDA**” is specified, the actual number of days in the Calculation Period divided by 365 (or, if any portion of that Calculation Period falls in a leap year, the sum of (1) the actual number of days in that portion of the Calculation Period falling in a leap year divided by 366, and (2) the actual number of days in that portion of the Calculation Period falling in a non-leap year divided by 365);
- (iii) if “**Actual/365 (Fixed)**” is specified, the actual number of days in the Calculation Period divided by 365;
- (iv) if “**Actual/360**” is specified, the actual number of days in the Calculation Period divided by 360;
- (v) if “**30/360**”, “**360/360**” or “**Bond Basis**” is specified, the number of days in the Calculation Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 \times (Y2 - Y1)] + [30 \times (M2 - M1)] + (D2 - D1)}{360}$$

where:

- (a) “Y1” is the year, expressed as a number, in which the first day of the Calculation Period falls;
 - (b) “Y2” is the year, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;
 - (c) “M1” is the calendar month, expressed as a number, in which the first day of the Calculation Period falls;
 - (d) “M2” is the calendar month, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;
 - (e) “D1” is the first calendar day, expressed as a number, of the Calculation Period, unless such number would be 31, in which case D1 will be 30; and
 - (f) “D2” is the calendar day, expressed as a number, immediately following the last day included in the Calculation Period, unless such number would be 31 and D1 is greater than 29, in which case D2 will be 30;
- (vi) if “**30E/360**” or “**Eurobond Basis**” is specified, the number of days in the Calculation Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 \times (Y2 - Y1)] + [30 \times (M2 - M1)] + (D2 - D1)}{360}$$

where:

- (a) “Y1” is the year, expressed as a number, in which the first day of the Calculation Period falls;
- (b) “Y2” is the year, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;
- (c) “M1” is the calendar month, expressed as a number, in which the first day of the Calculation Period falls;

- (d) “M2” is the calendar month, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;
 - (e) “D1” is the first calendar day, expressed as a number, of the Calculation Period, unless such number would be 31, in which case D1 will be 30; and
 - (f) “D2” is the calendar day, expressed as a number, immediately following the last day included in the Calculation Period, unless such number would be 31, in which case D2 will be 30; and
- (vii) if “**30E/360 (ISDA)**” is specified hereon, the number of days in the Calculation Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 \times (Y2 - Y1)] + [30 \times (M2 - M1)] + (D2 - D1)}{360}$$

where:

- (a) “Y1” is the year, expressed as a number, in which the first day of the Calculation Period falls;
- (b) “Y2” is the year, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;
- (c) “M1” is the calendar month, expressed as a number, in which the first day of the Calculation Period falls;
- (d) “M2” is the calendar month, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;
- (e) “D1” is the first calendar day, expressed as a number, of the Calculation Period, unless (i) that day is the last day of February or (ii) such number would be 31, in which case D1 will be 30; and
- (f) “D2” is the calendar day, expressed as a number, immediately following the last day included in the Calculation Period, unless (i) that day is the last day of February but not the Maturity Date or (ii) such number would be 31, in which case D2 will be 30;

“**EURIBOR**” means the rate for Euro deposits for such period as specified in the relevant Final Terms and for each Interest Period thereafter, for Euro deposits for the relevant Interest Period as determined by reference to (1) the display page designated EURIBOR01 on the Dow Jones Reuters Service (or such other page as may replace that page on that service, or such other service as may be nominated by the Agent Bank as the information vendor, for the purpose of displaying comparable rates) as of the Interest Determination Date or (2) if that service ceases to display such information, such page as displays such information on such service (or, if more than one, that one previously approved in writing by the Agent Bank) as may replace the Dow Jones Reuters Monitor as at or about 11.00 a.m. (Brussels time);

“**euro**” means the lawful currency of the Participating Member States;

“**Interest Commencement Date**” means the Issue Date or such other date as may be specified in the relevant Final Terms;

“**Interest Determination Date**” means, with respect to an Interest Rate and an Interest Period, the date specified as such in the relevant Final Terms or, if none is so specified, the day falling two Business Days in London prior to the first day of such Interest Period (or if the specified currency is sterling the first day of such Interest Period) (as adjusted in accordance with any Business Day Convention (as defined below) specified in the relevant Final Terms);

“**Interest Payment Date**” means the date(s) specified as such in the relevant Final Terms;

“**Interest Period**” means the period beginning on (and including) the Interest Commencement Date and ending on (but excluding) the first Interest Payment Date and each successive period beginning on (and including) an Interest Payment Date and ending on (but excluding) the next succeeding Interest Payment Date;

“**Interest Rate**” means the rate of interest payable from time to time in respect of the Bonds and which is either specified as such in, or calculated in accordance with the provisions of, these Conditions and/or the relevant Final Terms;

“**ISDA Definitions**” means the 2006 ISDA Definitions (as amended and updated as at the date of issue of the first Tranche of Bonds of the relevant Sub-Class as published by the International Swaps and Derivatives Association, Inc.);

“**Issue Date**” means the date specified as such in the relevant Final Terms;

“**LIBOR**” means the rate for Sterling or U.S. dollar (as applicable) deposits for such period as specified in the relevant Final Terms for each Interest Period thereafter, for Sterling or U.S. dollar (as applicable) deposits for the relevant Interest Period as determined by reference to the British Bankers Association LIBOR Rates display as quoted on the Bridge Reuters monitor as Reuters Screen LIBOR01 at 11am London time. If the Reuters Screen LIBOR01 stops providing these quotations, the replacement service for the purposes of displaying this information will be used. If the replacement service stops displaying the information, any page showing this information may be used. If there is more than one service displaying the information, the one approved in writing by the Agent Bank in its sole discretion will be used;

“**Margin**” means the rate per annum (expressed as a percentage) specified as such in the relevant Final Terms;

“**Maturity Date**” means the date specified in the relevant Final Terms as the final date on which the principal amount of the Bond is due and payable;

“**Page**” means such page, section, caption, column or other part of a particular information service (including the Reuters Money 3000 Service (“**Reuters**”) and the Telerate Monitor Screen (“**Telerate**”)) as may be specified in the relevant Final Terms as a Relevant Screen Page;

“**Participating Member State**” means a Member State of the European Communities which adopts the euro as its lawful currency in accordance with the Treaty establishing the European Communities (as amended), and “**Participating Member States**” means all of them;

“**Principal Amount Outstanding**” means, in relation to a Bond, Sub-Class or Class, the original face value thereof less any repayment of principal made to the Holder(s) thereof in respect of such Bond, Sub-Class or Class;

“**Redemption Amount**” means the amount provided under Condition 8(b) (Optional Redemption), unless otherwise specified in the relevant Final Terms;

“**Reference Banks**” means the institutions specified as such or, if none, four major banks selected by the Agent Bank (or the Calculation Agent, if applicable) in the interbank market (or, if appropriate, money market) which is most closely connected with the Relevant Rate as determined by the Agent Bank (or the Calculation Agent, if applicable), on behalf of the Issuer, in its sole and absolute discretion;

“**Relevant Currency**” means the currency specified as such or, if none is specified, the currency in which the Bonds are denominated;

“**Relevant Date**” means the earlier of (a) the date on which all amounts in respect of the Bonds have been paid, and (b) five days after the date on which all of the Principal Amount Outstanding (adjusted in the case of Indexed Bonds in accordance with Condition 7(b) (*Application of Index Ratio*)) has been received by the Principal Paying Agent or the Registrar, as the case may be, and notice to that effect has been given to the Bondholders in accordance with Condition 17 (*Notices*);

“**Relevant Financial Centre**” means, with respect to any Bond, the financial centre specified as such in the relevant Final Terms or, if none is so specified, the financial centre with which the Relevant Rate is most closely connected as determined by the Agent Bank (or the Calculation Agent, if applicable);

“**Relevant Rate**” means the offered rate for a Representative Amount of the Relevant Currency for a period (if applicable) equal to the Specified Duration (or such other rate as shall be specified in the relevant Final Terms);

“**Relevant Screen Page**” means EURIBOR or LIBOR, as applicable;

“**Relevant Time**” means, with respect to any Interest Determination Date, the local time in the Relevant Financial Centre specified in the relevant Final Terms or, if none is specified, the local time in the Relevant Financial Centre at which it is customary to determine bid and offered rates in respect of deposits in the Relevant Currency in the interbank market in the Relevant Financial Centre;

“**Representative Amount**” means, with respect to any rate to be determined on an Interest Determination Date, the amount specified in the relevant Final Terms as such or, if none is specified, an amount that is representative for a single transaction in the relevant market at the time;

“**Specified Duration**” means, with respect to any Floating Rate (as defined in the ISDA Definitions) to be determined on an Interest Determination Date, the period or duration specified as such in the relevant Final Terms or, if none is specified, a period of time equal to the relative Interest Period;

“**TARGET Settlement Day**” means any day on which the TARGET system is open; and

“**TARGET system**” means the Trans-European Automated Real-Time Gross Settlement Express Transfer (known as TARGET2) system which was launched on 19 November 2007 or any successor thereto.

(j) *Agent Bank, Calculation Agent and Reference Banks*

The Issuer will procure that there shall at all times be an Agent Bank (and a Calculation Agent, if applicable) and four Reference Banks selected by the Issuer acting through the Agent Bank (or the Calculation Agent, if applicable) with offices in the Relevant Financial Centre if provision is made for them in these Conditions applicable to this Bond and for so long as it is outstanding. If any Reference Bank (acting through its relevant office) is unable or unwilling to continue to act as a Reference Bank, then the Issuer acting through the Agent Bank (or the Calculation Agent, if applicable) will select another Reference Bank with an office in the Relevant Financial Centre to act as such in its place. If the Agent Bank (or the Calculation Agent, if applicable) is unable or unwilling to act as such or if the Agent Bank (or the Calculation Agent, if applicable) fails duly to establish the Interest Rate for any Interest Period or to calculate the Interest Amounts or any other requirements, the Issuer will appoint (with the prior written consent of the Bond Trustee) a successor to act as such in its place. The Agent Bank may not resign its duties without a successor having been appointed as aforesaid.

(k) *Determination or Calculation by Bond Trustee*

If the Agent Bank (or the Calculation Agent, if applicable) does not at any time for any reason determine any Interest Rate, Interest Amount, Redemption Amount, Instalment Amount or any other amount to be determined or calculated by it, the Bond Trustee shall (without liability for so doing) determine such Interest Rate, Interest Amount, Redemption Amount, Instalment Amount or other amount as aforesaid at

such rate or in such amount as in its absolute discretion (having regard as it shall think fit to the procedures described above, but subject to the terms of the Bond Trust Deed) it shall deem fair and reasonable in all the circumstances or, subject as aforesaid, apply the foregoing provisions of this Condition, with any consequential amendments, to the extent that, in its sole opinion, it can do so and in all other respects it shall do so in such manner as it shall, in its absolute discretion, deem fair and reasonable in the circumstances, and each such determination or calculation shall be deemed to have been made by the Agent Bank (or the Calculation Agent, if applicable).

(l) *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 Condition 6 (*Interest and Other Calculations*) whether by the Principal Paying Agent, the Agent Bank (or the Calculation Agent, if applicable) or, if applicable, any calculation agent, shall (in the absence of wilful default, negligence, bad faith or manifest error) be binding on the Issuer, SWS, SWSH, SWSGH, the Agent Bank, the Bond Trustee, the Principal Paying Agent, the other Agents and all Bondholders, Receiptholders and Couponholders and (in the absence as aforesaid) no liability to the Issuer, SWS, SWSH, SWSGH, the Bond Trustee, the Bondholders, the Receiptholders or the Couponholders shall attach to the Principal Paying Agent, the Agent Bank or, if applicable, any calculation agent in connection with the exercise or non-exercise by it of its powers, duties and discretions pursuant to such provisions.

(m) *Interest on Dual Currency Bonds*

The rate or amount of interest payable in respect of Dual Currency Bonds shall be determined in the manner specified in the applicable Final Terms.

(n) *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 Final Terms.

7 Indexation

This Condition 7 is applicable only if the relevant Final Terms specify the Bonds as Indexed Bonds.

(a) *Definitions*

“**affiliate**” means in relation to any person, any entity controlled, directly or indirectly, by that person, any entity that controls directly or indirectly, that person or any entity, directly or indirectly under common control with that person and, for this purpose, “**control**” means control as defined in the Companies Act 1985;

“**Base Index Figure**” means (subject to Condition 7(c)(i) (*Change in base*)) the base index figure as specified in the relevant Final Terms;

“**Index**” or “**Index Figure**” means, subject as provided in Condition 7(c)(i) (*Change in base*), the UK Retail Price Index (RPI) (for all items) published by the Central Statistical Office (January 1987 = 100) or any comparable index which may replace the UK Retail Price 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 Calculation Date shall, subject as provided in Condition 7(c) (*Changes in Circumstances Affecting the Index*) and Condition 7(e) (*Cessation of or Fundamental Changes to the Index*) below, and if "3 months lag" is specified in the relevant Final Terms, be calculated in accordance with the following formula:

$$\text{IFA} = \text{RPI}_{m-3} + \frac{(\text{Day of Calculation Date} - 1)}{(\text{Days in month of Calculation Date})} \times (\text{RPI}_{m-2} - \text{RPI}_{m-3})$$

and rounded to five decimal places (0.000005 being rounded upwards) and where:

"**IFA**" means the Index Figure applicable;

"**RPI_{m-3}**" means the Index Figure for the first day of the month that is three months prior to the month in which the payment falls due;

"**RPI_{m-2}**" means the Index Figure for the first day of the month that is two months prior to the month in which the payment falls due;

Any reference to the "**Index Figure applicable**" to a particular Calculation Date shall, subject as provided in Condition 7(c) (*Changes in Circumstances Affecting the Index*) and Condition 7(e) (*Cessation of or Fundamental Changes to the Index*) below, and if "8 months lag" is specified in the relevant Final Terms, be calculated in accordance with the following formula:

$$\text{IFA} = \text{RPI}_{m-8} + \frac{(\text{Day of Calculation Date} - 1)}{(\text{Days in month of Calculation Date})} \times (\text{RPI}_{m-7} - \text{RPI}_{m-8})$$

and rounded to five decimal places (0.000005 being rounded upwards) and where:

"**IFA**" means the Index Figure applicable;

"**RPI_{m-8}**" means the Index Figure for the first day of the month that is eight months prior to the month in which the payment falls due;

"**RPI_{m-7}**" means the Index Figure for the first day of the month that is seven months prior to the month in which the payment falls due;

If the Index is replaced, the Issuer will describe the replacement Index in a supplementary prospectus;

"**Index Ratio**" applicable to any month means the Index Figure applicable to such month divided by the Base Index Figure;

"**Limited Index Ratio**" means (a) in respect of any month prior to the relevant Issue Date, the Index Ratio for that month; (b) in respect of any Limited Indexation Month after the relevant Issue Date, the product of the Limited Indexation Factor for that month and the Limited Index Ratio as previously calculated in respect of the month twelve months prior thereto; and (c) in respect of any other month, the Limited Index Ratio as previously calculated in respect of the most recent Limited Indexation Month;

"**Limited Indexation Factor**" means, in respect of a Limited Indexation Month, the ratio of the Index Figure applicable to that month divided by the Index Figure applicable to the month twelve months prior thereto, provided that (a) if such ratio is greater than the Maximum Indexation Factor specified in the relevant Final Terms, it shall be deemed to be equal to such Maximum Indexation Factor and (b) if such ratio is less than the Minimum Indexation Factor specified in the relevant Final Terms, it shall be deemed to be equal to such Minimum Indexation Factor;

"**Limited Indexation Month**" means any month specified in the relevant Final Terms for which a Limited Indexation Factor is to be calculated;

"**Limited Indexed Bonds**" means Indexed Bonds to which a Maximum Indexation Factor and/or a Minimum Indexation Factor (as specified in the relevant Final Terms) applies; and

"**Reference Gilt**" means the Treasury Stock specified as such in the relevant Final Terms for so long as such stock is in issue, and thereafter such issue of index-linked Treasury Stock determined to be

appropriate by a gilt-edged market maker or other adviser selected by the Issuer and approved by the Bond Trustee (an “**Indexation Adviser**”).

(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 or Limited Index Ratio in the case of Limited Indexed Bonds applicable to the month in which such payment falls to be made and rounded in accordance with Condition 6(f) (*Rounding*).

(c) *Changes in Circumstances Affecting the Index*

- (i) Change in base: If at any time and from time to time the Index is changed by the substitution of a new base therefor, then with effect from the calendar month from and including that in which such substitution takes effect (1) the definition of “**Index**” and “**Index Figure**” in Condition 7(a) (*Definitions*) shall be deemed to refer to the new date or month in substitution for January 1987 (or, as the case may be, to such other date or month as may have been substituted therefor), and (2) the new Base Index Figure shall be the product of the existing Base Index Figure (being at the Initial Issue Date 178.2) and the Index Figure immediately following such substitution, divided by the Index Figure immediately prior to such substitution.
- (ii) Delay in publication of Index: If the Index Figure which is normally published in the seventh month and which relates 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 on which such payment is due (the “**date for payment**”), the Index Figure applicable to the month in which the date for payment falls shall be (1) such substitute index figure (if any) as the Bond Trustee considers 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 an Indexation Adviser (and approved by the Bond Trustee) or (2) if no such determination is made by such Indexation Adviser within seven days, the Index Figure last published (or, if later, the substitute index figure last determined pursuant to Condition 7(c)(i) (*Change in base*)) before the date for payment.

(d) *Application of Changes*

Where the provisions of Condition 7(c)(ii) (*Delay in publication of Index*) 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 Condition 7(c)(ii)(2), the Index Figure relating to the relevant month is subsequently published while a Bond is still outstanding, then:

- (i) in relation to a payment of principal or interest in respect of such Bond other than upon final redemption 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 Condition 7(c)(ii)(2), 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; and
- (ii) in relation to a payment of principal or interest upon final redemption, no subsequent adjustment to amounts paid will be made.

(e) *Cessation of or Fundamental Changes to the Index*

- (i) If (1) the Bond Trustee has been notified by the Agent Bank (or the Calculation Agent, if applicable) that the Index has ceased to be published or (2) 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 an 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.
- (ii) If the Issuer and the Bond Trustee fail to reach agreement as mentioned above within 20 business days following the giving of notice as mentioned in paragraph (i), a bank or other person in London shall be appointed by the Issuer and the Bond Trustee or, failing agreement on and the making of 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 and of any Indexation Adviser and of any of the Issuer and the Bond Trustee in connection with such appointment shall be borne by the Issuer.
- (iii) 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 and the Issuer agree are 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, the other Secured Creditors, the Bond Trustee and the Bondholders, and the Issuer shall give notice to the Bondholders in accordance with Condition 17 (*Notices*) of such amendments as promptly as practicable following such notification.

8 Redemption, Purchase and Cancellation

(a) *Partial and Final Redemption*

Unless previously redeemed, or purchased and cancelled as provided below, or unless such Bond is stated in the relevant Final Terms as having no fixed maturity date, each Bond will be redeemed at its Principal Amount Outstanding (in the case of Indexed Bonds as adjusted in accordance with Condition 7(b) (*Application of the Index Ratio*)), on the date or dates (or, in the case of Floating Rate Bonds, on the Interest Payment Date(s) specified in the relevant Final Terms plus accrued but unpaid interest (other than in the case of Zero Coupon Bonds) and, in the case of Indexed Bonds as adjusted in accordance with Condition 7(b) (*Application of the Index Ratio*)).

In the case of principal on Class B Bonds only, if on any date, prior to the taking of Enforcement Action after the termination of a Standstill Period, on which such Bond is to be redeemed (in whole or in part) there are insufficient funds available to the Issuer to pay such principal, the Issuer’s liability to pay such principal will be treated as not having fallen due and will be deferred until the earliest of (i) the next following Interest Payment Date on which the Issuer has, in accordance with the cash management provisions of Schedule 12 of the Common Terms Agreement, sufficient funds to pay such deferred

amounts (including any interest accrued thereon); (ii) the date on which all Class A Debt has been paid in full and (iii) an Acceleration of Liabilities (other than a Permitted Hedge Termination or a Permitted Lease Termination) and in the case of a Permitted Share Pledge Acceleration only to the extent that there would be sufficient funds available in accordance with the Payment Priorities to pay such deferred principal (including any accrued interest thereon). Interest will accrue on such deferred principal at the rate otherwise payable on unpaid principal of such Class B Bonds.

(b) *Optional Redemption*

Subject as provided below, 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, the Issuer may (prior to the Maturity Date) redeem any Sub-Class of the Bonds in whole or in part (but on a pro rata basis only) on any Interest Payment Date at their Redemption Amount, provided that Floating Rate Bonds may not be redeemed before the date specified in the relevant Final Terms, as follows:

- (i) In respect of Fixed Rate Bonds, the Redemption Amount will, unless otherwise specified in the relevant Final Terms, be an amount equal to the higher of (i) their Principal Amount Outstanding 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 such 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 UK 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, plus accrued but unpaid interest on the Principal Amount Outstanding.

For the purposes of this Condition 8(b)(i), “**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” published on 8 June 1998 with effect from 1 November 1998 and updated on 15 January 2002 page 5 or any replacement thereof; “**Reference Date**” means the date which is two Business Days prior to the despatch of the notice of redemption under this Condition 8(b)(i); and “**Reference Gilt**” means the Treasury Stock specified in the relevant Final Terms.

- (ii) In respect of Floating Rate Bonds, the Redemption Amount will, unless otherwise specified in the relevant Final Terms, be the Principal Amount Outstanding plus any premium for early redemption in certain years (as specified in the relevant Final Terms) plus any accrued but unpaid interest on the Principal Amount Outstanding.
- (iii) In respect of Indexed Bonds, the Redemption Amount will (unless otherwise specified in the relevant Final Terms) be the higher of (i) the Principal Amount Outstanding and (ii) the price determined to be appropriate (without any additional indexation beyond the implicit indexation in such determined price) by a financial adviser in London (selected by the Issuer and approved by the Bond Trustee as being the price at which the Gross Real Redemption Yield (as defined below) on the Bonds on the Reference Date (as defined below) is equal to the Gross Real Redemption Yield at 3:00 p.m. (London time) on the Reference Date on the Reference Gilt while that stock is in issue, and thereafter such UK 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, plus accrued but unpaid interest (as adjusted in accordance with Condition 7(b) (*Application of the Index Ratio*)) on the Principal Amount Outstanding.

For the purposes of this Condition 8(b)(iii), “Gross Real 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” published on 8 June 1998 with effect from 1 November 1998 and updated on 15 January 2002, page 4 or any replacement therefor, “Reference Date” means the date which is two Business Days prior to the despatch of the notice of redemption under this Condition 8(b)(iii); and “Reference Gilt” means the Treasury Stock specified in the relevant Final Terms.

In any such case, prior to giving any such notice, the Issuer must certify (as further specified in the Finance Documents) to the Bond Trustee that it will have the funds, not subject to any interest (other than under the Security) of any other person, required to redeem the Bonds as aforesaid.

(c) *Redemption for Index Event, Taxation or Other Reasons*

Redemption for Index Events: Upon the occurrence of any Index Event (as defined below), the Issuer may, upon giving not more than 60 nor less than 30 days’ notice to the Bond Trustee, the Security Trustee, the Majority Creditors and the holders of the Indexed Bonds in accordance with Condition 17 (*Notices*), redeem all (but not some only) of the Indexed Bonds of all Sub-Classes on any Interest Payment Date at the Principal Amount Outstanding (adjusted in accordance with Condition 7(b) (*Application of Index Ratio*)) plus accrued but unpaid interest. No single Sub-Class of Indexed Bonds may be redeemed in these circumstances unless all the other Classes and Sub-Classes of Indexed Bonds are also redeemed at the same time. Before giving any such notice, the Issuer shall provide to the Bond Trustee, the Security Trustee and the Majority Creditors a certificate signed by an authorised signatory (a) 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 and (b) confirming that the Issuer will have sufficient funds on such Interest Payment Date to effect such redemption.

“**Index Event**” means (i) if the Index Figure for three consecutive months falls to be determined on the basis of an Index Figure previously published as provided in Condition 7(c)(ii) (*Delay in publication of Index*) 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 the holders of the Reference Gilt, and (in either case) no amendment or substitution of the Index has been advised by the Indexation Adviser to the Issuer and such circumstances are continuing.

Redemption for Taxation Reasons: In addition, if at any time 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 the Cayman Islands 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 deductions or withholding, use its reasonable endeavours to arrange the substitutions of a company incorporated under another jurisdiction approved by the Bond Trustee as principal debtor under the Bonds and as lender under the Issuer/SWS Loan Agreements and as obligor under the Finance Documents upon satisfying the conditions for substitution of the Issuer as set out in the STID (and referred to in Condition 15 (*Meetings of Bondholders, Modification, Waiver and Substitution*)). If the Issuer is unable to arrange a substitution as described above having used reasonable endeavours to do so and, as a result, the relevant deduction or withholding is continuing then the Issuer may, 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 in accordance with Condition 17 (*Notices*), redeem all (but not some only) of the Bonds on any Interest Payment Date at their Principal Amount Outstanding plus accrued but unpaid interest thereon (each adjusted, in the case of Indexed Bonds, in accordance with Condition 7(b) (*Application of the Index Ratio*)). Before giving any such notice of redemption, the Issuer shall provide to the Bond Trustee, the Security Trustee and the Majority Creditors a certificate signed by an authorised

signatory (a) 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 and (b) confirming that the Issuer will have sufficient funds on such Interest Payment Date to discharge all its liabilities in respect of the Bonds and any amounts under the Security Agreement to be paid in priority to, or pari passu with, the Bonds under the Payment Priorities.

(d) *Redemption on Prepayment of Issuer/SWS Loan Agreements*

If SWS gives notice to the Issuer under an Issuer/SWS Loan Agreement that it intends to prepay all or part of any advance made under such Issuer/SWS Loan Agreement and such advance was funded by the Issuer from the proceeds of the issue of a Sub-Class of Bonds, the Issuer shall, 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 in accordance with Condition 17 (*Notices*) (where such advance is being prepaid in whole), redeem all of the Bonds of that Sub-Class or (where part only of such advance is being prepaid) the proportion of the relevant Sub-Class of Bonds which the proposed prepayment amount bears to the amount of the relevant advance. In the case of a voluntary prepayment, the relevant Bonds will be redeemed at their Redemption Amount determined in accordance with Condition 8(b) (*Optional Redemption*) except that, in the case of Fixed Rate Bonds and Indexed Bonds, for the purposes of this Condition 8(d), "**Reference Date**" means the date two Business Days prior to the despatch of the notice of redemption given under this Condition 8(d), plus accrued but unpaid interest and, in the case of any other prepayment, the relevant Bonds will be redeemed at their Principal Amount Outstanding plus accrued but unpaid interest.

(e) *Early redemption of Zero Coupon Bonds*

Unless otherwise specified in the relevant Final Terms, the Redemption Amount payable on redemption of a Zero Coupon Bond at any time before the Maturity Date shall be an amount equal to the sum of:

- (i) the Reference Price; and
- (ii) the product of the Accrual Yield (compounded annually) being applied to the Reference Price from (and including) the Issue Date to (but excluding) the date fixed for redemption or (as the case may be) the date upon which the Bond becomes due and payable.

Where such calculation is to be made for a period which is not a whole number of years, the calculation in respect of the period of less than a full year shall be made on the basis of such Day Count Fraction as may be specified in the Final Terms for the purposes of this Condition 8(e) or, if none is so specified, a Day Count Fraction of 30/360.

In these Conditions, "**Accrual Yield**" and "**Reference Price**" and "**Zero Coupon Bond**" have the meanings given to them in the relevant Final Terms.

(f) *Purchase of Bonds*

The Issuer may, provided that no Event of Default has occurred and is continuing, purchase Bonds (provided that all unmatured Receipts and Coupons and unexchanged Talons (if any) appertaining thereto are attached or surrendered therewith) in the open market or otherwise at any price. Any purchase by tender shall be made available to all Bondholders alike.

If not all the Bonds which are in registered form are to be purchased, upon surrender of the existing Individual Bond Certificate, the Registrar shall forthwith upon the written request of the Bondholder concerned issue a new Individual Bond Certificate in respect of the Bonds which are not to be purchased and despatch such Individual Bond Certificate to the Bondholder (at the risk of the Bondholder and to such address as the Bondholder may specify in such request).

While the Bonds are represented by a Global Bond or Global Bond Certificate (as defined below), the relevant Global Bond or Global Bond Certificate will be endorsed to reflect the Principal Amount Outstanding of Bonds to be so redeemed or purchased.

(g) Redemption by Instalments

Unless previously redeemed, purchased and cancelled as provided in this Condition 8, each Bond which provides for Instalment Dates (as specified in the relevant Final Terms) and Instalment Amounts (as specified in the relevant Final Terms) will be partially redeemed on each Instalment Date at the Instalment Amount.

(h) Cancellation

In respect of all Bonds purchased by or on behalf of the Issuer, the Bearer Bonds or the Registered Bonds shall be surrendered to or to the order of the Principal Paying Agent or the Registrar, as the case may be, for cancellation and, if so surrendered, will, together with all Bonds redeemed by the Issuer, be cancelled forthwith (together with, in the case of Bearer Bonds, all unmatured Receipts and Coupons and unexchanged Talons attached thereto or surrendered therewith). Any Bonds so surrendered for cancellation may not be reissued or resold and the obligations of the Issuer in respect of any such Bonds shall be discharged.

(i) Instalments

Instalment Bonds will be redeemed in the Instalment Amounts and on the Instalment Dates. In the case of early redemption, the Redemption Amount will be determined pursuant to paragraph (b) above.

(j) 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 Final Terms.

9 Payments

(a) Bearer Bonds

Payments to the Bondholders of principal (or, as the case may be, Redemption Amounts or other amounts payable on redemption) and interest (or, as the case may be, Interest Amounts) in respect of Bearer Bonds will, subject as mentioned below, be made against presentation and surrender of the relevant Receipts (in the case of payment of Instalment Amounts other than on the due date for final redemption and provided that the Receipt is presented for payment together with its relative Bond), Bonds (in the case of all other payments of principal and, in the case of interest, as specified in Condition 9(f) (*Unmatured Coupons and Receipts and Unexchanged Talons*)) or Coupons (in the case of interest, save as specified in Condition 9(f) (*Unmatured Coupons and Receipts and Unexchanged Talons*)), as the case may be, at the specified office of any Paying Agent outside the United States of America by transfer to an account denominated in the currency in which such payment is due with, or (in the case of Bonds in definitive form only) a cheque payable in that currency drawn on, a bank in (i) the principal financial centre of that currency provided that such currency is not euro, or (ii) the principal financial centre of any Participating Member State if that currency is euro.

(b) Registered Bonds

Payments of principal (or, as the case may be, Redemption Amounts) in respect of Registered Bonds will be made to the holder (or the first named of joint holders) of such Bond against presentation and surrender of the relevant Registered Bond at the specified office of the Registrar and in the manner provided in Condition 9(a) (*Bearer Bonds*).

Payments of instalments in respect of Registered Bonds will be made to the holder (or the first named of joint holders) of such Bond against presentation of the relevant Registered Bond at the specified office of the Registrar in the manner provided in Condition 9(a) (*Bearer Bonds*) above and annotation of such payment on the Register and the relevant Bond Certificate.

Interest (or, as the case may be, Interest Amounts) on Registered Bonds payable on any Interest Payment Date will be paid to the holder (or the first named if joint holders) on the day prior to the date for payment thereof (the “**Record Date**”). Payment of interest or Interest Amounts on each Registered Bond will be made in the currency in which such payment is due by cheque drawn on a bank in (a) the principal financial centre of the country of the currency concerned, provided that such currency is not euro, or (b) the principal financial centre of any Participating Member State if that currency is euro and mailed to the holder (or to the first named of joint holders) of such Bond at its address appearing in the Register. Upon application by the Bondholder to the specified office of the Registrar before the relevant Record Date, such payment of interest may be made by transfer to an account in the relevant currency maintained by the payee with a bank in (a) the principal financial centre of the country of that currency provided that such currency is not euro, or (b) the principal financial centre of any Participating Member State if that currency is euro.

A record of each payment so made will be endorsed on the schedule to the Global Bond or the Global Bond Certificate by or on behalf of the Principal Paying Agent or the Registrar, as the case may be, which endorsement shall be prima facie evidence that such payment has been made.

(c) *Payments in the United States of America*

Notwithstanding the foregoing, if any Bearer Bonds are denominated in U.S. dollars, payments in respect thereof may be made at the specified office of any Paying Agent in New York City in the same manner as aforesaid if:

- (i) the Issuer shall have appointed Paying Agents with specified offices outside the United States of America with the reasonable expectation that such Paying Agents would be able to make payment of the amounts on the Bonds in the manner provided above when due;
- (ii) payment in full of such amounts at all such offices is illegal or effectively precluded by exchange controls or other similar restrictions on payment or receipt of such amounts; and
- (iii) such payment is then permitted by the law of the United States of America, without involving, in the opinion of the Issuer, adverse tax consequences to the Issuer.

(d) *Payments subject to fiscal laws; payments on Global Bonds and Registered Bonds*

All payments are subject in all cases to any applicable fiscal or other laws, regulations and directives, but without prejudice to the provisions of this Condition 9. No commission or expenses shall be charged to the Bondholders, Couponholders or Receiptholders (if any) in respect of such payments.

The holder of a Global Bond or Global Bond Certificate shall be the only person entitled to receive payments of principal (or Redemption Amounts) and interest (or Interest Amounts) on the Global Bond or Global Bond Certificate (as the case may be) and the Issuer will be discharged by payment to, or to the order of, the holder of such Global Bond or Global Bond Certificate in respect of each amount paid.

(e) *Appointment of the Agents*

The Paying Agents, the Agent Bank, the Transfer Agents and the Registrar (the “**Agents**”) appointed by the Issuer (and their respective specified offices) are listed in the Agency Agreement. Any Calculation Agent will be listed in the relevant Final Terms and will be appointed pursuant to a Calculation Agency Agreement. The Agents act solely as agents of the Issuer and do not assume any obligation or relationship of agency or trust for or with any holder. The Issuer reserves the right, with the prior written

consent of the Bond Trustee at any time to vary or terminate the appointment of any Agent, and to appoint additional or other Agents, provided that the Issuer will at all times maintain (i) a Principal Paying Agent (in the case of Bearer Bonds), (ii) a Registrar (in the case of Registered Bonds), (iii) an Agent Bank or Calculation Agent (as specified in the relevant Final Terms) (in the case of Floating Rate Bonds or Indexed Bonds), (iv) a Paying Agent with a specified office in a European Union member state that will not be obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000; and (v) if and for so long as the Bonds are admitted to listing, trading and/or quotation by any listing authority, stock exchange and/or quotation system which requires the appointment of a Paying Agent, Transfer Agent or Registrar in any particular place, a Paying Agent, Transfer Agent and/or Registrar, as applicable, having its specified office in the place required by such listing authority, stock exchange and/or quotation system, which, while any Bonds are admitted to the Official List of the UK Listing Authority and/or admitted to trading on the London Stock Exchange's Regulated Market or the London Stock Exchange's Professional Securities Market shall be in London. Notice of any such variation, termination or appointment will be given in accordance with Condition 17 (*Notices*).

(f) *Unmatured Coupons and Receipts and Unexchanged Talons*

- (i) Subject to the provisions of the relevant Final Terms, upon the due date for redemption of any Bond which is a Bearer Bond (other than a Fixed Rate Bond, unless it has all unmaturing Coupons attached), unmaturing Coupons and Receipts relating to such Bond (whether or not attached) shall become void and no payment shall be made in respect of them.
- (ii) Upon the date for redemption of any Bond, any unmaturing Talon relating to such Bond (whether or not attached) shall become void and no Coupon shall be delivered in respect of such Talon.
- (iii) Upon the due date for redemption of any Bond which is redeemable in instalments, all Receipts relating to such Bond having an Instalment Date falling on or after such due date (whether or not attached) shall become void and no payment shall be made in respect of them.
- (iv) Where any Bond, which is a Bearer Bond and is a Fixed Rate Bond, is presented for redemption without all unmaturing Coupons and any unexchanged Talon relating to it, a sum equal to the aggregate amount of the missing unmaturing Coupons will be deducted from the amount of principal due for payment and, redemption shall be made only against the provision of such indemnity as the Issuer may require.
- (v) If the due date for redemption of any Bond is not an Interest Payment Date, interest accrued from the preceding Interest Payment Date or the Interest Commencement Date, as the case may be, or the Interest Amount payable on such date for redemption shall only be payable against presentation (and surrender if appropriate) of the relevant Bond and Coupon.

(g) *Non-Business Days*

Subject as provided in the relevant Final Terms, if any date for payment in respect of any Bond, Receipt or Coupon is not a business day, the holder shall not be entitled to payment until the next following business day nor to any interest or other sum in respect of such postponed payment. In this paragraph, "**business day**" means a day (other than a Saturday or a Sunday) on which banks are open for presentation and payment of debt securities and for dealings in foreign currency in London and in the relevant place of presentation and in the cities referred to in the definition of Business Days and (in the case of a payment in a currency other than euro), where payment is to be made by transfer to an account maintained with a bank in the relevant currency, on which dealings may be carried on in the relevant currency in the principal financial centre of the country of such currency and, in relation to any sum payable in euro, a day on which the TARGET system is open.

(h) *Talons*

On or after the Interest Payment Date for the final Coupon forming part of a coupon sheet issued in respect of any Bond, the Talon forming part of such coupon sheet may be surrendered at the specified office of any Paying Agent in exchange for a further coupon sheet (and if necessary another Talon for a further coupon sheet) (but excluding any Coupons which may have become void pursuant to Condition 13 (*Prescription*)).

10 Taxation

All payments in respect of the Bonds, Receipts or Coupons will be made (whether by the Issuer, any Paying Agent, the Registrar, the Bond Trustee, the Security Trustee) without withholding or deduction for, or on account of, any present or future taxes, duties or charges of whatsoever nature unless the Issuer, the Guarantors, any Paying Agent or the Registrar or, where applicable, the Bond Trustee or the Security Trustee is required by applicable law to make any payment in respect of the Bonds, Receipts or Coupons subject to any withholding or deduction for, or on account of, any present or future taxes, duties or charges of whatsoever nature. In that event, the Issuer, the Guarantors, such Paying Agent, the Registrar, the Bond Trustee or the Security Trustee, as the case may be, 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, the Guarantors, any Paying Agent, the Registrar, the Bond Trustee or the Security Trustee will be obliged to make any additional payments to the Bondholders, Receiptholders or the Couponholders in respect of such withholding or deduction. The Issuer, the Guarantors, any Paying Agent, the Registrar, the Bond Trustee or the Security Trustee 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.

11 Events of Default

The Events of Default (as defined in the Master Definitions Agreement) relating to the Bonds are set out in Schedule 7 of the Common Terms Agreement.

Following the notification of an Event of Default in respect of the Issuer, the STID provides for a Standstill Period (as defined in the Master Definitions Agreement) to commence and for restrictions to apply to all Secured Creditors of SWS. The Common Terms Agreement also contains various Trigger Events that will, if they occur, (among other things) permit the Majority Creditors to commission an Independent Review, require SWS to discuss its plans for appropriate remedial action and prevent the SWS Financing Group from making further Restricted Payments until the relevant Trigger Events have been remedied.

(a) *Events of Default*

If any Event of Default occurs and is continuing in relation to the Issuer, 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 Sub-Classes 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 Sub-Classes 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 Sub-Class are, and they shall immediately become, due and repayable, at their respective Redemption Amounts determined in accordance with Condition 8(b) (*Optional Redemption*) (except that, in the case of Fixed Rate Bonds and Indexed Bonds for the purposes of this Condition 11(a), the “**Reference Date**” means the date two Business Days prior to the

despatch of the notice of redemption given under this Condition 11(a)) or as specified in the applicable Final Terms.

(b) Confirmation of no Event of Default

The Issuer, pursuant to the terms of the Common Terms Agreement, shall provide written confirmation to the Bond Trustee, on an annual basis, that no Event of Default has occurred in relation to the Issuer.

(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 Sub-Class, a Standstill Period shall commence. The Security Trustee may only enforce the Security acting in accordance with the STID and, subject to certain limitations on enforcement during a Standstill Period, on the instructions of the Majority Creditors.

(d) Automatic Acceleration

In the event of the acceleration of the Secured Liabilities (other than a Permitted Share Pledge Acceleration, a Permitted Hedge Termination or a Permitted Lease Termination (as defined in the Master Definitions Agreement) as set out in the STID), the Bonds of each Series shall automatically become due and repayable at their respective Redemption Amounts determined in accordance with Condition 8(b) (*Optional Redemption*) (except that, in the case of Fixed Rate Bonds and Indexed Bonds for the purposes of this Condition 11(d), “**Reference Date**” means the date two Business Days prior to the date of such acceleration) or as specified in the applicable Final Terms plus, in each case, accrued and unpaid interest thereon.

12 Enforcement Against Issuer

No Bondholder is entitled to take any action against the Issuer or against any assets of the Issuer to enforce its rights in respect of the Bonds or to enforce any of the Security 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. The Security Trustee will act (subject to Condition 11(c) (*Enforcement of Security*)) on the instructions of the Majority Creditors pursuant to the STID, and neither the Bond Trustee nor the Security Trustee shall be bound to take any such action unless it is indemnified and/or secured to its satisfaction against all fees, costs, expenses, liabilities, claims and demands to which it may thereby become liable or which it may incur by so doing.

Neither the Bond Trustee nor the Bondholders may institute against, or join any person in instituting against, the Issuer any bankruptcy, winding up, re-organisation, arrangement, insolvency or liquidation proceeding (except for the appointment of a receiver and manager pursuant to the terms of the Security Agreement and subject to the STID) or other proceeding under any similar law for so long as any Bonds are outstanding or for two years and a day after the latest Maturity Date on which any Bond of any Series is due to mature.

13 Prescription

Claims against the Issuer for payment in respect of the Bonds, Receipts or Coupons (which, for this purpose, shall not include Talons) shall be prescribed and become void unless made within ten years (in the case of principal) or five years (in the case of interest) from the appropriate Relevant Date (as defined in Condition 6(i) (*Definitions*)) in respect thereof.

14 Replacement of Bonds, Coupons, Receipts and Talons

If any Bearer Bond, Registered Bond, Receipt, Coupon or Talon is lost, stolen, mutilated, defaced or destroyed it may be replaced, subject to applicable laws and requirements of the London Stock Exchange (in the case of listed Bonds) (and each other listing authority, stock exchange and or quotation system upon which the relevant

Bonds have then been admitted to listing, trading and/or quotation), at the specified office of the Principal Paying Agent or, as the case may be, the Registrar upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer may require. Mutilated or defaced Bonds, Receipts, Coupons or Talons must be surrendered before replacements will be issued.

15 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 (as defined in the Master Definitions Agreement) decisions made pursuant to the Emergency Instruction Procedure (as set out in Clause 9.12 of the STID)).

In the circumstances which do not relate to Entrenched Rights or Reserved Matters of the Bondholders (as set out in the STID), the Bond Trustee shall be entitled to vote as the DIG Representative (as defined in the Master Definitions Agreement) of holders of each Sub-Class of Bonds on intercreditor issues (“**Intercreditor Issues**”) but shall not be entitled to convene a meeting of any one or more Sub-Classes of Bondholders to consider the relevant matter unless a Default Situation is subsisting. If 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 or, if there are no Class A Bonds outstanding, Class B Bonds (i) by means of an Extraordinary Resolution of the relevant Sub-Class of Bonds or (ii) (in respect of a DIG Proposal (as defined in the Master Definitions Agreement) to terminate a Standstill (as defined in the Master Definitions Agreement)) as requested in writing by the holders of at least one quarter of the Principal Amount Outstanding of the relevant Sub-Class of Class A Bonds then outstanding, 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 STID 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 (as defined in the Master Definitions Agreement) 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*

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 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, 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 Fourth Schedule to the Bond Trust Deed (the “**Basic Terms Modifications**”) in respect of the holders of any particular Sub-Class of Bonds may be sanctioned only by an Extraordinary Resolution passed at a meeting of Bondholders of the relevant Sub-Class 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 Sub-Class, concur with the Issuer or any other relevant parties in making (i) any modification of these Conditions, the Bond Trust Deed 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 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 Sub-Class. Any such modification, consent, waiver or authorisation shall be binding on the Bondholders of that Sub-Class, 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 Sub-Class 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.

16 Bond Trustee Protections

(a) *Trustee considerations*

Subject to the terms of the STID and Condition 16(b) (*Exercise of rights by Bond Trustee*), in connection with the exercise, under these Conditions, the Bond Trust Deed 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 two or more Sub-Classes of Bonds of such Class, it shall consider the interests of the holders of the Sub-Class of 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 Sub-Classes 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, nor shall any Bondholders be entitled to claim from the Issuer 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*

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 or the Conditions 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 11 (*Events of Default*) and Condition 15(a) (*Decisions of the Majority Creditors*) only) been so requested in writing by the holders of at least 25 per cent. in nominal amount of the relevant Sub-Classes 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.

17 Notices

Notices to holders of Registered Bonds will be posted to them at their respective addresses in the Register and deemed to have been given on the date of posting. Other notices to Bondholders will be valid if published in a leading daily newspaper having general circulation in London (which is expected to be the Financial Times). The Issuer shall also ensure that all notices are duly published in a manner which complies with the rules and regulations of the London Stock Exchange and any other listing authority, stock exchange and/or quotation system on which the Bonds are for the time being listed. Any such notice (other than to holders of Registered Bonds as specified above) shall be deemed to have been given on the date of such publication or, if published more than once or on different dates, on the first date on which publication is made. Couponholders and Receiptholders will be deemed for all purposes to have notice of the contents of any notice given to the holders of Bearer Bonds in accordance with this Condition 17.

So long as any Bonds are represented by Global Bonds, notices in respect of those Bonds may be given by delivery of the relevant notice to Euroclear Bank S.A./N.V. as operator of the Euroclear System or Clearstream Banking, *société anonyme* or any other relevant clearing system as specified in the relevant Final Terms for

communication by them to entitled account holders in substitution for publication in a daily newspaper with general circulation in London. Such notices shall be deemed to have been received by the Bondholders on the day of delivery to such clearing systems.

18 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 and or any other person unless indemnified and/or secured to its satisfaction. The Bond Trustee or any of its affiliates (as defined in Condition 7 (*Indexation*)) are entitled to enter into business transactions with the Issuer, 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 (as defined in the Master Definitions Agreement).

19 European Economic and Monetary Union

(a) *Notice of redenomination*

The Issuer may, without the consent of the Bondholders, and on giving at least 30 days' prior notice to the Bondholders, the Bond Trustee and the Principal Paying Agent, designate a date (the "**Redenomination Date**"), being an Interest Payment Date under the Bonds falling on or after the date on which the United Kingdom becomes a Participating Member State.

(b) *Redenomination*

Notwithstanding the other provisions of these Conditions, with effect from the Redenomination Date:

- (i) the Bonds of each Sub-Class denominated in sterling (the "**Sterling Bonds**") shall be deemed to be redenominated into Euro in the denomination of Euro 0.01 with a principal amount for each Bond equal to the principal amount of that Bond in sterling, converted into Euro at the rate for conversion of such currency into Euro established by the Council of the European Union pursuant to the Treaty establishing the European Union, as amended, (including compliance with rules relating to rounding in accordance with European Community regulations), provided, however, that, if the Issuer determines, with the agreement of the Bond Trustee, that the then current market practice in respect of the redenomination into Euro 0.01 of internationally offered securities is different from that 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 London Stock Exchange and any stock exchange (if any) on which the Bonds are then listed and the Principal Paying Agent of such deemed amendments;

- (ii) if Bonds have been issued in definitive form:
 - (a) all Bonds denominated in sterling will become void with effect from the date (the “**Euro Exchange Date**”) on which the Issuer gives notice (the “**Euro Exchange Notice**”) to the Bondholders and the Bond Trustee that replacement Bonds denominated in Euro are available for exchange (provided that such Bonds are available) and no payments will be made in respect thereof;
 - (b) the payment obligations contained in all Bonds denominated in sterling will become void on the Euro Exchange Date but all other obligations of the Issuer thereunder (including the obligation to exchange such Bonds in accordance with this Condition 19) shall remain in full force and effect; and
 - (c) new Bonds denominated in Euro will be issued in exchange for Sterling Bonds in such manner as the Principal Paying Agent or the Registrar, as the case may be, may specify and as shall be notified to the Bondholders in the Euro Exchange Notice;
- (iii) all payments in respect of the Sterling Bonds (other than, unless the Redenomination Date is on or after such date as sterling ceases to be a sub-division of the Euro, payments of interest in respect of periods commencing before the Redenomination Date) will be made solely in Euro by cheque drawn on, or by credit or transfer to a Euro account (or any other account to which Euro may be credited or transferred) maintained by the payee with, a bank in the principal financial centre of any Participating Member State; and
- (iv) a Bond may only be presented for payment on a day which is a business day in the place of presentation.

(c) *Interest*

Following redenomination of the Bonds pursuant to this Condition 19:

- (i) where Sterling Bonds have been issued in definitive form, the amount of interest due in respect of the Sterling Bonds will be calculated by reference to the aggregate principal amount of the Sterling Bonds presented for payment by the relevant holder and the amount of such payment shall be rounded down to the nearest Euro 0.01; and
- (ii) the amount of interest payable in respect of each Sub-Class of Sterling Bonds for any Interest Period shall be calculated by applying the Interest Rate applicable to the Sub-Class of Bonds denominated in Euro ranking *pari passu* to the relevant Sub-Class.

20 Miscellaneous

(a) *Governing Law*

The Bond Trust Deed, STID, the Security Agreement, the Bonds, the Coupons, the Receipts, the Talons (if any) and the other Finance Documents are, and all matters arising from or in connection with such documents shall be governed by, and shall be construed in accordance with, English law.

(b) *Jurisdiction*

The courts of England are to have exclusive jurisdiction to settle any dispute that may arise out of or in connection with the Bonds, the Coupons, the Receipts, the Talons and the Finance Documents and accordingly any legal action or proceedings arising out of or in connection with the Bonds, the Coupons,

the Receipts, the Talons (if any) and/or the Finance Document may be brought in such courts. The Issuer has in each of the Finance Documents irrevocably submitted to the jurisdiction of such courts.

(c) *Third Party Rights*

No person shall have any right to enforce any term or condition of the Bonds or the Bond Trust Deed under the Contracts (Rights of Third Parties) Act 1999.

Forms of the Bonds

Form and Exchange – Bearer Bonds

Each Sub-Class of Bonds initially issued in bearer form will be issued either as a temporary global bond (the “**Temporary Global Bond**”), without Receipts, Coupons or Talons attached, or a permanent global bond (the “**Permanent Global Bond**”), without Receipts, Coupons or Talons attached, in each case as specified in the relevant Final Terms. Each Temporary Global Bond or, as the case may be, Permanent Global Bond (each a “**Global Bond**”) will be delivered on or prior to the issue date of the relevant Sub-Class of the Bonds to a depositary or a common depositary for Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system on or about the Issue Date of the relevant Sub-Class.

The relevant Final Terms will also specify whether United States Treasury Regulation §1.163-5(c)(2)(i)(C) (the “**TEFRA C Rules**”) or United States Treasury Regulation §1.163-5(c)(2)(i)(D) (the “**TEFRA D Rules**”) are applicable in relation to the Bonds.

Temporary Global Bond exchangeable for Permanent Global Bond

If the relevant Final Terms specify the form of Bonds as being represented by “Temporary Global Bond exchangeable for a Permanent Global Bond”, then the Bonds will initially be in the form of a Temporary Global Bond which will be exchangeable, in whole or in part, for interests in a Permanent Global Bond, without Receipts, Coupons or Talons attached, not earlier than 40 days after the Issue Date of the relevant Sub-Class of the Bonds upon certification as to non-U.S. beneficial ownership. No payments will be made under the Temporary Global Bond unless exchange for interests in the Permanent Global Bond is improperly withheld or refused. In addition, payments of interest in respect of the Bonds cannot be collected without such certification of non-U.S. beneficial ownership.

Whenever any interest in the Temporary Global Bond is to be exchanged for an interest in a Permanent Global Bond, the Issuer shall procure (in the case of first exchange) the prompt delivery (free of charge to the bearer) of such Permanent Global Bond, duly authenticated, to the bearer of the Temporary Global Bond or (in the case of any subsequent exchange) an increase in the principal amount of the Permanent Global Bond in accordance with its terms against:

- presentation and (in the case of final exchange) surrender of the Temporary Global Bond at the specified office of the Paying Agent; and
- receipt by the Paying Agent of a certificate or certificates of non-U.S. beneficial ownership issued by Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system,

within seven days of the bearer requesting such exchange.

The principal amount of the Permanent Global Bond shall be equal to the aggregate of the principal amounts specified in the certificates of non-U.S. beneficial ownership; provided, however, that in no circumstances shall the principal amount of the Permanent Global Bond exceed the aggregate initial principal amount of the Temporary Global Bond and any Temporary Global Bond representing a

fungible Sub-Class of Bonds with the Sub-Class of Bonds represented by the first Temporary Global Bond.

Temporary Global Bond exchangeable for Definitive Bonds

If the relevant Final Terms specifies the form of Bonds as being “Temporary Global Bond exchangeable for Definitive Bonds” and also specifies that the TEFRA C Rules are applicable or that neither the TEFRA C Rules nor the TEFRA D Rules are applicable, then the Bonds will initially be in the form of a Temporary Global Bond which will be exchangeable, in whole but not in part, for Definitive Bonds not earlier than 40 days after the Issue Date of the relevant Sub-Class of the Bonds.

If the relevant Final Terms specifies the form of Bonds as being “Temporary Global Bond exchangeable for Definitive Bonds” and also specifies that the TEFRA D Rules are applicable, then the Bonds will initially be in the form of a Temporary Global Bond which will be exchangeable, in whole or in part, for Definitive Bonds not earlier than 40 days after the Issue Date of the relevant Sub-Class of the Bonds upon certification as to non-U.S. beneficial ownership. Interest payments in respect of the Bonds cannot be collected without such certification of non-U.S. beneficial ownership.

Whenever the Temporary Global Bond is to be exchanged for Definitive Bonds, the Issuer shall procure the prompt delivery (free of charge to the bearer) of such Definitive Bonds, duly authenticated and with Receipts, Coupons and Talons attached (if so specified in the relevant Final Terms), in an aggregate principal amount equal to the principal amount of the Temporary Global Bond so exchanged to the bearer of the Temporary Global Bond against the presentation (and in the case of final exchange, surrender) of the Temporary Global Bond at the specified office of the Paying Agent within 30 days of the bearer requesting such exchange but not earlier than 40 days after the issue of such Bonds.

Permanent Global Bond exchangeable for Definitive Bonds

If the relevant Final Terms specifies the form of Bonds as being “Permanent Global Bond exchangeable for Definitive Bonds”, then the Bonds will initially be in the form of a Permanent Global Bond which will be exchangeable in whole, but not in part, for Bonds in definitive form (the “**Definitive Bonds**”) if Euroclear or Clearstream, Luxembourg or any other relevant clearing system is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention permanently to cease business.

Whenever the Permanent Global Bond is to be exchanged for Definitive Bonds, the Issuer shall procure the prompt delivery (free of charge to the bearer) of such Definitive Bonds, duly authenticated and with Receipts, Coupons and Talons attached (if so specified in the relevant Final Terms), in an aggregate principal amount equal to the principal amount of the Permanent Global Bond to the bearer of the Permanent Global Bond against the surrender of the Permanent Global Bond at the specified office of the Paying Agent within 30 days of the bearer requesting such exchange but not earlier than 40 days after the Issue Date of such Bonds.

In the event that a Global Bond is exchanged for Definitive Bonds, such Definitive Bonds shall be issued in Specified Denominations(s) only.

Conditions applicable to the Bonds

The Conditions applicable to any Definitive Bond will be endorsed on that Bond and will consist of the Conditions set out under “Terms and Conditions of the Bonds” above and the provisions of the relevant Final Terms which supplement, amend, vary and/or replace those Conditions.

The Conditions applicable to any Global Bond will differ from those Conditions which would apply to the Definitive Bond to the extent described under “Provisions Relating to the Global Bonds”.

Legend concerning United States persons

Global Bonds and Definitive Bonds having a maturity of more than 365 days and any Receipts, Coupons and Talons appertaining thereto will bear a legend to the following effect:

“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 in such legend provide that a United States person who holds a Bond, Receipt, Coupon or Talon will generally not be allowed to deduct any loss realised on the sale, exchange or redemption of such Bond, Receipt, Coupon or Talon and any gain (which might otherwise be characterised as capital gain) recognised on such sale, exchange or redemption will be treated as ordinary income.

Form and Exchange – Global Bond Certificates

The following description is in respect of registered bonds issued under the Programme that are offered outside the United States in accordance with Regulation 5 of the Securities Act.

Global Bond Certificates

Registered Bonds held in Euroclear and/or Clearstream, Luxembourg and/or other clearing system will be represented by a global bond certificate (each a “**Global Bond Certificate**”) which will be registered in the name of a nominee for, and deposited with, a depository for Euroclear and/or Clearstream, Luxembourg and/or such other relevant clearing system on or about the Issue Date of the relevant Sub-Class.

Exchange

The Global Bond Certificate will become exchangeable in whole, but not in part, for individual bond certificates (each a “**Individual Bond Certificate**”) if (a) Euroclear or Clearstream, Luxembourg and/or other relevant clearing system is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention permanently to cease business, (b) any of the circumstances described in Condition 11(a) (*Events of Default*) occurs, (c) at any time at the request of the registered Holder if so specified in the Final Terms or (d) the Issuer certifies to the Bond Trustee that it has or will, on the next payment date for interest or principal, become subject to adverse tax consequences which would not be suffered if the Bonds are not represented by a Global Bond Certificate.

Whenever the Global Bond Certificate is to be exchanged for Individual Bond Certificate, such will be issued in an aggregate principal amount equal to the principal amount of the Global Bond Certificate within seven business days of the delivery, by or on behalf of the registered Holder of the Global Bond Certificate to the Registrar or the Transfer Agents (as the case may be) of such information as is required to complete and deliver such Individual Bond Certificate (including the names and addresses of the persons in whose names the Individual Bond Certificate are to be registered and the principal amount of each such person’s holding) against the surrender of the Global Bond Certificate at the specified office of the Registrar or the Transfer Agent (as the case may be). Such exchange will be effected in accordance with the provisions of the Agency Agreement and the regulations concerning the transfer and registration of Bonds scheduled thereto and, in particular, shall be effected without charge to any holder, but against such indemnity as the Registrar or the Transfer Agents (as the case may be) may require in respect of any tax or other duty of whatsoever nature which may be levied or imposed in connection with such exchange.

Rights Against Issuer

Under the Bond Trust Deed, persons shown in the records of Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system as being entitled to interests in the Bonds will (subject to the terms of the Bond Trust Deed and the STID) acquire directly against the Issuer all those rights to which they would have been entitled if, immediately before the Global Bond or Global Bond Certificate became void, they had been the registered Holders of Bonds in an aggregate principal amount equal to the principal amount of Bonds they were shown as holding in the records of Euroclear, Clearstream, Luxembourg or any other relevant clearing system (as the case may be).

Provisions Relating to the Bonds while in Global Form

Clearing System Accountholders

References in the Conditions of the Bonds to “**Bondholder**” are references to the bearer of the relevant Global Bond or the person shown in the records of the relevant clearing system as the holder of the Global Bond Certificate.

Each of the persons shown in the records of Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system, as the case may be, as being entitled to an interest in a Global Bond or a Global Bond Certificate (each an “**Accountholder**”) must look solely to Euroclear and/or Clearstream, Luxembourg and/or such other relevant clearing system (as the case may be) for such Accountholder’s share of each payment made by the Issuer to such Accountholder and in relation to all other rights arising under the Global Bond or Global Bond Certificate. The extent to which, and the manner in which, Accountholders may exercise any rights arising under a Global Bond or Global Bond Certificate will be determined by the respective rules and procedures of Euroclear and Clearstream, Luxembourg and any other relevant clearing system (as the case may be) from time to time. For so long as the relevant Bonds are represented by a Global Bond or Global Bond Certificate, Accountholders shall have no claim directly against the Issuer in respect of payments due under the Bonds and such obligations of the Issuer will be discharged by payment to the bearer of the Global Bond or the registered holder of the Global Bond Certificate, as the case may be.

Amendment to Conditions

Global Bonds will contain provisions that apply to the Bonds which they represent, some of which modify the effect of the Conditions of the Bonds as set out in this Prospectus. The following is a summary of certain of those provisions:

*Meetings: The holder of a Global Bond or Global Bond Certificate shall be treated as being two persons for the purposes of any quorum requirements of a meeting of Bondholders and, at any such meeting, the holder of a Global Bond or Global Bond Certificate shall be treated as having one vote in respect of each minimum denomination of Bonds for which such Global Bond or Global Bond Certificate may be exchanged.

*Cancellation: Cancellation of any Bond represented by a Global Bond or Global Bond Certificate that is required by the Conditions to be cancelled (other than upon its redemption) will be effected by reduction in the principal amount of the relevant Global Bond or Global Bond Certificate.

*Notices: So long as any Bonds are represented by a Global Bond or Global Bond Certificate and such Global Bond or Global Bond Certificate is held on behalf of Euroclear, Clearstream, Luxembourg or any other relevant Clearing System, notices to the Bondholders may be given, subject always to listing requirements, by delivery of the relevant notice to Euroclear, Clearstream, Luxembourg or any other relevant Clearing System for communication by it to entitled Accountholders in substitution for publication as provided in the Conditions.

PRO FORMA FINAL TERMS

Final Terms dated [-]

SOUTHERN WATER SERVICES (FINANCE) LIMITED

Issue of [Sub-Class [-]] [Aggregate Nominal Amount of Sub-Class]

[Title of Bonds]

under the £6,000,000,000 Guaranteed Bond Programme

PART A – CONTRACTUAL TERMS

Terms used herein shall be deemed to be defined as such for the purposes of the conditions set forth in the Prospectus dated [-] 2013 [and the supplemental Prospectus dated [-] which [together] constitute[s] a base prospectus for the purposes of Directive 2003/71/EC (and amendments thereto, including Directive 2010/73/EU) (the “**Prospectus Directive**”). This document constitutes the Final Terms of the Bonds described herein for the purposes of Article 5.4 of the Prospectus Directive and must be read in conjunction with such Prospectus [as so supplemented]. Full information on the Issuer, the Guarantor(s) and the offer of the Bonds is only available on the basis of the combination of these Final Terms and the Prospectus [as so supplemented]. [The Prospectus [and the supplemental Prospectus] [is] [are] available for viewing at [-].]

[Terms used herein shall be deemed to be defined as such for the purposes of the Conditions (the “**Conditions**”) set forth in the Prospectus dated [-] and incorporated by reference into Prospectus [current date] [and the supplemental Prospectus dated [-]. This document constitutes the Final Terms of the Bonds described herein for the purposes of [Article 5.4 of Directive 2003/71/EC (and amendments thereto, including Directive 2010/73/EU) (the “**Prospectus Directive**”)] and must be read in conjunction with the Prospectus dated [-] 2013 [and the supplemental Prospectus dated [-], which [together] constitute[s] a base prospectus for the purposes of the Prospectus Directive. Full information on the Issuer and the offer of the Bonds is only available on the basis of the combination of these Final Terms and the base prospectus dated [-] 2013 [and the supplemental Prospectuses dated [-] and [-]. [The Prospectus [and the supplemental Prospectuses] are available for viewing at [-].]

1	(i)	Issuer:	Southern Water Services (Finance) Limited
	(ii)	Guarantors:	Southern Water Services Limited, SWS Holdings Limited and SWS Group Holdings Limited
2	(iii)	Series Number:	[-]
	(iv)	Sub-Class Number:	[-]
3		Relevant Currency or Currencies:	[-]
4		Aggregate Nominal Amount of Bonds admitted to trading:	
	(i)	Series:	[-]
	(ii)	Tranche:	[-]
	(iii)	Sub-Class:	[-]
5	(i)	Issue Price:	[-] per cent. of the Aggregate Nominal Amount [plus accrued interest from [-]]
	(ii)	Offer Price (if different from Issue Price):	[-]

6	(i) Specified Denominations:	[-] [€100,000 and integral multiples of [€1,000] in excess thereof up to and including [€199,000]. No notes in definitive form will be issued with a denomination above [€199,000].]
	(ii) Calculation Amount:	[-]
7	(i) Issue Date:	[-]
	(ii) Interest Commencement Date (if different from the Issue Date):	[-]
8	Maturity Date:	[- [-]/Interest Payment Date falling in or nearest to [-]]
9	Instalment Date:	[Not Applicable/[-]]
10	Interest Basis:	[[-] per cent. Fixed Rate] [[specify reference rate] +/- [-] per cent. Floating Rate] [Zero Coupon] [Index Linked Interest]
11	Redemption/Payment Basis:	[Redemption at par] [Index Linked Redemption] [Partly Paid] [Instalment] [Dual Currency]
12	Change of Interest or Redemption/Payment Basis:	[-]
13	Call Options:	Issuer Call Option
14	(i) Status and Ranking:	The Class A Bonds rank <i>pari passu</i> among each other in terms of interest and principal payments and rank in priority to the Class B Bonds. The Class B Bonds rank <i>pari passu</i> among each other and are subordinated in terms of interest and principal payments to the Class A Bonds.
	(ii) Status of the Guarantees:	Senior
	[(iii)] [Date [Board] approval for issuance of Bonds and Guarantee obtained:	[-] and [-] respectively]]

15 Method of distribution: [Syndicated/Non-syndicated]

PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE

16 Fixed Rate Bond Provisions: [Applicable/Not Applicable]

(i) Interest Rate: [-] per cent. per annum [payable [annually/semi-annually/quarterly/monthly] in arrear]

	(ii)	Interest Determination Date:	[-] in each year
	(iii)	Interest Payment Date(s):	[-] in each year [adjusted in accordance with /not adjusted]
	(iv)	First Interest Payment Date	[-]
	(v)	Fixed Coupon Amount[(s)]:	[-] per [-] in Calculation Amount
	(vi)	Day Count Fraction:	[Actual/Actual ICMA] [Actual/Actual or Actual/Actual-ISDA] [Actual/365 Fixed] [Actual/360] [30/360 or 360/360 or bond basis] [30E/360 or Eurobond Basis] [30E/360 (ISDA)]
	(vii)	Other terms relating to the method of calculating interest for Fixed Rate Bonds:	[-]/Not Applicable
	(viii)	Reference Gilt:	[-]
17		Floating Rate Bond Provisions:	[Applicable/Not Applicable]
	(i)	Interest Period(s)/Specified Interest Payment Dates:	[-]
	(ii)	First Interest Payment Date:	[-]
	(iii)	Business Day Convention:	[Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention]
	(iv)	Business Centre:	[-]
	(v)	Manner in which the Rate(s) of Interest is/are to be determined:	[Screen Rate Determination/ISDA Determination]
	(vi)	Party responsible for calculating the Rate(s) of Interest, Interest Amount(s) and Redemption Amount (if not the Agent Bank):	[Not Applicable/Calculation Agent]
	(vii)	Screen Rate Determination:	
		– Relevant Rate:	[EURIBOR/LIBOR]
		– Interest Determination Date(s):	[-]
		– Page:	[-]
		– Relevant Time:	[-]
	(viii)	ISDA Determination:	
		– Floating Rate Option:	[-]
		– Designated Maturity:	[-]
		– Specified Duration:	[-]
		– Reset Date:	[-]
	(ix)	Margin(s):	[+/-][[-] per cent. per annum
		[Step-Up Fees:]	[-]
		[Step-Up Date:]	[-]

	(x)	Minimum Rate of Interest:	[Not Applicable]
	(xi)	Maximum Rate of Interest:	[Not Applicable]
	(xii)	Day Count Fraction:	[Actual/Actual ICMA] [Actual/Actual or Actual/Actual – ISDA] [Actual/365 Fixed] [Actual/360] [30/360 or 360/360 or bond basis] [30E/360 or Eurobond Basis][30E/360 (ISDA)]
	(xiii)	Additional Business Centre(s):	[-]
	(xiv)	Fall back provisions, rounding provisions, denominator and any other terms relating to the method of calculating interest on Floating Rate Bonds, if different from those set out in the Conditions:	[-]
	(xv)	Relevant Financial Centre:	[-]
	(xvi)	Representative Amount:	[-]
	(xvii)	Reference Banks:	[-]
18		Zero Coupon Bond Provisions:	[Applicable/Not Applicable]
	(i)	Accrual Yield:	[-] per cent. per annum
	(ii)	Reference Price:	[-]
	(iii)	Any other formula/basis of determining amount payable:	[-]
	(iv)	Day Count Fraction in relation to Early Redemption Amounts and late payment:	[Condition 8(e)]
19		Indexed Bond Provisions:	[Applicable/Not Applicable]
	(i)	Index/Formula:	[UK Retail Price Index]
	(ii)	Interest Rate:	[-]
	(iii)	Party responsible for calculating the Rate(s) of Interest, Interest Amount and Redemption Amount(s) (if not the Agent Bank):	[Not Applicable/Calculation Agent]
	(iv)	Provisions for determining Coupon where calculated by reference to Index and/or Formulae:	[Conditions 7(a) – (e) apply]
	(v)	Determination Date:	
	(vi)	Provisions for determining Coupon where calculation by reference to Index and/or Formula is impossible or impracticable or otherwise disrupted:	Applicable – Condition 7(c) and 7(e)
	(vii)	Interest Payment Dates:	[-]

(viii)	First Interest Payment Date:	[-]
(ix)	Business Day Convention:	[Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention]
(x)	Business Centre:	[-]
(xi)	Minimum Indexation Factor:	[Not Applicable/[-]]
(xii)	Maximum Indexation Factor:	[Not Applicable/[-]]
(xiii)	Limited Indexation Month(s):	[-]
(xiv)	Reference Gilt:	[-]
(xv)	Day Count Fraction:	[Actual/Actual ICMA] [Actual/Actual or Actual/Actual-ISDA] [Actual/365 Fixed] [Actual/360] [30/360 or 360/360 or bond basis] [30E/360 or Eurobond Basis][30E/360 (ISDA)]
20	Dual Currency Bond Provisions	[Applicable/Not Applicable]
(i)	Rate of Exchange/method of calculating Rate of Exchange:	[-]
(ii)	Party responsible for calculating the Rate(s) of Interest, Interest Amount and Redemption Amount(s) (if not the Agent Bank):	[-]
(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		
21	Issuer Call Option:	Applicable in accordance with Condition 8(b)/Not Applicable
(i)	Optional Redemption Date(s):	Any Interest Payment Date [In the case of Floating Rate Bonds falling on or after [-] and at a premium of [-], if any]
(ii)	Optional Redemption Amount(s) and method, if any, of calculation of such amount(s):	[-]
(iii)	If redeemable in part:	
	Minimum Redemption Amount:	[Not Applicable] [[-] per Calculation Amount]
	Maximum Redemption Amount:	[Not Applicable] [[-] per Calculation Amount]
(iv)	Notice period (if other than as set out in the Conditions):	[Not Applicable]
22	Final Redemption Amount:	[Principal Amount Outstanding plus accrued but unpaid

interest]

GENERAL PROVISIONS APPLICABLE TO THE BONDS

23	Form of Bonds	[Bearer/Registered]
	(i) If issued in Bearer form:	[Temporary Global Bond exchangeable for a Permanent Global Bond which is exchangeable for Definitive Bonds on [-] days' notice/at any time/in the limited circumstances specified in the Permanent Global Bond/for tax reasons.]
		[Temporary Global Bond exchangeable for Definitive Bonds on [-] days' notice.]
		[Permanent Global Bond exchangeable for Definitive Bonds in the limited circumstances specified in the Permanent Global Bond.]
	(ii) If Registered Bonds:	[Global Bond Certificate exchangeable for Individual Bond Certificates]
24	Relevant Financial Centre(s) or other special provisions relating to Payment Dates:	[Not Applicable/[-].]
25	Talons for future Coupons or Receipts to be attached to Definitive Bonds (and dates on which such Talons mature):	[Yes/No.]
26	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 (if any) of failure to pay, including any right of the Issuer to forfeit the Bonds and interest due on late payment:	[[-]/Not Applicable]
27	Details relating to Instalment Bonds:	[[-]/Not Applicable]
	(i) Instalment Date:	[-]
	(ii) Instalment Amount:	[-]
28	Redenomination, renominatisation and reconventioning provisions:	[Not Applicable/The provisions [in Condition 19/annexed to this Final Terms] apply]
29	Consolidation provisions:	[Not Applicable/The provisions annexed to this Final Terms] apply]
30	TEFRA rules:	[TEFRA C/TEFRA D/Not Applicable]

ISSUER/SWS LOAN TERMS

31	Interest rate on relevant Term Advance/Index Linked Advances:	[-]
32	Term of relevant Term Advance/Index Linked Advances:	[-]
33	Other relevant provisions:	[-]

PURPOSE OF FINAL TERMS

These Final Terms comprise the final terms required for issue and admission to trading on the London Stock Exchange's Regulated Market the issue of Bonds described herein pursuant to the listing of the Programme for the issuance of Guaranteed Bonds financing Southern Water Services Limited.

THIRD PARTY INFORMATION

[Relevant third party information] has been extracted from [[-]]. [Each of the] [The] Issuer [and the Guarantor] confirms that such information has been accurately reproduced and that, so far as it is aware, and is able to ascertain from information published by [-], no facts have been omitted which would render the reproduced information inaccurate or misleading.]

Signed on behalf of the Issuer:

By: _____
Duly authorised

Signed on behalf of Southern Water Services Limited:

By: _____
Duly authorised

Signed on behalf of SWS Holdings Limited:

By: _____
Duly authorised

Signed on behalf of SWS Group Holdings Limited:

By: _____
Duly authorised

PART B – OTHER INFORMATION

1 Listing

- (i) Listing: [London]
- (ii) Admission to trading: [Application has been made for the Bonds to be admitted to trading on [-] with effect from [-].]
- (iii) Estimate of total expenses related to admission to trading: [-]

2 Ratings

- Ratings: The Bonds to be issued have been rated:
- [S&P: [-]]
- [Moody's: [-]]
- [Fitch: [-]]

3 [Notification

The UK Listing Authority [has been requested to provide/has provided – include first alternative for an issue which is contemporaneous with the establishment or update of the Programme and the second alternative for subsequent issues] the [include names of competent authorities of host Member States] with a certificate of approval attesting that the Prospectus has been drawn up in accordance with the Prospectus Directive.]

4 [Interests of Natural and Legal Persons involved in the [Issue/Offer]]

[-]

5 Reasons for the offer, estimated net proceeds and total expenses

- (i) [Reasons for the offer: [-]
- (ii) [Estimated net proceeds: [-]
- (iii) [Estimated total expenses: [-]

6 [Fixed Rate Bonds only – YIELD

- Indication of yield: [-]
- The yield is calculated at the Issue Date on the basis of the Issue Price. It is not an indication of future yield.]

7 [Floating Rate Bonds Only – HISTORIC INTEREST RATES

Details of historic [LIBOR/EURIBOR] rates can be obtained from [Telerate/Reuters].]

8 [Index-Linked or other variable-linked Bonds only – PERFORMANCE OF INDEX/FORMULA/OTHER VARIABLE AND OTHER INFORMATION CONCERNING THE UNDERLYING

- (i) Name of underlying index: U.K. Retail Price Index (RPI) (all items) published by the Office of National Statistics

(ii) Information about the Index, its volatility and past and future performance can be obtained from: More information on RPI including past and current performance and its volatility and fall back provisions in the event of a disruption in the publication of RPI, can be found at [www.statistics.gov.uk]/[name of any replacement page]]

9 [Dual currency Bonds only – PERFORMANCE OF RATE[S] OF EXCHANGE

[–]

10 Operational information

ISIN Code: [–]

Common Code: [–]

Any clearing system(s) other than Euroclear Bank S.A./N.V. and Clearstream Banking Société Anonyme and the relevant identification number(s): [[–]/Not Applicable]

Delivery: Delivery [against/free of] payment

Names and addresses of additional Paying Agent(s) (if any): [–]

CHAPTER 9
USE OF PROCEEDS

The net proceeds from each issue of Bonds under the Programme will be on-lent to SWS under the terms of further Issuer/SWS Loan Agreements to be applied by SWS for its general corporate purposes or used to repay or service the Issuer's Financial Indebtedness.

CHAPTER 10

DESCRIPTION OF HEDGE COUNTERPARTIES

ABBEY NATIONAL TREASURY SERVICES PLC

Abbey National Treasury Services plc (“**ANTS**”) is a public limited liability company incorporated and registered in England and Wales under the Companies Act 1985. ANTS was incorporated on 24 January 1989 with registered number 2338548, is regulated by the Financial Services Authority and is authorised with permission to accept deposits under the Financial Services and Markets Act 2000.

ANTS is a wholly-owned subsidiary of Santander UK plc (“**Santander UK**”) (formerly Abbey National plc) which has given a full and unconditional guarantee in respect of the liabilities of ANTS incurred prior to 30 June 2015. Santander UK and its subsidiaries are part of Banco Santander, S.A. (“**Banco Santander**”), which is the ultimate parent company.

As at 1 February 2013, Santander UK has a long-term credit rating of “A” by Standard & Poor’s Credit Market Services Europe Limited (“**S&P**”), “A2” by Moody’s Investors Service Ltd (“**Moody’s**”) and “A” by Fitch Ratings Ltd (“**Fitch**”) and a short-term credit rating of “A-1” by S&P, “P-1” by Moody’s and “F1” by Fitch.

We refer you to the description of Santander UK within the section entitled “Santander UK plc and the Santander UK Group” of the prospectus.

ANTS’ registered office is 2 Triton Square, Regent’s Place, London, NW1 3AN. The telephone number of ANTS’ registered office is 0870 607 6000.

The business divisions of ANTS consist of:

- Corporate Banking;
- Markets; and
- Corporate Centre.
- Corporate Banking

Corporate Banking offers a wide range of products and financial services to customers through a network of 35 regional CBCs and through telephony and e-commerce channels. It principally serves companies with annual turnover of more than £250,000 including SMEs, and larger businesses with annual turnover of less than £150m. Larger multinational corporate customers are also included in Corporate Banking, through the Large Corporates business. Corporate Banking products and services include loans, bank accounts, deposits, treasury services, invoice discounting, cash transmission and asset finance. The Large Corporates business offers specialist treasury services in fixed income and foreign exchange, lending, transactional banking services, capital markets and money market.

Markets

Markets division/business offers risk management and value added services to financial institutions, as well as other Santander UK divisions. Its main product areas are fixed income and foreign exchange, equity, capital markets and institutional sales.

Corporate Centre

Corporate Centre, formally known as Group Infrastructure, includes Asset and Liability Management (‘ALM’) and the non-core corporate and legacy portfolios. ALM is responsible for managing capital and funding, balance sheet composition, structural market risk and strategic liquidity risk for the rest of the group. The non-core corporate and legacy portfolios include aviation, shipping, infrastructure, commercial mortgages, social housing loans and structured credit assets, all of which are being run-down and/or managed for value.

Bank of America, N.A.

Bank of America, N.A. (the “**Bank**”) is a national banking association organized under the laws of the United States, with its principal executive offices located in Charlotte, North Carolina. The Bank is a wholly-owned indirect subsidiary of Bank of America Corporation (the “**Corporation**”) and is engaged in a general consumer banking, commercial banking and trust business, offering a wide range of commercial, corporate, international, financial market, retail and fiduciary banking services. As of September 30, 2012, the Bank had consolidated assets of \$1.45 trillion, consolidated deposits of \$1.08 trillion and stockholder’s equity of \$180.43 billion based on regulatory accounting principles.

The Corporation is a bank holding company and a financial holding company, with its principal executive offices located in Charlotte, North Carolina. Additional information regarding the Corporation is set forth in its Annual Report on Form 10-K for the fiscal year ended December 31, 2011, together with its subsequent periodic and current reports filed with the Securities and Exchange Commission (the “**SEC**”).

Filings can be inspected and copied at the public reference facilities maintained by the SEC at 100 F Street, N.E., Washington, D.C. 20549, United States, at prescribed rates. In addition, the SEC maintains a website at <http://www.sec.gov>, which contains reports, proxy statements and other information regarding registrants that file such information electronically with the SEC.

The information concerning the Corporation and the Bank is furnished solely to provide limited introductory information and does not purport to be comprehensive. Such information is qualified in its entirety by the detailed information appearing in the referenced documents and financial statements referenced therein.

The Bank will provide copies of the most recent Bank of America Corporation Annual Report on Form 10-K, any subsequent reports on Form 10-Q, and any required reports on Form 8-K (in each case as filed with the SEC pursuant to the Exchange Act), and the publicly available portions of the most recent quarterly Call Report of the Bank delivered to the Comptroller of the Currency, without charge, to each person to whom this document is delivered, on the written request of such person. Written requests should be directed to:

Bank of America Corporate Communications
100 North Tryon Street, 18th Floor
Charlotte, North Carolina 28255
Attention: Corporate Communication

This information shall not create any implication that there has been no change in the affairs of the Corporation or the Bank since the date of the most recent filings referenced herein, or that the information contained or referred to in this disclosure is correct as of any time subsequent to the referenced date.

BARCLAYS BANK PLC

Barclays Bank PLC is a public limited company registered in England and Wales under number 1026167. The liability of the members of Barclays Bank PLC is limited. It has its registered head office at 1 Churchill Place, London, E14 5HP, United Kingdom (telephone number +44 (0)20 7116 1000). Barclays Bank PLC was incorporated on 7 August 1925 under the Colonial Bank Act 1925 and on 4 October 1971 was registered as a company limited by shares under the Companies Acts 1948 to 1967. Pursuant to The Barclays Bank Act 1984, on 1 January 1985, Barclays Bank was re-registered as a public limited company and its name was changed from “Barclays Bank International Limited” to “Barclays Bank PLC”.

Barclays Bank PLC and its subsidiary undertakings (taken together, the “**Barclays Group**”) is a major global financial services provider engaged in retail and commercial banking, credit cards, investment banking, wealth management and investment management services. The whole of the issued ordinary share capital of Barclays Bank PLC is beneficially owned by Barclays PLC, which is the ultimate holding company of the Barclays Group.

The short term unsecured obligations of Barclays Bank PLC are rated A-1 by Standard & Poor's Credit Market Services Europe Limited, P-1 by Moody's Investors Service Ltd. And F1 by Fitch Ratings Limited and the long-term obligations of Barclays Bank PLC are rated A+ by Standard & Poor's Credit Market Services Europe Limited, A2 by Moody's Investors Service Ltd. And A by Fitch Ratings Limited.

Based on the Barclays Group's unaudited financial information for the year ended 31 December 2012, the Barclays Group had total assets of £1,490,747 million (2011: £1,563,402 million), total net loans and advances¹ of £466,627 million (2011: £478,726 million), total deposits² of £462,806 million (2011: £457,161 million), and total shareholders' equity of £62,894 million (2011: £65,170 million) (including non-controlling interests of £2,856 million (2011: £3,092 million)). The profit before tax from continuing operations of the Barclays Group for the year ended 31 December 2012 was £99 million (2011: £5,974 million) after credit impairment charges and other provisions of £3,596 million (2011: £3,802 million). The financial information in this paragraph is extracted from the unaudited consolidated financial statements of Barclays Bank PLC for the year ended 31 December 2012.

CITIBANK, N.A., LONDON BRANCH

Citibank, N.A. ("**Citibank**") was originally organised on 16 June 1812, and now is a national banking association organised under the National Bank Act of 1864 of the United States. Citibank is an indirect wholly owned subsidiary of Citigroup Inc; ("**Citigroup**"), a Delaware holding company. As of 31 December 2012, the total assets of Citibank and its consolidated subsidiaries represented approximately 70.43 per cent. of the total assets of Citigroup and its consolidated subsidiaries.

Citibank is a commercial bank that, along with its subsidiaries and affiliates, offers a wide range of banking and trust services to its customers throughout the United States and the world.

Citibank, N.A., London Branch was registered in the United Kingdom as a foreign company in July 1920. The principal offices of the London Branch are located at Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB, England. Citibank is primarily regulated by The Financial Services Authority as a fully authorised commercial banking institution offering a wide range of corporate banking products conducted from its UK office.

Citibank submits quarterly to the Comptroller, Call Reports. The Call Reports are on file with and publicly available at the Comptroller's offices at 250 E Street, S.W., Washington, D.C. 20219 and are also available on the website of the U.S. Federal Deposit Insurance Corporation of the United States (<http://www.fdic.gov>). Each Call Report consists of a Balance Sheet, Income Statement, Changes in Equity Capital and other supporting schedules at the end of and for the period to which the report relates. The Call Reports are prepared in accordance with the regulatory instructions issued by the U.S. Federal Financial Institutions Examination Council in the United States. While the Call Reports are supervisory and regulatory documents, not primarily accounting documents, and do not provide a complete range of financial disclosure about Citibank, the reports nevertheless provide further information concerning the financial condition and results of operations of Citibank. Citibank's Call Report as of the close of business on 30 September 2011 and any subsequent Call Reports filed by Citibank with the Comptroller are available upon request, without charge, from Citi Document Services, by calling toll free at (877) 936 2737 (outside the United States at (718) 831 8413), by emailing a request to docservice@citi.com or by writing to Citi Document Services, 4224 Ridge Lea Road, Amherst, New York, 14226.

The obligations of Citibank, N.A., London Branch under the Hedging Agreement will not be guaranteed by Citigroup or by any other affiliate.

¹ Total net loans and advances include balances relating to both bank and customer accounts.

² Total deposits include deposits from bank and customer accounts.

COMMERZBANK AKTIENGESELLSCHAFT

Commerzbank was founded in Hamburg as “Commerz- und Disconto-Bank” in 1870. Following temporary decentralization, Commerzbank was re-established on July 1, 1958 after a re-merger of the successor institutions created as part of the post-war breakup in 1952. Commerzbank’s registered office is Frankfurt am Main and its head office is at Kaiserstrasse 16 (Kaiserplatz), 60311 Frankfurt am Main, Germany. It is entered in the commercial register of the Local Court of Frankfurt am Main under the number HRB 32000. The Bank was established under German law for an indefinite period.

In accordance with Article 2 of the Articles of Association, Commerzbank’s corporate purpose is to engage in banking transactions and to offer all types of financial services and other related services and transactions, including acquiring, holding and disposing of interests in other entities. Commerzbank may realize its corporate purpose itself, through affiliated companies and equity participations or through the conclusion of affiliation and cooperation agreements with third parties. It is entitled to have recourse to all transactions and measures which are suitable for promoting its corporate purpose, in particular the establishment of branches in Germany and abroad and the acquisition, management and disposal of interests in other enterprises.

DEUTSCHE BANK AKTIENGESELLSCHAFT

Deutsche Bank Aktiengesellschaft ("**Deutsche Bank**" or the "**Bank**") originated from the reunification of Norddeutsche Bank Aktiengesellschaft, Hamburg, Rheinisch-Westfälische Bank Aktiengesellschaft, Duesseldorf and Süddeutsche Bank Aktiengesellschaft, Munich; pursuant to the Law on the Regional Scope of Credit Institutions, these had been disincorporated in 1952 from Deutsche Bank which was founded in 1870. The merger and the name were entered in the Commercial Register of the District Court Frankfurt am Main on 2 May 1957. Deutsche Bank is a banking institution and a stock corporation incorporated under the laws of Germany under registration number HRB 30 000. The Bank has its registered office in Frankfurt am Main, Germany. It maintains its head office at Theodor-Heuss-Allee 70, 60486 Frankfurt am Main and branch offices in Germany and abroad including in London, New York, Sydney, Tokyo and an Asia-Pacific Head Office in Singapore which serve as hubs for its operations in the respective regions.

The Bank is the parent company of a group consisting of banks, capital market companies, fund management companies, a real estate finance company, instalment financing companies, research and consultancy companies and other domestic and foreign companies (the "Deutsche Bank Group"). The Bank offers a wide variety of investment, financial and related products and services to private individuals, corporate entities and institutional clients around the world.

“**Deutsche Bank AG London**” is the London branch of Deutsche Bank AG. On 12 January 1973, Deutsche Bank AG filed in the United Kingdom the documents required pursuant to section 407 of the Companies Act 1948 to establish a place of business within Great Britain. On 14 January 1993, Deutsche Bank registered under Schedule 21A to the Companies Act 1985 as having established a branch (Registration No. BR000005) in England and Wales. Deutsche Bank AG London is an authorized person for the purposes of section 19 of the Financial Services and Markets Act 2000.

As of 31 December 2011, Deutsche Bank’s issued share capital amounted to Euro 2,379,519,078.40 consisting of 929,499,640 ordinary shares without par value. The shares are fully paid up and in registered form. The shares are listed for trading and official quotation on all the German Stock Exchanges. They are also listed on the New York Stock Exchange.

Pursuant to Regulation (EC) No 1606/2002 and accompanying amendment to the HGB, the consolidated financial statements for the years ended 31 December 2011 and 2010 were prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and endorsed by the European Union. As of 31 December 2011, Deutsche Bank Group had total assets of EUR 2,164 billion, total liabilities of EUR 2,109 billion and total equity of EUR 54.7 billion on the basis of IFRS.

Deutsche Bank's long-term senior debt has been assigned a rating of "A+" (outlook negative) by Standard & Poor's, "Aa3" (outlook under review for downgrade) by Moody's Investors Services and "A+" (outlook negative) by Fitch Ratings.

HSBC BANK PLC

HSBC Bank plc and its subsidiaries form a UK-based group providing a comprehensive range of banking and related financial services.

HSBC Bank plc (formerly Midland Bank plc) was formed in England in 1836 and subsequently incorporated as a limited company in 1880. In 1923, the company adopted the name Midland Bank Limited which it held until 1982 when it re-registered and changed its name to Midland Bank plc.

During the year ended 31 December, 1992, Midland Bank plc became a wholly owned subsidiary undertaking of HSBC Holdings plc, whose Group Head Office is at 8 Canada Square, London E14 5HQ. HSBC Bank plc adopted its current name, changing from Midland Bank plc, in the year ended 31 December, 1999.

The HSBC Group is one of the largest banking and financial services organisations in the world, with over 6,900 offices in 80 countries and territories in six geographical regions: Europe; Hong Kong; Rest of Asia-Pacific; Middle East and North Africa; North America and Latin America. Its total assets at 30 September 2012 were U.S.\$2,721 billion. HSBC Bank plc is the HSBC Group's principal operating subsidiary undertaking in Europe.

The short term senior unsecured and unguaranteed obligations of HSBC Bank plc are currently rated P-1 by Moody's, A-1+ by S&P and F1+ by Fitch and the long term senior, unsecured and unguaranteed obligations of HSBC Bank plc are currently rated Aa3 by Moody's, AA- by S&P and AA- by Fitch.

ING Bank N.V., incorporated in the Netherlands, with registered address at Bijlmerplein 888, 1102 MG Amsterdam Zuidoost, The Netherlands.

ING Bank N.V. is the 100 per cent. owned, non-listed subsidiary of ING Groep N.V. ING Groep N.V. was incorporated as a Naamloze Vennootschap (public limited liability company) under the laws of the Netherlands on 21 January 1991 to effect the merger between Nationale-Nederlanden, which was the largest insurer in the Netherlands, and NMB Postbank Group, which was one of the largest banks in the Netherlands, by way of a public offering for the shares of the latter companies. This public offering was successfully completed on 4 March 1991. ING Groep N.V. is registered as number 33231073 in the Dutch Company Registry and its Articles of Association are available in the Netherlands. ING Groep N.V. operates under several commercial names, including "ING Groep N.V.", "ING Groep", "ING Group" and "ING". ING Groep has its statutory and head office in Amsterdam, the Netherlands and operates under Dutch law. Shares in ING Groep are traded on the Amsterdam Exchange and the New York Stock Exchange.

ING Groep is a global financial institution offering banking, investments, life insurance and retirement products and services. As of 30 September 2012, ING Groep had total assets of EUR 1,248 billion and shareholders' equity of EUR 53 billion. ING Groep has a senior unsecured debt rating of A3 by Moody's, A from S&P, and A from Fitch. With a diverse workforce of about 93,000 people, ING is dedicated to setting the standard in helping their clients manage their financial future.

JPMORGAN CHASE BANK, NATIONAL ASSOCIATION

JPMorgan Chase Bank, National Association ("the Bank") is a wholly owned subsidiary of JPMorgan Chase & Co., a Delaware corporation whose principal office is located in New York, New York. The Bank offers a wide range of banking services to its customers, both domestically and internationally. It is chartered and its business is subject to examination and regulation by the Office of the Comptroller of the Currency.

As of December 31st, 2012, JPMorgan Chase Bank, National Association, had total assets of \$1,896.8 billion, total net loans of \$608.7 billion, total deposits of \$1,246.3 billion, and total stockholder's equity of \$146.3

billion. These figures are extracted from the Bank's unaudited Consolidated Reports of Condition and Income (the "Call Report") as of December 31st, 2012, prepared in accordance with regulatory instructions that do not in all cases follow U.S. generally accepted accounting principles. The Call Report including any update to the above quarterly figures is filed with the Federal Deposit Insurance Corporation and can be found at www.fdic.gov.

Additional information, including the most recent annual report on Form 10-K for the year ended December 31, 2011, of JPMorgan Chase & Co., the 2011 Annual Report of JPMorgan Chase & Co., and additional annual, quarterly and current reports filed with or furnished to the Securities and Exchange Commission (the "SEC") by JPMorgan Chase & Co., as they become available, may be obtained without charge by each person to whom this Official Statement is delivered upon the written request of any such person to the Office of the Secretary, JPMorgan Chase & Co., 270 Park Avenue, New York, New York 10017 or at the SEC's website at www.sec.gov.

NATIONAL AUSTRALIA BANK

National Australia Bank Limited ("NAB") is registered in the State of Victoria with Australian Business Number 12 004 044 937. NAB was incorporated on 23 June 1893.

NAB is a public limited company incorporated in the Commonwealth of Australia and it operates under Australian legislation including the Corporations Act 2001 of Australia. Its registered office is Level 4 (UB4440), 800 Bourke Street, Docklands, Victoria 3008, Australia (telephone number +61 3 8634 2345).

NAB and its controlled entities ("NAB Group") is an international financial services group, providing a comprehensive and integrated range of financial products and services. The principal activities of the NAB Group are banking services, credit and access card facilities, leasing, housing and general finance, international banking, investment banking, wealth management, funds management, life insurance, and custodian, trustee and nominee services.

SANTANDER UK PLC AND THE SANTANDER GROUP

Background

Santander UK plc ("Santander UK") was formed as a building society in 1944 and is now a public limited liability company incorporated and registered in England and Wales under the Companies Act 1985. Santander UK was incorporated on 12 September 1988 with registered number 2294747.

The registered office of Santander UK is at 2 Triton Square, Regent's Place, London, NW1 3AN. The telephone number of Santander UK's registered office is +44 (0) 870 607 6000.

On 12 November 2004, Banco Santander S.A. ("Banco Santander") completed the acquisition of the entire issued ordinary share capital of Santander UK, implemented by means of a scheme of arrangement under Section 425 of the Companies Act 1985 making Santander UK a wholly-owned subsidiary of Banco Santander. Banco Santander is one of the largest banks in the world by market capitalisation. Banco Santander was founded in 1857 and, at the close of 2012 the Banco Santander group had more than 100 million customers and over 14,000 branches.

Corporate Purpose and Strategy

Santander UK's purpose is to maximise value for its shareholder, Banco Santander and its subsidiary company, Santusa Holding, S.L., by focusing on offering a full diversified, customer-centred, full commercial banking service in the United Kingdom providing value-for-money products to customers. With the continuing support of Banco Santander, Santander UK aims to be the best commercial bank in the United Kingdom.

Business and Support Divisions

Santander UK's management structure is headed by Ana Botín, Chief Executive Officer. The management structure consists of a number of business and support divisions. The business divisions consist of:

Retail Banking

Retail Banking offers a wide range of products and financial services to customers through a network of branches, agencies and ATMs, as well as through, telephony, e-commerce and intermediary channels. It principally serves personal banking customers (including private banking and other high net worth individuals), but also services small businesses with a turnover of less than £250,000 per annum. Retail Banking products include, residential mortgage loans, savings and current accounts, credit cards and personal loans as well as a range of insurance policies.

Corporate Banking

Corporate Banking offers a wide range of products and financial services to customers through a network of 35 regional CBCs and through telephony and e-commerce channels. It principally serves companies with annual turnover of more than £250,000 including SMEs, and larger businesses with annual turnover of less than £150m. Larger multinational corporate customers are also included in Corporate Banking, through the Large Corporates business. Corporate Banking products and services include loans, bank accounts, deposits, treasury services, invoice discounting, cash transmission and asset finance. The Large Corporates business offers specialist treasury services in fixed income and foreign exchange, lending, transactional banking services, capital markets and money market.

Markets

Markets division/business offers risk management and value added services to financial institutions, as well as other Santander UK divisions. Its main product areas are fixed income and foreign exchange, equity, capital markets and institutional sales.

Corporate Centre

Corporate Centre, formally known as Group Infrastructure, includes Asset and Liability Management ('ALM') and the non-core corporate and legacy portfolios. ALM is responsible for managing capital and funding, balance sheet composition, structural market risk and strategic liquidity risk for the rest of the group. The non-core corporate and legacy portfolios include aviation, shipping, infrastructure, commercial mortgages, social housing loans and structured credit assets, all of which are being run-down and/or managed for value.

The support divisions consist of:

- Retail Products and Marketing – responsible for integrating and gaining the maximum value from Santander's products, marketing and brand communications to serve Santander UK's customers better.
- Human Resources – responsible for delivering the human resources strategy and personnel support.
- Manufacturing – responsible for all information technology, cost control and operations activity, including service centres.
- Risk – responsible for ensuring that the Board of Directors and senior management team of Santander UK are provided with an appropriate risk policy and control framework, and to report any material risk issues to the Board Risk Committee and the Board of Directors.
- Internal Audit – responsible for supervising the compliance, effectiveness and efficiency of Santander UK's internal control systems to manage its risks.

In addition there are a number of corporate units – Financial Management Information, Financial Reporting and Tax, Cost Management and Control, Legal and Secretariat, Strategy and Corporate Development, Regulatory Affairs and Pensions, Service Quality, Communications and Santander Universities in the UK.

The Royal Bank of Scotland plc

The Royal Bank of Scotland plc ('the Royal Bank', 'RBS plc' or 'the Bank') is a wholly-owned subsidiary of The Royal Bank of Scotland Group plc ('RBSG' or 'the holding company'), a large banking and financial services group. The 'Group' comprises the Bank and its subsidiary and associated undertakings. The Group has a large and diversified customer base and provides a wide range of products and services to personal, commercial and large corporate and institutional customers. 'RBS Group' comprises the holding company and its subsidiary and associated undertakings.

RBS Group had total assets of £1,415 billion and owners' equity of £74 billion as at 30 June 2012. RBS Group's capital ratios, as at 30 June 2012, were a total capital ratio of 14.6 per cent., a Core Tier 1 capital ratio of 11.1 per cent. and a Tier 1 capital ratio of 13.4 per cent.

The Group had total assets of £1,359 billion and owners' equity of £62 billion as at 30 June 2012. As at 30 June 2012, the Group's capital ratios were a total capital ratio of 15.4 per cent., a Core Tier 1 capital ratio of 9.9 per cent. and a Tier 1 capital ratio of 11.6 per cent.

UBS AG

UBS AG is a company incorporated with limited liability in Switzerland on 28 February 1978 registered at the Commercial Registry Office of the Canton of Zurich and the Commercial Registry Office of the Canton of Basel-City with Identification No: CH-270.3.004.646-4 having its registered offices at Bahnhofstrasse 45, 8001 Zurich and Aeschenvorstadt 1, 4051 Basel, Switzerland and having established in the United Kingdom a branch office situated at 1 Finsbury Avenue, London EC2M 2PP registered at Companies House, Cardiff, as a UK Establishment pursuant to Part 34 (Sections 1044 to 1052) of the Companies Act 2006 and the Overseas Companies Regulations 2009 (SI 2009/1801) (being successor legislation to Schedule 21A to the Companies Act 1985 under which that branch office was originally registered on 16 June 1998) with Company No: FC021146 and UK Establishment (formerly referred to as Branch) No: BR004507 ('UBS AG London Branch') acting through, and by, UBS AG London Branch.

CHAPTER 11 TAX CONSIDERATIONS

The following is a general summary of the UK withholding taxation treatment in relation to payments of principal and interest in respect of the Bonds as at the date of this Prospectus and is not intended to be exhaustive. These comments do not deal with other UK tax aspects of acquiring, holding or disposing of Bonds and do not take into consideration any tax implications which may arise on substitution of the Issuer. They relate only to the position of persons who are unconnected with the Issuer and are the absolute beneficial owners of their Bonds and who hold their Bonds as investments. Some sections do not apply to certain classes of taxpayers (such as dealers). Prospective purchasers of Bonds should be aware that the particular terms of issue of any Sub-Class of Bonds as specified in the relevant Final Terms may affect the tax treatment of that and other Sub-Classes or Series of Bonds. This summary as it applies to UK taxation is based upon UK law and HM Revenue & Customs practice as in effect on the date of this Prospectus and is subject to any change in law or practice that may take effect after such date (including with retrospective effect).

Bondholders who may be liable to taxation in respect of their acquisition, holding or disposal of Bonds are advised to consult their professional advisers as to whether they are so liable (and if so under the laws of which jurisdictions) and, if so liable, the basis of determining (including any method of calculating) their liability to tax with respect to the Bonds, since the following comments relate only to certain UK 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 UK.

The references to “interest” in this section mean “interest” as understood in UK tax law. The statements do not take any account of any different definitions of “interest” or “principal” which may prevail under any other law or which may be created by the terms and conditions of the Bonds or any related documentation.

The following description of the UK withholding tax position assumes that there will be no substitution of an issuer pursuant to Condition 8(c) or 15(d) of the Bonds or otherwise and does not consider the tax consequences of any such substitution.

UK Withholding Tax on UK source interest

The Bonds issued by the Issuer will constitute “quoted Eurobonds” provided they are and continue to be listed on a recognised stock exchange within the meaning of Section 1005 of the Income Tax Act 2007. The London Stock Exchange is a recognised stock exchange for these purposes. Securities will be treated as listed on the London Stock Exchange if they are included in the Official List by the United Kingdom Listing Authority and are admitted to trading on the London Stock Exchange. HM Revenue & Customs have confirmed that securities that are admitted to trading on the Professional Securities Market satisfy the condition of being admitted to trading on the London Stock Exchange. While the Bonds are and continue to be quoted Eurobonds, payments of interest on the Bonds may be made without withholding or deduction for or on account of United Kingdom income tax.

In all cases falling outside the exemption described above, interest on the Bonds will generally be paid under deduction of United Kingdom income tax at the basic rate (currently 20 per cent.) unless:

- (i) when that interest is paid the company which makes the payment reasonably believes that the person beneficially entitled to the interest is:
 - (a) a company resident in the United Kingdom; or

- (b) a company not resident in the United Kingdom which carries on a trade in the United Kingdom through a permanent establishment and which brings into account the interest in computing its United Kingdom taxable profits; or
- (c) a partnership each member of which is a company referred to in (a) or (b) above or a combination of companies referred to in (a) or (b) above;

and HM Revenue & Customs has not given a direction that the interest should be paid under deduction of tax; or

- (ii) the Issuer has received a direction to the contrary from HM Revenue & Customs in respect of such relief as may be available pursuant to the provisions of any applicable double taxation treaty.

However, this withholding will not apply if the relevant interest is paid on Bonds with a maturity of less than one year from the date of issue and which are not issued under arrangements the effect of which is to render such Bonds part of a borrowing with a total term of a year or more. Unless otherwise specified in the applicable Final Terms, if United Kingdom withholding tax is imposed, then the Issuer will not pay additional amounts in respect of the Bonds.

Provision of Information by United Kingdom Paying and Collecting Agents

Bondholders in the United Kingdom (i) paying interest to or receiving interest on behalf of another person who is an individual, or (ii) paying amounts due on redemption of any Bonds which constitute deeply discounted securities as defined in Section 430 in chapter 8 of Part 4 of the Income Tax (Trading and Other Income) Act 2005 to or receiving such amounts on behalf of another person who is an individual, may be required to provide certain information to HM Revenue & Customs regarding the identity of the payee or person entitled to the interest and, in certain circumstances such information may be exchanged with tax authorities in other countries. However, in relation to amounts payable on the redemption of such Bonds HM Revenue & Customs published practice indicates that HM Revenue & Customs will not exercise its power to obtain information where such amounts are paid or received on or before 5 April 2013.

The provisions referred to above may also apply, in certain circumstances to payments made on redemption of any Bonds where the amount payable on redemption is greater than the issue price of the Bonds.

Other Rules relating to United Kingdom Withholding Tax

Bonds may be issued at an issue price of less than 100 per cent. of their principal amount. Any discount element on any such Bonds will not be subject to any United Kingdom withholding tax pursuant to the provisions mentioned in “*UK Withholding Tax on UK source interest*” above, but may be subject to reporting requirements as outlined in “*Provision of Information by United Kingdom Paying and Collecting Agents*” above.

Where Bonds are issued with a redemption premium, as opposed to being issued at a discount, then any element of such premium may constitute a payment of interest. Payments of interest are subject to United Kingdom withholding tax and reporting requirements as outlined above.

Where interest has been paid under deduction of United Kingdom income tax, Bondholders who are not resident in the United Kingdom may be able to recover all or part of the tax deducted if there is an appropriate provision in any applicable double taxation treaty.

The references to “interest” above mean “interest” as understood in UK tax law. The statements above do not take any account of any different definitions of “interest” or “principal” which may prevail under any other law or which may be created by the terms and conditions of the Bonds or any related documentation.

The above description of the United Kingdom withholding tax position assumes that there will be no substitution of the Issuer pursuant to Condition 15(d) (*Substitution of the Issuer*) of the Bonds and does not consider the tax consequences of any such substitution.

EU Savings Directive

EU Council a Directive 2003/48/EC regarding the taxation of savings income (the “**EU Savings Directive**”) requires Member States to provide to the tax authorities of another Member State details of payments of interest and other similar income paid by a person established within its jurisdiction to an individual or to certain other persons in that other Member State, except that Austria and Luxembourg will instead impose a withholding system for a transitional period unless during such period they elect otherwise. A number of third countries including Switzerland and certain dependent or associated territories of certain Member States have adopted similar measures to the EU Savings Directive.

The European Commission has proposed certain amendments to the EU Savings Directive which may, if implemented, amend or broaden the scope of the requirements described above.

Cayman Islands

The Issuer has been incorporated under the laws of the Cayman Islands as an exempted company and, as such, the Issuer (which was incorporated under the name London 70 Limited) has obtained an undertaking from the Governor in Council of the Cayman Islands substantially in the following form:

“The Tax Concessions Law (1999 Revision) Undertaking as to Tax Concessions

In accordance with Section 6 of the Tax Concessions Law (1999 Revision), the Governor in Council undertakes with London 70 Limited (the “**Company**”):

- (a) that no Law which is hereafter enacted in the Islands imposing any tax to be levied on profits, income gains or appreciations shall apply to the Company or its operations; and
- (b) in addition, that no tax to be levied on profits, income gains or appreciations or which is in the nature of estate duty or inheritance tax shall be payable:
 - (i) on or in respect of the shares debentures or other obligations of the Company; or
 - (ii) by way of the withholding in whole or in part of any relevant payment as defined in Section 6(3) the Tax Concessions Law (1999 Revision).

The concessions shall be for a period of twenty years from 4 September 2001.

Governor in Council”

CHAPTER 12 SUBSCRIPTION AND SALE

Dealership Agreement

Bonds may be sold from time to time by the Issuer to any one or more of Banco Santander, S.A., Barclays Bank PLC, BNP Paribas, HSBC Bank plc and The Royal Bank of Scotland plc, and any other dealer appointed from time to time (the “**Dealers**”) or to subscribers from whom subscriptions have been procured by the Dealers, in each case pursuant to the amended and restated dealership agreement dated on or about the date of this Prospectus (and as amended from time to time) made between, amongst others, SWS, the Issuer, the Arranger and the Dealers (the “**Dealership Agreement**”). The arrangements under which a particular Sub-Class of Bonds may from time to time be agreed to be sold by the Issuer to, and purchased by, Dealers or subscribers are set out in the Dealership Agreement and the subscription agreements relating to each Sub-Class of Bonds. Any such agreement will, *inter alia*, make provision for the form and terms and conditions of the relevant Bonds, the price at which such Bonds will be purchased by the Dealers or subscribers and the commissions or other agreed deductibles (if any) payable or allowable by the Issuer in respect of such purchase. The Dealership Agreement makes provision for the resignation or termination of appointment of existing Dealers and for the appointment of additional or other Dealers either generally in respect of the Programme or in relation to a particular Series, Class or Sub-Class of Bonds.

In the Dealership Agreement, the Issuer, failing whom SWS, has each agreed to reimburse the Dealers for certain of their expenses in connection with the establishment and maintenance of the Programme and the issue of Bonds under the Dealership Agreement and each of the Obligor has agreed to indemnify the Dealers against certain liabilities incurred by them in connection therewith.

Selling and Transfer Restrictions of the United States of America

Selling Restrictions

The Bonds and any 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. Terms used in this paragraph have the meaning given to them in Regulation S.

Bearer Bonds 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 and regulations thereunder.

Each Dealer has agreed and each further Dealer appointed under the Programme will be required to agree, in the case of Bearer Bonds, that, except as permitted by the Dealership Agreement, it will not offer, sell or deliver Bonds, (i) as part of their distribution at any time or (ii) otherwise until 40 days after the completion of the distribution of the Bonds comprising the relevant Sub-Class, as certified to the Principal Paying Agent or the Issuer by such Dealer (or, in the case of a sale of a Sub-Class of Bonds to or through more than one Dealer, by each of such Dealers as to the Bonds of such Sub-Class purchased by or through it, in which case the Principal Paying Agent or the Issuer shall notify each such Dealer when all such Dealers have so certified) within the United States or to, or for the account or benefit of, U.S. persons, and such Dealer will have sent to each Dealer to which it sells Bonds during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Bonds within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meaning given to them in Regulation S.

In addition, until 40 days after the commencement of the offering of Bonds comprising any Sub-Class, any offer or sale of Bonds within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act.

This Prospectus has been prepared by the Issuer for use in connection with the offer and sale of the Bonds outside the United States. The Issuer and the Dealers reserve the right to reject any offer to purchase the Bonds, in whole or in part, for any reason. This Prospectus does not constitute an offer to any person in the United States. Distribution of this Prospectus by any non-U.S. person outside the United States to any U.S. person or to any other person within the United States, is unauthorised and any disclosure without the prior written consent of the Issuer of any of its contents to any such U.S. person or other person within the United States, is prohibited.

Transfer Restrictions

Each purchaser of the Bonds outside the United States pursuant to Regulation S and each subsequent purchaser of such Bonds in resales prior to the expiration of the distribution compliance period, by accepting delivery of this Prospectus and the Bonds, will be deemed to have represented, agreed and acknowledged that:

- (a) It is, or at the time the Bonds are purchased will be, the beneficial owner of such Bonds and (i) it is not a U.S. person and it is located outside the United States (within the meaning of Regulation S) and (ii) it is not an affiliate of the Issuer or a person acting on behalf of such an affiliate.
- (b) It understands that such Bonds and the Guarantees have not been and will not be registered under the Securities Act and that, prior to the expiration of the distribution compliance period, it will not offer, sell, pledge or otherwise transfer such Bonds except in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S, in each case in accordance with any applicable securities laws of any State of the United States.
- (c) It understands that such Bonds, unless otherwise determined by the Issuer in accordance with applicable law, will bear a legend to the following:

“THIS NOTE AND THE GUARANTEES IN RESPECT THEREOF HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933 (THE “SECURITIES ACT”) OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED WITHIN THE UNITED STATES EXCEPT PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT.”
- (d) It understands that the Issuer, the Registrar, the Dealers and their affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements.

Public Offer Selling Restrictions under the Prospectus Directive

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a "**Relevant Member State**"), each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the "**Relevant Implementation Date**") it has not made and will not make an offer of Bonds which are the subject of the offering contemplated by this Prospectus as completed by the Final Terms in relation thereto to the public in that Relevant Member State except that it may, with effect from and including the Relevant Implementation Date, make an offer of such Bonds to the public in that Relevant Member State:

- (a) at any time to any legal entity which is a qualified investor as defined in the Prospectus Directive;
- (b) at any time to fewer than 100 or, if the Relevant Member State has implemented the relevant provision of the 2010 PD Amending Directive (as defined below), 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive) subject to obtaining the prior consent of the relevant Dealer or Dealers nominated by the Issuer for any such offer; or
- (c) at any time in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Bonds referred to in (a) to (c) above shall require the Issuer or any Dealer to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression an "offer of Bonds to the public" in relation to any Bonds in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Bonds to be offered so as to enable an investor to decide to purchase or subscribe the Bonds, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and, for the purposes of this section, the expression "Prospectus Directive" means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in any Relevant Member State) and includes any relevant implementing measure in each Relevant Member State and the expression "**2010 PD Amending Directive**" means Directive 2010/73/EU.

United Kingdom

Each Dealer has represented, warranted and agreed that:

- (a) **No deposit-taking:** in relation to any Bonds having a maturity of less than one year:
 - (i) 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
 - (ii) it has not offered or sold and will not offer or sell any Bonds other than to persons:
 - (A) whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses; or
 - (B) 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;

- (b) **Financial Promotion:** it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of any Bonds in circumstances in which section 21(1) of the FSMA does not apply to the Issuer or the Guarantors; and
- (c) **General Compliance:** 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.

Cayman Islands

No invitation or solicitation will be made to the public in the Cayman Islands to subscribe for the Bonds.

General

Save for obtaining the approval of the Prospectus by the UK Listing Authority in accordance with Part VI of the FSMA for the Bonds to be admitted to listing on the Official List of the UK Listing Authority and to trading on the Market or the PSM, no action has been or will be taken in any jurisdiction by the Issuer, the other Obligors or the Dealers that would permit a public offering of Bonds, or possession or distribution of the Prospectus or any other offering material, in any jurisdiction where the action for that purpose is required. Each Dealer shall to the best of its knowledge comply with all applicable laws, regulations and directives in each country or jurisdiction in or from which they purchase, offer, sell or deliver Bonds or have in their possession or distribute the Prospectus or any other offering material, in all cases at their own expense.

The Dealership Agreement provides that the Dealers shall not be bound by any of the restrictions relating to any specific country or jurisdiction (set out above) to the extent that such restrictions shall, as a result of change(s) in the official interpretation, after the date of the Dealership Agreement, of applicable laws and regulations, no longer be applicable but without prejudice to the obligations of the Dealers described in the paragraph above.

Selling restrictions may be supplemented or modified with the agreement of the Issuer. Any such supplement or modification will be set out in the relevant Final Terms (in the case of a supplement or modification relevant only to a particular Sub-Class of Bonds) or (in any other case) in a supplement to this Prospectus.

CHAPTER 13

GENERAL INFORMATION

Authorisation

The establishment of the Programme and the issue of Bonds thereunder have been duly authorised by resolutions of the Board of Directors of the Issuer passed at a meeting of the Board held on 9 June 2003 (as approved by resolutions of SWI dated 9 June 2003) and at a meeting of the Board held on 15 July 2003 (as also approved by resolutions of SWI dated 15 July 2003 and SWS dated 15 July 2003). The update of the Programme and the issue of Bonds thereunder have been duly authorised by resolutions of the Board of Directors of the Issuer passed at a meeting of the Board held on 18 February 2009 (as approved by a written resolution executed by SWS as shareholder of the Issuer dated 18 February 2009), 23 March 2011 (as approved by a written resolution executed by SWS as shareholder of the Issuer dated 23 March 2011 and 27 February 2013 (as approved by a written resolution executed by SWS as shareholder of the Issuer dated 27 February 2013)). 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 guarantees by each of SWS, SWSGH and SWSH has been duly authorised by resolutions of the Board of Directors of each of SWS, SWSGH and SWSH, respectively, dated 15 July 2003 and further resolutions of the committee of the Board of Directors of SWS dated 18 February 2009, 23 March 2011 and 27 February 2013, further resolutions of the Board of Directors of SWSGH dated 18 February 2009, 23 March 2011 and 27 February 2013, and further resolutions of the Board of Directors of SWSH dated 18 February 2009, 23 March 2011 and 27 February 2013, respectively.

Listing of Bonds

It is expected that each Sub-Class of Bonds which is to be admitted to the Official List and to trading on the Market or the PSM 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 Sub-Class. The listing of the Programme in respect of Bonds was granted on 23 July 2003, updated on 26 May 2005, 13 October 2006, 27 February 2009 and 12 April 2011 and is expected to be further updated on 28 February 2013.

However, Bonds may also be issued pursuant to the Programme which will not be listed on the Market or the PSM or any other Stock Exchange or which will be listed on such Stock Exchange as the Issuer and the relevant Dealer(s) may agree.

Documents Available

For so long as the Programme remains in effect or any Bonds shall be outstanding, copies of the following documents may (when published) be inspected during normal business hours (in the case of Bearer Bonds) at the specified office of the Principal Paying Agent, (in the case of Registered Bonds) at the specified office of the Registrar and the Transfer Agents and (in all cases) at the registered office of the Bond Trustee:

- (i) the Memorandum and Articles of Association of each of the Issuer and the other Obligors;
- (ii) the audited financial statements of SWS for the years ended 31 March 2011 and 31 March 2012;
- (iii) the unaudited financial statements of SWS for the six months ended 30 September 2012;
- (iv) the audited financial statements of SWSGH for the years ended 31 March 2011 and 31 March 2012;
- (v) the audited financial statements of SWSH for the years ended 31 March 2011 and 31 March 2012;
- (vi) the audited financial statements of the Issuer for the years ended 31 March 2011 and 31 March 2012;
- (vii) a copy of this Prospectus;
- (viii) a copy of an offering circular dated 17 July 2003 in respect of the Programme;

- (ix) a copy of an offering circular dated 24 May 2005 in respect of the Programme;
- (x) a copy of a prospectus dated 13 October 2006 in respect of the Programme (as supplemented by a supplemental prospectus dated 12 July 2007);
- (xi) a copy of the prospectus dated 27 February 2009 in respect of the Programme;
- (xii) each Final Terms relating to Bonds which are admitted to listing, trading and/or quotation by any listing authority, stock exchange and/or quotation system. (In the case of any Bonds which are not admitted to listing, trading and/or quotation by any listing authority, stock exchange and/or quotation system, copies of the relevant Final Terms will only be available for inspection by the relevant Bondholders);
- (xiii) each Investors' Report;
- (xiv) each Financial Guarantee relating to each Sub-Class of Wrapped Bonds previously issued under the Programme;
- (xv) each G&R Deed;
- (xvi) each Issuer/SWS Loan Agreement;
- (xvii) the Common Terms Agreement;
- (xviii) the Registered Office Agreement;
- (xix) the Master Definitions Agreement;
- (xx) the STID;
- (xxi) the Indemnification Deeds;
- (xxii) the Security Agreement;
- (xxiii) the Bond Trust Deed;
- (xxiv) each DSR Liquidity Facility Agreement;
- (xxv) each O&M Reserve Facility Agreement (if any);
- (xxvi) each Hedging Agreement;
- (xxvii) the Account Bank Agreement;
- (xxviii) the Agency Agreement;
- (xxix) the Tax Deeds of Covenant;
- (xxx) the Initial Term Facility Agreement, the NAB Facility, the Existing RCF Agreement, and the Second Artesian Term Facility Agreement;
- (xxxi) the Senior Mezzanine Facility Agreement; and
- (xxxii) the SWS/SWSG Loan Agreement and related security document.

This Prospectus can also be viewed on the website of the Regulatory News Service operated by the London Stock Exchange at <http://www.londonstockexchange.com/exchange/news/market-news/market-news-home.html>.

Clearing Systems

The Bonds have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The appropriate Common Code and ISIN for each Sub-Class of Bonds allocated by Euroclear and Clearstream,

Luxembourg will be specified in the applicable Final Terms. If the Bonds are to clear through an additional or alternative clearing system, the appropriate information will be specified in the applicable Final Terms.

The address of Euroclear is 1 Boulevard du Roi Albert II, B-1210 Brussels, Belgium and the address of Clearstream, Luxembourg is 42 Avenue JF Kennedy L-1855 Luxembourg. The address of any alternative clearing system will be specified in the applicable Final Terms.

Significant or Material Change

There has been no significant change in the financial or trading position and no material adverse change in the financial position or prospects of either the Issuer, SWSH (or its subsidiaries) or SWSGH (or its subsidiaries), and/or the SWS Financing Group each since 31 March 2012. There has been no significant change in the financial or trading position of SWS (or its subsidiaries) since 30 September 2012 and no material adverse change in the financial position or prospects of SWS (or its subsidiaries) and/or the SWS Financing Group since 31 March 2012.

Litigation

There are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the relevant Obligor is aware) during the 12 months preceding the date of this Prospectus, which may have, or have had in the recent past, significant effects on the financial position or profitability of the Issuer and/or the Group.

Availability of Financial Statements

The audited annual financial statements of the Issuer and the audited annual financial statements of SWS will be prepared as of 31 March in each year. The Issuer has not published and does not intend to publish any interim financial statements, but SWS intends to publish semi-annual unaudited financial statements. The unaudited interim financial statements of SWS will be prepared as of 30 September in each year. All future audited annual financial statements (and any published interim financial statements) of SWS and the audited annual financial statements of the Issuer will be available free of charge in accordance with “*Documents Available*”.

Auditors

The auditors of SWS are Deloitte LLP (regulated by the Financial Services Authority for designated investment business), chartered accountants, of 2 New Street Square, London, EC4A 3BZ who have audited SWS’s accounts, without qualification, in accordance with generally accepted auditing standards in the United Kingdom for the financial year ended on 31 March 2012. For the financial year ended on 31 March 2011, PricewaterhouseCoopers LLP (as successor entity to PricewaterhouseCoopers and authorised and regulated by the Financial Services Authority for designated investment business), chartered accountants, of 1 Embankment Place, London, WC2N 6RH audited SWS’s accounts, without qualification, in accordance with generally accepted auditing standards in the United Kingdom.

Deloitte LLP, chartered accountants, have audited, without qualification, the regulatory financial information of SWS in accordance with generally accepted auditing standards in the United Kingdom for the financial year ended on 31 March 2012. For the financial year ended on 31 March 2011, PricewaterhouseCoopers LLP, chartered accountants, of 1 Embankment Place, London, WC2N 6RH audited SWS’s accounts, without qualification, in accordance with generally accepted auditing standards in the United Kingdom.

Deloitte LLP, chartered accountants, of 2 New Street Square, London, EC4A 3BZ have audited, without qualification, the financial statements of the Issuer in accordance with generally accepted auditing standards in the United Kingdom for the financial year ended on 31 March 2012. For the financial year ended on 31 March 2011, PricewaterhouseCoopers LLP, chartered accountants, of 1 Embankment Place, London, WC2N 6RH audited the Issuer’s accounts, without qualification, in accordance with generally accepted auditing standards in the United Kingdom.

The auditors of SWSGH are Deloitte LLP, chartered accountants, of 2 New Street Square, London, EC4A 3BZ who have audited SWSGH's accounts, without qualification, in accordance with generally accepted auditing standards in the United Kingdom for the financial year ended on 31 March 2012. For the financial year ended on 31 March 2011, PricewaterhouseCoopers LLP, chartered accountants, of 1 Embankment Place, London, WC2N 6RH audited SWGHS's accounts, without qualification, in accordance with generally accepted auditing standards in the United Kingdom.

The auditors of SWSH are Deloitte LLP, chartered accountants, of 2 New Street Square, London, EC4A 3BZ who have audited SWSH's accounts, without qualification, in accordance with generally accepted auditing standards in the United Kingdom for the financial year ended on 31 March 2012. For the financial year ended on 31 March 2011, PricewaterhouseCoopers LLP, chartered accountants, of 1 Embankment Place, London, WC2N 6RH audited SWSH's accounts, without qualification, in accordance with generally accepted auditing standards in the United Kingdom. Each report of Deloitte LLP and PricewaterhouseCoopers LLP that is referred to above was produced at the request of the company to which it related.

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.

Legend

Bonds, Receipts, Talons and Coupons appertaining thereto will bear a legend substantially to the following effect: "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 in such legend provide that a United States person who holds a Bond, Coupon, Receipt or Talon generally will not be allowed to deduct any loss realised on the sale, exchange or redemption of such Bond, Coupon, Receipt or Talon and any gain (which might otherwise be characterised as capital gain) recognised on such sale, exchange or redemption will be treated as ordinary income.

Information in respect of the Bonds

The issue price and the amount of the relevant Bonds will be determined, before filing of the relevant Final Terms of each Tranche, based on then prevailing market conditions. The Issuer does not intend to provide any post-issuance information in relation to any issues of Bonds other than the Investors' Report described in Chapter 2 "*Overview of the Programme – Investor Information*". However, see the requirements to deliver an Investors' Report in accordance with the CTA as described in Chapter 7 "*Overview of the Financing Agreements*" under "*Common Terms Agreement*"

Material Contracts

SWS has not entered into contracts outside the ordinary course of its business, which could result in SWS or any member of its group being under an obligation or entitlement that is material to SWS's ability to meet its obligation to holders of Bonds in respect of the Bonds being issued.

INDEX OF DEFINED TERMS

The following terms are used throughout this Prospectus

“2009 Periodic Review”	means the Periodic Review for the period 1 April 2010 to 31 March 2015.
“2014 Periodic Review”	means the Periodic Review for the period 1 April 2015 to 31 March 2020.
“2010 PD Amending Directive”	means the EU Directive 2010/73/EU which amends the Prospectus Directive 2003/71/EC and the Transparency Directive 2004/109/EC.
“A Category”	means a credit rating of at least A- from S&P, A3 from Moody’s or A- from Fitch.
“Acceleration of Liabilities” or “Acceleration”	means an acceleration of any Secured Liabilities or termination of a commitment (or equivalent action) including: <ul style="list-style-type: none">(a) the delivery of a termination notice from a Finance Lessor or SWS terminating the leasing of Equipment under a Finance Lease;(b) the delivery of a notice by SWS 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, and “ acceleration ” and “ accelerate ” will be construed accordingly.
“Accession Memorandum”	means (a) with respect to the STID, each memorandum entered into or to be entered into pursuant to Clause 2 (<i>Accession</i>) or Clause 19 (<i>Benefit of Deed</i>) (as applicable) of the STID and (b), with respect to the Bond Trust Deed, a memorandum in substantially the form set out in Schedule 5 to the Bond Trust Deed pursuant to which a Financial Guarantor accedes to the Bond Trust Deed.
“Account”	means any bank account of any Obligor.
“Account Bank”	means National Westminster Bank Plc or any successor account bank appointed pursuant to the Account Bank Agreement.
“Account Bank Agreement”	means the account bank agreement dated the Initial Issue Date (as amended and/or supplemented from time to time) between, among others, the Obligors, the Standstill Cash Manager, the Account Bank and the Security Trustee.
“Additional Secured Creditor”	means any person not already a Secured Creditor which becomes a

	Secured Creditor pursuant to the provisions of the STID.
“Adjusted Lease Reserve Amount”	means, in respect of any Finance Lease and from the commencement of a Standstill in any 12 month period commencing on 1 April in any year, the relevant portion of the Annual Finance Charge for such 12 month period relating to such Finance Lease as calculated pursuant to Paragraph 5.10 of Schedule 12 (<i>Cash Management</i>) of the CTA.
“Advance”	means any advance or other credit accommodation provided under any Authorised Credit Facility.
“Affiliate”	means a Subsidiary or a Holding Company of a person or any other Subsidiary of that Holding Company (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).
“Assured Guaranty (Europe)”	means Assured Guaranty (Europe) Limited, formerly known as Financial Security Assurance (U.K.) Limited.
“Agency Agreement”	means the agreement dated the Initial Issue Date (as amended, supplemented, restated and/or novated from time to time) between the Issuer, SWS and the Agents referred to therein under which, among other things, the Principal Paying Agent is appointed as issuing agent, principal paying agent and agent bank for the purposes of the Programme.
“Agent”	means the Agent Bank, the Principal Paying Agent, the Registrar, the Transfer Agent and any Paying Agent or any other agent appointed by the Issuer pursuant to the Agency Agreement or a Calculation Agency Agreement.
“Agent Bank”	means Deutsche Bank AG London (or any successor thereto) in its capacity as agent bank under the Agency Agreement in respect of the Bonds.
“AMP”	means an asset management plan submitted by SWS to the economic regulator in respect of a five-year period.
“AMP Period”	means a five year period in relation to which an asset management plan is submitted by SWS to the economic regulator, and in this respect “ AMP2 Period ” means the AMP Period commencing on 1 April 1995; “ AMP3 Period ” means the AMP Period commencing on 1 April 2000; “ AMP4 Period ” means the AMP Period commencing on 1 April 2005; “ AMP5 Period ” means the AMP Period commencing on 1 April 2010; and “ AMP6 Period ” means the AMP Period commencing on 1 April 2015.
“AMP2”	means the asset management plan prepared for the AMP2 Period.
“AMP3”	means the asset management plan prepared for the AMP3 Period.
“AMP4”	means the asset management plan prepared for the AMP4 Period.
“AMP5”	means the asset management plan prepared for the AMP5 Period
“AMP6”	means the asset management plan prepared for the AMP6 Period
“Ancillary Documents”	means the valuations, reports, legal opinions, tax opinions, accountants’ reports and the like addressed to or given for the

benefit of the Security Trustee, any Obligor or any Secured Creditor in respect of the Security Assets.

“Annual Finance Charge”

means, in respect of each 12 month period commencing 1 April in any subsequent year, the aggregate of all interest due or to become due (after taking account of the impact on interest rates of any Hedging Agreements then in place) during that 12 month period on the Class A Debt and the Class B Debt (including, for the avoidance of doubt, all interest due on Class B Debt but not yet payable as a result of the restrictions imposed upon the payment of that indebtedness contained in the Finance Documents), any Financial Guarantee Fee payable to any Financial Guarantor within that 12 month period, all fees and commissions payable to each Finance Party within that 12 month period and the Lease Reserve Amounts and Adjusted Lease Reserve Amounts falling due in that 12 month period, excluding all indexation of principal, all costs incurred in raising such debt, amortisation of the costs of issue of such debt in that 12 month period and all other costs incurred in connection with the raising of such debt) less all interest received or, in respect of forward-looking ratios, receivable by any member of the SWS Financing Group from a third party during such period (excluding any interest received or receivable from SWSG under the SWS/SWSG Loan Agreement).

“Applicable Accounting Principles”

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 directors of the relevant company may consider appropriate arising out of changes to applicable accounting principles or otherwise from time to time.

“Appointed Business”

means the appointed business of a “relevant undertaker” (as that term is defined by the WIA).

“Artesian”

means Artesian Finance plc.

“Artesian II”

means Artesian Finance II plc.

“Associate”

means:

- (a) any person who has a Controlling interest in any member of the SWS Financing Group;
- (b) any person who directly or indirectly holds at least 15 per cent. or more of the voting share capital in any member of the SWS Financing Group;
- (c) any person who is Controlled by a member of the SWS Financing Group; or
- (d) any person in which a member of the SWS Financing Group holds directly or indirectly at least 15 per cent. or more of the voting share capital,

and in each case, any Affiliate of such person.

“Auditors”

means Deloitte LLP or such other firm of accountants of international repute as may be appointed by SWS in accordance with the CTA as the Auditors for the SWS Financing Group.

“Authorised Credit Facility”	means any facility or agreement entered into by the Issuer or SWS for Class A Debt or Class B Debt or Subordinated Debt as permitted by the terms of the CTA or for the issue of Financial Guarantees in relation thereto, the providers of which have acceded to the STID and the CTA, and includes the Liquidity Facilities, the Existing RCF Agreement, the Initial Term Facility Agreement, the NAB Facility Agreement, the Issuer/SWS Loan Agreements, the Bonds, the Hedging Agreements, the Financial Guarantee Fee Letters, the G&R Deeds, the Senior Mezzanine Facility Agreement, the Second Artesian Term Facility Agreement and any other document entered into in connection with the foregoing facilities or agreements or the transactions contemplated in the foregoing facilities or agreements (excluding, however, the Dealership Agreement and the Common Agreements).
“Authorised Credit Provider”	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 Financial Guarantee issued by that Financial Guarantor is outstanding, and each Bondholder.
“Authorised Investments”	means: <ul style="list-style-type: none"> (a) securities issued by the government of the United Kingdom; (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; (c) any other obligations provided that in each case the relevant investment has the Minimum Short-term Rating and is either denominated in pounds 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 (d) any money market funds or equivalent investments which have a rating of at least AAA by S&P or V-1+ by Fitch or Aaa by Moody’s.
“Authorised Signatory”	means any person who is duly authorised by any Obligor or any Party and in respect of whom a certificate has been provided signed by a director of that Obligor or such Party setting out the name and signature of that person and confirming such person’s authority to act.
“Base Cash Flows”	means the annual cash flows of the amount 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 (as defined in the Licence).
“Base Currency”	means pounds sterling.
“Base Prospectus”	has the meaning given to that term under the “ <i>Important Notice</i> ”

	above.
“ Bearer Bonds ”	means those of the Bonds which are in bearer form.
“ Bond Trust Deed ”	means the bond trust deed dated the Initial Issue Date (and as amended and/or supplemented from time to time) between, among others, the Issuer, the Initial Financial Guarantors and the Bond Trustee, under which Series 1 Bonds, Series 2 Bonds, Series 3 Bonds, Series 4 Bonds and Series 5 Bonds are constituted and any further Bonds will, on issue, be constituted and any bond trust deed supplemental thereto.
“ Bond Trustee ”	means Deutsche Trustee Company Limited or any successor trustee appointed pursuant to the Bond Trust Deed for and on behalf of the relevant Bondholders.
“ Bond Trustee Reserved Matters ”	means those matters set out in Part B (<i>Bond Trustee Reserved Matters</i>) of Schedule 3 of the STID and Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Security Trust and Intercreditor Deed</i> ” of this Prospectus.
“ Bondholders ”	means the holders from time to time of the Bonds.
“ Bonds ”	means the Class A Bonds and/or the Class B Bonds, as the context may require, and “ Bond ” shall be construed accordingly.
“ Bridge Facility Agreement ”	means the £1,900,000,000 credit agreement dated 8 March 2002, as amended from time to time, between, among others, the Issuer as original borrower and original guarantor and The Royal Bank of Scotland plc as arranger, agent and security trustee under which the relevant lenders made advances that funded the First Aqua Acquisition and funded SWS’s working capital requirements and general corporate expenditure. All amounts payable by the SWS Financing Group to the lenders under such credit agreement have been discharged in full.
“ BSI ”	means the British Standards Institution.
“ Business ”	means Appointed Business and Permitted Non-Appointed Business or otherwise as permitted under the Finance Documents.
“ Business Day ”	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"> (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 Final Terms; (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 U.S. dollars shall be New York) and in each (if any) additional city or cities specified in the relevant Final Terms; and

	(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.
“Calculation Agency Agreement”	means, in relation to the Bonds of any Tranche, an agreement in or substantially in the form of Schedule 1 of the Agency Agreement.
“Calculation Agent”	means, in relation to any Tranche of Bonds, the person appointed as calculation agent in relation to such Tranche of Bonds by the Issuer pursuant to the provisions of a Calculation Agency Agreement (or any other agreement) and shall include any successor calculation agent appointed in respect of such Tranche of Bonds.
“Calculation Date”	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 30 September 2003 or any other calculation date agreed as a result of a change in the financial year end date of any Obligor.
“Capex Contract”	means any agreement pursuant to which SWS outsources any investment, construction works and other Capital Expenditure.
“Capex Reserve Account”	means the account of SWS 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.
“Capital Expenditure”	means Capital Maintenance Expenditure and any investment expenditure (net of associated grants and contributions) incurred (or, in respect of any future period, forecast to be incurred in the SWS Business Financial Model) relating to increases in capacity or enhancement of service levels, quality or security of supply.
“Capital Maintenance Expenditure”	means investment expenditure (net of associated grants and contributions) incurred (or, in respect of any future period, forecast to be incurred in the SWS Business Financial Model) on maintaining base service levels in the Appointed Business but excluding any investment expenditure relating to increases in capacity or enhancement of service levels, quality or security of supply.
“Cash Expenses”	means the aggregate of all expenses including capital expenditure incurred by SWS in any period (excluding depreciation, IRC and interest on Financial Indebtedness).
“Cash Manager”	means The Royal Bank of Scotland plc during a Standstill Period in its capacity as Standstill Cash Manager under the CTA, or any successor Standstill Cash Manager, and at all other times SWS.
“CAT”	means the Competition Appeal Tribunal of the United Kingdom.
“CC” or “Competition Commission”	means the United Kingdom Competition Commission.
“CCD”	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 SWS in the Director General’s most recent Final Determination adjusted as appropriate for any subsequent

IDOK and for Out-turn Inflation provided that for the purposes of calculating any financial ratio for any Test Period for which there is no Final Determination, “**CCD**” shall be SWS’s good faith, honestly held present estimate of such expenditure for such Test Period.

“ Class ”	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.
“ Class A Adjusted ICR ”	means, in respect of a Test Period, the ratio of Net Cash Flow less the aggregate of CCD and IRC during such Test Period to Class A Debt Interest during such Test Period.
“ Class A Average Adjusted ICR ”	means the sum of the ratios of Net Cash Flow less the aggregate of CCD and IRC to Class A Debt Interest for each of the Test Periods comprised in a Rolling Average Period comprised in a Rolling Average divided by three.
“ Class A Bonds ”	means the Class A Wrapped Bonds and the Class A Unwrapped Bonds.
“ Class A Debt ”	means any financial accommodation that is, for the purposes of the STID, to be treated as Class A Debt and includes all debt outstanding under: <ul style="list-style-type: none">(a) the Class A Wrapped Bonds and the Class A Unwrapped Bonds (if any) issued by the Issuer on or after the Initial Issue Date;(b) the Initial Term Facility the Second Artesian Term Facility Agreement and the Existing RCF;(c) all Interest Rate Hedging Agreements and the Currency Hedging Agreements in relation to Class A Debt;(d) the DSR Liquidity Facility and any O&M Reserve Facility entered into after the Initial Issue Date;(e) the Financial Guarantee Fee Letters; and(f) each G&R Deed in respect of Class A Wrapped Debt.
“ Class A Debt Instructing Group ” or “ Class A DIG ”	means a group of representatives (each a “ Class A DIG Representative ”) of Qualifying Class A Debt, comprising: <ul style="list-style-type: none">(a) in respect of each Sub-Class of Class A Wrapped Bonds or other Class A Wrapped Debt (if no FG Event of Default has occurred and is continuing in respect of the Financial Guarantor of those Bonds), the Financial Guarantor of such Sub-Class of Class A Wrapped Bonds or other Class A Wrapped Debt;(b) in respect of each Sub-Class 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 Sub-Class of Class A Unwrapped Bonds, the Bond Trustee;(c) in respect of the Existing RCF Agreement, the Existing RCF Agent, in respect of the Initial Term Facility, Artesian

II and, in respect of the Second Artesian Term Facility, Financial Security Assurance (U.K.) Limited; and

- (d) in respect of any other Secured Liabilities of the type referred to in paragraphs (a) to (c) above (excluding liabilities under all Interest Rate Hedging Agreements and under Currency Hedging Agreements in respect of the Class A Debt and under the Liquidity Facilities) 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 or the STID 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:

- (a) all interest paid, due but unpaid or, in respect of forward-looking ratios, payable, on the Issuer’s and/or SWS’s obligations under or in connection with all Class A Debt and any Financial Indebtedness which falls under paragraph (e) of Permitted Financial Indebtedness;
- (b) all fees paid, due but unpaid or, in respect of forward-looking ratios, payable, to any Financial Guarantor of Class A Debt; and
- (c) 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 SWS’s 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, amortisation of the costs of issue of any Class A Debt and/or Class B Debt within such Test Period and all other costs incurred in connection with the raising of such Class A Debt and/or Class B Debt) less all interest received or in respect of forward-looking ratios receivable by any member of the SWS Financing Group from a third party during such period (excluding any interest received or receivable by SWS under the SWS/SWSG Loan Agreement).

“Class A Debt Provider”

means a provider of, or Financial Guarantor of, Class A Debt.

“Class A ICR”

means, in respect of a Test Period, the ratio of Net Cash Flow for such Test Period to Class A Debt Interest for such Test Period.

“Class A Net Indebtedness”

means, as at any date, all the Issuer’s and SWS’s nominal debt outstanding (or, in respect of a future date, forecast to be outstanding) under and in connection with any Class A Debt on such date and the nominal amount of any Financial Indebtedness

falling within paragraph (e) of Permitted Financial Indebtedness which is outstanding (or, in respect of a future date, forecast to be outstanding) on such date including all indexation accrued on any such liabilities which are indexed together with any interest due but unpaid up to and including such date (after taking account of the effect of any relevant 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 an amount equal to the Excluded Insurance Proceeds Amount and an amount equal to the aggregate of any amounts which represent Customer Rebates or Distributions which have been declared but not paid on such date); where such debt is denominated other than in pounds 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 specified in the relevant Currency Hedging Agreements; (ii) in respect of debt with no. associated Currency Hedging Agreements, by reference to the Exchange Rate on such date).

“Class A RAR”	means, on any Calculation Date, the ratio of Class A Net Indebtedness to RCV as at such Calculation Date or, in the case of any forward-looking ratios for Test Periods ending after such Calculation Date, as at the 31 March falling in such Test Period.
“Class A Required Balance”	means, on any Payment Date, the following 12 months’ interest forecast to be due on the Class A Debt.
“Class A Unwrapped Bonds”	means the Class A Bonds that do not have the benefit of a guarantee from a Financial Guarantor.
“Class A Unwrapped Debt”	means Class A Debt that does not have the benefit of a guarantee from a Financial Guarantor.
“Class A Wrapped Bonds”	means the Class A Bonds that have the benefit of a guarantee from a Financial Guarantor.
“Class A Wrapped Debt”	means Class A Debt that has the benefit of a guarantee from a Financial Guarantor.
“Class A1 Preference Shares”	means the fixed dividend (£40 per share net) cumulative redeemable preference shares 2038 of £1 each in the capital of SWS.
“Class A2 Preference Shares”	means the cumulative participating redeemable preference shares 2038 of 1p each in the capital of SWS.
“Class B Bonds”	means the Class B Wrapped Bonds and the Class B Unwrapped Bonds.
“Class B Debt”	means any financial accommodation that is, for the purposes of the STID, to be treated as Class B Debt and includes all debt outstanding under the Class B Bonds and all Currency Hedging Agreements in relation to Class B Debt.
“Class B Debt Instructing Group” or “Class B DIG”	means a group of representatives (each a “Class B DIG Representative”) of Qualifying Class B Debt, comprising: <ul style="list-style-type: none"> (a) in respect of each Sub-Class of Class B Wrapped Bonds (if

no FG Event of Default has occurred and is continuing in respect of the Financial Guarantor of those Bonds), the Financial Guarantor of such Sub-Class of Class B Wrapped Bonds;

- (b) in respect of each Sub-Class 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 Sub-Class of Class B Unwrapped Bonds, the Bond Trustee;
- (c) in respect of any other Secured Liabilities of the type referred to in paragraphs (a) to (b) above (excluding liabilities under the Currency Hedging Agreements in relation to Class B Debt) 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 of which provides an appropriate indemnity to the Security Trustee each time it votes irrespective of whether it is a Majority Creditor.

“Class B Debt Provider”	means any provider of, or Financial Guarantor of, Class B Debt.
“Class B Preference Shares”	means the fixed dividend (£70 per share net) cumulative redeemable preference shares 2038 of £1 each in the capital of SWS.
“Class B Required Balance”	means, on any Payment Date, the next 12 months’ interest forecast to be due on the Class B Debt.
“Class B Unwrapped Bonds”	means the Class B Bonds that do not have the benefit of a guarantee from a Financial Guarantor.
“Class B Unwrapped Debt”	means Class B Debt that does not have the benefit of a guarantee from a Financial Guarantor.
“Class B Wrapped Bonds”	means the Class B Bonds that have the benefit of a guarantee from a Financial Guarantor.
“Class B Wrapped Debt”	means Class B Debt that has the benefit of a guarantee from a Financial Guarantor.
“Clearstream, Luxembourg”	means Clearstream Banking, <i>société anonyme</i> .
“Arranger”	means Barclays Bank PLC, the arranger of the Programme.
“Common Agreements”	means the Security Documents, the Bond Trust Deed, the Common Terms Agreement, the Master Definitions Agreement, the Account Bank Agreement, the CP Agreement, the SW Tax Deeds of Covenant, the SWS/SWSG Loan Agreement, the SWSG Security Agreement, the SWS Preference Share Deed, the Calculation Agency Agreement and any Finance Document to which no Secured Creditor other than the Security Trustee and/or the Issuer and/or any Agent is a party.
“Common Terms Agreement” or	means the common terms agreement entered into on the Initial

“CTA”	Issue Date (as amended, supplemented, restated and/or novated from time to time) between, among others, the Obligors, the Initial Financial Guarantors and the Security Trustee, and which contains certain representations and covenants of the Obligors and Events of Default.
“Companies Act 1985”	means the United Kingdom Companies Act 1985, as amended or re-enacted from time to time.
“Competition Act”	means the United Kingdom Competition Act 1998.
“Competition Commission” or “CC”	means the United Kingdom Competition Commission.
“Compliance Certificate”	means a certificate, substantially in the form of Schedule 10 (<i>Form of Compliance Certificate</i>) of the CTA in which each of the Issuer and SWS, periodically, provides certain financial statements to the Security Trustee and each Rating Agency as required by the CTA.
“Conditions”	means the terms and conditions of the Bonds set out in the Bond Trust Deed as may from time to time be amended, modified, varied or supplemented in the manner permitted under the STID.
“Construction Output Price Index”	means the index issued by the Office for National Statistics 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.
“Contractor”	means any person (being either a single entity, consortium or joint venture) that is a counterparty to an Outsourcing Agreement or Capex Contract.
“Control”	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 “Controlled” and “Controlling” shall be construed accordingly).
“Coupon”	means an interest coupon appertaining to a Definitive Bond (other than a Zero Coupon Bond) and includes, where applicable, the Talon(s) appertaining thereto and any replacements for Coupons and Talons issued pursuant to Condition 14 (<i>Replacement of Bonds, Coupons, Receipts and Talons</i>).
“Couponholders”	means the several persons who are for the time being holders of the Coupons and includes, where applicable, the Talonholders.
“Court”	means the High Court of England and Wales.
“CP Agreement”	means the conditions precedent agreement dated the Initial Issue Date (as amended from time to time) between, among others, the Bond Trustee, the Security Trustee and the Obligors.
“CSP”	means the Company Stakeholder Plan for SWS employees.
“Currency Hedging Agreement”	means any Hedging Agreement with a Hedge Counterparty in

	respect of a currency exchange transaction.
“Customer Rebates”	means, in respect of any Financial Year, an amount equal to the difference between the total revenue that is projected by SWS to be raised during such Financial Year on the basis of the announced charges and the revenue that would have accrued if SWS had established prices at the full price cap available to it under the Instrument of Appointment.
“Date Prior”	means, at any time, the date which is one day before the next Periodic Review Effective Date.
“Dealers”	means Banco Santander, S.A., Barclays Bank PLC, BNP Paribas, HSBC Bank plc and The Royal Bank of Scotland plc and any other entity which the Issuer and the other 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 Dealership Agreement but excluding any entity whose appointment has been terminated in accordance with the provisions of the Dealership 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 Dealership Agreement and references to a “relevant Dealer” or the “relevant Dealer(s)” mean, in relation to any Tranche of Bonds, the Dealer or Dealers with whom the Issuer has agreed the issue of the Bonds of such Tranche and “Dealer” means any one of them.
“Dealership Agreement”	means the amended and restated agreement dated on or about the date of this Prospectus 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.
“Debt Instructing Group” or “DIG”	means the Class A DIG or, following the repayment in full of the Class A Debt, the Class B DIG
“Debt Service Payment Account”	means the account of the Issuer titled “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.
“Debt Service Reserve Account”	means the account of the Issuer titled “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.
“Default”	means (a) an Event of Default; (b) a Trigger Event; or (c) a Potential Event of Default.
“Default Situation”	means any period during which there subsists: <ul style="list-style-type: none"> (a) a Standstill Period; or (b) an Event of Default.

“Definitive Bond”	means a Bearer Bond in definitive form issued or, as the case may require, to be issued by the Issuer in accordance with the provisions of the Dealership Agreement or any other agreement between the Issuer and the relevant Dealer(s), the Agency Agreement and the Bond Trust Deed in exchange for either a Temporary Global Bond or part thereof or a Permanent Global Bond (all as indicated in the applicable Final Terms), such Bearer Bond in definitive form being in the form or substantially in the form set out in Schedule 2, Part C to the Bond Trust Deed and having the Conditions endorsed thereon and having the relevant information supplementing, replacing or modifying the Conditions appearing in the applicable Final Terms endorsed thereon or attached thereto and (except in the case of a Zero Coupon Bond in bearer form) having Coupons and, where appropriate, Receipts and/or Talons attached thereto on issue.
“Defra”	means the United Kingdom Department for the Environment, Food and Rural Affairs.
“Determination Date”	means the date which is seven Business Days prior to each Payment Date.
“DETR”	means the Department of the Environment, Transport and the Regions which had responsibility for the Environment prior to Defra.
“DGWS” or “Director General”	means the Director General of Water Services appointed under Section 1 of the WIA.
“DIG Directions Request”	means a written notice of each DIG Proposal sent by the Security Trustee to the relevant DIG Representatives pursuant to the STID.
“DIG Proposal”	means a proposal pursuant to the STID requiring a Majority Creditor decision in relation to the resignation of the Security Trustee or any vote to terminate or extend Standstill in accordance with the STID.
“DIG Representatives”	means the Class A DIG Representative, or the Class B DIG Representative or the Senior Mezzanine Facility Agent as the context requires, and “DIG Representative” means any of them.
“Directors”	means the Board of Directors for the time being of the Issuer or, as the case may be, the relevant Obligor.
“Discharge Date”	means the date on which all obligations of the Issuer and SWS under the Finance Documents have been irrevocably satisfied in full and no further obligations are capable of arising under the Finance Documents.
“Distribution”	means, other than in respect of payments under the SWS Preference Shares or Subordinated Debt, any payments (including any payments of distributions, dividends, bonus issues, return of capital, fees, interest, principal or other amounts whatsoever) (by way of loan or repayment of any loan or otherwise) (in cash or in kind) to any Associate other than: <ul style="list-style-type: none"> (a) payments made to such persons pursuant to arrangements entered into for the provision of management and know-

how services and which are 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 £10,000,000 (indexed) in any consecutive 12 month period; or

- (b) any payments made to such persons pursuant to any Outsourcing Agreements and/or Capex Contracts which were entered into and remain in compliance with the Outsourcing Policy save that if any Outsourcing Agreement and/or Capex Contract should cease to comply with the Outsourcing Policy, all payments thereunder made by SWS shall only be made as Distributions where such non-compliance has remained unremedied for a period in excess of 365 days from the date on which SWS became aware of such non-compliance; or
- (c) 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 12 month period; or
- (d) payments to The Royal Bank of Scotland plc under or in relation to any Authorised Credit Facility, the Account Bank Agreement or the CTA or in relation to the making by SWS or the Issuer of any Authorised Investments.

“Draft Water Bill”	means the draft Water Bill published by the Government for pre-legislative scrutiny on 10 July 2012.
“Drought Order”	means Emergency Drought Order or Ordinary Drought Order as the case may be.
“Drought Permit”	means a permit granted by the EA that allows a Regulated Company to take water from new sources, or to increase the amount of water taken from existing sources.
“DSR Liquidity Facility”	means a debt service reserve liquidity facility made available under a DSR Liquidity Facility Agreement.
“DSR Liquidity Facility Agreement”	means any agreement establishing a DSR Liquidity Facility.
“DSR Liquidity Facility Provider”	means The Royal Bank of Scotland plc, or any other lender under a DSR Liquidity Facility Agreement.
“Dual Currency Bonds”	means a Bond in respect of which the amount payable (whether in respect of principal or interest and whether at maturity or otherwise) will be made in such currencies, and based on such rates of exchange, as the Issuer and the relevant Dealer may agree.
“DWI”	means the United Kingdom Drinking Water Inspectorate.
“EA”	means the United Kingdom Environment Agency.
“Early Redemption Amount”	has the meaning, in relation to a Sub-Class of Bonds, given to such term in the Conditions relating to such Sub-Class of Bonds.
“EIN Signatories”	means the DIG Representatives representing 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, the Qualifying Class B Debt) after excluding the 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.

“Emergency”

means the disruption of the normal service of the provision of water or wastewater services which is treated as an emergency under SWS’s policies, standards and procedures for emergency planning manual (EMPROC) (as amended from time to time).

“Emergency Instruction Notice”

means a notice setting out the written instructions of the EIN Signatories given to the Security Trustee after (in the case of a STID Proposal) the date specified in the STID Directions Request, being not less than 10 Business Days or (in the case of a DIG Proposal) the date specified in the DIG Directions Request being not less than five Business Days after the date that the STID Directions Request or DIG Directions Request (as applicable) is deemed to be given in accordance with Clause 17.3 (*Effectiveness*) of the Common Terms Agreement.

“Emergency Instruction Procedure”

means an emergency instruction procedure provided for in the Intercreditor Arrangements, subject to Entrenched Rights and Reserved Matters, to cater for circumstances when a Default Situation is subsisting, and certain decisions and instructions may be required in a timeframe which does not allow the Bond Trustee to convene Bondholder meetings.

“Emergency Drought Order”

means an order granted by Defra that allows a Regulated Company to limit usage “for such purposes as it thinks fit”, and to set up standpipes or water tanks to provide water during rota cuts.

“Enforcement Action”

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, the declaration of an Event of Default, 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 or a Permitted Hedge Termination) by a Secured Creditor or Secured Creditors pursuant to the terms of the applicable Finance Documents.

“Enforcement Order”

means an enforcement order, a final enforcement order or a provisional enforcement order, each as referred to and defined in the WIA.

“Enterprise Act”

means the Enterprise Act 2002.

“Entrenched Rights”

means the rights of the Secured Creditors provided by the terms of Clauses 8.3 to 8.9 (inclusive) of the STID and reproduced in Chapter 7 “*Summary of the Financing Agreements*” under

	“ <i>Security Trust and Intercreditor Deed</i> ” of this Prospectus.
“ Entrenched Rights or Reserved Matters Notice ”	means a notice sent by a Secured Creditor (or, where applicable, its Secured Creditor Representative) in response to a STID Directions Request certifying that the consent of such Secured Creditor (or, where applicable, its Secured Creditor Representative) to implementation of the STID Proposal, in relation to which the STID Directions Request is given, is required.
“ Environmental Approvals ”	means any permit, licence, consent, approval or other authorisation and the filing of any notification, report or assessment required under any Environmental Law for the operation of the Business conducted on or from the properties owned or used by SWS.
“ Environmental Claim ”	means any claim, proceeding, formal notice or investigation by any person pursuant to any Environmental Law.
“ Environmental Law ”	means any applicable law (including DETR Circular 02/2000) in force in any jurisdiction in which SWS or any of its Subsidiaries or any Joint Venture in which it has an interest conducts business which relates to the pollution or protection of the environment or harm to or the protection of human health or the health of animals or plants.
“ Environmental Permits ” or “ Environmental Approvals ”	shall, in either case where used, mean any permit, licence, consent, approval or other authorisation and the filing of any notification, report or assessment required under any Environmental Law for the operation of the Business conducted on or from the properties owned or used by SWS.
“ Equipment ”	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.
“ Equivalent Amount ”	means the amount in question expressed in the terms of the Base Currency, calculated on the basis of the Exchange Rate.
“ EU ”	means the European Union.
“ Euro ”	means the single currency introduced at the start of the third stage of the European Economic and Monetary Union pursuant to the Treaty establishing the European Community, as amended, from time to time.
“ Euroclear ”	means Euroclear Bank S.A./N.V.
“ Event of Default ”	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 CTA (<i>Events of Default</i>) as more particularly described in Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Security Trust and Intercreditor Deed</i> ” of this Prospectus.
“ Exchange Rate ”	means the spot rate at which the Non-Base Currency is converted

to the Base Currency 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.

“Excluded Accounts”

means the Issuer’s O&M Reserve Account and Debt Service Reserve Account to the extent the balance standing to the credit of such accounts is attributable to a Standby Drawing under the relevant Liquidity Facility.

“Excluded Agreement”

has the meaning set out in the MDA.

“Excluded Insurance Proceeds Amount”

means, at any date, the aggregate of all proceeds of insurance received by SWS to cover the capital cost of reinstatement of assets which have not been applied by SWS in accordance with paragraph 6.5 of Schedule 12 (*Cash Management*) to the CTA; provided that if such aggregate is an amount less than £5,000,000 (indexed) then the “Excluded Insurance Proceeds Amount” on such date shall be zero.

“Existing Authorised Credit Facilities”

means the Existing RCF, the Initial Term Facility, the Second Artesian Term Facility and the NAB Facility.

“Existing Hedging Agreements”

means the interest rate transactions entered into by the Issuer with the Initial Hedge Counterparties on or prior to the Initial Issue Date, as amended from time to time.

“Existing DSR Liquidity Facility”

means the DSR Liquidity Facility currently made available under the Existing DSR Liquidity Facility Agreement.

“Existing DSR Liquidity Facility Agreement”

means the DSR Liquidity Facility Agreement dated 24 June 2010 between, among others, the Issuer and the Existing DSR Liquidity Facility Providers (as renewed from time to time).

“Existing DSR Liquidity Facility Providers”

means Abbey National Treasury Services Plc, Barclays Bank PLC, BNP Paribas, London Branch, HSBC Bank plc and The Royal Bank of Scotland plc or their respective successors.

“Existing RCF”

means the revolving credit facilities of an aggregate facility amount of £200,000,000 made available to SWS by the Initial RCF Providers from 9 July 2010.

“Existing RCF Agent”

means The Royal Bank of Scotland plc, or any successor thereto.

“Existing RCF Agreement”

means a facility agreement dated 24 June 2010, under which the Existing RCF was made available to SWS.

“Existing RCF Providers”

means the syndicate of banks which together provide the Existing RCF.

“Extraordinary Resolution”

means a resolution passed by a meeting of 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 at such meeting.

“Facility Agent”

means any facility agent under any Authorised Credit Facility.

“FG Event of Default”

means (A) in relation to each of MBIA Assurance S.A. and MBIA UK:

- (a) any Guaranteed Amount which is Due for Payment (each as defined under the relevant Financial Guarantee) 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 Financial Guarantee;
- (b) such Financial Guarantor disclaims, disaffirms, repudiates and/or challenges the validity of any of its obligations under the relevant Financial Guarantee 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.

(B) In relation to Assured Guaranty (Europe) only, means the occurrence of the following:

- (a) any amount which is due for payment by Assured Guaranty (Europe) under the relevant Financial Guarantee

is not paid on the due date;

- (b) Assured Guaranty (Europe) disclaims, disaffirms, repudiates and/or challenges the validity of any of its obligations under the relevant Financial Guarantee or seeks to do so;
- (c)
 - (i) a court of competent jurisdiction enters a final and non-appealable order, judgment or decree for relief under any Insolvency Law in any applicable jurisdiction against Assured Guaranty (Europe);
 - (ii) an encumbrancer takes possession of a material part of Assured Guaranty (Europe)'s property or assets; or
 - (iii) the appointment of an administrator or receiver (including an administrative receiver or manager), conciliator, trustee, assignee, custodian, sequestrator, liquidator or similar official under any Insolvency Law, of Assured Guaranty (Europe) (or as the case may be, of a material part of its property or assets);
- (d) Assured Guaranty (Europe):
 - (i) presents any petition or takes any formal steps or proceedings for the winding-up, or the appointment of an administrator or receiver (including an administrative receiver or manager), conciliator, trustee, assignee, custodian, sequestrator, liquidator or similar official under any Insolvency Law, of Assured Guaranty (Europe) (or, as the case may be, of a material part of its property or assets);
 - (ii) makes or enters into any general assignment, composition, arrangement (including, a voluntary arrangement under Part I of the Insolvency Act 1986) or compromise with or for the benefit of any of its creditors;
 - (iii) becomes unable to pay its debts within the meaning of section 123(2) or section 123(1)(e) of such Insolvency Act or admits in writing its inability, or fails generally, to pay its debts as they become due; or
- (e) at any time it is or becomes unlawful for Assured Guaranty (Europe) to perform or comply with any part of all of its obligations under the relevant Financial Guarantee or any of its obligations thereunder are not or cease to be legal, valid or binding.

(C) in relation to any other Financial Guarantor, such events as are specified in that Financial Guarantor's G&R Deed or equivalent document and, in relation to Wrapped Bonds, set out in the relevant Final Terms.

For the purpose of this definition, "**Bankruptcy Law**" means (i) in relation to MBIA Assurance S.A. only, articles L260-1 et seq. and L611-1 et seq. of the French Commercial Code, 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 (ii) in relation to MBIA UK only, any applicable United Kingdom bankruptcy or insolvency law, including the Enterprise Act 2002, the Insolvency Act 2000, the Insolvency Act 1986, the Insolvency Rules 1986, the Insolvency Regulations 1994 or any legislation passed in substitution or replacement thereof or amendment thereof or similar law, statute or regulation for the relief of debtors of the United Kingdom or any other applicable jurisdiction.

For the purpose of this definition and in relation to Assured Guaranty (Europe) only, “**Insolvency Law**” means any applicable United Kingdom bankruptcy or insolvency law, including the Enterprise Act 2002, the Insolvency Act 2000, the Insolvency Act 1986, the Insolvency Rules 1986, the Insolvency Regulations 1994 or any legislation passed in substitution, replacement or supplement thereof or amendment thereof or similar law, statute or regulation for the relief of debtors of the United Kingdom or any other applicable jurisdiction.

“ FG Excepted Amounts ”	means any additional amounts relating to premium, prepayment or acceleration, accelerated amounts and Subordinated Coupon Amounts.
“ Fifth Issue Date ”	means 17 July 2007.
“ Fifth Issuer/SWS Loan Agreement ”	means the loan agreement entered into between the Issuer and SWS on 17 July 2007.
“ Final Business Plan ”	means the SWS final business plan for the AMP5 Period submitted to Ofwat.
“ Final Determination ”	means the final price determination made by the Director General on a five-yearly basis.
“ Final Terms ”	means the Final Terms issued in relation to each Tranche or Sub-Class of Bonds as a supplement to the Conditions and giving details of the Tranche or Sub-Class.
“ Finance Documents ”	means: <ul style="list-style-type: none">(a) the Security Documents;(b) the Bond Trust Deed;(c) the Bonds (including the applicable Final Terms);(d) the Financial Guarantees;(e) the G&R Deeds;(f) the Financial Guarantee Fee Letters;(g) the Finance Lease Documents;(h) the Hedging Agreements;(i) the Common Terms Agreement;(j) the Issuer/SWS Loan Agreements;(l) the Second Revolving Credit Facility Agreement;

- (m) the Existing RCF Facility Agreement
- (n) the Initial Term Facility Agreement;
- (o) the Second Artesian Term Facility Agreement;
- (p) the Liquidity Facility Agreements;
- (q) the Agency Agreement;
- (r) the Mezzanine Facility Agreements;
- (s) the Master Definitions Agreement;
- (t) the Account Bank Agreement;
- (u) the CP Agreement;
- (v) any other Authorised Credit Facilities;
- (w) the Tax Deeds of Covenant;
- (x) the Indemnification Deeds;
- (y) the SWS/SWSG Loan Agreement and any related security document;
- (z) SWS Preference Share Deed; and
- (aa) each agreement or other instrument between SWS or the Issuer (as applicable) and an Additional Secured Creditor designated as a Finance Document by SWS or the Issuer (as applicable), the Security Trustee 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 any finance lease entered into by SWS 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) permitted to be entered into under the terms of the CTA, each a **“Finance Lease”**.

“Finance Lessors”

means any person entering into a Finance Lease with SWS, as permitted by the CTA and the STID, who accedes to the STID and the CTA as a Finance Lessor (each a **“Finance Lessor”**).

“Finance Party”

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 Facility.

“Financial Guarantee Fee”

means any fees payable to the Financial Guarantor under a Financial Guarantee Fee Letter.

“Financial Guarantee Fee Letter”

means any letter or other agreement between a Financial Guarantor and one or more of the Obligor setting the terms on which premia are payable in relation to one or more Financial Guarantees issued or to be issued by that Financial Guarantor and includes the MBIA Financial Guarantee Fee Letter.

“Financial Guarantees”

means any financial guarantee issued by a Financial Guarantor in respect of any Wrapped Debt and includes the Initial Financial

Guarantees and “**Financial Guarantee**” shall be construed accordingly.

“Financial Guarantor”

means any person, including the Initial Financial Guarantors, which provides a financial guarantee, including the Financial Guarantees, in respect of any of the Wrapped Debt, and “**Financial Guarantors**” means all of them if there is more than one at any time.

“Financial Indebtedness”

means (without double-counting) any indebtedness for or in respect of:

- (a) moneys borrowed or raised (whether or not for cash);
- (b) any documentary or standby letter of credit facility;
- (c) any acceptance credit;
- (d) any bond, note, debenture, loan stock or other similar instrument;
- (e) any finance or capital lease or hire purchase contract which would, in accordance with Applicable Accounting Principles, be treated as such;
- (f) any amount raised pursuant to any issue of shares which are capable of redemption;
- (g) receivables sold or discounted (other than on a non-recourse basis to any member of the SWS Financing Group);
- (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;
- (i) any termination amount due from any member of the SWS Financing Group in respect of any Treasury Transaction that has terminated;
- (j) any other transaction (including any forward sale or purchase agreement) which has the commercial effect of a borrowing (other than any trade credit or indemnity granted in the ordinary course of SWS’s trading and upon terms usual for such trade);
- (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; and
- (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 (other than any guarantee or indemnity in respect of obligations owed by one member of the SWS Financing Group to another).

“Financial Statements”

means, at any time, the financial statements of an Obligor, consolidated where applicable, most recently delivered to the

	Security Trustee.
“Financial Year”	means the 12 months ending on the 31 March in each year or such other period as may be approved by the Security Trustee.
“First Aqua Acquisition”	means the acquisition of Southern Water (NR) Limited and its subsidiaries (including SWS) from Scottish Power UK plc in April 2002.
“Fitch”	means Fitch Ratings Limited and any successor to the rating agency business of Fitch Ratings Limited.
“Fixed Rate Bond”	means a Bond on which interest is calculated at a fixed rate payable in arrear on a fixed date or fixed dates in each year and on redemption or on such other dates as may be agreed between the Issuer and the relevant Dealer(s) (as indicated in the applicable Final Terms).
“Floating Rate Bond”	means a Bond on which interest is calculated at a floating rate payable in arrear in respect of such period or on such date(s) as may be agreed between the Issuer and the relevant Dealer(s) (as indicated in the applicable Final Terms).
“Form of Transfer”	means the form of transfer endorsed on an Individual Bond Certificate in the form or substantially in the form set out in Schedule 3, Part B to the Bond Trust Deed.
“Fourth Issue Date”	means 18 October 2006.
“Fourth Issuer/SWS Loan Agreement”	means the loan agreement entered into between the Issuer and SWS on 18 October 2006.
“Full Greensands Group”	means Greensands Holdings Limited and its Subsidiaries from time to time.
“FSMA”	means the Financial Services and Markets Act 2000, as amended.
“G&R Deed”	means a guarantee and reimbursement deed (or agreement of similar name and effect) between, among others, the Issuer and a Financial Guarantor in connection with a particular Sub-Class of Class A Wrapped Bonds and/or Class B Wrapped Bonds or any other Class A Wrapped Debt.
“GAAP”	means Generally Accepted Accounting Principles.
“Global Bond”	means a Temporary Global Bond and/or a Permanent Global Bond, as the context may require.
“Global Bond Certificate”	means a Registered Bond in global form in the form or substantially in the form set out in Part A (Form of Global Bond Certificate) of Schedule 3 to the Bond Trust Deed, together with such modifications (if any) as may be agreed between the Issuer, the Principal Paying Agent, the Bond Trustee and the relevant Dealer(s), together with the copy of each applicable Final Terms annexed thereto, comprising some or all of the Registered Bonds of the same Sub-Class sold outside the United States in reliance on Regulation S under the Securities Act, issued by the Issuer pursuant to the Dealership Agreement or any other agreement between the Issuer and the relevant Dealer(s) relating to the Programme, the Agency Agreement and the Bond Trust Deed and

	refers to a Regulation S Global Bond Certificate and/or a Rule 144A Global Bond Certificate, as the context may require.
“Good Industry Practice”	means the standards, practices, methods and procedures as practised in the United Kingdom conforming to all applicable laws and the 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.
“Government”	means the government of the United Kingdom.
“Greensands Companies”	means Greensands Investments Limited, Greensands Senior Finance Limited, Greensands Junior Finance Limited, Greensands (UK) Limited and Greensands Europe Limited, all incorporated in England and Wales, and Greensands Holdings.
“Greensands Holdings”	means Greensands Holdings Limited, incorporated in Jersey.
“Greensands Group”	means Greensands Holdings Limited and its Subsidiaries, excluding the SWS Financing Group.
“Group”	means Southern Water Investments Limited and its Subsidiaries.
“Guarantee”	means, in relation to each Obligor, the guarantee of such Obligor given by it pursuant to the Security Document to which it is a party.
“Guarantors”	means SWSH, SWSGH and SWS, each a “Guarantor” .
“Hedge Counterparties”	means (i) the Initial Hedge Counterparties and (ii) any counterparty to a Hedging Agreement which is or becomes party to the STID in accordance with the STID and “Hedge Counterparty” means any of such parties.
“Hedging Agreement”	means: <ul style="list-style-type: none"> (a) 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 certain provisions of Schedule 8 (<i>Hedging Policy and Overriding Provisions Relating to Hedging Agreements</i>) to the CTA); (b) 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 certain provisions of Schedule 8 (<i>Hedging Policy and Overriding Provisions Relating to Hedging Agreements</i>) to the CTA) designated a Hedging Agreement by the Security Trustee and the Issuer, <p>(and references to “Hedging Agreements” shall be construed accordingly).</p>
“Hedging Policy”	means the initial hedging policy applicable to SWS and the Issuer set out in Schedule 8 (<i>Hedging Policy and Overriding Provisions</i>

Relating to Hedging Agreements) of the CTA as such hedging policy may be amended from time to time by agreement between the Security Trustee, the Issuer and, in certain circumstances, the Hedge Counterparties in accordance with the STID.

“Holding Company”	means a holding company within the meaning of section 736 of the Companies Act 1985.
“IDOK”	means an interim determination of K as provided for in Part IV of Condition B of the Licence.
“Income”	means any interest, dividends or other income arising from or in respect of an Authorised Investment.
“Indemnification Deed”	<p>means:</p> <ul style="list-style-type: none">(a) the deed so named and entered into on 18 July 2003 (as amended from time to time) between, among others, the Obligors, MBIA Assurance S.A. and the Dealers;(b) the deed so named and entered dated 25 May 2005 between the Issuer, SWSGH, SWSH, SWS, MBIA Assurance S.A., RBS and Citigroup Global Markets Limited;(c) the deed so named and entered dated 18 October 2006 between the Issuer, SWSGH, SWSH, SWS, MBIA UK and RBS;(d) the deed so named and entered dated 12 July 2007 between Assured Guaranty (Europe), the Issuer and RBS; <p>and each other deed entered into between a Financial Guarantor, the Obligors and the Dealers in respect of any previous issuance of Wrapped Bonds.</p>
“Independent Review”	means an independent review resulting from a Trigger Event as set out in Paragraph 3, Part 2 (<i>Trigger Event Consequences</i>) of Schedule 6 to the CTA and set out in Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Common Terms Agreement</i> ”.
“Indexed Bond”	means a bond in respect of which the amount payable in respect of principal and interest is calculated by reference to an index and/or formula as the Issuer and the relevant Dealer(s) may agree (as indicated in the relevant Final Terms).
“Individual Bond Certificate”	means a Registered Bond in definitive form issued or to be issued by the Issuer in accordance with the provisions of the Dealership Agreement or any other agreement between the Issuer and the relevant Dealer(s), the Agency Agreement and the Bond Trust Deed either on issue or in exchange for a Global Bond Certificate or part thereof (all as indicated in the applicable Final Terms), such Registered Bond in definitive form being in the form or substantially in the form set out in Schedule 3 to the Bond Trust Deed with such modifications (if any) as may be agreed between the Issuer, the Principal Paying Agent, the Bond Trustee and the relevant Dealer(s) and having the Conditions endorsed thereon or, if permitted by the relevant Stock Exchange, incorporating the

	Conditions by reference as indicated in the applicable Final Terms and having the relevant information supplementing the Conditions appearing in the applicable Final Terms endorsed thereon or attached thereto and having a Form of Transfer endorsed thereon.
“Initial Authorised Credit Facility Arranger”	means The Royal Bank of Scotland plc, or any successor thereto.
“Initial Date Representation”	has the meaning set out in Chapter 7 <i>“Summary of the Financing Agreements”</i> under <i>“Common Terms Agreement – Representations”</i> .
“Initial Financial Guarantees”	means the financial guarantees issued by the Initial Financial Guarantors (subject to the satisfaction of certain conditions set out in the CP Agreement) in connection with the Sub-Classes of Class A Wrapped Bonds issued on the Initial Issue Date, the Sub-Classes of Class A Wrapped Bonds issued on 27 May 2005, the Sub-Classes of Class A Wrapped Bonds issued on 18 October 2006 and the Sub-Class of Class A Wrapped Bonds issued on 17 July 2007.
“Initial Financial Guarantors”	means each of MBIA Assurance S.A., MBIA UK and Assured Guaranty (Europe). (A decision of the Comité des Entreprises d’Assurance (the French insurance regulator) on 27 December 2007 approved the transfer of the business of MBIA Assurance S.A. to MBIA UK Insurance Limited with effect from 28 December 2007 pursuant to article L.324-1 of the French Insurance Code; MBIA UK Insurance Limited has, therefore, assumed all rights and obligations of MBIA Assurance S.A. under the Transaction Documents as if it were the Initial Financial Guarantor of the Series of Wrapped Bonds issued on 23 July 2003 and 27 May 2005.)
“Initial Hedge Counterparties”	means The Royal Bank of Scotland plc and Citibank, N.A., London Branch with whom the Issuer has entered into the Initial Hedging Agreements.
“Initial Hedging Agreements”	means each Hedging Agreement entered into with the Initial Hedge Counterparties on or before the Initial Issue Date.
“Initial Issue Date”	means 23 July 2003.
“Initial Issuer/SWS Loan Agreement”	means the loan agreement entered into between the Issuer and SWS on the Initial Issue Date.
“Initial Mezzanine Facility Providers”	has the meaning given to that term on page 13 of the Prospectus.
“Initial RCF”	means the revolving credit facilities of an aggregate facility amount of £150,000,000 made available to SWS by the Initial RCF Providers on the Initial Issue Date.
“Initial RCF Agreement”	means a facility agreement dated the Initial Issue Date, as amended and restated on 26 July 2005, and cancelled in full by SWS on 9 July 2010, under which the Initial RCF was made available to SWS.
“Initial RCF Providers”	means the syndicate of banks which together provided the Initial RCF.
“Initial Term Facility”	means the initial term facility made available to the Issuer by the

Initial Term Facility Provider on the Initial Issue Date.

“Initial Term Facility Agreement”

means a facility agreement under which the Initial Term Facility was made available to the Issuer and includes that facility agreement in the form amended and restated at the time of the novation of such facility agreement to Artesian II.

“Initial Term Facility Provider”

means The Royal Bank of Scotland plc, or any successor thereto including, upon novation of the Initial Term Facility Agreement to Artesian II, Artesian II.

“Insolvency Event”

means, in respect of any company:

- (a) the initiation of or consent to Insolvency Proceedings by such company or any other person or the presentation of a petition or application for the making of an administration order (other than in the case of the Issuer) and, in the opinion of the Security Trustee, such proceedings are not being disputed in good faith with a reasonable prospect of success;
- (b) the giving of notice of appointment of an administrator or the making of an administration order or an administrator being appointed in relation to such company;
- (c) an encumbrancer (excluding, in relation to the Issuer, the Security Trustee or any receiver) taking possession of the whole or any part of the undertaking or assets of such company;
- (d) any distress, execution, attachment or other process being levied or enforced or imposed upon or against the whole or any substantial part of the undertaking or assets of such company (excluding, in relation to the Issuer, by 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;
- (e) the making of an arrangement, composition, scheme of arrangement, 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;
- (f) the passing by such company of an effective resolution or the making of an order by a court of competent jurisdiction for the winding up, liquidation 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 connection with any Insolvency Proceedings in relation to a company, a liquidator, provisional liquidator, administrator, Special Administrator, administrative receiver, receiver, 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, in respect of any company, the winding-up, liquidation, dissolution, administration of such company, or any equivalent or analogous proceedings under the law of the jurisdiction in which such company is incorporated or of any jurisdiction in which such company carries on business, including the seeking of liquidation, winding-up, reorganisation, dissolution, administration, arrangement, adjustment, protection or relief of debtors.

“Instalment Bonds”

means any Bonds specified as being instalment bonds in the relevant Final Terms.

“Instructing Group”

means the Class A DIG or, following repayment in full of the Class A Debt, the Class B DIG or, following repayment of the Class A Debt and the Class B Debt in full, the “Majority Lenders” under the Senior Mezzanine Facility Agreement (as defined therein).

**“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 September 1989) under which the Secretary of State for the Environment appointed SWS 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.

“Insurances”

means, as the context may require, any or all of the insurances described in or taken out pursuant to Schedule 16 (*Insurances*) of the CTA and any other contract or policy of insurance taken out by an Obligor from time to time, including in each case any future renewal or replacement of any such insurance whether with the same or different insurers and whether on the same or different terms as further defined in Schedule 16 (*Insurances*) of the CTA.

“Intellectual Property Right”

means all right, title and interest in:

- (a) any trade mark, service mark, trade name, logo, patent, invention, design or similar right;
- (b) any designs, copyright, semi-conductor topography, database and know-how or intellectual property right; and
- (c) all such similar rights which may subsist in any part of the

	world,
	in each case whether registered or not, whether in existence now or in the future, and includes any related application.
“Intercompany Loan”	means the principal amount of all advances from time to time outstanding under an Issuer/SWS Loan Agreement.
“Intercreditor Arrangements”	means the arrangements between the Secured Creditors of the SWS Financing Group in the STID summarised in Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Security Trust and Intercreditor Deed</i> ”.
“Interest Commencement Date”	means, in the case of interest-bearing Bonds, the date specified in the applicable Final Terms from (and including) which such Bonds bear interest, which may or may not be the Issue Date.
“Interest Payment Date”	means any date upon which interest or payments equivalent to interest become payable under the terms of any Authorised Credit Facility.
“Interest Rate Hedging Agreement”	means a Treasury Transaction to swap interest rates and rates linked to inflation.
“Investment Grade”	means a rating of at least BBB- by Fitch, Baa3 by Moody’s or BBB- by S&P.
“Investors Report”	means each report produced by SWS and the Issuer to be delivered within 120 days from 31 March or 60 days from 30 September in each year substantially in the form set out in the CTA.
“IRC”	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 SWS in the Director General’s most recent Final Determination adjusted as appropriate for any subsequent IDOK and for Out-turn Inflation, provided that for the purposes of calculating any financial ratio for any Test Period for which there is no Final Determination, “ IRC ” shall be SWS’s good faith, honestly held present estimate of such infrastructure renewals charge for such Test Period.
“ISDA Master Agreement”	means an agreement in the form of the 1992 or 2002 ISDA Master Agreement (Multi-Currency Cross Border) or any successor thereto published by ISDA unless otherwise agreed by the Security Trustee.
“Issue Date”	means the date of issue of any Tranche of Bonds or the date upon which all conditions precedent to a utilisation under any other Authorised Credit Facility have been fulfilled or waived and the Issuer makes a utilisation of that facility.
“Issue Price”	means the price as stated on the relevant Final Terms, generally expressed as a percentage of the nominal amount of the Bonds, at which the Bonds will be issued.
“Issuer”	means Southern Water Services (Finance) Limited an exempted company incorporated under the laws of the Cayman Islands with limited liability and company number 112331.

“Issuer/SWS Loan Agreement”	means any loan agreement entered into between the Issuer and SWS, including the Initial Issuer/SWS Loan Agreement, the Second Issuer/SWS Loan Agreement, the Third Issuer/SWS Loan Agreement, the Fourth Issuer/SWS Loan Agreement, the Fifth Issuer/SWS Loan Agreement and the Sixth Issuer/SWS Loan Agreement.
“Joint Venture”	means any arrangement or agreement for any joint venture, co-operation or partnership pursuant to, required for or conducive to the operation of the Business by SWS but shall exclude any arrangements or framework agreements entered into with a Contractor which are in accordance with and subject to the Outsourcing Policy.
“Junior Mezzanine Debt”	means the loan outstanding under a £106,000,000 junior mezzanine facility agreement dated the Initial Issue Date between, amongst others, the Issuer and The Royal Bank of Scotland plc as agent, which was prepaid in full on 15 April 2009.
“K”	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.
“K5 Period”	means the Periodic Review Period that started on 1 April 2010.
“Lead Manager”	means in relation to any Tranche of Bonds, the person named as the lead manager in the relevant Subscription Agreement.
“Lease Calculation Cashflow”	means, in respect of any 12 month period commencing on 1 April in any year, 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 12 month period and in accordance with its terms and the terms of the relevant Accession Memorandum, and using, <i>inter alia</i> , for the purposes of calculating the amount shown for each Rental Payment Date falling within the relevant 12 month 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 certain reference banks 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 12 month period and as agreed between SWS 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 12 month period commencing on 1 April in any year, the Lease Calculation Cashflow applicable to that Finance Lease for such 12 month period shall also include a cashflow statement, produced as soon as reasonably practicable after the time of recalculating the Rental and in accordance with its terms, and the terms of the relevant 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 12 month period.

“Lease Calculation Date”

means in respect of any Finance Lease:

- (a) the date of the Accession Memorandum executed by the relevant Finance Lessor relating to such Finance Lease; and
- (b) the date falling 10 days before the Rental Payment Date immediately preceding the commencement date of the first 12 month period to commence on 1 April immediately after the date referred to in (a) above; and
- (c) each yearly anniversary of the date referred to in (b) above, save that where any date referred to in (a), (b) or (c) is not a Business Day, such date shall be deemed to be the preceding Business Day.

“Lease Reserve Amount”

means in respect of any Finance Lease in any 12 month period commencing on 1 April in any year, 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 during such 12 month period (inclusive of VAT) (after adding back any additional rentals (inclusive of VAT) payable and deducting any estimated rental rebates (inclusive of any credit for VAT), in each case as determined in accordance with the provisions of the relevant Finance Lease).

“LIBOR”

has the meaning given to that term in the relevant Finance Document.

“Licence”

means the Instrument of Appointment.

“Liquidity Facility”

means a DSR Liquidity Facility or an O&M Reserve Facility made available under a Liquidity Facility Agreement and **“Liquidity Facilities”** means all of them.

“Liquidity Facility Agent”

means, in respect of the Existing DSR Liquidity Facility Agreement, The Royal Bank of Scotland plc and, in respect of any other Liquidity Facility Agreement, the Facility Agent under such Liquidity Facility Agreement.

“Liquidity Facility Agreement”

means each liquidity facility agreement which has the characteristics set out in Schedule 15 (*DSR Liquidity Facility/O&M Reserve Facility Terms*) of the CTA, as established in connection with each Sub-Class of Bonds issued by or other Authorised Credit Facility provided to the Issuer or SWS or

	shortfalls in funding for Projected Operating Expenditure or projected Capital Maintenance Expenditure, each counterparty to which has acceded to the terms of the STID and the CTA.
“Liquidity Facility Provider”	means any lender from time to time under a Liquidity Facility Agreement that has agreed to be bound by the terms of the STID and the CTA, including the DSR Liquidity Facility Provider(s) and any O&M Reserve Facility Provider(s).
“Liquidity Facility Requisite Ratings”	means together the Minimum Short-term Rating from at least two Rating Agencies.
“London Stock Exchange”	means The London Stock Exchange plc.
“Majority Creditors”	means the 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, the 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 (<i>Modifications, Consents and Waivers</i>) and Clause 9 (<i>Voting, Instructions and Notification of Outstanding Principal Amount of Qualifying Debt</i>) of the STID as set out in Chapter 7 “ <i>Summary of the Financing Agreements</i> ”.
“Make-Whole Amount”	means any amount above par payable on redemption of any Class A Debt or Class B Debt except where such amount is limited to accrued interest.
“Mandatory Cost Rate”	means, in relation to any Authorised Credit Facility, the addition to the interest rate payable to compensate that Authorised Credit Provider for the cost of compliance with the requirements of the Bank of England and/or the Financial Services Authority (or, in either case, any other authority which replaces all or any of its functions) in accordance with the formula(e) set out in the relevant Authorised Credit Facility.
“Market”	means the Regulated Market of the London Stock Exchange.
“Master Definitions Agreement” or “MDA”	means the master definitions agreement entered into on the Initial Issue Date, as amended on 13 October 2006 and from time to time.
“Material Adverse Effect”	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"> (a) the business, property, operations or financial condition of SWS, the Issuer or of the SWS Financing Group as a whole; (b) the ability of any member of the SWS Financing Group to perform its material obligations under any Finance Document; (c) the validity or enforceability of any Finance Document or the rights or remedies of any Secured Creditor thereunder; or (d) the ability of SWS to perform or comply with any of its

obligations under the Instrument of Appointment or the WIA.

“Material Agreement”

means:

- (a) for the purpose of Schedule 2 (Material Entity Events) to the CTA and Paragraph 11 (Material Entity Event) of Part 1 and Part 3 of Schedule 6 (Trigger Events) only:
 - (i) any Capex Contract (or series of Capex Contracts) with the same Contractor (or its Affiliates) entered into by SWS for the purposes of, or in connection with, SWS carrying out its Regulated Business, where the NPV at the later of (a) the Initial Issue Date and (b) the date at which it is entered into or amended, supplemented or novated, of the agreed target cost payable by SWS under that Capex 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 £25 million (indexed); and/or
 - (ii) any Outsourcing Agreement (or series of Outsourcing Agreements) entered into with the same Contractor (or its Affiliates) where the annual value of the contracts entered into between SWS and such Contractor (or its Affiliates) (which in each case has not been terminated or expired in accordance with its terms) exceeds (or would exceed if entered into on arms’ length terms) 10 per cent. of the Projected Operating Expenditure for the Test Periods in which such contracts are entered into.
- (b) except as provided for in (i) above, any Material Capex Agreement and Material O&M Agreement.

“Material Capex Agreement”

has the meaning given to that term in the Outsourcing Policy.

“Material Entity Event”

means the events or circumstances set out in Schedule 2 (*Material Entity Events*) to the CTA and described in Chapter 7 “*Summary of the Financing Agreements*” under “*Common Terms Agreement – Material Entity Events*” of this Prospectus.

“Material O&M Agreement”

has the meaning given to that term in the Outsourcing Policy.

“Maturity Date”

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.

“MBIA UK”

means MBIA UK Insurance Limited

“MBIA Financial Guarantee Fee Letter”

means the Financial Guarantee Fee Letters between MBIA Assurance S.A. and the Issuer relating to the MBIA S.A. Initial Financial Guarantees. (A decision of the Comité des Entreprises d’Assurance (the French insurance regulator) on 27 December 2007 approved the transfer of the business of MBIA Assurance S.A. to MBIA UK Insurance Limited with effect from 28

	December 2007 pursuant to article L.324-1 of the French Insurance Code; MBIA UK Insurance Limited has, therefore, assumed all rights and obligations of MBIA Assurance S.A. under the Transaction Documents as if it were the Initial Financial Guarantor of the Series of Wrapped Bonds issued on 23 July 2003 and 27 May 2005.)
“MBIA S.A. Initial Financial Guarantees”	means the financial guarantees issued by MBIA Assurance S.A. in respect of Class A Wrapped Bonds issued on 23 July 2003 and on 27 May 2005. (A decision of the Comité des Entreprises d’Assurance (the French insurance regulator) on 27 December 2007 approved the transfer of the business of MBIA Assurance S.A. to MBIA UK Insurance Limited with effect from 28 December 2007 pursuant to article L.324-1 of the French Insurance Code; MBIA UK Insurance Limited has, therefore, assumed all rights and obligations of MBIA Assurance S.A. under the Transaction Documents as if it were the Initial Financial Guarantor of the Series of Wrapped Bonds issued on 23 July 2003 and 27 May 2005.)
“Member State”	means a member state of the European Union.
“Mezzanine Debt”	means the Senior Mezzanine Debt.
“Mezzanine Facilities”	means the Senior Mezzanine Facility.
“Mezzanine Facility Agreements”	means the Senior Mezzanine Facility Agreement.
“Mezzanine Facility Provider”	means a Senior Mezzanine Facility Provider.
“Mezzanine Finance Parties”	means the Senior Mezzanine Finance Parties.
“Minimum Short-term Rating”	means, in respect of any person, such person’s short-term unsecured debt obligations being rated, in the case of Moody’s, “Prime-1”; in the case of S&P, “A-1”; and in the case of Fitch, “F-1”.
“Monthly Payment Amount”	has the meaning set out in Paragraph 5.9 of Schedule 12 (<i>Cash Management</i>) to the Common Terms Agreement, approximately (and subject to adjustment) equal to 1/12 th of SWS’s Annual Finance Charge for the relevant 12 month period.
“Moody’s”	means Moody’s Investors Service, Limited, or any successor to the rating agency business of Moody’s Investors Service, Limited.
“Moody’s Minimum Long-term Rating”	means in respect of any person, such person’s long-term unsecured debt obligations being rated A2 by Moody’s.
“NAB Facility”	means the term facility of an aggregate facility amount of £50,000,000 made available to SWS by the NAB Facility Provider from 5 June 2009.
“NAB Facility Agreement”	means the term facility agreement dated 5 June 2009, under which the NAB Facility was made available to SWS.
“NAB Facility Provider”	means National Australia Bank Limited.
“Net Cash Flow”	means: <ul style="list-style-type: none"> (a) in respect of any historical element of a Test Period, the aggregate of net cash flow from operating activities as

shown in the SWS 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 (other than non-cash exceptional items), any recoverable VAT, any Capital Expenditure and any movement in debtors and/or creditors relating to Capital Expenditure) minus corporation tax paid which shall exclude payments in respect of a Permitted Tax Loss Transaction as part of any SWS/SWSG Debt Service Distribution, during such Test Period; and

- (b) in respect of any forward-looking element of a Test Period, the aggregate of anticipated net cash flow from operating activities (after adding back, without double counting and to the extent that such items are included in the anticipated net cash flow from operating activities, any exceptional items (other than non-cash exceptional items), any recoverable VAT, any Capital Expenditure and any movement in debtors and/or creditors relating to Capital Expenditure in each case anticipated to occur during such Test Period) minus corporation tax which shall exclude payments in respect of a Permitted Tax Loss Transaction as part of any SWS/SWSG Debt Service Distributions anticipated to be paid during such Test Period less any anticipated net cash flow from operating activities of its business other than its Appointed Business and after adding back corporation tax anticipated to be paid as a result of such businesses during such Test Period.

“New Money Advance”

means any drawing during a Standstill under any Authorised Credit Facility which is not made (or to the extent not made) for the purpose of refinancing a drawing under such Authorised Credit Facility.

“Non-Appointed Expense”

means any expense incurred in connection with activities other than Appointed Business.

“Non-Base Currency”

means a currency other than pounds sterling.

“Notice” or “notice”

means, in respect of a notice to be given to Bondholders, a notice validly given pursuant to Condition 17 (Notices).

“Notified Item”

has the meaning given to such term in Chapter 6 “*Regulation of the Water and Wastewater Industry in England and Wales*” under “*Interim Determinations of K*”.

“Notional Amount”

means, in respect of any Finance Lease, a sum, certified by any 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 12 month period commencing on 1 April, the amount shown for each Rental Payment Date falling in that relevant 12 month period under the headings “interest” and “margin” (or any equivalents thereof (howsoever worded)) in such Lease Calculation Cashflow, together with an amount equal to the VAT on such amount at the

	rate applicable to rentals payable under the relevant Finance Lease.
“NPV”	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 a discount rate of 7.5 per cent.
“O&M Reserve”	means the amounts standing to the credit of the O&M Reserve Accounts.
“O&M Reserve Accounts”	means the accounts of SWS and/or the Issuer 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.
“O&M Reserve Facility”	means any operation and maintenance reserve liquidity facility made available under a Liquidity Facility Agreement.
“O&M Reserve Facility Agreement”	means an agreement establishing an O&M Reserve Facility.
“O&M Reserve Facility Provider”	means any provider from time to time of an O&M Reserve Facility.
“O&M Reserve Required Amount”	means not less than 10 per cent. of Projected Operating Expenditure and Capital Maintenance Expenditure required for the next succeeding 12 month period as forecast in the SWS Business Financial Model.
“Obligors”	means the Issuer, SWS, SWSH and SWSGH and “Obligor” means any of them.
“Official List”	means the official list of the UK Listing Authority.
“OFT”	means the Office of Fair Trading in the United Kingdom.
“Ofwat”	means the WSRA including its successor office or body.
“Operating Accounts”	means each account of SWS with the following titles: SWS Ltd. CAO Income, SWS Ltd. Misc Income, SWS Collections, SWS Ltd. No.2 Refunds, General Payments No.3, and SWS Ltd. Central Account held at the Account Bank and includes any sub-account or sub-accounts relating to that account and any replacement account or accounts from time to time.
“Order”	means the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005.
“Ordinary Drought Order”	means an order granted by Defra that allows a Regulated Company to stop or limit the use of water for a range of purposes specified in the Drought Direction 1991.
“Original Senior Mezzanine Facility Provider”	means Royal Bank Investments Limited.
“Other Parties”	means the Hedge Counterparties, the Liquidity Facility Providers, the Authorised Credit Providers, the Mezzanine Facility Providers, the Agents, the Account Bank, the Standstill Cash Manager and members of the Full Greensands Group (other than the Obligors).
“Outsourcing Agreement”	means any agreement pursuant to which SWS sub-contracts, tenders or outsources either the day to day operation of its assets, business services and service delivery (including any maintenance

expenditure) or acquires technical know-how and access to other Intellectual Property Rights in relation to water and sewerage services that, in the case of any outsourcing SWS could, if not outsourced, perform itself.

“Outsourcing Policy”

means the outsourcing policy set out in Schedule 9 (*Outsourcing Policy*) to the CTA (as amended or replaced from time to time).

“Outstanding”

means, in relation to the Bonds of all or any Sub-Class, all the Bonds of such Sub-Class issued other than:

- (a) those Bonds which have been redeemed pursuant to the Bond Trust Deed;
- (b) those Bonds in respect of which the date (including, where applicable, any deferred date) for redemption in accordance with the Conditions has occurred and the redemption moneys (including all interest payable thereon) have been duly paid to the Bond Trustee or to the Principal Paying Agent in the manner provided in the Agency Agreement (and where appropriate notice to that effect has been given to the relative Bondholders in accordance with Condition 17 (*Notices*)) and remain available for payment against presentation of the relevant Bonds and/or Receipts and/or Coupons;
- (c) those Bonds which have been purchased and cancelled in accordance with Conditions 8(f) (*Purchase of Bonds*) and (h) (*Redemption, Purchase and Cancellation – Cancellation*);
- (d) those Bonds which have become void or in respect of which claims have become prescribed, in each case under Condition 13 (*Prescription*);
- (e) those mutilated or defaced Bonds which have been surrendered and cancelled and in respect of which replacements have been issued pursuant to Condition 14 (*Replacement of Bonds, Coupons, Receipts and Talons*);
- (f) (for the purpose only of ascertaining the nominal amount of the Bonds outstanding and without prejudice to the status for any other purpose of the relevant Bonds) those Bonds which are alleged to have been lost, stolen or destroyed and in respect of which replacements have been issued pursuant to Condition 14 (*Replacement of Bonds, Coupons, Receipts and Talons*); and
- (g) in the case of Bearer Bonds, any Global Bond to the extent that it shall have been exchanged for Definitive Bonds or another Global Bond and, in the case of Registered Bonds, any Global Bond Certificate to the extent that it shall have been exchanged for Individual Bond Certificate, and, in each case, pursuant to its provisions, the provisions of the Bond Trust Deed and the Agency Agreement,

PROVIDED THAT for each of the following purposes, namely:

- (i) the right to attend and vote at any meeting of the holders of the Bonds of any Sub-Class;
- (ii) the determination of how many and which Bonds of any Sub-Class are for the time being outstanding for the purposes of Clause 8 of the Bond Trust Deed, Condition 15 (*Meetings of Bondholders, Modification, Waiver and Substitution*), Clause 9 (*Voting, Instructions and Notification of Outstanding Principal Amount of Qualifying Debt*) of the STID and Paragraphs 2, 5, 6 and 13 of Schedule 4 to the Bond Trust Deed;
- (iii) any discretion, power or authority (whether contained in the Bond Trust Deed or vested by operation of law) which the Bond Trustee is required, expressly or impliedly, to exercise in or by reference to the interests of the holders of the Bonds of any Sub-Class; and
- (iv) the determination by the Bond Trustee whether any event, circumstance, matter or thing is, in its opinion, materially prejudicial to the interests of the holders of the Bonds of any Sub-Class,

those Bonds of the relevant Sub-Class (if any) which are for the time being held by or on behalf of the Issuer, the other Obligors, or any Associate of the Issuer or the other Obligors (other than any Associate which is a licensed or regulated financial institution which holds Bonds in the ordinary course of its business), in each case as beneficial owner, shall (unless and until ceasing to be so held) be deemed not to remain outstanding.

“Outstanding Principal Amount”

means, as at any date that the same falls to be determined:

- (a) in respect of Wrapped Debt (unless an FG Event of Default has occurred and is continuing in respect of the Financial Guarantor of such Wrapped Debt), the aggregate of any unpaid amounts owing to a Financial Guarantor under a G&R Deed to reimburse it for any amount paid by it under a Financial Guarantee in respect of unpaid principal on such Wrapped Debt and the principal amount outstanding (or the Equivalent Amount) under such Wrapped Debt (including, in the case of Wrapped Bonds, any premium);
- (b) in respect of Wrapped Debt (if an FG Event of Default has occurred and is continuing in respect of the Financial Guarantor of such Wrapped Debt), the principal amount outstanding (or the Equivalent Amount) of such Wrapped Debt (including, in the case of Wrapped Bonds, any premium);
- (c) in respect of Unwrapped Debt, the principal amount outstanding (or the Equivalent Amount) of such Unwrapped Debt (including, in the case of Wrapped Debt, any premium);
- (d) in respect of any Authorised Credit Facilities that are loans

(but do not constitute Wrapped Debt), the principal amount (or the Equivalent Amount) of any drawn amounts that are outstanding under such Authorised Credit Facility;

- (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) under such Finance Lease 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 cashflow report which is current on such date) or (ii) following any Acceleration of Liabilities (other than a Permitted Lease Termination) under such Finance Lease, 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 on such date 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 Schedule 8 (*Hedging Policy and Overriding Provisions Relating to Hedging Agreements*) of the CTA; 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.

“Out-turn Inflation”

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 Retail Price Index 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 Ofwat may specify for the purposes of Condition B, of the Instrument of Appointment or otherwise) relative to the Retail Price Index from their base levels as used in the most recent Final Determination or IDOK and their relative movement as projected by Ofwat 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.

“Participating Member State”	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.
“Partly Paid Bond”	means a bond issued in the amount as specified in the relevant Final Terms and in respect of which further instalments will be payable in the amounts and on the dates as specified in the relevant Final Terms.
“Party”	means in relation to a Finance Document a party to such Finance Document.
“Paying Agents”	means, in relation to all or any Sub-Classes of the Bonds, the several institutions (including, where the context permits, the Principal Paying Agent and/or the Registrar) 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 Sub-Classes of the Bonds.
“Payment Date”	means each date on which a payment is made or is scheduled to be made by an Obligor in respect of any obligations or liability under any Authorised Credit Facility.
“Payment Priorities”	means the order of priority of the Permitted Payments to be made by the Issuer on each Payment Date as set out in Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Cash Management</i> ” as adjusted following the taking of any Enforcement Action and following termination of a Standstill (other than pursuant to a waiver or revocation by the Majority Creditors) in accordance with Paragraph 8.12 of Schedule 12 to the CTA.
“Pension Companies”	means SWEPST (which no longer serves a function) and SWPT.
“Periodic Information”	means: <ul style="list-style-type: none">(a) SWS’s annual charges scheme with details of tariffs;(b) a summary of SWS’s strategic business plan at each Periodic Review;(c) SWS’s current Procurement Plan (if any);(d) SWS’s annual drinking water quality report;(e) SWS’s annual environmental report;(f) SWS’s annual conservation and access report; and(g) such other periodic information compiled by SWS for Ofwat.
“Periodic Review”	means the periodic review of K (as that term is defined in the

	Instrument of Appointment) as provided for in Condition B of the Instrument of Appointment.
“Periodic Review Effective Date”	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.
“Periodic Review Period”	means the period commencing on a Periodic Review Effective Date and ending on the next Date Prior.
“Permanent Global Bond”	means in relation to any Sub-Class of Bearer Bonds a global bond in the form or substantially in the form set out in Schedule 2, Part B to the Bond Trust Deed with such modifications (if any) as may be agreed between the Issuer, the Principal Paying Agent, the Bond Trustee and the Relevant Dealers, together with the copy of each applicable Final Terms annexed thereto, comprising some or all of the Bearer Bonds of the same Sub-Class, issued by the Issuer pursuant to the Dealership Agreement or any other agreement between the Issuer and the relevant Dealer(s) relating to the Programme, the Agency Agreement and the Bond Trust Deed in exchange for the whole or part of any Temporary Global Bond issued in respect of such Bearer Bonds.
“Permitted Acquisition”	means any of the following carried out by SWS: <ul style="list-style-type: none"> (a) an acquisition (including Authorised Investments), but not of any company or shares therein, partnership or Joint Venture, made on arm’s length terms and in the ordinary course of trade; (b) an acquisition of assets required to replace surplus, obsolete, worn-out, damaged or destroyed assets which in the reasonable opinion of SWS are required for the efficient operation of its Business or in accordance with the Finance Leases; (c) an acquisition of assets (but not of any company or shares therein, partnership or Joint Venture) made on arm’s length terms entered into for bona fide commercial purposes in furtherance of SWS’s statutory and regulatory obligations; (d) an inset business in the United Kingdom which is or will be included in RCV and which breaches neither the Instrument of Appointment nor the WIA; and (e) any acquisition made or Joint Venture entered into with the consent of the Security Trustee and each Financial Guarantor.
“Permitted Book Debt Disposal”	means the disposal of book debts in each financial year with a nominal value of up to £5,000,000 (indexed) (or a greater amount with the prior written consent of the Security Trustee and each Financial Guarantor) by SWS on arm’s length terms to any person other than an Affiliate, where: <ul style="list-style-type: none"> (a) such book debts are sold to a person or persons whose business is the recovery of debts;

- (b) SWS has made a prudent provision in its accounts against the non-recoverability of such debts;
- (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 SWS has expired; and
- (d) the SWS Business Financial Model is updated to ensure that the transaction is taken into account in calculating all relevant financial ratios under the CTA.

“Permitted Disposal”

means any disposal made by SWS 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 more than or equal to 0.900:1;
- (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 SWS, are not required for the efficient operation of its Business and which does not cause a Trigger Event under Paragraph 1, Part 1 (*Trigger Events*) of Schedule 6 to the CTA;
- (f) is made pursuant to the Outsourcing Policy;
- (g) is a Permitted Book Debt Disposal;
- (h) is a disposal of Protected Land (as that term is defined in the WIA) in accordance with the terms of the Instrument of Appointment;
- (i) is a disposal or surrender of tax losses which is a Permitted Tax Loss Transaction;
- (j) is the disposal of assets owned by SWS which form part of its Permitted Non-Appointed Business;
- (k) is any other disposal which is in accordance with the Instrument of Appointment provided that the consideration (both cash and non-cash) received by SWS (or which would be received by SWS 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 (i) the immediately preceding 12 month period does not exceed 2.5 per cent. of RCV (or its equivalent) and (ii) in

the immediately preceding five-year period does not exceed 10 per cent. of RCV (or its equivalent); or

- (l) is a disposal of assets to a partnership or a Joint Venture made on arm's lengths terms entered into for bona fide commercial purposes in furtherance of SWS's statutory and regulatory obligations,

provided that in each case such disposal does not cause any of the Trigger Event Ratio Levels to be breached.

“Permitted Emergency Action”

means any remedial action taken by SWS during an Emergency which is in accordance with the policies, standards and procedures for emergency planning manual (EMPROC) of SWS (as amended from time to time), Ofwat guidance notes and Public Procurement Rules and which SWS 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 SWS, the Security Trustee and each Financial Guarantor.

“Permitted Existing Non-Appointed Business”

means any business other than the Appointed Business which is carried on by SWS at the Initial Issue Date and (a) which falls within the Permitted Non-Appointed Business Limits applicable to Permitted Existing Non-Appointed Business, and (b) in respect of which all material risks related thereto are insured in accordance with Good Industry Practice, and (c) which does not give rise to any material actual or contingent liabilities for SWS that are not properly provided for in its financial statements.

“Permitted Existing Pension Schemes”

means (i) the SWPS (ii) the SWEPS, (iii) the ScottishPower group Final Salary Scheme, (iv) the ScottishPower group Money Purchase LifePlan, (v) the Manweb Group of the Electricity Supply Pension Scheme and (vi) the Scottish Power group Pension Scheme.

“Permitted Financial Indebtedness”

means:

- (a) Financial Indebtedness incurred under the Issuer/SWS Loan Agreements;
- (b) Financial Indebtedness incurred by one member of the SWS Financing Group to another member if the recipient of that Financial Indebtedness is an Obligor;
- (c) Financial Indebtedness incurred under any Finance Document as at the Initial Issue Date;
- (d) Financial Indebtedness incurred under a Treasury Transaction provided it is in compliance with the Hedging Policy;
- (e) any unsecured indebtedness provided that the aggregate amount of such Financial Indebtedness does not exceed £25,000,000 (indexed from the Initial Issue Date);
- (f) any Subordinated Debt entered into after the Initial Issue Date and the SWS Preference Shares;
- (g) such further Financial Indebtedness incurred by the Issuer

or SWS 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 Credit Facility Agreement the provider of which is a party to, or has acceded to, the CTA and STID;
- (iii) as a result of the incurrence of the Financial Indebtedness:
 - (A) SWS and the Issuer will not be in breach of Paragraph 4 (*DSR Liquidity Facility*) of Part 2 of Schedule 5 (*Financial Covenants*) and Paragraph 38 (*Control of Repayment Schedules*) of Part 3 (*General Covenants*) of Schedule 5 (*Covenants*) to the CTA; and
 - (B) no Authorised Credit Provider will have substantially better or additional Entrenched Rights under the STID than those Authorised Credit Providers providing similar Financial Indebtedness 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 (save for, if applicable, any Financial Guarantee) *pari passu* in all respects with all other Class A Debt and the Financial Indebtedness that is Class B Debt ranks (save for, if applicable, any Financial Guarantee) *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 pro forma basis to take into account the proposed incurrence of such further Financial Indebtedness) must be less than or equal to 0.900:1 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 proposed incurrence of such debt) the Class A RAR must be less than or equal to 0.75:1 and the Class A Adjusted ICR 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; and
- (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 15 per cent. of RCV or its equivalent.

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 provisions of Schedule 8 (<i>Hedging Policy and Overriding Provisions Relating to Hedging Agreements</i>) of the CTA.
“Permitted Lease Termination”	means any termination of the leasing of all or any part of the Equipment (or the prepayment of the Rentals arising by reason of such termination) in the following circumstances: <ul style="list-style-type: none"> (a) Total Loss: Pursuant to any 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 SWS 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 other than Permitted Hedge Terminations and Permitted Lease Terminations in respect of other Finance Leases has occurred or (ii) a Default Situation is subsisting or would occur as a result of such payment; or (b) Illegality: Pursuant to any provision of a Finance 22; or (c) Voluntary Prepayment/Termination: Pursuant to any provision of a Finance Lease whereby SWS 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 other than Permitted Hedge Terminations and Permitted Lease Terminations in respect of other Finance Leases has occurred or (ii) no Default Situation is subsisting or would occur as a result of such prepayment or termination.
“Permitted New Non-Appointed Business”	means any business other than the Appointed Business and Permitted Existing Non-Appointed Business provided that (a) such business: (I) is prudent in the context of the overall business of SWS and continues to be prudent for the duration of that Permitted New Non-Appointed Business; and (ii) is not reasonably likely to be objected to by the Director General; and (iii) falls within the Permitted Non-Appointed Business Limits applicable to Permitted Non-Appointed Business; (b) all material risks related thereto are insured in accordance with Good Industry Practice; and (c) such business does not give rise to any material actual or contingent liabilities for SWS that are not properly provided for in its financial statements.
“Permitted Non-Appointed Business”	means Permitted Existing Non-Appointed Business and Permitted New Non-Appointed Business.
“Permitted Non-Appointed Business Limits”	means, in respect of Permitted Non-Appointed Business, that the average of the Non-Appointed Expenses during the current Test Period and the immediately two preceding Test Periods does not

exceed 2.5 per cent. of Cash Expenses of SWS during such Test Periods.

“Permitted Payments”

means the application of monies credited to the Debt Service Payment Account in accordance with the Payment Priorities.

“Permitted Post Closing Events”

means:

- (a) payment of transaction fees and expenses to the extent not paid on the Initial Issue Date; or
- (b) payments of all amounts outstanding under the Bridge Facility Agreement and related documentation and the discharge of the security created under such document; or
- (c) any other payments listed in writing by SWS as at the Initial Issue Date and signed by way of approval by the Security Trustee.

“Permitted Security Interest”

means any security interest falling under paragraphs (a) to (g) (inclusive) below which is created by any Obligor, any security interest falling under paragraphs (h) to (k) (inclusive) below which is created by SWS or the Issuer and any security interest falling under paragraphs (l) to (r) (inclusive) below which is created by SWS:

- (a) Security Interest created under the Security Documents or contemplated by the Finance Documents;
- (b) any Security Interest specified in Schedule 12 (*Cash Management*) to the CTA, 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 SWS Financing Group in the ordinary course of its banking arrangements;
- (d) a right of set-off, banker’s liens or the like arising by operation of law 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 SWS Financing Group in good faith and with a reasonable prospect of success;
- (f) any Security Interest created in respect of any pre-judgment legal process or any judgment or judicial award relating to security for costs, where the relevant proceedings are being contested in good faith by the relevant member of the SWS Financing Group by appropriate procedures and with a reasonable prospect of success;
- (g) 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);

- (h) 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;
- (i) 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;
- (j) a Security Interest approved by the Security Trustee, the holder of which has become a party to the STID;
- (k) 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 SWS Financing Group; and
 - (iii) unless such Security Interest falls within any of paragraphs (m) to (r) below (A) such Security Interest is removed or discharged within six months of the date of acquisition of such asset; or (B) the holder thereof becomes party to the STID;
- (l) 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;
- (m) 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 where the counterparty becomes party to the STID;
- (n) a right of set-off existing in the ordinary course of trading activities between SWS and its suppliers or customers;
- (o) 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 SWS Financing Group becoming aware that the amount owing in respect of such lien has become due;

- (p) a Security Interest arising on rental deposits in connection with the occupation of leasehold premises in the ordinary course of business;
- (q) any retention of title arrangements entered into by SWS in the ordinary course of business; or
- (r) 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 from the Initial Issue Date),

to the extent and for so long, in each case, as the creation or existence of the 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 Share Pledge Acceleration”

means the acceleration by the Secured Creditors (subject to the availability of funds) of their respective claims to the extent necessary to apply proceeds of enforcement of the share pledges provided by SWSGH and SWSH pursuant to the Security Agreement.

“Permitted Subsidiaries”

means the Pension Companies and the Issuer and any other Subsidiary of SWS from time to time which is acquired by SWS pursuant to a Permitted Acquisition and is notified in writing to the Security Trustee on or as soon as practicable after the date of such acquisition.

“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 any other agreement relating to tax between:

- (a) an Obligor and any other member of the SWS Financing Group; or
- (b) an Obligor and any other member of the Group (not being a member of the SWS Financing Group) in the following circumstances;
 - (i) where the company receiving the benefit, tax loss or relief (the “Recipient Company”) is an Obligor, the Obligor either makes no payment for the benefit, tax loss or relief or makes a payment which does not exceed the tax saved and is made only in circumstances in which (if SWS is the Recipient Company and SWSG is the surrendering company) it will be applied in immediate payment to SWS of interest due and payable under the SWS/SWSG Loan Agreement or in which it has been demonstrated to the satisfaction of the Security Trustee (acting in accordance

with STID) that the utilisation of the benefit, tax loss or relief by the Recipient Company would not be subject to challenge by HM Revenue & Customs (save in the event of fraud or negligence);

- (ii) where the Recipient Company is a member of the Group (other than an Obligor), a payment is made to the Obligor of an amount equal to the tax saved 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 HM Revenue & Customs, provided that to the extent that it is subsequently demonstrated to the satisfaction of the Security Trustee (acting in accordance with the STID) that there is no such utilisation of such benefit, tax loss or relief by the Recipient Company, then amounts paid to the Obligor by the Recipient Company for such benefit, tax loss or relief should be refunded within 30 days of such fact being so demonstrated.

“Permitted Volume Trading Arrangements”

means contracts entered into by any member of the Group or any Associate thereof with suppliers for the supply of goods and services to the SWS 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 relevant member of the Group or Associate for any Financial Indebtedness by way of amounts payable by such member of the Group or Associate to such supplier as a result of such Obligor making use of such arrangements.

“Potential Event of Default”

means (other than in any Hedging Agreement, where “**Potential Event of Default**” has the meaning given to it in that Hedging Agreement) an event 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 any event which would (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.

“Preference Shares”

means the Class A1 Preference Shares, Class A2 Preference Shares and Class B Preference Shares.

“Principal Amount Outstanding”

means, in relation to a Bond, Sub-Class or Class, the original face value thereof less any repayment of principal made to the holder(s) thereof in respect of such Bond, Sub-Class or Class.

“Principal Paying Agent”

means Deutsche Bank AG London under the Agency Agreement, or its Successors thereto.

“Proceeds”

means the aggregate of all receipts or recoveries by the Security Trustee pursuant to, or upon enforcement of, any of the Rights (including pursuant to Clause 11.6 (*Receipts Held in Trust*) of the STID) after deducting (to the extent not already deducted or retained prior to such receipt or recovery by the Security Trustee)

all sums which the Security Trustee is required under the Finance Documents or by applicable law to pay to any other person before distributing any such receipts or recoveries to any of the Secured Creditors.

“Procurement Plan”

means the procurement plan (if any) prepared and amended from time to time by SWS in accordance with its obligations under the Instrument of Appointment after notifying the Security Trustee and each Financial Guarantor and consulting with the Security Trustee and each Financial Guarantor who, within reasonable time thereafter, notifies SWS that it wishes to be consulted.

“Programme”

means the £6,000,000,000 guaranteed bond programme established by the Issuer admitted to the Official List and to the London Stock Exchange.

“Projected Operating Expenditure”

means, at any time, the operating expenditure projected in the operating budget for the Test Period in which such date falls.

“Prospectus”

has the meaning given to that term on page 5 of this prospectus.

“Prospectus Directive”

means Directive 2003/71/EC as amended by the 2010 PD Amending Directive.

“Protected Land”

means, in relation to a Regulated Company, any land which, or any interest or right in or over land which:

- (a) was transferred to that company in accordance with a scheme under Schedule 2 to the Water Act 1989 or, where that company is a statutory water company (as defined in the WIA), was held by that company at any time during the financial year ending 31 March 1990;
- (b) is or has at any time on or after 1 September 1989 been held by that company for purposes connected with the carrying out of its functions as a water undertaker or sewerage undertaker; or
- (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.

“PSM”

means the London Stock Exchange’s Professional Securities Market.

“Public Procurement Rules”

means public procurement rules of the United Kingdom (including the Utilities Contracts Regulations 1996 (SI 1996/2911) as amended by the Utilities Contracts (Amendment) Regulations 2001 (SI 2001/2418)) 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.

“Published Regulatory Accounts”

means the annual report and accounting statements of a licenced water company as at 31 March 2012, which have been published

	on its website.
“Qualifying Class A Debt”	means the aggregate Outstanding Principal Amount of Class A Debt entitled to be voted by the Class A DIG Representatives.
“Qualifying Class A Debt Provider”	means a provider of Qualifying Class A Debt.
“Qualifying Class B Debt”	means the aggregate Outstanding Principal Amount of Class B Debt entitled to be voted by the Class B DIG Representatives.
“Qualifying Class B Debt Provider”	means a provider of Qualifying Class B Debt.
“Qualifying Debt”	means the Qualifying Class A Debt, the Qualifying Class B Debt, the Senior Mezzanine Debt or Junior Mezzanine Debt, as the context requires.
“Rating Agencies”	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 and able to provide credit ratings generally (and “Rating Agency” means any one of them).
“Rating Requirement”	means confirmation from any two Rating Agencies or, where expressly stated, all Rating Agencies then rating the Bonds that, in respect of any matter where such confirmation is required, 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.
“RBS”	means The Royal Bank of Scotland plc.
“RBSG”	means The Royal Bank of Scotland Group plc, a company incorporated in Scotland and ultimate holding company of the RBS Group.
“RBS Group”	means RBSG and its Subsidiaries.
“RCV”	means, in relation to any date, the regulatory capital value for such date as last determined (excluding any draft determination of the regulatory capital value by Ofwat) and notified to SWS by Ofwat at the most recent Periodic Review or IDOK or other procedure through which in future Ofwat 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), provided that “RCV” for the purposes of calculating the Senior RAR and Class A RAR for any Test Period for which there is no Final Determination shall be SWS’s good faith, honestly held present estimate of its regulatory capital value on the last day of such Test Period.
“Receipt”	means a receipt attached on issue to a Definitive Bond redeemable in instalments for the payment of an instalment of principal and includes any replacements for Receipts and Talons issued pursuant to Condition 14 (<i>Replacement of Bonds, Coupons, Receipts and</i>

	<i>Talons</i>).
“Receiptholders”	means the several persons who are for the time being holders of the Receipts.
“Register”	means a register of the Bondholders of a Sub-Class of Registered Bonds.
“Registered Bonds”	means those of the Bonds which are for the time being in registered form.
“Registered Office Agreement”	means the registered office agreement dated 1 January 2002 between the Issuer, Maples and Calder and M&C Corporate Services Limited (now known as Maples Corporate Services Limited).
“Registrar”	means Deutsche Bank Luxembourg S.A. as a registrar under the Agency Agreement and any other entity appointed as a registrar under the Agency Agreement.
“Regulated Company”	means a company appointed as a water undertaker or a water and sewerage undertaker under section 6 of the WIA.
“Regulation S”	has the meaning given to such term under the Securities Act.
“Relevant Date”	has the meaning set out in Condition 6(i) (<i>Definitions</i>).
“Remedial Plan”	means any remedial plan agreed by SWS and the Security Trustee under Part 2 of Schedule 6 (<i>Trigger Events</i>) of the CTA.
“Rental”	means any scheduled payment of rental, periodic charge or equivalent sum under a Finance Lease.
“Rental Payment Date”	means any date on which Rental is scheduled to be paid under any Finance Lease.
“Rental Period”	means, in respect of a Finance Lease, each period falling between two Rental Payment Dates under the Finance Lease.
“Repeated Representations”	means: <ul style="list-style-type: none"> (a) the representations set out in Paragraphs 1 to 3, 8 to 10, 12 to 14 and 17 to 19 (inclusive) of Schedule 3 (<i>General Representations</i>) of the CTA; (b) the representations set out in Paragraphs 1 and 5 of Schedule 4 (<i>SWS representations</i>) of the CTA; And which are deemed, pursuant to the CTA to be repeated on: <ul style="list-style-type: none"> – the date of each Request and the first day of any borrowing; – each Payment Date; – in relation to any new Material Agreement, the day on which such agreement is entered into and only in relation to such new Material Agreement; and – each date on which a Restricted Payment is made. See Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Common Terms Agreement – Representations</i> ”.
“Request”	means a request for utilisation of any Authorised Credit Facility.

“Required Balance”	means the sum of the Class A Required Balance and the Class B Required Balance.
“Reserved Matters”	means matters which, subject to the Intercreditor Arrangements, a Secured Creditor is free to exercise in accordance with its own facility arrangements and not by the direction of the Majority Creditors as more particularly described in the STID.
“Restricted Chargors”	means each of the Issuer and SWS and any other entity which accedes to the Security Agreement pursuant to Clause 27.3 (<i>Assignments and transfers</i>) thereof that is restricted from providing guarantees by its regulatory or statutory obligations.
“Restricted Payment”	means any Distribution, Customer Rebate, or payment under the Subordinated Debt or the SWS Preference Shares other than: <ul style="list-style-type: none"> (a) to the extent required to make any payment under an Authorised Credit Facility in accordance with the provisions of the CTA and the STID, a payment by SWS under any Issuer/SWS Loan Agreement; (b) a payment made under a Permitted Tax Loss Transaction; (c) any Permitted Post-Closing Event; (d) a Subordinated Debt Replacement Event or SWS Preference Share Conversion Event; or (e) an SWS/SWSG Debt Service Distribution.
“Restricted Payment Condition”	means each of the conditions which must be satisfied or waived by the Security Trustee before a Restricted Payment may be made by the Issuer or SWS.
“Restricted Secured Liabilities”	means all present and future obligations and liabilities (whether actual or contingent and whether owed jointly or severally or in any other capacity whatsoever) of each Restricted Chargor to any Secured Creditor under each Finance Document to which such Restricted Chargor is a party, except for any obligation which, if it were secured under the Security Agreement, would result in a contravention of Section 151 of the Companies Act 1985.
“Retail Price Index” or “RPI”	means the all items retail prices index for the United Kingdom Published by the Office for National Statistics or at any future date such other index of retail prices as may have then replaced it for the purposes of Ofwat’s determination of price limits for water and sewerage services.
“Rights”	means all rights vested in the Security Trustee by virtue of, or pursuant to, its holding the interests conferred on it by the Security Documents or under the Ancillary Documents and all rights to make demands, bring proceedings or take any other action in respect of such rights.
“Rolling Average Period”	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.
“Scheduled Debt Service”	means the amounts referred to in sub-paragraphs (i)-(xii) of the Payment Priorities (other than principal repayments on the Class A

	Debt and Class B Debt) payable on a particular Payment Date.
“Second Artesian Term Facility”	means the £155,484,023.05 index-linked term facility made available to the Issuer by Artesian.
“Second Artesian Term Facility Agreement”	means a facility agreement dated 5 July 2004 under which the Second Artesian Term Facility was made available to the Issuer and includes that facility agreement in the form amended and restated at the time of the novation of such facility agreement to Artesian.
“Second Issue Date”	means 5 July 2004.
“Second Issuer/SWS Loan Agreement”	means the loan agreement entered into between the Issuer and SWS on 5 July 2004.
“Second Revolving Credit Facility”	means the revolving credit facility of an aggregate facility amount of £120,000,000 made available to SWS by RBS and Bayerische Landesbank, London Branch on 30 June 2005 and cancelled in full by SWS on 9 July 2010.
“Second Revolving Credit Facility Agreement”	means the agreement in respect of the Second Revolving Credit Facility.
“Secretary of State”	means one of Her Majesty’s principal secretaries of state.
“Section 19 Undertaking”	means an undertaking given by a Regulated Company to secure or facilitate compliance with a licence condition or a relevant statutory or other requirement and which is capable of direct enforcement under the WIA.
“Secured Creditor”	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), the Bondholders, each Financial Guarantor, the Hedge Counterparties, the Issuer, the Liquidity Facility Agents, each Liquidity Facility Provider, Artesian II, Artesian and each other Authorised Credit Provider, the Standstill Cash Manager, each Agent, the Mezzanine Finance Parties, and any Additional Secured Creditors.
“Secured Creditor Representative”	means: <ul style="list-style-type: none"> (a) in respect of the Bondholders, the Bond Trustee (b) in respect of the Existing RCF Providers, the Existing RCF Agent; (c) in respect of Artesian II, Artesian II; (d) in respect of Artesian, Artesian; (e) in respect of the Issuer/SWS Loan Agreements, the Security Trustee (on behalf of the Issuer); (f) in respect of any Liquidity Facility Provider, the facility agent under the relevant Liquidity Facility Agreement; (g) in respect of the Senior Mezzanine Finance Parties, the Senior Mezzanine Facility Agent; and (h) 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 Liabilities”	means the Restricted Secured Liabilities and the Unrestricted Secured Liabilities.
“Securities Act”	means the United States Securities Act of 1933, as amended.
“Security”	means the security constituted by the Security Documents, including any Guarantee or obligation to provide cash collateral or further assurance thereunder.
“Security Agreement”	means the deed of charge and guarantee executed in favour of the Security Trustee by each of the Obligors on the Initial Issue Date.
“Security Assets”	means all property, assets, rights and undertakings the subject of the Security created by the Obligors pursuant to any Security Document, together with the Rights.
“Security Documents”	means: <ul style="list-style-type: none"> (a) the Security Agreement; (b) the STID and each deed of accession thereto; and (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.
“Security Interest”	means: <ul style="list-style-type: none"> (a) any mortgage, pledge, lien, charge, assignment or hypothecation, or other encumbrance securing any obligation of any person; (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 (c) any other type of preferential arrangement (including any title transfer and retention arrangement) having a similar effect.
“Security Trustee”	means Deutsche Trustee Company Limited or any successor appointed pursuant to the STID.
“Senior Adjusted ICR”	means, in respect of a Test Period, the ratio of Net Cash Flow less the aggregate of CCD and IRC during such Test Period to Senior Debt Interest during such Test Period.
“Senior Average Adjusted ICR”	means the sum of the ratios of Net Cash Flow less the aggregate of CCD and IRC to Senior Debt Interest for each of the Test Periods comprised in a Rolling Average Period divided by three.
“Senior Debt”	means all Class A Debt and Class B Debt and any other debt ranking in priority to subordinated debt of any member of the SWS Financing Group.
“Senior Debt Interest”	means, in relation to any Test Period and without double counting, an amount equal to the aggregate of:

- (a) all interest paid, due but unpaid or, in respect of forward-looking ratios, payable, on the Issuer's and/or SWS's obligations under and in connection with all Class A Debt and Class B Debt;
- (b) all interest paid, due but unpaid or, in respect of forward-looking ratios, payable under or in connection with any Permitted Financial Indebtedness falling within paragraph (e) of that definition;
- (c) all fees paid, due but unpaid or, in respect of forward-looking ratios, payable, to any Financial Guarantor; and
- (d) 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 SWS'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 related Hedging Agreements then in force) (excluding all indexation of principal to the extent it has been included in such interest or other amounts, amortisation of the costs of issue of any Class A Debt and Class B Debt within such Test Period and all other costs incurred in connection with the raising of such Class A Debt or Class B Debt) less all interest received or, in respect of forward-looking ratios, receivable by any member of the SWS Financing Group from a third party during such Test Period (excluding any interest received or receivable from SWSG under the SWS/SWSG Loan Agreement).

“Senior Mezzanine Debt”

means the principal amount outstanding for the time being under the loan made by the Senior Mezzanine Facility Providers under the Senior Mezzanine Facility Agreement.

“Senior Mezzanine Facility”

means a credit facility in the original amount of £127,200,000 provided by the Senior Mezzanine Facility Providers to the Issuer pursuant to the Senior Mezzanine Facility Agreement.

“Senior Mezzanine Facility Agent”

means The Royal Bank of Scotland plc or any successor thereto as agent under the Senior Mezzanine Facility Agreement.

“Senior Mezzanine Facility Agreement”

means the £127,200,000 senior mezzanine facility agreement dated the Initial Issue Date between the Issuer, the Senior Mezzanine Facility Agent, the Senior Mezzanine Facility Arranger, the Original Senior Mezzanine Facility Provider and the Security Trustee.

“Senior Mezzanine Facility Arranger”

means RBEF Limited.

“Senior Mezzanine Facility Providers”

means the “Lenders” (as defined in the Senior Mezzanine Facility Agreement).

“Senior Mezzanine Finance Parties”

means:

- (a) the Senior Mezzanine Facility Agent;
- (b) the Senior Mezzanine Facility Arranger; and
- (c) the Senior Mezzanine Facility Providers.

“Senior Net Indebtedness”	means, as at any date, all the Issuer’s and SWS’s nominal debt outstanding (or, in respect of a future date, forecast to be outstanding) under and in connection with any Class A Debt and Class B Debt on such date and the nominal amount of any Financial Indebtedness falling within paragraph (e) of the definition of Permitted Financial Indebtedness which is outstanding (or, in respect of a future date, forecast to be outstanding) on such date including, in each case, all indexation accrued but unpaid up to and including such date (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 all other amounts standing to the credit of any Account (other than an amount equal to the Excluded Insurance Proceeds Amount an amount equal to the aggregate of any amounts which represent Customer Rebates or Distributions which have been declared but not paid on such date) (where such debt is denominated other than in pounds sterling, the nominal amount outstanding will be calculated (i) in respect of debt with associated Currency Hedging Agreements, by reference to applicable hedge rates; or (ii) in respect of debt with no associated Currency Hedging Agreements, by reference to the Exchange Rate on such date).
“Senior RAR”	means, on any Calculation Date, the ratio of Senior Net Indebtedness to RCV as at such Calculation Date or, in the case of forward-looking ratios in respect of Test Periods ending after such Calculation Date, as at the 31 March falling in such Test Period.
“Series”	means a series of Bonds issued under the Programme on a particular Issue Date, together with any Tranche or Tranches of Bonds which are expressed to be consolidated and form a single Sub-Class with any Sub-Class issued on such Issue Date.
“Series 1 Bonds”	means the Issuer’s Series 1 Bonds issued on the Initial Issue Date, as further defined in Chapter 4 “ <i>Summary Financing Structure</i> ”.
“Series 1 Redeemed Bonds”	has the meaning given to that term on page 43 of this Prospectus.
“Series 2 Bonds”	means the Issuer’s Series 2 Bonds issued on the Third Issue Date, as further defined in Chapter 4 “ <i>Summary Financing Structure</i> ”.
“Series 3 Bonds”	means the Issuer’s Series 3 Bonds issued on the Fourth Issue Date, as further defined in Chapter 4 “ <i>Summary Financing Structure</i> ”.
“Series 4 Bonds”	means the Issuer’s Series 4 Bonds issued on the Fifth Issue Date, as further defined in Chapter 4 “ <i>Summary Financing Structure</i> ”.
“Series 5 Bonds”	means the Issuer’s Series 5 Bonds issued on the Sixth Issue Date, as further defined in Chapter 4 “ <i>Summary Financing Structure</i> ”.
“Sewerage Region”	means the geographical area for which a Regulated Company has been appointed as the sewerage undertaker under Section 6 of the WIA.

“Share Pledges”	means the pledges dated on or about the Initial Issue Date, in favour of the Security Trustee, over the shares in SWSH, SWS and the Issuer respectively and “Share Pledge” means any one of them.
“Shipwreck Clause”	means a clause which may be contained in the licence of a Regulated Company and which is contained in the Licence of SWS 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 Appointed 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.
“Shortfall Paragraph”	means to the extent that (after payment of all relevant operating expenditure) there is a shortfall of forecast revenues, the relevant sub-paragraph of the Payment Priorities in relation to which the revenue that is forecast to be available is insufficient to meet all of the payments in such sub-paragraph.
“Sixth Issue Date”	means 5 March 2009.
“Sixth Issuer/SWS Loan Agreement”	means the loan agreement entered into between the Issuer and SWS on 27 February 2009.
“Special Administration”	means the insolvency process specific to Regulated Companies under Sections 23 to 26 of the WIA.
“Special Administration Order”	means an order of the High Court under sections 23 to 25 of the WIA under the insolvency process specific to Regulated Companies.
“Special Administration Petition Period”	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.
“Special Administrator”	means the person appointed by the High Court under Sections 23 to 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.
“Standard & Poor’s” or “S&P”	means Standard & Poor’s Ratings Services, a division of the McGraw-Hill Companies Inc. or any successor to the rating business of Standard & Poor’s Rating Services.
“Standby Drawing”	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 the term of such Liquidity Facility Agreement.
“Standstill”	means, as provided for in Clause 13.1 (<i>Commencement of Standstill</i>) of the STID, a standstill of claims of the Secured Creditors against SWS and the Issuer immediately upon notification to the Security Trustee of the occurrence of an Event of Default. See Chapter 7 <i>“Summary of the Financing</i>

	<i>Agreements</i> ” under “ <i>Security Trust and Intercreditor Deed – Standstill</i> ” for a summary.
“Standstill Cash Manager”	means The Royal Bank of Scotland plc in its capacity as Standstill Cash Manager under the CTA, or any successor Standstill Cash Manager.
“Standstill Event”	means an event giving rise to a Standstill in accordance with the STID. See Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Security Trust and Intercreditor Deed – Standstill</i> ” for a summary.
“Standstill Extension”	means any of the periods for which a Standstill Period is extended under Clause 13.5 (<i>Extension of Standstill</i>) of the STID, See Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Security Trust and Intercreditor Deed – Standstill Extension</i> ” for a summary.
“Standstill Period”	means a period during which a standstill arrangement is subsisting, commencing on the date as determined by Clause 13.1 (<i>Commencement of Standstill</i>) of the STID and ending on the date as determined by Clause 13.4 (<i>Termination of Standstill</i>) of the STID. See Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Security Trust and Intercreditor Deed – Standstill</i> ” for a summary.
“Statutory Accounts”	means the statutory accounts which SWS is required to prepare in compliance with the Companies Act 1985, as amended from time to time.
“STID”	means the security trust and intercreditor deed entered into on the Initial Issue Date between, among others, the Security Trustee, the Obligors, the Bond Trustee and MBIA Assurance S.A., together with any deed supplemental to the STID and referred to in the STID as a “Supplemental Deed”.
“STID Directions Request”	means a written notice of each STID Proposal sent by the Security Trustee to the Secured Creditors or their Secured Creditor Representatives and requesting directions from the relevant Secured Creditors in accordance with the STID.
“STID Proposal”	means a proposal or request made by any Secured Creditor or its Secured Creditor Representative or any Obligor in accordance with the STID proposing or requesting the Security Trustee: to execute a supplemental deed to the STID; to change, modify or waive any term or condition of any Finance Document; to substitute the Issuer; or to take any Enforcement Action or any other action in respect of the transactions contemplated by the Finance Documents; as defined more particularly in the STID.
“Stock Exchange”	means the London Stock Exchange or any other or further stock exchange(s) on which any Bonds may from time to time be listed, and references in these presents (as defined in this Prospectus) to the “ relevant Stock Exchange ” shall, in relation to any Bonds, be references to the Stock Exchange on which such Bonds are, from time to time, or are intended to be, listed.

“Sub-Class”	is a division of a Class.
“Subordinated Authorised Loan Amounts”	means, in relation to any Authorised Credit Facility, the aggregate of any amounts payable by the Issuer or SWS to the relevant Authorised Credit Provider on an accelerated basis as a result of illegality (excluding accrued interest, principal and recurring fees and commissions) on the part of the Authorised Credit Provider or any other amounts not referred to in any other paragraph of the Payment Priorities.
“Subordinated Coupon Amounts”	means, in the case of Fixed Rate Bonds or Indexed Bonds, any amounts (other than deferred interest) by which the Coupon on such Bonds exceeds the initial Coupon as at the date on which such Bonds were issued and, in the case of 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.
“Subordinated Debt”	means any Financial Indebtedness (other than Financial Indebtedness falling within paragraph (e) of the definition of Permitted 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 or upon an SWS Preference Share Conversion Event, the SWS Preference Share Deed, including, for the avoidance of doubt, the Mezzanine Debt.
“Subordinated Debt Replacement Event”	means any refinancing of any or all of the Senior Mezzanine Debt or Junior Mezzanine Debt at any time so long as (i) no Event of Default is continuing or would result from such refinancing; (ii) no Trigger Event described in Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Common Terms Agreement: Trigger Events – Financial Ratios</i> ”; “ <i>Common Terms Agreement: Trigger Events – Liquidity for Capital Expenditure and Working Capital</i> ”; “ <i>Common Terms Agreement: Trigger Events – Debt Service Required Payment Shortfall</i> ” and “ <i>Common Terms Agreement: Trigger Events – Drawdown on DSR Liquidity Facilities and O&M Reserve Facility</i> ” is continuing; and (iii) the Financial Indebtedness incurred in order to raise funds for such refinancing (which may, for the avoidance of doubt, be by way of subordinated bonds) ranks below the Class B Debt and is on substantially the same terms as the Senior Mezzanine Debt or the Junior Mezzanine Debt, as the case may be, being refinanced.
“Subordinated Liquidity Facility Amounts”	means, in relation to any Liquidity Facility: <ul style="list-style-type: none"> (a) the amount by which the amount of interest accruing at the Mandatory Cost Rate at any time exceeds the Mandatory Cost Rate on the date of the relevant Liquidity Facility Agreement; and (b) the aggregate of any amounts payable by the Issuer to the relevant Liquidity Facility Provider in respect of its

obligation to gross-up any payments made by it in respect of such Liquidity Facility as a result of such Liquidity Facility Provider ceasing to be a Liquidity Facility Provider or to make any payment of increased costs to such Liquidity Facility Provider (other than any such increased costs in respect of regulatory changes relating to capital adequacy requirements applicable to such Liquidity Facility Provider) or to amounts payable on an accelerated basis as a result of illegality (excluding accrued interest, principal and commitment fees) on the part of such Liquidity Facility Provider, or any other amounts not referred to in any other paragraph of the Payment Priorities.

“Subscription Agreement”

means an agreement supplemental to the Dealership Agreement (by whatever name called) substantially in the form set out in Schedule 6 to the Dealership Agreement or in such other form as may be agreed between, among others, the Issuer and the Lead Manager or one or more Dealers (as the case may be).

“Subsidiary”

means:

- (a) a subsidiary within the meaning of section 736 of the Companies Act; and
- (b) unless the context otherwise requires, a subsidiary undertaking within the meaning of section 258 of the Companies Act.

“Successor”

means, in relation to the Principal Paying Agent, the other Paying Agents, the Registrar, the Transfer Agent, the Agent Bank and the Calculation Agent, any successor to any one or more of them in relation to the Bonds which shall become such pursuant to the provisions of the Bond Trust Deed and/or the Agency Agreement (as the case may be) and/or such other or further principal paying agent, paying agents, registrar, transfer agents, agent bank and calculation agent (as the case may be) in relation to the Bonds as may (with the prior approval of, and on terms previously approved by, the Bond Trustee in writing) from time to time be appointed as such, and/or, if applicable, such other or further specified offices (in the case of the Principal Paying Agent being within the same city as the office(s) for which it is substituted) as may from time to time be nominated, in each case by the Issuer and the Obligors, and (except in the case of the initial appointments and specified offices made under and specified in the Conditions and/or the Agency Agreement, as the case may be) notice of whose appointment or, as the case may be, nomination has been given to the Bondholders.

“Super-Majority Creditor”

means the Class A DIG Representatives in respect of more than 66 per cent. of the Voted Qualifying Class A Debt or, following the repayment in full of the Class A Debt, the Class B DIG Representatives in respect of more than 66 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 as summarised in Chapter 7 “Summary of the Financing Agreements” under “Security Trust and Intercreditor Deed – Super-Majority Creditor Decisions”.

“Supplemental Deed”	means a deed supplemental to the STID entered into by the Security Trustee on its own behalf and on behalf of the Secured Creditors in the circumstances referred to in Clause 2.1 (<i>Accession of Additional Secured Creditor</i>) or Clause 3 (<i>Additional Finance Documents</i>) of the STID.
“Surveillance Letter”	means a letter issued by the Issuer and/or SWS to a Financial Guarantor from time to time, in which the Issuer and/or SWS undertakes to provide the relevant Financial Guarantor with certain information and to comply with certain reporting requirements as outlined in that letter.
“SWC”	means Southern Water Capital Limited.
“SWEPT”	means Southern Water Executive Pension Scheme Trustees Limited although this no longer performs any function.
“SWI”	means Southern Water Investments Limited.
“SWPS”	means the Southern Water Pension Scheme for SWS employees.
“SWPT”	means Southern Water Pension Trustees Limited.
“SWS” or “Southern Water”	means Southern Water Services Limited.
“SWS Business Financial Model”	means the business Financial model prepared by SWS and delivered to the Security Trustee from time to time.
“SWS Change of Control”	means the occurrence of any of the following events or circumstances: <ul style="list-style-type: none">(a) SWSGH ceasing to hold legally and beneficially all rights in 100 per cent. of the issued share capital of, or otherwise ceasing to control, SWSH;(b) SWSH ceasing to hold legally and beneficially all rights in 100 per cent. of the issued ordinary share capital of, or otherwise ceasing to control, SWS; or(c) SWS 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 and the SWS Pension Companies.
“SWS Event of Default”	means the events of default set out in Part 2 (<i>Events of Default (SWS)</i>) of Schedule 7 (<i>Events of Default</i>) of the CTA.
“SWS Financing Group”	means SWSGH, SWSH, SWS, the Issuer and any other Permitted Subsidiaries.
“SWS Pension Schemes”	means the Southern Water Pension Scheme and the Southern Water Executive Pension Scheme.
“SWS Preference Share Conversion Event”	means an exercise of a Conversion Option as defined in SWS’s articles of association.
“SWS Preference Share Deed”	means the deed entered into by among others, the initial holders of the SWS Preference Shares and the Security Trustee.

“SWS Preference Shareholders”	means the holders of the SWS Preference Shares from time to time.
“SWS Preference Shares”	means the Class A1 Preference Shares, the Class A2 Preference Shares and the Class B Preference Shares.
“SWS VAT Group”	means the VAT group registration comprising SWI, SWS and SWC of which SWS is the representative member.
“SWS Water Resources Management Plan”	means the water resources strategy that SWS has developed for the next 25 years, which was approved by Defra and published on 1 October 2009.
“SWSG”	means Southern Water Services Group Limited, a company incorporated under the laws of England and Wales (registered number 0437 4956). and the holding company of the SWS Financing Group.
“SWSGH”	means SWS Group Holdings Limited.
“SWSH”	means SWS Holdings Limited.
“SWS/SWSG Debt Service Distribution”	means any Distribution or payment in respect of a Permitted Tax Loss Transaction to be made by SWS for the purpose of providing SWSG with the funds required to enable SWSG to meet its scheduled payment obligations under the SWS/SWSG Loan Agreement.
“SWS/SWSG Loan”	means the principal amount outstanding under the SWS/SWSG Loan Agreement from time to time.
“SWS/SWSG Loan Agreement”	means the loan agreement entered into between the Security Trustee, SWS and SWSG on the Initial Issue Date evidencing the terms of the SWS/SWSG Loan.
“SW Tax Deed of Covenant”	means the deed of covenant entered into on the Initial Issue Date (as amended from time to time) by, among others, the Security Trustee, SWI, MBIA Assurance S.A. and the Obligors.
“Talons”	means the talons (if any) appertaining to, and exchangeable in accordance with the provisions therein contained for further Coupons appertaining to, the Definitive Bonds (other than Zero Coupon Bonds) and includes any replacements for Talons issued pursuant to Condition 14 (<i>Replacement of Bonds. Coupons, Receipts and Talons</i>).
“Talonholders”	means the several persons who are for the time being holders of the Talons.
“TARGET Settlement Day”	has the meaning given to such term in Condition 6(i) (<i>Definitions</i>) as set out in Chapter 8 “ <i>The Bonds</i> ”.
“Tax”	means any tax, levy, impost, duty or other charge or withholding of a similar nature (including any related penalty or interest) and “ Taxes ”, “ taxation ”, “ taxable ” and comparable expressions will be construed accordingly.
“Tax Deeds of Covenant”	means the SW Tax Deed of Covenant.
“TDC Breach”	means any breach of any covenant or representation given by, or other obligation imposed upon, any person in either of the Tax

Deeds of Covenant which is considered to constitute a TDC Breach, in accordance with the terms of the relevant Tax Deed of Covenant (which, among other things, prevents a breach being a TDC Breach unless it causes, or could reasonably be expected to cause, a Material Adverse Effect).

“Temporary Global Bond”

means in relation to any Sub-Class of Bearer Bonds a temporary global bond in the form or substantially in the form set out in Schedule 2, Part A to the Bond Trust Deed together with the copy of the applicable Final Terms annexed thereto, with such modifications (if any) as may be agreed between the Issuer, the Principal Paying Agent, the Bond Trustee and the relevant Dealer(s), comprising some or all of the Bearer Bonds of the same Tranche, issued by the Issuer pursuant to the Dealership Agreement or any other agreement between the Issuer and the relevant Dealer(s) relating to the Programme, the Agency Agreement and the Bond Trust Deed.

“Test Period”

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) if the Calculation Date falls within the 13 month period immediately prior to the Date Prior, the 12 month period from the Date Prior”

“Third Issue Date”

means 27 May 2005.

“Third Issuer/SWS Loan Agreement”

means the loan agreement entered into between the Issuer and SWS on 27 May 2005.

“Tranche”

means all Bonds which are identical in all respects (save for the Issue Date, Interest Commencement Date and Issue Price).

“Transaction Documents”

means:

- (a) a Finance Document;
- (b) a Material Capex Agreement or a Material O&M Agreement; and
- (c) any other document designated as such by the Security Trustee and the Issuer.

“Transfer Agent”

means Deutsche Bank AG London under the Agency Agreement, including any Successor thereto.

“Transfer Scheme”

means a transfer scheme under Schedule 2 of the WIA.

“Treasury Transaction”

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.
“ Trigger Credit Rating ”	means each credit rating identified as such in Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Trigger Events</i> ”.
“ Trigger Event ”	means any of the events or circumstances identified as such in Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Trigger Events</i> ”.
“ Trigger Event Consequences ”	means any of the consequences of a Trigger Event identified as such in Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Trigger Event Consequences</i> ”.
“ Trigger Event Ratio Levels ”	means the financial ratios set out in Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Trigger Events: Financial Ratios</i> ”.
“ Trigger Event Remedies ”	means any remedy to a Trigger Event as identified in Chapter 7 “ <i>Summary of the Financing Agreements</i> ” under “ <i>Trigger Event Remedies</i> ”.
“ UK ”	means the United Kingdom.
“ UK Listing Authority ” or “ UKLA ”	means the Financial Services Authority in its capacity as competent authority under the FSMA.
“ Unrestricted Chargor ”	means each of SWSH and SWSGH and any other entity which accedes to the Security Agreement pursuant to Clause 27.3 (<i>Assignments and Transfers</i>) thereof that is not restricted by its regulatory or statutory obligations from providing guarantees to any other entity.
“ Unrestricted Secured Liabilities ”	means all present and future obligations and liabilities (whether actual or contingent and whether owed jointly or severally or in any other capacity whatsoever) of each Unrestricted Chargor to any Secured Creditor under each Finance Document to which such Unrestricted Chargor is a party, except for any obligation which, if it were secured under the Security Agreement, would result in a contravention of Section 151 of the Companies Act 1985.
“ Unwrapped Debt ” or “ Unwrapped Bond ”	means any indebtedness or bond (respectively) that does not have the benefit of a guarantee from a Financial Guarantor.
“ Unwrapped Bondholders ”	means the holders for the time being of the Unwrapped Bonds and “ Unwrapped Bondholder ” shall be construed accordingly.
“ UWWTD ”	means the Urban Waste Water Treatment Directive (91/271/EEC).
“ VAT ”	(a) in respect of any Finance Lease Document, has the meaning given thereto in such Finance Lease Document; and (b) otherwise, means value added tax as imposed by the Value Added Tax Act 1994 and legislation supplemental thereto and other tax of a similar fiscal nature whether imposed in the United Kingdom (instead of, or in addition to, VAT) or elsewhere.
“ Voted Qualifying Class A Debt ”	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.

“Voted Qualifying Class B Debt”	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.
“Water Act”	means the United Kingdom Water Act 2003.
“Water Region”	means the geographical area for which a Regulated Company has been appointed as water undertaker under Section 6 of the WIA.
“Water Quality Regulations”	means the Water Supply (Water Quality) Regulations 2000, as amended by subsequent legislation.
“Water White Paper”	means the white paper “Water for Life”, published by the Government on 8 December 2011.
“WIA”	means the United Kingdom Water Industry Act 1991 (as amended by subsequent legislation, including the Competition and Service (Utilities) Act 1992 and the WIA 99).
“WIA 99”	means the United Kingdom Water Industry Act 1999.
“WRA”	means the United Kingdom Water Resources Act 1991, as amended by subsequent legislation including the United Kingdom Environment Act 1995.
“Wrapped Debt” or “Wrapped Bond”	means any indebtedness or bond (respectively) that has the benefit of a guarantee from a Financial Guarantor.
“Wrapped Bondholders”	means the holders for the time being of the Wrapped Bonds and “Wrapped Bondholder” shall be construed accordingly.
“WSRA”	means the Water Services Regulation Authority.
“Zero Coupon Bond”	means a Bond specified as such in the relevant Final Terms and on which no interest is payable.

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