

OFFERING CIRCULAR



SOUTH WEST WATER FINANCE PLC

(Incorporated in England and Wales with limited liability under registered number 5722435)

£150,000,000 5.875% Guaranteed Bonds due 2040

unconditionally and irrevocably guaranteed by

SOUTH WEST WATER LIMITED

(Incorporated in England and Wales with limited liability under registered number 2366665)

Issue price: 98.416%

The £150,000,000 5.875 per cent. Guaranteed Bonds due 2040 (the **Bonds**) are issued by South West Water Finance Plc (the **Issuer**) and unconditionally and irrevocably guaranteed by South West Water Limited (the **Guarantor**).

Interest on the Bonds will be payable annually in arrear on 16 July, from and including 16 July 2011 up to and including 16 July 2040, at a rate of 5.875 per cent. per annum. See "Terms and Conditions of the Bonds – Interest". The Bonds mature on 16 July 2040.

The denominations of the Bonds shall be GBP 50,000 and integral multiples of GBP 1,000 in excess thereof up to and including GBP 99,000. No Notes in definitive form will be issued with a denomination above GBP 99,000.

The Issuer may, at its option, redeem all, but not some only, of the Bonds at any time at par plus accrued interest, in the event of certain tax changes as described under "Terms and Conditions of the Bonds – Redemption and Purchase". The Bonds may also be redeemed at the option of Bondholders upon the occurrence of a Put Event (as defined in the Terms and Conditions).

Application has been made to the Financial Services Authority in its capacity as competent authority under the Financial Services and Markets Act 2000 (the **UK Listing Authority**) for the Bonds to be admitted to the Official List of the UK Listing Authority and to the London Stock Exchange plc (the **London Stock Exchange**) for the Bonds to be admitted to trading on the London Stock Exchange's regulated market. The London Stock Exchange's regulated market is a regulated market for the purposes of Directive 2004/39/EC (the **Markets in Financial Instruments Directive**).

The Bonds will initially be represented by a temporary global bond (the **Temporary Global Bond**), without interest coupons, which will be deposited on or about 16 July 2010 (the **Closing Date**) with a common depositary for Euroclear Bank SA/NV (**Euroclear**) and Clearstream Banking, *société anonyme* (**Clearstream, Luxembourg**). Interests in the Temporary Global Bond will be exchangeable for interests in a permanent global bond (the **Permanent Global Bond** and, together with the Temporary Global Bond, the **Global Bonds**), without interest coupons, on or after 25 August 2010 (the **Exchange Date**), upon certification as to non-U.S. beneficial ownership. Interests in the Permanent Global Bond will be exchangeable for definitive Bonds only in certain limited circumstances – see "Summary of Provisions relating to the Bonds while represented by the Global Bonds".

An investment in Bonds involves certain risks. Prospective investors should have regard to the factors described under the heading "Risk Factors" on page 6.

LEAD MANAGER

DEUTSCHE BANK

The date of this Offering Circular is 9 July 2010

This Offering Circular (the **Offering Circular**) comprises a prospectus for the purposes of Article 5.3 of Directive 2003/71/EC (the **Prospectus Directive**).

The Issuer and the Guarantor (the **Responsible Persons**) accept responsibility for the information contained in this Offering Circular. To the best of the knowledge of each of the Issuer and the Guarantor (each having taken all reasonable care to ensure that such is the case) the information contained in this Offering Circular is in accordance with the facts and does not omit anything likely to affect the import of such information.

This Offering Circular is to be read in conjunction with all documents which are deemed to be incorporated herein by reference (see "Documents Incorporated by Reference"). This Offering Circular should be read and construed on the basis that such documents are incorporated and form part of this Offering Circular.

Neither the Lead Manager (as described under "Subscription and Sale") nor the Trustee has independently verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability, whether arising in tort or contract or otherwise, is accepted by the Lead Manager or the Trustee as to the accuracy or completeness of the information contained in, or incorporated by reference into, this Offering Circular or any other information provided by the Issuer or the Guarantor in connection with the offering of the Bonds or for any other statement made or purported to be made by the Lead Manager or on its behalf in connection with the Issuer, the Guarantor or the issue or offering of any of the Bonds. Neither the Lead Manager nor the Trustee accepts any liability in relation to the information contained in, or incorporated by reference into, this Offering Circular or any other information provided by the Issuer or the Guarantor in connection with the offering or distribution of the Bonds.

No person is or has been authorised by the Issuer, the Guarantor, the Lead Manager or the Trustee to give any information or to make any representation not contained in or not consistent with this Offering Circular or any other information supplied in connection with the offering of the Bonds and, if given or made, such information or representation must not be relied upon as having been authorised by or on behalf of the Issuer, the Guarantor, the Lead Manager or the Trustee.

Neither this Offering Circular nor any other information supplied in connection with the offering of the Bonds (a) is intended to provide the basis of any credit or other evaluation or (b) should be considered as a recommendation by the Issuer, the Guarantor, the Lead Manager or the Trustee that any recipient of this Offering Circular or any other information supplied in connection with the offering of the Bonds should purchase any Bonds. Each investor contemplating purchasing any Bonds should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer and the Guarantor. Neither this Offering Circular nor any other information supplied in connection with the offering of the Bonds constitutes an offer or invitation by or on behalf of the Issuer, the Guarantor, the Lead Manager or the Trustee to any person to subscribe for or to purchase any Bonds.

Neither the delivery of this Offering Circular nor the offering, sale or delivery of the Bonds shall, in any circumstances, imply that the information contained herein concerning the Issuer and/or the Guarantor is correct at any time subsequent to the date hereof or that any other information supplied in connection with the offering of the Bonds is correct as of any time subsequent to the date indicated in the document containing the same. The Lead Manager and the Trustee expressly do not undertake to review the financial condition or affairs of the Issuer or the Guarantor during the life of the Bonds or to advise any investor in the Bonds of any information coming to their respective attention.

The Bonds have not been and will not be registered under the United States Securities Act of 1933, as amended (the **Securities Act**), and are subject to U.S. tax law requirements. Subject to certain exceptions, the Bonds may not be offered, sold or delivered within the United States or to U.S. persons. For a further description of certain restrictions on the offering and sale of the Bonds and on distribution of this document, see "Subscription and Sale" below.

This Offering Circular does not constitute an offer to sell or the solicitation of an offer to buy the Bonds in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Offering Circular and the offer or sale of Bonds may be restricted by law in certain jurisdictions. None of the Issuer, the Guarantor, the Lead Manager and the Trustee represent that this Offering Circular may be lawfully distributed, or that the Bonds may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Issuer, the Guarantor, the Lead Manager or the Trustee which is intended to permit a public offering of the Bonds or the distribution of this Offering Circular in any jurisdiction where action for that purpose is required. Accordingly, no Bonds may be offered or sold, directly or indirectly, and neither this Offering Circular nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Offering Circular or any Bonds may come must inform themselves about, and observe, any such restrictions on the distribution of this Offering Circular and the offering and sale of Bonds. In particular, there are restrictions on the distribution of this Offering Circular and the offer or sale of Bonds in the United States and the United Kingdom, see "Subscription and Sale".

IN CONNECTION WITH THE ISSUE OF THE BONDS, DEUTSCHE BANK AG, LONDON BRANCH AS STABILISING MANAGER (THE STABILISING MANAGER) (OR ANY PERSON ACTING ON BEHALF OF THE STABILISING MANAGER) MAY OVER-ALLOT BONDS OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE BONDS AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL. HOWEVER, THERE IS NO ASSURANCE THAT THE STABILISING MANAGER (OR ANY PERSON ACTING ON BEHALF OF THE 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 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 BONDS AND 60 DAYS AFTER THE DATE OF THE ALLOTMENT OF THE BONDS. ANY STABILISATION ACTION OR OVER-ALLOTMENT MUST BE CONDUCTED BY THE STABILISING MANAGER (OR PERSONS ACTING ON BEHALF OF THE STABILISING MANAGER) IN ACCORDANCE WITH ALL APPLICABLE LAWS AND RULES.

All references in this document to **Sterling**, **GBP** and **£** refer to the currency of the United Kingdom. In addition, all references to **U.S. dollars**, **U.S.\$** and **\$** refer to United States dollars and all references to **Euro** and **€** refer to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty on the functioning of the European Union, as amended.

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RISK FACTORS

Prospective investors should consider carefully the risks set forth below and other information contained in this Offering Circular prior to making any investment decision with respect to the Bonds. Each of the Issuer and the Guarantor believes that the following factors may affect its ability to fulfil its obligations under the Bonds and the Trust Deed. All of these factors are contingencies which may or may not occur and neither the Issuer nor the Guarantor is in a position to express a view on the likelihood of any such contingency occurring. In addition, factors which are material for the purpose of assessing the market risks associated with the Bonds are also described below.

Each of the Issuer and the Guarantor believes that the factors described below represent the principal risks inherent in investing in the Bonds, but the Issuer or the Guarantor may be unable to pay interest, principal or other amounts on or in connection with any Bonds for other reasons which may not be considered significant risks by the Issuer and the Guarantor based on information currently available to it or which it may not currently be able to anticipate and any of these risks could have the effects set forth above.

Neither the Issuer nor the Guarantor represents that the statements below regarding the risks of holding any Bonds are exhaustive. The Issuer and the Guarantor have described only those risks relating to its operations that it considers to be material. Prospective investors should also read the detailed information set out elsewhere in this Offering Circular and analyse all other relevant market and economic factors as they deem appropriate in order to reach their own views prior to making any investment decision.

Factors that may affect the Issuer's and the Guarantor's ability to fulfil their obligations under or in connection with the Bonds and the Trust Deed

The Issuer's ability to fulfil its obligations under the Bonds may be affected by certain factors as set out below.

The Issuer is a funding vehicle for the Group

The Issuer is a funding vehicle for the Group. As such it raises finance in the international capital markets and finances the Group through the subscription of debt instruments issued by it, which are unconditionally and irrevocably guaranteed by the Guarantor. In the event that the Guarantor fails to meet its obligations to the Issuer under, or in respect of, any such debt instruments (including, *inter alia*, the Bonds), the Issuer may not be able to meet its payment obligations under the Bonds.

The Guarantor's ability to fulfil its obligations under the Bonds may be affected by certain factors as set out below.

The Guarantor could lose its Licence of Appointment

In the event that the Guarantor did not comply with its Licence of Appointment (as defined in the Conditions on page 31 of this Offering Circular) as a water and sewerage undertaker or breached its obligations under the Water Industry Act 1991 or other relevant legislation, the Secretary of State could petition the High Court to make a special administration order in relation to the Guarantor, if such non compliance or contravention was considered serious enough (a **Special Administration Order**). Such non-compliance or contravention could arise if, *inter alia*, the Guarantor should fail to deliver the capital programme set by the Water Regulator for each successive five year period or comply with laws and regulations which establish, amongst other things, quality standards for drinking water, effluent treatment (including sewage sludge disposal) and discharges into the environment which affect the Guarantor's operations.

Under a Special Administration Order, a special administrator will or may be appointed to, *inter alia*, transfer to one or more companies as a going concern as much of the Guarantor's undertaking as is necessary

to ensure that the functions which have been vested in the Guarantor by virtue of its Licence of Appointment may be properly carried out (a **Transfer Scheme**). It is not certain whether or not the Guarantor's obligations to guarantee the Bonds are necessary to the Guarantor's functions as a water undertaker under its Appointment and would, therefore, be transferred to a new company under any such Transfer Scheme. Any such Transfer Scheme could, accordingly, materially affect the Guarantor's business, profitability or financial condition and, consequently, its ability to fulfil its obligations under the Guarantee.

The Guarantor cannot affirm that it will be in total compliance at all times with these laws and regulations, however, the Guarantor has a track record of delivering its capital programme in accordance with regulatory requirements and it endeavours to comply with all regulatory standards.

The Guarantor's Licence of Appointment could be terminated

The Appointment could be terminated upon 25 years' notice. No such notice has been issued to date and the Guarantor is not aware of any intention by the Secretary of State to issue such a notice.

Potential impact of regulatory enforcement action

Ofwat¹ is empowered under section 22A (11) of the Water Industry Act 1991 to impose financial penalties on water and sewerage companies in the event of a company being in breach of its statutory and licence obligations. The maximum penalty that can be imposed is 10 per cent. of a company's turnover. Enforcement action is likely only to be taken by Ofwat against such a company in the event of serious or persistent breaches, but the imposition of any fine of this magnitude on the Guarantor could seriously impact its profitability in that year.

Holders of the Bonds rely on the creditworthiness of the Issuer and the Guarantor

The Bonds and the Guarantee (as applicable) will constitute unsubordinated and unsecured obligations of the Issuer and the Guarantor and will rank equally among themselves and equally with all other unsubordinated and (subject to Condition 3 (*Negative Pledge*)) unsecured obligations of the Issuer and the Guarantor, respectively (other than obligations preferred by mandatory provisions of law). As a matter of contract, a purchaser of the Bonds relies on the creditworthiness of the Issuer and the Guarantor and no other person. In addition, investment in the Bonds involves the risk that subsequent changes in actual or perceived creditworthiness of the Issuer or the Guarantor (as applicable) may adversely affect the market value of the Bonds.

Price controls applicable to the Guarantor's regulated business could adversely affect profitability

Every five years, Ofwat sets limits on the prices that water and sewerage companies in England and Wales can charge their customers by issuing price determinations. In November 2009, Ofwat published its final proposals for the limits on prices chargeable between 2010 and 2015 (the **Final Determination**), having taken into account business plans submitted by the various water and sewerage companies in England and Wales.

South West Water has accepted the Final Determination and expects to deliver the outputs required within the price limits set by Ofwat. However, if it is unable to achieve such outputs within the prescribed price limits, due for example to unexpected cost increases, this could impact the Guarantor's profitability, although there is a regulatory mechanism available for specific cost pressures which would allow the prescribed price limits to be changed between 5-year determinations.

Ofwat is expected to determine price limits for the 2015 – 2020 period in 2014. Ofwat has a duty to ensure, *inter alia*, that an efficient company is able to finance its functions. However, if it adopts unrealistic

¹ **Ofwat** means the Water Services Regulatory Authority.

parameters and assumptions, the value of the resulting price limits may hinder the Guarantor's ability to efficiently fund its business, operations and future capital investment programme. These limitations may consequently adversely affect the Guarantor's cash flows and profitability.

Failure to deliver the capital investment programme could adversely affect profitability

The Guarantor requires significant capital for additions to and replacement of plant and equipment for its operations. The price limits set by Ofwat for the K5² period (in the Final Determination) take into account Ofwat's assumed level of expected capital expenditure and associated funding costs. In the event of significant under-performance by the Guarantor against regulatory targets, Ofwat could, in the future, intervene to lower the maximum permitted charges to customers stipulated in the Final Determination, by undertaking an Interim Determination³, which could adversely affect the Guarantor's profitability.

Failure to obtain an Interim Determination could adversely affect profitability

In the event of the Guarantor being materially affected by additional costs or lower revenues, regulatory mechanisms allow for the Guarantor to apply to Ofwat for price limits to be re-set through an Interim Determination, either as a result of specific relevant changes in circumstances, such as a new legal obligation requiring additional capital investment, or through the 'Substantial Effect Clause', where the total adverse impact on the Guarantor amounts to at least 20 per cent. of its turnover. These processes are however subject to a degree of interpretation and challenge by Ofwat, such that the mechanisms cannot be regarded as offering certainty in providing additional revenues.

The Guarantor may be unable to raise sufficient funds to finance its functions

Historically, the Guarantor has financed expenditure from cash flows from operations and debt financing. In setting price limits, Ofwat has a duty to ensure that a company can finance the proper carrying out of its functions. There can be no assurance that cash flows from operations will not decline or that additional debt financing or other sources of capital will be available to finance the Guarantor, in order that it can carry out its functions.

If the Guarantor were unable to secure the anticipated capital efficiencies associated with its capital investment programme, or if the programme were to fall behind schedule for other reasons, banks and other lenders may become less willing to lend to the Guarantor and it may be unable to raise sufficient funds to finance its functions, may incur increased costs as a result of delays and, as a result, profitability of the Guarantor may suffer.

Failure to deliver the operating cost savings assumed by Ofwat in determining Price Determinations could adversely affect profitability

Operating cost savings are set by Ofwat for each Periodic Review period. Should operating cost savings not be achieved, the Guarantor's profitability could suffer. A significant proportion of the Guarantor's operating costs, including energy, bad debts, pensions and abstraction charges, are subject to fluctuation from external factors. This could result in the Guarantor having to achieve a greater level of operating efficiencies in other areas, which may not be achievable without impacting on regulatory targets and service levels.

Environmental regulations and quality standards could increase the Guarantor's costs and adversely affect profitability

Various environmental, consumer protection and health and safety laws and regulations govern the Guarantor's waste water and water distribution businesses. These laws and regulations establish, amongst

² **K5** means the Periodic Review period 2010-2015 for South West Water and **Periodic Review** means the process of determining the water industry's price limits and expenditure plans for five-year regulatory periods undertaken by Ofwat.

³ **Interim Determination** means a re-setting of price limits ("K" factors) during the relevant Periodic Review period.

other things, quality standards for drinking water, effluent treatment (including sewage sludge disposal) and discharges into the environment. All of these affect the Guarantor's operations.

In addition, the Guarantor is required to obtain various environmental permissions from regulatory agencies for its operations. The Guarantor endeavours to comply with all regulatory standards but cannot guarantee that it will be in full compliance with them at all times.

Environmental laws are complex and change frequently. These laws and their enforcement have tended to become more stringent over time. The Guarantor budgets for future capital and operating expenditures to achieve compliance with current and known future changes in law and regulation. However, it is possible that new or stricter standards could be imposed that would raise the Guarantor's capital and operating expenditures by requiring modifications to its assets or operations. It is also possible that future legislation will impose constraints on existing water abstractions requiring the Guarantor to source alternative water supplies. These costs are recoverable in part or in whole through the regulatory process of setting appropriate future price limits. In the event of these being significant, the Guarantor could apply to Ofwat for a revision of its price limits through an Interim Determination.

As environmental laws are becoming more stringent, the Guarantor may also be unable to comply with all new regulatory and environmental performance standards. Such non-compliance could result in the potential for fines or other sanctions imposed by either Ofwat or the courts, including ultimately the loss of the Guarantor's licence.

Contamination of water supplies could adversely affect profitability

Water supplies may be subject to contamination, which may emanate from naturally occurring compounds, and pollution resulting from man-made sources. Although the Guarantor has established contingency plans and incident management procedures and has controls in place in respect of its water supplies, if one or more of the Guarantor's water supplies becomes contaminated and the Guarantor is unable to substitute a supply or to treat the contaminated water source adequately, there may be an adverse effect on its reputation, operating results and financial position. Some or all of the remedial costs may be recoverable through future price reviews or through insurance policies maintained by the Guarantor (although there is no guarantee that all or any of the costs associated with these risks would be covered or that coverage will continue to be available in the future). The Guarantor could also be held liable for human exposure to hazardous substances in its water supplies or other environmental damage.

Non-recovery of customer debt could adversely affect profitability

The Guarantor is responsible for the billing, cash collection and debt management activities for around 778,700 domestic and business water and waste water customers. The Water Industry Act 1997 prohibits the disconnection of a domestic water supply for non-payment.

Non-recovery of debt is therefore a risk to the Guarantor and may cause the Guarantor's profitability to suffer. Allowance is made by Ofwat in each price determination for its estimate of debt deemed to be irrecoverable, but there can be no assurance that the amount allowed by Ofwat is or will be adequate. In addition to existing strategies, the Guarantor is implementing new initiatives to improve and secure cash collection, including the use of property charging orders. In addition the Final Determination includes provision for companies to seek an Interim Determination in the event of bad debts being significantly greater than the amount allowed by Ofwat due to the impact of economic recession. To the extent that these initiatives and the right to seek an Interim Determination prove insufficient to enable the Guarantor to recover any bad debt costs, in addition to those allowed by Ofwat, such bad debt costs could have an adverse impact on the Guarantor's profitability.

Risks associated with current UK economic conditions affecting the Guarantor

There is a risk that the current economic slowdown could reduce income from customers. However the impact has been marginal to date partly because the Guarantor has a lower than average proportion of large industrial customers in its area. There is also a risk that levels of bad debts from domestic customers may increase beyond the level allowed for by Ofwat in the Final Determination. The longer that the adverse economic conditions continue, the greater the risk that the level of income from customers could decrease and hence affect the profitability of the Guarantor.

Energy cost volatility

Energy costs are approximately 12 per cent. of the Guarantor's operating costs excluding depreciation and restructuring costs. Whilst Ofwat allows for energy costs in a price determination and although the Guarantor mitigates, in part, rising energy costs through careful system operation to reduce consumption, by maximising renewable energy generation and by purchasing more cost-effective or efficient energy, increases in energy costs beyond the level assumed in the Final Determination by Ofwat would adversely affect the Guarantor's profitability. However, the Guarantor has already purchased 75 per cent. of its energy requirements for the K5 period at prices lower than those assumed by Ofwat in the Final Determination.

Operational failures

A failure of the equipment operated by the Guarantor could lead to the escape of water or waste water including sewage effluent. The Guarantor has processes in place whereby it is able to monitor its significant assets by automated and remote operation and has routine controls and procedures in place that are kept under review. It also employs asset management techniques such as assessing the reliability of assets against breakdown and maintaining back-up controls and procedures to pre-empt the failure of assets. If such processes or asset management techniques were not to prove effective or any other controls and procedures employed by the Guarantor to monitor equipment were to fail, this could result in damage to third party property or personal injury and the Guarantor could incur liability. The Guarantor could also be prosecuted by the EA⁴ or DWI⁵ and/or be required to undertake changes to its equipment or controls and procedures. Any such additional costs would adversely affect the Guarantor's profitability.

Meter option take-up greater than forecast, resulting in reduced revenues for the Guarantor

Higher than national average water and sewerage charges exist within the Guarantor area. This has encouraged many customers to change from an unmeasured rateable value based charging system to a payment based on volume of water used as measured by a meter. Properties constructed since 1989 do not have a rateable value assessment and are therefore charged by the volume of water used. Most customers in properties built prior to 1989 can choose to opt for metered charges. In doing so they have an option to switch back to rateable value payment within 12 months of meter installation. The rate at which customers elect to switch to metered charges is estimated during each Periodic Review.

Customers will generally switch to rateable value payment where such a change would result in lower water bills for them, which concurrently also tends to lead to better water conservation practices by households. As such, if more customers change to a payment based on volume of water used as charged by a meter, to the extent the effect of such change is not adequately provided for in the Final Determination, the Guarantor's profitability will be adversely affected during the K5 period.

Ofwat has introduced a new "Revenue Correction Price Control" mechanism, which will enable revenue variances to its assumptions, caused by meter option take up or demand, to be adjusted for at subsequent price reviews which should, to an extent, mitigate the revenue risk described in the immediately preceding paragraph.

⁴ EA means the Environment Agency.

⁵ DWI means the Drinking Water Inspectorate.

Reduced revenue from falling customer demand for water

Customer demand for water is subject to variation and may decrease, which has the potential to impact negatively on the Guarantor's revenue. Ofwat makes assumptions about the level of customer demand when setting maximum prices for a five year regulatory period. If actual demand is lower than this assumption, as has happened in the last regulatory period (from 2005 to 2010), it has not historically been possible for the Guarantor to recover this shortfall in income. Approximately 68 per cent. of domestic customers already have water meters. Customers who opt to have a water meter generally adopt better water conservation measures, as they are more aware of the level of water usage by their household. As a result, the level of volatility in customer demand for water increases with the number of further customers opting to have a water meter. The reduced demand experienced in the last regulatory period has been taken into account by Ofwat in setting a baseline turnover for the start of the next regulatory period from 2010. As noted above, Ofwat has introduced a form of revenue cap regulation from 2010, which will allow water companies to recover a shortfall in income in respect of a five year regulatory period in the following five year regulatory period (which commences in 2015) and, thereafter, on a rolling five year basis. There can be no guarantee that any such adjustment provision will provide adequate revenue compensation to the Guarantor and if it does not, this could have an adverse effect on the business, profitability and cash flow of the Guarantor.

Water resource adequacy

A water shortage due to a severe drought could reduce the water supply available to customers, which could reduce usage and have a material impact on the profitability of the Guarantor.

Although the Guarantor has a number of schemes in place to maintain water resources (such as pumped storage for certain reservoirs), these schemes are not without their inherent risks. For example, pumped storage is only a viable option if there has been sufficient rainfall and to the extent that water levels of rivers are not too low. In addition, although the Guarantor promotes conservation measures, these simultaneously lower customer demand and hence lead to reduced profitability.

The Guarantor prepares a new "Water Resources Plan" every five years and reviews it annually for a range of climate change and demand scenarios. The "Water Resources Plan" published in November 2009 indicates that no new reservoirs are required before the planning horizon of 2035. However, investment is needed to develop the overall trunk main infrastructure and to expand and maintain treatment capacity. The Final Determination allows for a level of capital expenditure to fund the trunk main infrastructure and expand and maintain treatment capacity for the next 5-year period. The Water Resources Plan has been based upon the most severe historic drought and takes into account climate change and population projections. It also includes a headroom allowance to allow for uncertainties in data and information. However, should conditions arise which are outside the design parameters on which the Water Resources Plan has been formulated, then additional costs may be incurred by the Guarantor in order to ensure the continuation of public water supplies. These costs may have an adverse effect on the business, profitability and cash flow of the Guarantor.

The Guarantor may be impacted by the long-term effects of climate change. Extreme weather conditions (including drought), together with increased demand from customers resulting from, for example, hotter drier summers, could affect the Guarantor's resources, water quality and biodiversity. The Guarantor has established contingency plans, and will adapt the way it conducts its business, to respond effectively to the hotter, drier summers and wetter winters which are predicted. However, the Guarantor's assets and infrastructure could also increasingly be vulnerable to rising sea-levels, more intense storms and flooding. These conditions could affect the Guarantor's ability to provide water and wastewater services. Costs may be incurred in taking action to tackle vulnerable sites and infrastructure, this having an adverse effect on the business, profitability and cash flow of the Guarantor.

Deflation

Deflation (negative RPI⁶) could affect the Guarantor in the form of lower customer bills and hence lower revenues and could also result in a lower Regulatory Capital Value (**RCV**) for the Guarantor, resulting in increased gearing due to the majority of the Guarantor's debt not being index linked. At present, the Guarantor is conservatively financed with debt to RCV gearing in Ofwat's preferred range of 55-65 per cent., but deflation may result in an adverse effect on the profitability of the Guarantor and its ability to raise debt finance against the value of the RCV.

Financial loss arising from the insolvency of a major supplier or contractor

Although the Guarantor does not have material creditor exposure as it does not make payments before receipt of goods and services, and also uses a third party credit monitoring service for changes to suppliers' financial status and creditworthiness to supplement an annual risk review of key and strategic suppliers, the Guarantor may nevertheless be vulnerable to financial loss in the event of one of its key suppliers or contracts becoming insolvent in circumstances previously unknown to the Guarantor.

Impact of competition in the industry

The Guarantor is assessing the implications of the Cave Report published by the UK Government in April 2009 in order to prepare for an extension of competition for non-household customers in the water industry. Legislation will be required for any further extension of competition in the water and sewerage services markets. To the extent that competition is increased within the water and sewerage services markets, this could result in a reduced customer base and market share for the Guarantor and could as a result have an adverse impact on profitability of the Guarantor.

Guarantor pension costs may increase due to factors outside the Guarantor's control

Certain of the Guarantor's employees are eligible to participate in funded defined benefit schemes operated by its parent company. Employer costs have been limited as a result of the introduction of defined contribution arrangements for all new employees since April 2008. As at 31 March 2010, 75 per cent. of the Guarantor's employees were in defined benefit schemes and 8 per cent. in defined contribution schemes.

The Guarantor's share of the pension schemes' net liabilities (before deferred tax relief) at 31 March 2010 of was approximately £83 million (compared to £51 million as at 31 March 2009), the increase principally resulting from a reduced discount rate and higher than expected inflation. The net liabilities (after deferred tax relief) of £60 million represented less than 2.5 per cent. of the Guarantor's Regulatory Capital Value as at 31 March 2010.⁷

The triennial actuarial valuation at March 2007 of the defined benefit schemes resulted in higher cash costs for both future service and deficit recovery contributions. For IAS 19 reporting, the longevity assumption was strengthened to a scheme-specific "medium cohort" basis which allows for improved life expectancy for existing and future pensioners. The next triennial Actuarial valuation is currently in progress.

The future costs of defined benefit schemes are subject to a number of factors including:

- the returns achieved on pension fund investments;
- movements in interest rates and inflation; and
- pensioner longevity.

Pension trustees keep the pension schemes' investment policy under review and use professional investment

⁶ **RPI** means the UK Government's Retail Price Index.

⁷ Explanation of the Guarantor's pension liabilities is available in the Guarantor's audited financial statements for 2010, incorporated by reference into this Offering Circular, at Note 24 to such financial statements..

advisers. The pension trustees also review the investment strategy to improve the match of investments and liabilities. In addition, employee and employer contributions are kept under review and have been increased.

For IAS 19 reporting, independent actuaries have identified scheme-specific mortality experience which is reflected in liabilities.

A significant increase in pension costs could have a materially adverse effect on the Guarantor and/or its Group.

Factors which are material for the purpose of assessing the market risks associated with the Bonds

The Bonds may not be a suitable investment for all investors

Each potential investor in the Bonds must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

- (a) have sufficient knowledge and experience to make a meaningful evaluation of the Bonds, the merits and risks of investing in the Bonds and the information contained or incorporated by reference in this Offering Circular;
- (b) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Bonds and the impact the Bonds will have on its overall investment portfolio;
- (c) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Bonds until the maturity of the Bonds, including where the currency for principal or interest payments is different from the potential investor's currency;
- (d) understand thoroughly the terms of the Bonds and be familiar with the behaviour of any relevant indices and financial markets;
- (e) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks; and
- (f) have a good understanding of the water regulatory environment in the United Kingdom.

Risks related to Bonds generally

Set out below is a brief description of certain risks relating to the Bonds generally:

Modification, waivers and substitution

The Terms and Conditions contain provisions for convening meetings of Bondholders to consider matters relating to the Bonds. These provisions permit defined majorities to bind all Bondholders including Bondholders who did not attend and vote at the relevant meeting and Bondholders who voted in a manner contrary to the majority.

The Terms and Conditions also provide that the Trustee may, without the consent of Bondholders, agree to (a) any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of the Terms and Conditions or any of the provisions of the Trust Deed which is, in the opinion of the Trustee, of a formal, minor or technical nature or is made to correct a manifest or proven error (b) any other modification of, or to the waiver or authorisation of any breach or proposed breach of, any of the Terms and Conditions or any of the provisions of the Trust Deed which is in the opinion of the Trustee not materially prejudicial to the

interests of the Bondholders and may determine without the consent of the Bondholders or the Couponholders, that any Event of Default or Potential Event of Default (as defined in the Trust Deed) shall not be treated as such provided it is in the opinion of the Trustee not materially prejudicial to the interests of the Bondholders and the Trust Deed provides that the Trustee may, without the consent of Bondholders, agree to the substitution of the Guarantor or any Subsidiary of the Guarantor (other than an Excluded Subsidiary (as defined in Condition 18)) as principal debtor under the Trust Deed and the Bonds in place of the Issuer or of any previous substituted company, in the circumstances described in Condition 12.

EU Directive on the Taxation of Savings Income

Under European Council Directive 2003/48/EC on the taxation of savings income (the **Savings Directive**), Member States are required to provide to the tax authorities of another Member State details of payments of interest (and similar income) paid by a person within its jurisdiction to an individual resident in that other Member State or to certain limited types of entities established in that other Member State. However, for a transitional period, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments, subject to a procedure whereby, on meeting certain conditions, the beneficial owner of the interest or other income may request that no tax be withheld (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have adopted similar measures (a withholding system in the case of Switzerland).

On 15 September 2008 the European Commission issued a report to the Council of the European Union on the operation of the Savings Directive, which included the Commission's advice on the need for changes to the Savings Directive. On 13 November 2008 the European Commission published a more detailed proposal for amendments to the Savings Directive, which included a number of suggested changes. The European Parliament approved an amended version of this proposal on 24 April 2009. If any of those proposed changes are made in relation to the Savings Directive, they may amend or broaden the scope of the requirements described above.

If a payment were to be made or collected through a Member State which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment pursuant to the Savings Directive or any law implementing or complying with, or introduced in order to conform to, the Savings Directive, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Bond as a result of the imposition of such withholding tax. The Issuer is required to maintain a Paying Agent in a Member State that is not obliged to withhold or deduct tax pursuant to the Savings Directive or any law implementing or complying with, or introduced in order to conform to, the Savings Directive.

Change of law

The Terms and Conditions are based on English law in effect as at the date of this Offering Circular. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of this Offering Circular.

European Monetary Union

If the United Kingdom joins the European Monetary Union prior to the maturity of the Bonds, there is no assurance that this would not adversely affect investors in the Bonds. It is possible that prior to the maturity of the Bonds the United Kingdom may become a participating Member State and that the Euro may become the lawful currency of the United Kingdom. In that event (i) all amounts payable in respect of the Bonds may become payable in Euro; and (ii) the law may allow or require the Bonds to be re-denominated into Euro and additional measures to be taken in respect of such Bonds. The introduction of the Euro could also be accompanied by a volatile interest rate environment, which could adversely affect investors in the Bonds.

Denominations involve integral multiples: definitive Bonds

The Bonds have denominations consisting of a minimum of GBP 50,000 plus one or more higher integral multiples of GBP 1,000. It is possible that the Bonds may be traded in amounts that are not integral multiples of GBP 50,000. In such a case a holder who, as a result of trading such amounts, holds an amount which is less than GBP 50,000 in his account with the relevant clearing system at the relevant time may not receive a definitive Bond in respect of such holding (should definitive Bonds be printed) and would need to purchase a principal amount of Bonds such that its holding amounts to GBP 50,000.

If definitive Bonds are issued, holders should be aware that definitive Bonds which have a denomination that is not an integral multiple of GBP 50,000 may be illiquid and difficult to trade.

Risks related to the market generally

Set out below is a brief description of the principal market risks, including liquidity risk, exchange rate risk, interest rate risk and credit risk:

The secondary market generally

Currently no secondary market exists for the Bonds and one may never develop. In the event that a secondary market in the Bonds does develop, there can be no assurance that it will provide the Bondholders with liquidity of investment or that it will continue for the life of the Bonds. Therefore, investors may not be able to sell their Bonds easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. Accordingly, the purchase of Bonds is suitable only for investors who can bear the risks associated with a lack of liquidity in the Bonds and the financial and other risks associated with an investment in the Bonds. Investors must be prepared to hold the Bonds until maturity.

Exchange rate risks and exchange controls

The Issuer will pay principal and interest on the Bonds in Sterling. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the **Investor's Currency**) other than Sterling. These include the risk that exchange rates may significantly change (including changes due to devaluation of Sterling or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to Sterling would decrease (1) the Investor's Currency-equivalent yield on the Bonds, (2) the Investor's Currency equivalent value of the principal payable on the Bonds and (3) the Investor's Currency equivalent market value of the Bonds.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

Interest rate risks

Investment in the Bonds involves the risk that subsequent changes in market interest rates may adversely affect the value of them.

As the Global Bonds are held by or on behalf of Euroclear and Clearstream, Luxembourg, investors will have to rely on their procedures for transfer, payment and communication with the Issuer

The Bonds will be represented by the Global Bonds and, except in certain limited circumstances described in the Permanent Global Bond, investors will not be entitled to receive definitive Bonds. The Global Bonds will

be deposited with the Common Depositary for Euroclear and Clearstream, Luxembourg. Euroclear and Clearstream, Luxembourg will maintain records of the beneficial interests in the Global Bonds. While the Bonds are represented by the Global Bonds, investors will be able to trade their beneficial interests only through Euroclear and Clearstream, Luxembourg.

The Issuer will discharge its payment obligations under the Bonds by procuring that payments are made to Euroclear and Clearstream, Luxembourg for distribution to their account holders. A holder of a beneficial interest in a Global Bond must rely on the procedures of Euroclear and Clearstream, Luxembourg to receive payments under the Bonds. The Issuer has no responsibility or liability for the records relating to, or payments made in respect of, beneficial interests in the Global Bonds.

Holders of beneficial interests in the Global Bonds will not have a direct right to vote in respect of the Bonds. Instead, such holders will be permitted to act only to the extent that they are enabled by Euroclear and Clearstream, Luxembourg to appoint appropriate proxies.

Legal investment considerations may restrict certain investments

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (1) Bonds are legal investments for it, (2) Bonds can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of any Bonds. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of Bonds under any applicable risk-based capital or similar rules.

DOCUMENTS INCORPORATED BY REFERENCE

This Offering Circular should be read and construed in conjunction with:

- (i) the Issuer's annual report and financial statements 2009, which includes the audited non-consolidated financial statements of the Issuer and the audit report thereon, for the financial year ended 31 March 2009 (which appear on pages 3 to 14 of such annual report);
- (ii) the Issuer's annual report and financial statements 2010, which includes the audited non-consolidated financial statements of the Issuer and the audit report thereon, for the financial year ended 31 March 2010 (which appear on pages 4 to 18 of such annual report);
- (iii) the Guarantor's annual report and financial statements 2009, which includes the audited non-consolidated financial statements of the Guarantor and the audit report thereon, for the financial year ended 31 March 2009 (which appear on pages 22 to 63 of such annual report); and
- (iv) the Guarantor's annual report and financial statements 2010, which includes the audited non-consolidated financial statements of the Guarantor and the audit report thereon, for the financial year ended 31 March 2010 (which appear on pages 23 to 67 of such annual report),

which, in each case, have been previously published and which have been filed with the United Kingdom Financial Services Authority.

The documents referred to above shall be incorporated by reference in, and form part of this Offering Circular, save that any statement contained in a document which is incorporated by reference herein shall be modified or superseded for the purpose of this Offering Circular to the extent that a statement contained herein modifies or supersedes such earlier statement (whether expressly, by implication or otherwise). Any statement so modified or superseded shall not, except as so modified or superseded, constitute a part of this Offering Circular.

For the avoidance of doubt, any documents themselves incorporated by reference in any of the documents incorporated by reference in this Offering Circular shall not form part of this Offering Circular.

Copies of documents incorporated by reference in this Offering Circular may be obtained (without charge) from the registered offices of the Issuer and the Guarantor, respectively.

CONDITIONS OF THE BONDS

The following is the text of the Terms and Conditions of the Bonds which (subject to amendment) will be endorsed on each Bond in definitive form if issued:

The £150,000,000 5.875 per cent. Guaranteed Bonds due 2040 (the “**Bonds**”, which expression shall in these Terms and Conditions, unless the context otherwise requires, include any further bonds issued pursuant to Condition 17 and forming a single series with the Bonds) are constituted by a trust deed (the “**Trust Deed**”) dated 16 July 2010 (the “**Closing Date**”) between South West Water Finance Plc (the “**Issuer**”), South West Water Limited (the “**Guarantor**”) as guarantor and Deutsche Trustee Company Limited (the “**Trustee**”, which expression shall include all persons for the time being the trustee or trustees under the Trust Deed) as trustee for the holders of the Bonds (the “**Bondholders**”). The issue of the Bonds was authorised by a resolution of the board of directors of the Issuer passed on 15 June 2010 and a resolution of the Issuer new bond subcommittee passed on 8 July 2010 and the guarantee of the Bonds was authorised by a resolution of the board of directors of the Guarantor passed on 15 June 2010 and a resolution of the Guarantor new bond subcommittee passed on 8 July 2010. The statements in these Terms and Conditions include summaries of, and are subject to, the detailed provisions of and definitions in the Trust Deed. Copies of the Trust Deed and the agency agreement (the “**Paying Agency Agreement**”) dated the Closing Date between the Issuer, the Guarantor, Deutsche Bank AG, London Branch as principal paying agent (the “**Principal Paying Agent**”, which expression shall include any successor in such capacity), the other paying agents named therein (together with the Principal Paying Agent, the “**Paying Agents**”, which expression shall include any additional or successor paying agents) and the Trustee are available for inspection during normal business hours by the Bondholders and the holders of the interest coupons appertaining to the Bonds (the “**Couponholders**” and the “**Coupons**” respectively) at the specified office for the time being of the Trustee, being at the date of issue of the Bonds at Winchester House, 1 Great Winchester Street, London EC2N 2DB and at the specified office of each of the Paying Agents. The expression “**Coupons**” shall, unless the context otherwise requires, include the talons for further interest coupons (the “**Talons**”) and the expression “**Couponholders**” shall, unless the context otherwise requires, include the holders of the Talons. The Bondholders and the Couponholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and the Paying Agency Agreement applicable to them.

Unless defined elsewhere in these Terms and Conditions, capitalised words and expressions used in these Terms and Conditions shall have the meanings given to them in Condition 18.

1 Form, Denomination and Title

The Bonds are in bearer form, serially numbered, in the denomination of £50,000 and integral multiples of £1,000 in excess thereof up to and including £99,000 with Coupons and one Talon attached on issue. No definitive Bonds will be issued with a denomination above £99,000. Bonds of one denomination may not be exchanged for Bonds of another denomination. Title to the Bonds and the Coupons will pass by delivery.

The Issuer, the Guarantor, any Paying Agent and the Trustee may (to the fullest extent permitted by applicable laws) deem and treat the holder of any Bond or Coupon as the absolute owner for all purposes (whether or not the Bond or Coupon shall be overdue and notwithstanding any notice of ownership, trust or any interest in it or writing on the Bond or Coupon or any notice of previous loss

or theft of the Bond or Coupon) and shall not be required to obtain any proof thereof or as to the identity of such holder.

2 Guarantee and Status

- (a) The Guarantor has unconditionally and irrevocably guaranteed the due payment of all sums expressed to be payable by the Issuer under the Trust Deed, the Bonds and the Coupons. Its obligations in that respect (the “**Guarantee**”) are contained in the Trust Deed.
- (b) The Bonds and the Coupons are direct, unconditional and, subject to the provisions of Condition 3, unsecured obligations of the Issuer and, subject as aforesaid, rank and will rank *pari passu* without any preference among themselves. The payment obligations of the Issuer under the Bonds and the Coupons and of the Guarantor under the Guarantee shall, save for such exceptions as may be provided by applicable laws and subject to Condition 3, at all times rank at least equally with all their respective other outstanding unsecured and unsubordinated obligations, present and future.

3 Negative Pledge

So long as any of the Bonds remain outstanding (as defined in the Trust Deed) each of the Issuer and the Guarantor will ensure that no Relevant Indebtedness of the Issuer, the Guarantor, any Principal Subsidiary or any other person and no guarantee by the Issuer, the Guarantor or any Principal Subsidiary of any Relevant Indebtedness of any person will be secured by a mortgage, charge, lien, pledge or other security interest (each a “**Security Interest**”) upon, or with respect to, any of the present or future business, undertaking, assets or revenues (including any uncalled capital) of the Issuer, the Guarantor or any Principal Subsidiary unless, before or at the same time as the creation of the Security Interest, the Issuer and/or the Guarantor shall take any and all action necessary to ensure that:

- (a) all amounts payable by the Issuer under the Bonds, the Coupons and the Trust Deed or, as the case may be, the Guarantor’s obligations under the Trust Deed are secured equally and rateably with such Relevant Indebtedness or guarantee, as the case may be, by the same Security Interest, in each case to the satisfaction of the Trustee; or
- (b) such other Security Interest or guarantee or other arrangement (whether or not including the giving of a Security Interest) is provided in respect of all amounts payable by the Issuer under the Bonds, the Coupons and the Trust Deed or, as the case may be, the Guarantor’s obligations under the Trust Deed either (i) as the Trustee shall in its absolute discretion deem not materially less beneficial to the interests of the Bondholders or (ii) as shall be approved by an Extraordinary Resolution (as defined in the Trust Deed) of the Bondholders,

save that the Issuer, the Guarantor or any Principal Subsidiary may create or have outstanding a Security Interest in respect of any Relevant Indebtedness and/or any guarantees given by the Issuer, the Guarantor or any Principal Subsidiary in respect of any Relevant Indebtedness of any person (without the obligation to provide a Security Interest or guarantee or other arrangement in respect of the Bonds, the Coupons and the Trust Deed as aforesaid) where: (1) such Relevant Indebtedness is of a maximum aggregate amount outstanding at any time not exceeding the greater of £150,000,000 and 15 per cent. of the Capital and Reserves; or (2) such Security Interest is provided by or in respect of a

company becoming a Subsidiary of the Guarantor after the Closing Date and where such Security Interest exists at the time that company becomes a Subsidiary of the Guarantor (provided that such Security Interest was not created in contemplation of that company becoming a Subsidiary of the Guarantor and the principal amount secured at the time of that company becoming a Subsidiary of the Guarantor is not subsequently increased).

4 **Interest**

Each Bond bears interest from (and including) the Closing Date at the rate of 5.875 per cent. per annum (the “**Rate of Interest**”) payable annually in arrear on 16 July in each year (each an “**Interest Payment Date**”). Interest in respect of any Bond shall be calculated per £1,000 in principal amount of the Bonds (the “**Calculation Amount**”). All amounts of interest due on each Bond will be rounded, if necessary, to the nearest penny (half a penny being rounded upwards). The period from and including the Closing Date to but excluding the first Interest Payment Date, and each successive period from and including an Interest Payment Date to but excluding the next succeeding Interest Payment Date, is called an Interest Period.

Each Bond will cease to bear interest from (and including) its due date for redemption unless, upon due presentation, payment of the principal in respect of such Bond is improperly withheld or refused or unless default is otherwise made in respect of such payment, in which event interest shall continue to accrue as provided in the Trust Deed.

The amount (the “**Interest Amount**”) of interest payable on each Bond for any period other than an Interest Period or the Short First Interest Period, will be calculated by:

- (A) applying the Rate of Interest to the Calculation Amount;
- (B) multiplying the resulting amount by the Day Count Fraction; and
- (C) rounding the resulting figure to the nearest one penny (half a penny being rounded upwards).

Where the denomination of a Bond comprises more than one Calculation Amount, the amount of interest payable in respect of such Bond shall be the aggregate of the amounts (determined in the manner provided above) for each Calculation Amount comprising the denomination without any further rounding.

The “**Day Count Fraction**” is a fraction: (i) the numerator of which is the number of days from and including the most recent Interest Payment Date (or Closing Date if such period is before the first scheduled Interest Payment Date) to but excluding the next Interest Payment Date or, if earlier, the date of payment; and (ii) the denominator of which is the actual number of days (including the first and excluding the last) in the relevant Interest Period.

5 **Payments and exchanges of Talons**

Payments of principal and interest in respect of each Bond will be made against presentation and surrender (or, in the case of part payment only, endorsement) of such Bond, except that payments of interest due on an Interest Payment Date will be made against presentation and surrender (or, in the case of part payment only, endorsement) of the relevant Coupons, in each case at the specified office of any of the Paying Agents.

Payments will be made at the specified office of any Paying Agent, at the option of the holder, by sterling cheque drawn on, or by transfer to a sterling account maintained by the payee with, a bank in London subject in all cases to any applicable fiscal or other laws and regulations, but without prejudice to the provisions of Condition 8. No commissions or expenses shall be charged to the Bondholders or the Couponholders in respect of such payments.

Upon the date on which any Bond becomes due and repayable, all unmatured Coupons appertaining to the Bond (whether or not attached) shall become void and no payment shall be made in respect of such Coupons.

A holder shall be entitled to present a Bond or Coupon for payment only on a Presentation Date and shall not, except as provided in Condition 4, be entitled to any further interest or other payment if a Presentation Date falls after the due date.

On and after the Interest Payment Date on which the final Coupon comprised in any Coupon sheet matures, the Talon comprised in the Coupon sheet may be surrendered at the specified office of any Paying Agent in exchange for a further Coupon sheet (including any appropriate further Talon), subject to the provisions of Condition 9. Each Talon shall, for the purposes of these Conditions, be deemed to mature on the Interest Payment Date on which the final Coupon comprised in the relative Coupon sheet matures.

The names of the initial Paying Agents and their initial specified offices are set out at the end of these Terms and Conditions. The Issuer and the Guarantor reserve the right, subject to the prior written approval of the Trustee, at any time to vary or terminate the appointment of any Paying Agent and to appoint additional or other Paying Agents provided that:

- (a) there will at all times be a Principal Paying Agent;
- (b) there will at all times be at least one Paying Agent (which may be the Principal Paying Agent) having its specified office in a European city which so long as the Bonds are admitted to official listing on the London Stock Exchange shall be London or such other place as the UK Listing Authority may approve; and
- (c) the Issuer ensures that it maintains a Paying Agent in a Member State of the European Union (if any) that is not obliged to withhold or deduct tax pursuant to any law implementing or complying with, or introduced in order to conform to, European Council Directive 2003/48/EC on the taxation of savings income.

Notice of any termination or appointment and of any changes in specified offices will be given to the Bondholders promptly by the Issuer in accordance with Condition 14.

6 Redemption and Purchase

- (a) Unless previously redeemed or purchased and cancelled as provided below, each Bond will be redeemed by the Issuer at its principal amount on 16 July 2040.
- (b) If, as a result of any change in, or amendment to, the laws or regulations of the United Kingdom or any political sub-division of, or any authority in or of, the United Kingdom having power to tax, or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective after the Closing Date, the Issuer

(or, if the Guarantee were called, the Guarantor) has or will become obliged to pay additional amounts as provided or referred to in Condition 8 (and such amendment or change has been evidenced by the delivery by the Issuer or, as the case may be, the Guarantor to the Trustee (who shall, in the absence of manifest error, accept such certificate as sufficient evidence thereof) of a certificate signed by two directors of the Issuer or, as the case may be, the Guarantor on behalf of the Issuer or, as the case may be, the Guarantor stating that such amendment or change has occurred (irrespective of whether such amendment or change is then effective), describing the facts leading thereto and stating that such obligation cannot be avoided by the Issuer or, as the case may be, the Guarantor taking reasonable measures available to it), the Issuer may, at its option, at any time, having given not less than 30 nor more than 60 days' notice to the Bondholders in accordance with Condition 14 (which notice shall be irrevocable), redeem all, but not some only, of the Bonds at their principal amount together with interest (if any) accrued to but excluding the date of redemption, provided that no notice of redemption shall be given earlier than 90 days before the earliest date on which the Issuer or, as the case may be, the Guarantor would be required to pay such additional amounts were a payment in respect of the Bonds or, as the case may be, the Guarantee then due.

Notices of redemption will specify the date fixed for redemption.

- (c) Each of the Issuer, the Guarantor or any other Subsidiary of the Guarantor may at any time purchase Bonds (together with unmatured Coupons appertaining thereto) in any manner and at any price.
- (d) All Bonds which are redeemed by the Issuer will forthwith be cancelled (together with all relative unmatured Coupons attached to the Bonds or surrendered with the Bonds) and may not be reissued or resold. Bonds purchased by the Issuer, the Guarantor or any other Subsidiary of the Guarantor may be held or reissued or resold or surrendered for cancellation, unless redeemed pursuant to Condition 7, in which case such Bonds (together with all relative unmatured Coupons attached to the Bonds or surrendered with the Bonds) will forthwith be cancelled as aforesaid.

7 Redemption at the Option of Bondholders

- (a) Subject as provided in this Condition 7 below, if, at any time while any of the Bonds remains outstanding a Put Event occurs then, unless at any time the Issuer shall have given a notice under Condition 6(b) or have exercised its rights pursuant to Condition 6(c), the holder of each Bond will, upon the giving of a Put Event Notice (as defined below), have the option (the **"Put Option"**) to require the Issuer to redeem or, at the option of the Issuer, purchase (or procure the purchase of) that Bond on the Put Date (as defined below), at its principal amount together with (or, where purchased, together with an amount equal to) interest (if any) accrued to (but excluding) the Put Date.

If, at any time while any of the Bonds remains outstanding, a Restructuring Event occurs and prior to the commencement of or during the Restructuring Period an Independent Financial Adviser certifies in writing to the Trustee that such Restructuring Event will not be or is not, in its opinion, materially prejudicial to the interests of the Bondholders, the provisions of this Condition 7 shall cease to have any further effect in relation to such Restructuring Event. Any

certification by an Independent Financial Adviser as aforesaid as to whether or not, in its opinion, any Restructuring Event is materially prejudicial to the interests of the Bondholders shall, in the absence of manifest error, be conclusive and binding on the Trustee, the Issuer, the Guarantor and the Bondholders.

Notwithstanding the determination of any Independent Financial Adviser pursuant to the foregoing provisions of this Condition 7, a Restructuring Event shall be deemed not to be materially prejudicial to the interests of the Bondholders if, notwithstanding the occurrence of a Rating Downgrade or a Negative Rating Event, the rating assigned to the Rated Securities by any Rating Agency is subsequently increased to, or, as the case may be, any Rating Agency assigns to the Bonds or other unsecured and unsubordinated debt of the Guarantor (or of the Issuer or any other Subsidiary of the Guarantor which, in any such case, is guaranteed on an unsecured and unsubordinated basis by the Guarantor) having an initial maturity of five years or more, an investment grade rating (BBB-/Baa3 or their respective equivalents for the time being) or better prior to any Negative Certification being issued.

If the rating designations employed by any Rating Agency is changed from those which are described in this Condition 7 (or the definitions attributable thereto), the Guarantor shall determine, with the approval in writing of the Trustee, the rating designations of that Rating Agency as are most equivalent to the prior rating designations of that Rating Agency, and this Conditions shall be construed accordingly.

- (b) Promptly upon, and in any event within 14 days after, the Issuer or the Guarantor becoming aware that a Put Event has occurred, the Issuer or, as the case may be, the Guarantor shall, and at any time upon the Trustee having express notice that a Put Event has occurred the Trustee may, and if so requested by the holders of at least one-quarter in principal amount of the Bonds then outstanding shall (at their expense), give notice (a **"Put Event Notice"**) to the Bondholders in accordance with Condition 14 specifying the nature of the Put Event and the procedure for exercising the Put Option.
- (c) To exercise the Put Option, the holder of a Bond must deliver such Bond to the specified office of any Paying Agent, on a day which is a Business Day in London and in the place of the specified office of such Paying Agent falling within the period (the **"Put Period"**) of 45 days following the date on which a Put Event Notice is given, accompanied by a duly completed and signed notice of exercise in the form (for the time being current) obtainable from the specified office of any Paying Agent (a **"Put Notice"**) and in which the holder may specify a bank account complying with the requirements of Condition 5 to which payment is to be made under this Condition 7. Each Bond should be delivered together with all Coupons appertaining thereto maturing after the day (the **"Put Date"**) being the fifteenth day after the date of expiry of the Put Period. Upon the Put Date, all unmatured Coupons (which shall, for the avoidance of doubt, include Coupons falling to be issued on exchange of matured Talons) appertaining to the Bond (whether or not attached) shall become void and no payment shall be made in respect of such Coupons. The Paying Agent to which such Bond and Put Notice are delivered shall issue to the Bondholder concerned a non-transferable receipt in respect of the Bond so delivered. Payment in respect of any Bond so delivered shall be made, if the holder duly specifies an account with a bank in London in the Put Notice to which payment is to be made, on the Put Date by transfer to that bank account and, in every other case, on or

after the Put Date in each case against presentation and surrender or (as the case may be) endorsement of such receipt at the specified office of any Paying Agent, subject, in any such case, as provided in Condition 5. A Put Notice, once given, shall be irrevocable. For the purposes of these Terms and Conditions and the Trust Deed, receipts issued pursuant to this Condition 7 shall be treated as if they were Bonds. The Issuer shall redeem or, at the option of the Issuer, purchase (or procure the purchase of) the relevant Bond on the applicable Put Date unless previously redeemed or purchased.

- (d) A Rating Downgrade or a Negative Rating Event or a non-investment grade rating shall be deemed not to have occurred as a result or in respect of a Restructuring Event if the Rating Agency making the relevant reduction in rating or, where applicable, declining to assign a rating of at least investment grade as provided in this Condition 7 does not announce or publicly confirm or inform the Trustee in writing that the reduction or, where applicable, declining to assign a rating of at least investment grade was the result, in whole or in part, of any event or circumstance comprised in or arising as a result of the applicable Restructuring Event.
- (e) The Trust Deed provides that the Trustee is under no obligation to ascertain whether a Restructuring Event, a Negative Rating Event, a Rating Downgrade or a Put Event or any event which could lead to the occurrence of or could constitute a Restructuring Event, a Negative Rating Event, a Rating Downgrade or a Put Event has occurred and until it shall have actual knowledge or express notice pursuant to the Trust Deed to the contrary the Trustee may assume that no Restructuring Event, Negative Rating Event, Rating Downgrade or Put Event or such other event has occurred. The Trust Deed also provides that in determining whether or not a Restructuring Event, a Negative Rating Event, a Rating Downgrade or a Put Event has occurred, the Trustee may rely solely on an opinion given in a certificate signed by two directors of the Issuer or the Guarantor. The Trustee shall have no liability to any person for so assuming or relying as contemplated in this Condition 7(e).

8 Taxation

All payments in respect of the Bonds and the Coupons or under the Guarantee shall be made free and clear of, and without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature (“**Taxes**”) imposed or levied by or on behalf of the United Kingdom, or any political sub-division of, or any authority in or of, the United Kingdom having power to tax, unless the withholding or deduction of such Taxes is required by law. In the event that such withholding or deduction of such Taxes is required by law, the Issuer or, as the case may be, the Guarantor will pay such additional amounts as may be necessary in order that the net amounts received by the Bondholders and Couponholders after withholding or deduction of such Taxes shall equal the respective amounts which would have been receivable in respect of the Bonds or, as the case may be, Coupons in the absence of the withholding or deduction of such Taxes, except that no additional amounts shall be payable in relation to any payment in respect of any Bond or Coupon:

- (a) presented for payment by or on behalf of a holder who is liable to such Taxes in respect of the Bond or Coupon by reason of his having some connection with the United Kingdom other than the mere holding of the Bond or Coupon; or

- (b) presented for payment more than 30 days after the Relevant Date except to the extent that a holder would have been entitled to additional amounts on presenting the same for payment on the last day of such period of 30 days, assuming, whether or not such is in fact the case, such last day to be a Presentation Date; or
- (c) to, or to a third party on behalf of, a holder who would not be liable or subject to the withholding or deduction by making a declaration of beneficial ownership of the Bond or Coupon or of non-residence or other similar claim for exemption to the relevant tax authority or paying agent or any other relevant person; or
- (d) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (e) presented for payment by or on behalf of a holder who would be able to avoid such withholding or deduction by presenting the relevant Bond or Coupon to another Paying Agent in a Member State of the European Union.

As used herein, “**Relevant Date**” means the date on which the payment first becomes due but, if the full amount of the money payable has not been received by the Principal Paying Agent or the Trustee on or before the due date, it means the date on which, the full amount of the money having been so received, notice to that effect shall have been duly given to the Bondholders by the Issuer in accordance with Condition 14.

Any reference in these Terms and Conditions to any amounts in respect of the Bonds shall be deemed also to refer to any additional amounts which may be payable under this Condition or under any undertakings given in addition to, or in substitution for, this Condition pursuant to the Trust Deed.

9 Prescription

Claims against the Issuer and the Guarantor in respect of principal and interest shall be prescribed and become void unless the relevant Bond or Coupon is presented for payment within periods of ten years (in the case of principal) and five years (in the case of interest) from the Relevant Date in respect thereof.

10 Events of Default

The Trustee at its discretion may, and if so requested in writing by the holders of at least one-quarter in principal amount of the Bonds then outstanding or if so directed by an Extraordinary Resolution of the Bondholders shall subject to being indemnified and/or secured and/or pre-funded to its satisfaction (but, in the case of the happening of any of the events mentioned in sub-paragraphs (b), (c), (e), (f), (g), (h) and (i) below, only if the Trustee shall have certified in writing to the Issuer that such event is, in its opinion, materially prejudicial to the interests of the Bondholders), give notice to the Issuer that the Bonds are, and they shall accordingly thereby forthwith become, immediately due and repayable at their principal amount together with accrued interest (as provided in the Trust Deed) if any of the following events (each an “**Event of Default**”) shall have occurred (unless (other than in the case of an event mentioned in sub-paragraph (a) below) such event has been remedied to the satisfaction of the Trustee):

- (a) if default is made for a period of 15 days or more in the payment of any principal of or interest on the Bonds or in the payment of the purchase price due in respect of any Bond pursuant to Condition 7; or
- (b) if the Issuer or the Guarantor fails to perform or observe any of its other obligations under the Bonds or the Trust Deed and (except where the Trustee shall have certified to the Issuer or the Guarantor, as the case may be, in writing that it considers such failure to be incapable of remedy in which case no such notice or continuation as is hereinafter mentioned will be required) such failure continues for the period of 60 days (or such longer period as the Trustee may in its absolute discretion permit) next following the service by the Trustee of notice on the Issuer or the Guarantor, as the case may be, specifying such failure and requiring the same to be remedied; or
- (c) if (i) any other present or future indebtedness for borrowed money of the Issuer, the Guarantor or any Principal Subsidiary becomes due and repayable prior to its stated maturity by reason of an event of default howsoever described or (ii) any such indebtedness for borrowed money is not paid when due (or, as the case may be, within any originally applicable grace period) or (iii) the Issuer, the Guarantor or any Principal Subsidiary fails to pay when due (or, as the case may be, within any originally applicable grace period) any amount payable by it under any present or future guarantee for, or indemnity in respect of, any indebtedness for borrowed money of any person or (iv) any security given by the Issuer, the Guarantor or any Principal Subsidiary for any indebtedness for borrowed money of any person or for any guarantee or indemnity of indebtedness for borrowed money of any person becomes enforceable by reason of default in relation thereto and steps are taken to enforce such security, save (A) in any such case where there is a *bona fide* dispute as to whether the relevant indebtedness for borrowed money or any such guarantee or indemnity as aforesaid shall be due and payable or any such security as aforesaid shall be enforceable, and (B) provided that the aggregate amount of the relevant indebtedness for borrowed money in respect of which any one or more of the events mentioned above in this sub-paragraph (c) has or have occurred equals or exceeds £15,000,000 (or its equivalent in other currencies (as determined by the Trustee)) or, if greater, 1.5 per cent. of the Capital and Reserves, and for the purposes of this sub-paragraph (c), “**indebtedness for borrowed money**” shall exclude Project Finance Indebtedness; or
- (d) if any order shall be made by any competent court or any resolution shall be passed for the winding up or dissolution of the Issuer or the Guarantor, save for the purposes of amalgamation, merger, consolidation, reorganisation, reconstruction or other similar arrangement on terms previously approved in writing by the Trustee or by an Extraordinary Resolution of the Bondholders; or
- (e) if (i) any order shall be made by any competent court or any resolution shall be passed for the winding up or dissolution of a Principal Subsidiary (other than the Issuer), save for the purposes of amalgamation, merger, consolidation, reorganisation, reconstruction or other similar arrangement (A) not involving or arising out of the insolvency of such Principal Subsidiary and under which all the surplus assets of such Principal Subsidiary are transferred to the Issuer or the Guarantor or any other of their respective Subsidiaries (other than an Excluded Subsidiary) or (B) the terms of which have previously been approved in writing by

the Trustee or by an Extraordinary Resolution of the Bondholders or (ii) a petition is presented under section 24 of the Water Industry Act (and is not dismissed within 60 days) or a special administration order is made under section 24 or section 25 of the Water Industry Act in respect of the Guarantor; or

- (f) if the Issuer, the Guarantor or any Principal Subsidiary shall cease to carry on the whole or, in the opinion of the Trustee, substantially the whole of its business, save in each case for the purposes of amalgamation, merger, consolidation, reorganisation, reconstruction or other similar arrangement (i) in respect of a Principal Subsidiary, not involving or arising out of the insolvency of such Principal Subsidiary and under which all or, in the opinion of the Trustee, substantially all of its assets are transferred to another member or members of the Group (other than an Excluded Subsidiary) or to a transferee or transferees which is or are, or immediately upon such transfer become(s), a Principal Subsidiary or Principal Subsidiaries or (ii) in respect of a Principal Subsidiary, under which all or substantially all of its assets are transferred to a third party or parties (whether associates or not) for full consideration by such Principal Subsidiary on an arm's length basis or (iii) in respect of the Issuer, the Guarantor or any Principal Subsidiary, the terms of which have previously been approved in writing by the Trustee or by an Extraordinary Resolution of the Bondholders; or
- (g) if the Issuer, the Guarantor or any Principal Subsidiary shall suspend or announce its intention to suspend payment of its debts generally or shall be declared or adjudicated by a competent court to be unable, or shall admit in writing its inability, to pay its debts generally (within the meaning of section 123(1) or (2) of the Insolvency Act 1986) as they fall due, or shall be adjudicated or found insolvent by a competent court or shall enter into any composition or other similar arrangement with its creditors generally under section 1 of the Insolvency Act 1986; or
- (h) if a receiver, administrative receiver, administrator or other similar official shall be appointed in relation to the Issuer, the Guarantor or any Principal Subsidiary or in relation to the whole or, in the opinion of the Trustee, a substantial part of the undertaking or assets of any of them or a distress, execution or other process shall be levied or enforced upon or sued out against, or any encumbrancer shall take possession of, the whole or, in the opinion of the Trustee, a substantial part of the assets of any of them and in any of the foregoing cases it or he shall not be paid out or discharged within 60 days (or such longer period as the Trustee may in its absolute discretion permit); or
- (i) if the Issuer ceases to be a Subsidiary of the Guarantor; or
- (j) the Guarantee is not (or is claimed by the Guarantor not to be) in full force and effect.

For the purposes of sub-paragraph (g) above, section 123(1)(a) of the Insolvency Act 1986 shall have effect as if for "£750" there was substituted "£350,000". Neither the Issuer, the Guarantor nor any Principal Subsidiary shall be deemed to be unable to pay its debts for the purposes of sub-paragraph (g) above if any such demand as mentioned in section 123(1)(a) of the Insolvency Act 1986 is being contested in good faith by the Issuer, the Guarantor or the relevant Principal Subsidiary with recourse to all appropriate measures and procedures or if any such demand is satisfied before the expiration of such period as may be stated in any notice given by the Trustee under this Condition.

11 Enforcement

The Trustee may at any time, at its discretion and without notice, take such steps, actions or proceedings against the Issuer and/or the Guarantor as it may think fit to enforce the provisions of the Trust Deed, the Bonds and the Coupons but it shall not be bound to take any proceedings or any other steps or action in relation to the Trust Deed, the Bonds or the Coupons unless (a) it shall have been so directed by an Extraordinary Resolution of the Bondholders or so requested in writing by the holders of at least one-quarter in principal amount of the Bonds then outstanding, and (b) it shall have been indemnified and/or secured and/or prefunded to its satisfaction. No Bondholder or Couponholder shall be entitled to proceed directly against the Issuer or the Guarantor unless the Trustee, having become bound so to proceed, fails so to do within a reasonable period and such failure shall be continuing.

12 Substitution

The Trustee may, without the consent of the Bondholders or Couponholders, agree with the Issuer to the substitution in place of the Issuer (or of any previous substitute or substitutes under this Condition) as the principal debtor under the Bonds, the Coupons and the Trust Deed of the Guarantor or any other Subsidiary of the Guarantor (other than an Excluded Subsidiary) (a “**Substitution**”) subject to (a) the Trustee being satisfied that the interests of the Bondholders will not be materially prejudiced by the Substitution and (b) certain other conditions set out in the Trust Deed being complied with.

13 Replacement of Bonds and Coupons

If any Bond or Coupon be lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Principal Paying Agent subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Issuer and the Guarantor may reasonably require. Mutilated or defaced Bonds or Coupons must be surrendered before replacements will be issued.

14 Notices

All notices to the Bondholders will be valid if published in a leading English language daily newspaper published in London (which is expected to be the *Financial Times*) or, if in the opinion of the Trustee such publication shall not be practicable, in an English language daily newspaper with general circulation in Europe. Any notice shall be deemed to have been given on the date of publication or, if so published more than once, on the date of the first publication. If publication as provided above is not practicable, notice will be given in such other manner, and shall be deemed to have been given on such date, as the Trustee may approve. Couponholders will be deemed for all purposes to have notice of the contents of any notice given to the Bondholders in accordance with this Condition 14.

15 Meetings of Bondholders, Modification, Waiver and Authorisation

- (a) The Trust Deed contains provisions for convening meetings of the Bondholders to consider any matter affecting their interests, including the modification by Extraordinary Resolution of any of these Terms and Conditions or any of the provisions of the Trust Deed. The quorum at any meeting for passing an Extraordinary Resolution will be one or more persons present holding or representing a clear majority in principal amount of the Bonds for the time being outstanding, or at any adjourned such meeting one or more persons present whatever the principal amount of the Bonds held or represented by him or them, except that at any meeting, the business of which includes modification of certain of the provisions of these Terms and Conditions and certain of the provisions of the Trust Deed, the necessary quorum for passing an Extraordinary Resolution will be one or more persons present holding or representing not less than two-thirds, or at any adjourned such meeting not less than one-third, of the principal amount of the Bonds for the time being outstanding.
- (b) The Trust Deed provides that (i) a resolution passed at a meeting duly convened and held by or on behalf of the holder(s) of not less than three-fourths of the persons eligible to vote at such meeting, (ii) a resolution in writing signed by or on behalf of the holders of not less than three-fourths in principal amount of the Bonds for the time being outstanding or (iii) consents given by way of electronic consents through the relevant clearing system(s) (in a form satisfactory to the Trustee) by or on behalf of the holder(s) of not less than three-fourths in principal amount of the Bonds for the time being outstanding, shall, in each case, be effective as an Extraordinary Resolution of the Bondholders and will be binding on all Bondholders, whether or not they are present at the meeting, and on all Couponholders.
- (c) The Trustee may agree, without the consent of the Bondholders or Couponholders, to any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of these Terms and Conditions or any of the provisions of the Trust Deed, or determine, without any such consent as aforesaid, that any Event of Default or Potential Event of Default shall not be treated as such (provided that, in any such case, it is not, in the opinion of the Trustee, materially prejudicial to the interests of the Bondholders) or may agree, without any such consent as aforesaid to any modification which is in the opinion of the Trustee of a formal, minor or technical nature or to correct a manifest error.
- (d) In connection with the exercise by it of any of its trusts, powers, authorities and discretions (including, without limitation, any modification, waiver, authorisation, determination or substitution), the Trustee shall have regard to the general interests of the Bondholders as a class but shall not have regard to any interests arising from circumstances particular to individual Bondholders or Couponholders and, in particular but without limitation, shall not have regard to the consequences of any such exercise for individual Bondholders and Couponholders resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub-division thereof and the Trustee shall not be entitled to require, nor shall any Bondholder or Couponholder be entitled to claim, from the Issuer, the Guarantor, the Trustee or any other person, any indemnification or payment in respect of any tax consequence of any such exercise upon individual Bondholders or Couponholders except to the extent already

provided for in Condition 8 and/or any undertaking given in addition to, or in substitution for, Condition 8 pursuant to the Trust Deed.

- (e) Any modification, waiver or authorisation referred to in paragraph (b) above and any substitution under Condition 12 shall be binding on the Bondholders and the Couponholders and, unless the Trustee agrees otherwise, any such modification or substitution shall be notified by the Issuer to the Bondholders as soon as practicable thereafter in accordance with Condition 14.

16 Indemnification of the Trustee

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility, including provisions relieving it from taking action unless indemnified and/or secured and/or pre-funded to its satisfaction. The Trustee is entitled to enter into business transactions with the Issuer or the Guarantor and any entity related to the Issuer or the Guarantor without accounting for any profit. The Trustee may rely without liability to Bondholders on a certificate signed by two directors of the Issuer or the Guarantor, as the case may be, or a report of the Auditors, whether or not addressed to it and whether or not the directors or Auditors, as the case may be, have any liability to it in respect of the same and whether or not the Auditors' liability in respect thereof is limited by monetary cap or otherwise.

17 Further Issues

The Issuer is at liberty from time to time without the consent of the Bondholders or Couponholders to create and issue further bonds or notes either (a) ranking *pari passu* in all respects (or in all respects save for the first payment of interest thereon) and so that the same shall be consolidated and form a single series with the outstanding bonds or notes of any series (including the Bonds) constituted by the Trust Deed or any deed supplemental to it or (b) upon such terms as to ranking, interest, conversion, redemption and otherwise as the Issuer may determine at the time of the issue. Any further bonds or notes which are to form a single series with the outstanding bonds or notes of any series (including the Bonds) constituted by the Trust Deed or any deed supplemental to it shall, and any other further bonds or notes may (with the consent of the Trustee), be constituted by a deed supplemental to the Trust Deed. The Trust Deed contains provisions for convening a single meeting of the Bondholders and the holders of bonds or notes of other series in certain circumstances where the Trustee so decides.

18 Definitions

For the purposes of these Terms and Conditions:

“Appointment” means the instrument of appointment dated 24 August 1989 under sections 11 and 14 of the Water Act 1989 (now sections 6, 7, 11 and 12 of the Water Industry Act) as in effect on the Closing Date appointing the Guarantor as a water undertaker and sewerage undertaker for the areas described therein.

“Asset-Backed Bonds” means bonds, notes or other securities (however defined) (i) supported by present or future revenues or assets of the Issuer, the Guarantor or any Principal Subsidiary in a

securitisation of receivables, and (ii) such other similar financing structure originated by the Issuer, the Guarantor or any Principal Subsidiary whereby all payment obligations are to be discharged solely from such assets or revenues.

“**Auditors**” means the auditors for the time being of the Issuer or, as the case may be, the Guarantor or, in the event of their being unable or unwilling promptly to carry out any action requested of them pursuant to the provisions of these Terms and Conditions or the Trust Deed, such other firm of accountants or financial advisers as may be nominated by the Issuer and approved in writing by the Trustee for the purpose.

“**Business Day**” means, in relation to any place, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in that place.

“**Capital and Reserves**” means the aggregate of:

- (a) the amount paid up or credited as paid up on the share capital of the Guarantor; and
- (b) the total of the capital, revaluation and revenue reserves of the Group, including any share premium account, capital redemption reserve and credit balance on the profit and loss account, but excluding sums set aside for taxation and amounts attributable to minority interests and deducting any debit balance on the profit and loss account,

all as shown in the then latest audited consolidated balance sheet and profit and loss account of the Group prepared in accordance with generally accepted accounting principles in the United Kingdom, but adjusted as may be necessary in respect of any variation in the paid up share capital or share premium account of the Group since the date of that balance sheet and further adjusted as may be necessary to reflect any change since the date of that balance sheet in the Subsidiary Undertakings comprising the Group and/or as the Auditors may consider appropriate. A certificate signed by two directors of the Guarantor as to the amount of the Capital and Reserves at any given time shall, in the absence of manifest error, be conclusive and binding on the Issuer, the Guarantor, the Trustee, the Bondholders and the Couponholders whether or not addressed to each such party, and the Trustee shall be entitled to rely thereon without liability to any person.

“**Excluded Subsidiary**” means any Subsidiary of the Guarantor:

- (a) which is a single purpose company whose principal assets and business are constituted by the ownership, acquisition, development and/or operation of an asset or is a holding company whose sole assets are shares in, or loans to, another Excluded Subsidiary;
- (b) none of whose indebtedness for borrowed money in respect of the financing of such ownership, acquisition, development and/or operation of such asset is subject to any recourse whatsoever to any member of the Group (other than such Subsidiary or another Excluded Subsidiary) in respect of the repayment thereof, except as expressly referred to in subparagraph (b) of the definition of Project Finance Indebtedness; and
- (c) which has been designated as such by the Guarantor by written notice to the Trustee,

provided that the Guarantor may give written notice to the Trustee at any time that any Excluded Subsidiary is no longer an Excluded Subsidiary, whereupon it shall cease to be an Excluded Subsidiary.

“**Group**” means the Guarantor and its Subsidiary Undertakings and “**member of the Group**” shall be construed accordingly.

“**indebtedness for borrowed money**” means any present or future indebtedness (whether being principal, premium, interest or other amounts) for or in respect of (a) money borrowed, (b) liabilities under or in respect of any acceptance or acceptance credit, or (c) any notes, bonds, debentures, debenture stock, loan stock or other securities offered, issued or distributed whether by way of public offer, private placing, acquisition consideration or otherwise and whether issued for cash or in whole or in part for a consideration other than cash.

“**Independent Financial Adviser**” means an independent financial adviser appointed by the Issuer and approved in writing by the Trustee or, if the Issuer shall not have appointed such an adviser within 21 days after becoming aware of the occurrence of a Restructuring Event and the Trustee is indemnified and/or secured and/or pre-funded to its satisfaction against the costs of such adviser, appointed by the Trustee following consultation with the Issuer.

“**K**” has the meaning provided in the Appointment.

A “**Negative Certification**” means, in respect of a Restructuring Event, a certification in writing to the Issuer, the Guarantor and the Trustee by an Independent Financial Adviser that such Restructuring Event is, in the opinion of such Independent Financial Adviser, materially prejudicial to the interests of the Bondholders.

A “**Negative Rating Event**” shall be deemed to have occurred if (a) the Issuer does not, either prior to or not later than 14 days after the date of a Negative Certification in respect of the relevant Restructuring Event, seek, and thereupon use all reasonable endeavours to obtain from a Rating Agency, a rating of the Bonds or any other unsecured and unsubordinated debt of the Guarantor (or of the Issuer or of any Subsidiary of the Guarantor which, in any such case, is guaranteed on an unsecured and unsubordinated basis by the Guarantor) having an initial maturity of five years or more or (b) if it does so seek, it is unable, as a result of such Restructuring Event, to obtain such a rating of at least investment grade (BBB-/Baa3, or their respective equivalents for the time being) by the end of the Restructuring Period.

“**Ofwat**” means The Water Services Regulation Authority.

“**Potential Event of Default**” means any condition, event or act which, with the lapse of time and/ or the issue, making or giving of any notice, certification, declaration, demand, determination and/or request and/or the taking of any similar action and/or the fulfilment of any similar condition in each case as provided in Condition 10, would constitute an Event of Default.

“**Presentation Date**” means a day which (subject to Condition 9):

- (a) is or falls after the relevant due date, but, if the due date is not or was not a Business Day in London, is or falls after the next following such Business Day; and
- (b) is a Business Day in the place of the specified office of the Paying Agent at which the Bond or Coupon is presented for payment; and
- (c) in the case of payment by credit or transfer to a sterling account with a bank in London as referred to in these Terms and Conditions, is a Business Day in London.

“Principal Subsidiary” at any time shall mean any Subsidiary of the Guarantor (not being an Excluded Subsidiary or any other Subsidiary of the Guarantor the whole of whose indebtedness for borrowed money (other than indebtedness for borrowed money owed to another member of the Group) is Project Finance Indebtedness):

- (a) whose (i) profits on ordinary activities before taxation or (ii) net assets (in each case consolidated in respect of a Subsidiary which itself has Subsidiaries and in each case attributable to the Guarantor) represent 15 per cent. or more of the consolidated profits on ordinary activities before taxation of the Group or consolidated net assets of the Group respectively (in each case attributable to the Guarantor), in each case as calculated by reference to the then latest audited consolidated or, if none, unconsolidated financial statements of such Subsidiary and the then latest audited consolidated financial statements of the Group provided that:
 - (A) if the latest audited consolidated accounts of the Group show (x) a net loss for the relevant financial period then there shall be substituted for the words “profits on ordinary activities before taxation” the words “turnover” for the purposes of this definition and/or (y) negative assets at the end of the relevant financial period then there shall be substituted for the words “net assets” the words “total assets” for the purposes of this definition; and
 - (B) in the case of a Subsidiary of the Guarantor acquired after the end of the financial period to which the then latest audited consolidated financial statements of the Group relate, the reference to the then latest audited consolidated financial statements of the Group for the purposes of the calculation above shall, until consolidated financial statements for the financial period in which the acquisition is made have been prepared and audited as aforesaid, be deemed to be a reference to such first-mentioned financial statements as if such Subsidiary had been shown in financial statements by reference to its then latest relevant audited financial statements, adjusted as deemed appropriate by the Auditors; or
- (b) to which is transferred all or substantially all of the business, undertaking and assets of a Subsidiary of the Guarantor which immediately prior to such transfer is a Principal Subsidiary, whereupon the transferor Subsidiary shall immediately cease to be a Principal Subsidiary (and the transferee Subsidiary shall cease to be a Principal Subsidiary under the provisions of this sub-paragraph (b) (but without prejudice to the provisions of sub-paragraph (a) above), upon publication of its next audited financial statements).

A certificate signed by two directors of the Guarantor that, in their opinion, a Subsidiary of the Guarantor is or is not or was or was not at any particular time or throughout any specified period a Principal Subsidiary shall, in the absence of manifest error, be conclusive and binding on the Issuer, the Guarantor, the Trustee, the Bondholders and the Couponholders whether or not addressed to each such party.

“Project Finance Indebtedness” means any present or future indebtedness incurred to finance or refinance the ownership, acquisition, development and/or operation of an asset, whether or not an asset of a member of the Group:

- (a) which is incurred by an Excluded Subsidiary; or

- (b) in respect of which the person or persons to whom any such indebtedness is or may be owed by the relevant borrower (whether or not a member of the Group) has or have no recourse whatsoever to any member of the Group (other than an Excluded Subsidiary) for the repayment thereof other than:
- (i) recourse for amounts limited to the cash flow or net cash flow (other than historic cash flow or historic net cash flow) from such asset; and/or
 - (ii) recourse for the purpose only of enabling amounts to be claimed in respect of such indebtedness in an enforcement of any encumbrance given by such borrower over such asset or project or the income, cash flow or other proceeds deriving therefrom (or given by any shareholder or the like in the borrower over its shares or the like in the capital of, or any loans to, the borrower) to secure such indebtedness, provided that (A) the extent of such recourse is limited solely to the amount of any recoveries made on any such enforcement, and (B) such person or persons is/are not entitled, by virtue of any right or claim arising out of or in connection with such indebtedness, to commence proceedings for the winding up or dissolution of any member of the Group (other than an Excluded Subsidiary) or to appoint or procure the appointment of any receiver, trustee or similar person or officer in respect of any member of the Group (other than an Excluded Subsidiary) or any of its assets (save for the assets the subject of such encumbrance); and/or
 - (iii) recourse under any form of assurance, undertaking or support, which recourse is limited to a claim for damages for breach of an obligation (not being a payment obligation or an obligation to procure payment by another or an indemnity in respect thereof or any obligation to comply or to procure compliance by another with any financial ratios or other tests of financial condition) by any member of the Group (other than an Excluded Subsidiary).

A “**Put Event**” occurs:

- (a) if the Appointment is terminated except in respect of such part of its area as is the subject of an appointment or variation by virtue of section 7(4)(b), (bb) or (c) of the Water Industry Act; or
- (b) if a Restructuring Event occurs and (subject as provided in Condition 7):
 - (i) within the Restructuring Period, either:
 - (A) if at the time such Restructuring Event occurs there are Rated Securities, a Rating Downgrade in respect of such Restructuring Event also occurs; or
 - (B) if at such time there are no Rated Securities, a Negative Rating Event in respect of such Restructuring Event also occurs; and
 - (ii) an Independent Financial Adviser shall have provided a Negative Certification,

and in the circumstances set out in this sub-paragraph (b) the Put Event shall occur on the date of the last to occur of (I) such Restructuring Event, (II) either a Rating Downgrade or, as the case may be, a Negative Rating Event and (III) the relevant Negative Certification.

“Rated Securities” means the Bonds, if at any time and for so long as they have a rating from a Rating Agency, and otherwise any other unsecured and unsubordinated debt of the Guarantor (or of the Issuer or any Subsidiary of the Guarantor which, in any such case, is guaranteed on an unsecured and unsubordinated basis by the Guarantor) having an initial maturity of five years or more which is rated by a Rating Agency.

“Rating Agency” means Standard & Poor’s Ratings Services, a division of The McGraw-Hill Companies, Inc. or any of its Subsidiaries and their successors, Moody’s Investors Service Limited or any of its Subsidiaries and their successors or any rating agency substituted for any of them (or any permitted substitute of them) by the Issuer from time to time with the prior written approval of the Trustee.

A **“Rating Downgrade”** shall be deemed to have occurred in respect of a Restructuring Event if the then current rating assigned to the Rated Securities by any Rating Agency (whether provided by a Rating Agency at the request of the Issuer or by its own volition) is withdrawn or reduced from an investment grade rating (BBB-/Baa3, or their respective equivalents for the time being, or better) to a non-investment grade rating (BB+/Ba1, or their respective equivalents for the time being, or worse) or, if the Rating Agency shall then have already rated the Rated Securities below investment grade (as described above), the rating is lowered one full rating category (from BB+/Ba1 to BB/Ba2 or such similar lowering).

“Relevant Indebtedness” means any present or future indebtedness (whether being principal, premium, interest or other amounts) in the form of or represented by notes, bonds, debentures, debenture stock, loan stock or other securities (other than (i) such notes, bonds, debentures, debenture stock, loan stock or other securities which, on issue, had a maturity of not less than 30 years and (ii) Asset-Backed Bonds), whether issued for cash or in whole or in part for a consideration other than cash, and which (with the agreement of the person issuing the same) are quoted, listed or ordinarily dealt in on any stock exchange or recognised over-the-counter or other securities market, but shall in any event not include Project Finance Indebtedness.

“Restructuring Event” means the occurrence of one or both of the following events:

- (a) any material rights, benefits or obligations of the Guarantor as a water undertaker or sewerage undertaker arising under the Appointment or the Water Industry Act as in force on the Closing Date or any material terms of the Appointment are modified (whether or not with the consent of the Guarantor and whether pursuant to the Water Industry Act or otherwise) unless two directors of the Guarantor have certified in good faith to the Trustee that such modified rights, benefits, obligations or terms are not materially less favourable to the business of the Group and to the business of the Guarantor (provided that an adjustment to K shall not fall within this paragraph (a)); or
- (b) any legislation (whether primary or subordinate) is enacted removing, reducing or qualifying the duties or powers of the Secretary of State for the Environment, Food and Rural Affairs (or any successor) and/or Ofwat (or any successor) (including, without limitation, any such legislation removing, reducing or qualifying such duties or powers under or pursuant to sections 2, 9 or 24 of the Water Industry Act but excluding, in all circumstances, the Water Act 2003) in each case as compared to those in force on the Closing Date unless two directors of the Guarantor have certified in good faith to the Trustee that such removal, reduction or

qualification is unlikely to have a material adverse effect on the financial condition of the Group and the Guarantor.

“Restructuring Period” means:

- (a) if at any time a Restructuring Event occurs there are Rated Securities, the period of 60 days starting from and including the day on which that Restructuring Event occurs; or
- (b) if at the time a Restructuring Event occurs there are no Rated Securities, the period starting from and including the day on which that Restructuring Event occurs and ending on the day 60 days following the later of (i) the date on which the Issuer or the Guarantor shall seek to obtain a rating as contemplated in the definition of Negative Rating Event prior to the expiry of the 14 days referred to in that definition and (ii) the date on which a Negative Certification shall have been given to the Issuer, the Guarantor and the Trustee in respect of that Restructuring Event.

“Subsidiary” means a subsidiary within the meaning of section 1159 of the Companies Act 2006.

“Subsidiary Undertaking” shall have the meaning given to it by section 1162 of the Companies Act 2006 (but, in relation to the Guarantor, shall exclude any undertaking (as defined in the Companies Act 2006) whose accounts are not included in the then latest published audited consolidated accounts of the Guarantor or (in the case of an undertaking which has first become a subsidiary undertaking of a member of the Group since the date as at which any such audited accounts were prepared) would not have been so included or consolidated if it had become so on or before that date).

“Water Industry Act” means the Water Industry Act 1991 as amended or re-enacted from time to time and all subordinate legislation made pursuant thereto.

Any reference to an obligation being guaranteed shall include a reference to an indemnity being given in respect of the obligation.

19 Governing Law

The Trust Deed, the Bonds and the Coupons and any non-contractual obligations arising out of or in connection with them are governed by, and will be construed in accordance with, English law.

20 Contracts (Rights of Third Parties) Act 1999

No rights are conferred on any person under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of the Bonds or the Coupons but this does not affect any right or remedy of any person which exists or is available apart from that Act.

SUMMARY OF PROVISIONS RELATING TO THE BONDS WHILE IN GLOBAL FORM

The following is a summary of the provisions to be contained in the Trust Deed to constitute the Bonds and in the Global Bonds which will apply to, and in some cases, modify the Conditions of the Bonds while the Bonds are represented by the Global Bonds.

1. Exchange

The Temporary Global Bond is exchangeable in whole or in part for interests in the Permanent Global Bond on or after a date which is expected to be 25 August 2010, upon certification as to non-U.S. beneficial ownership. The Permanent Global Bond will be exchangeable in whole but not in part (free of charge to the holder) for the definitive Bonds described below only:

- (a) if the Permanent Global Bond is held on behalf of a clearing system and such clearing system is closed for business for a continuous period of 14 days (other than by reason of holidays, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so and no alternative clearing system satisfactory to the Issuer and the Trustee is available; or
- (b) if the Issuer would suffer a disadvantage in respect of the Bonds as a result of a change in the laws or regulations (taxation or otherwise) of the United Kingdom which would not be suffered were the Bonds in definitive form and a certificate to such effect signed by two directors of the Issuer is delivered to the Trustee.

Thereupon (in the case of (a) above) the holder of the Permanent Global Bond (acting on the instructions of a person having a beneficial interest in the Permanent Global Bond) or the Trustee may give notice to the Issuer, and (in the case of (b) above) the Issuer may give notice to the Trustee and the Bondholders, of its intention to exchange the Permanent Global Bond for definitive Bonds on or after the Exchange Date (as defined below).

On or after the Exchange Date the holder of the Permanent Global Bond may or, in the case of (b) above, shall surrender the Permanent Global Bond to or to the order of the Principal Paying Agent. In exchange for the Permanent Global Bond the Issuer will deliver, or procure the delivery of, an equal aggregate principal amount of duly executed and authenticated definitive Bonds (having attached to them all Coupons in respect of interest which has not already been paid on the Permanent Global Bond and in respect of which claims shall not have become prescribed), security printed in accordance with any applicable legal and stock exchange requirements and in or substantially in the form set out in the Trust Deed. On exchange of the Permanent Global Bond, the Issuer will procure that it is cancelled and, if the holder so requests, returned to the holder together with any relevant definitive Bonds.

For these purposes, **Exchange Date** means a day specified in the notice requiring exchange falling not less than 60 days after that on which the notice requiring exchange is given and on which banks are open for general business in the place in which the specified office of the Principal Paying Agent is located and, except in the case of exchange pursuant to (a) above, in the place in which the relevant clearing systems are located.

2. Payments

No payment will be made on the Temporary Global Bond unless exchange for an interest in the Permanent Global Bond is improperly withheld or refused. Payments of principal and interest in respect of Bonds represented by the Permanent Global Bond will, subject as set out below, be made against presentation for endorsement and, if no further payment falls to be made in respect of the

Bonds, surrender of the Permanent Global Bond to or to the order of the Principal Paying Agent or such other Paying Agent as shall have been notified to the Bondholders for such purpose. A record of each payment so made will be endorsed on the appropriate schedule to the Permanent Global Bond, which endorsement will be *prima facie* evidence that such payment has been made in respect of the Bonds. Payments of interest on the Temporary Global Bond (if permitted by the first sentence of this paragraph) will be made only upon certification as to non-U.S. beneficial ownership, unless such certification has already been made.

3. Notices

For so long as the Bonds are represented by one or both of the Global Bonds and such Global Bond(s) is/are held on behalf of a clearing system, notices to Bondholders may be given by delivery of the relevant notice to that clearing system for communication by it to entitled accountholders in substitution for publication as required by Condition 14 provided that, so long as the Bonds are admitted to listing by the UK Listing Authority and admitted to trading on the regulated market of the London Stock Exchange plc, the requirements of the UK Listing Authority have been complied with. Any such notice shall be deemed to have been given to the Bondholders on the day on which such notice is delivered to the clearing system(s) as aforesaid.

For so long as any of the Bonds held by a Bondholder are represented by a Global Bond, notices to be given by such Bondholder may be given by such Bondholder (where applicable) through the relevant clearing system and otherwise in such manner as the Principal Paying Agent and the relevant clearing system may approve for this purpose.

4. Prescription

Claims against the Issuer and the Guarantor in respect of principal and interest on the Bonds while the Bonds are represented by a Global Bond shall be prescribed and become void unless it is presented for payment within a period of ten years (in the case of principal) and five years (in the case of interest) from the appropriate Relevant Date (as defined in Condition 9).

5. Cancellation

Cancellation of any Bond represented by a Global Bond and required by the Conditions to be cancelled following its redemption or purchase will be effected by endorsement by or on behalf of the Principal Paying Agent of the reduction in the principal amount of such Global Bond on the relevant part of the Schedule thereto.

6. Trustee's Powers

While the Bonds are represented by one or both of the Global Bonds and such Global Bond(s) is/are held on behalf of a clearing system, the Trustee may, in considering the interests of Bondholders, have regard to any information provided to it by such clearing system or its operator as to the identity (either individually or by category) of its accountholders with entitlements to the Global Bond(s) and may consider such interests as if such accountholders were the holder(s) of the Global Bond(s).

7. Put Option

For so long as all of the Bonds are represented by one or both of the Global Bonds and such Global Bond(s) is/are held on behalf of a clearing system, the option of the Bondholders provided for in Condition 7 may be exercised by the holder of the relevant Global Bond giving either a duly completed Put Notice or a duly completed notice of exercise in accordance with the standard procedures of the relevant clearing system to the Principal Paying Agent of the principal amount of

the Bonds in respect of which such option is exercised and at the same time presenting or procuring the presentation of the relevant Global Bond to the Principal Paying Agent for notation accordingly within the time limits set forth in that Condition.

USE OF PROCEEDS

The Issuer will lend the net proceeds of the issue of the Bonds to the Guarantor. The Guarantor will use such proceeds to refinance existing indebtedness and to plan pre-funding of capital expenditure.

DESCRIPTION OF THE ISSUER

South West Water Finance Plc was incorporated with limited liability in England and Wales on 27 February 2006 under the Companies Act 1985, with the registered number 05722435. The registered address of the Issuer is Peninsula House, Rydon Lane, Exeter EX2 7HR and its telephone number is +44 (0) 1392 446688.

Business Overview

The Issuer is a finance company established to provide financing to the Guarantor.

Organisational Structure

The Issuer is a wholly owned subsidiary of the Guarantor and is dependent on the Guarantor for the provision of sufficient financial support to meet its obligations in relation to the Bonds.

Board of Directors

The Issuer's Directors are Susan Davy, David Dupont, Anthony Hooper, Christopher Loughlin and Kenneth Woodier.

The business address of all the above Directors is Peninsula House, Rydon Lane, Exeter EX2 7HR.

There are no conflicts of interest between the Directors' duties to the Issuer and the Directors' other duties and private interests.

DESCRIPTION OF THE GUARANTOR

History and Development

The Guarantor is South West Water Limited, commercially known as South West Water and domiciled in the United Kingdom. The Guarantor was incorporated in England on 1 April 1989. The Guarantor is registered in England under registration number 02366665. The principal legislation under which the Guarantor operates is the Companies Act 2006, together with regulations made under those Acts.

The Guarantor's address is Peninsula House, Rydon Lane, Exeter EX2 7HR and its telephone number is +44 1392 446688.

Organisational Structure

The Guarantor is a wholly owned subsidiary of Pennon Group Plc (**Pennon**) though, whilst it has a number of trading and other arrangements with Pennon and/or other subsidiaries of Pennon, none is considered material to the ongoing performance of the Guarantor as, by virtue of regulatory requirements, all such arrangements are at arms length and could be provided by external third parties. To comply with regulatory requirements, the Guarantor is ring fenced in accordance with the Guarantor's Licence of Appointment. In addition, as the Guarantor is ring fenced in accordance with its Licence of Appointment, Pennon is not able to require the transfer of any assets out of the Guarantor of a value in excess of £1,000,000 and which are required for the regulated business of providing water and sewerage services of the Guarantor, except, in any such case, at arms length and with the consent of the Water Regulator.

Principal Activities

The Guarantor is the licensed water and sewerage service provider for Devon, Cornwall and parts of Dorset and Somerset. It serves a region of nearly 10,300 square kilometres with 1.65 million residents and in excess of 10 million annual visitors. On average, each day the Guarantor distributes over 420 million litres of treated water and disposes of around 235 million litres of waste water through an asset base comprising, as at 31 March 2010, approximately 15,000 kilometres of water distribution mains, 9,200 kilometres of sewers, 15 impounding reservoirs, 39 water treatment works, 634 waste water treatment works including 55 works with ultra-violet treatment and three with membrane filtration and 1,668 intermittent discharges, including 1,029 combined sewer overflows

Since privatisation in 1989, the Guarantor has successfully delivered the largest capital programme per capita of any of the water and sewerage companies in England and Wales, with an initial focus on improving coastal waste water treatment and disposal. The region currently has 144 EU designated bathing waters, almost one third of the total in England and Wales, and 132 of these have been improved over the last 18 years as a result of the company's marine investment programme. The emphasis moved, more recently, to completing a 15 year programme of improving the quality of drinking water and to providing better customer service, which was completed in 2009.

Ofwat issued its Final Determination for 2010-2015 in November 2009. Subject to the delivery of the targets set out within that determination, the Guarantor expects to create value through delivering the regulatory contract agreed with Ofwat. As well as determining outputs, Ofwat sets prices to enable efficient companies to earn a reasonable rate of return on their assets.

In the current regulatory period (2010 – 2015) Ofwat assumed that the equity cost of capital for all companies would be 7.1 per cent. real after tax with an overall weighted average cost of capital of 4.5 per cent. real after tax. Ofwat's determination allowed for further investment by the Guarantor to improve the quality of water and sewerage services. As a result, the Guarantor's RCV is expected to increase from £2.55 billion in March 2010 to approximately £2.84 billion in March 2015, an increase of approximately 11 per

cent. This will enlarge the base for the calculation of the rate of return allowed by Ofwat. Additional value may be created if the Guarantor outperforms Ofwat's assumptions by, for example, delivering service at lower operating and/or capital costs and/or financing its investment programme and operations at lower cost.

Board of Directors

The members of the Board of Directors of the Guarantor, their functions and the principal activities performed by them outside the Guarantor are, as of the date thereof, set forth in the following table:

Name	Function	Principal Activities performed outside the Guarantor
Kenneth Harvey	Chairman	Chairman of Pennon Group Plc Senior independent non-executive director of National Grid Plc
Christopher Loughlin	Chief Executive	Chairman of Water UK
Susan Davy	Finance Director	None
Dr Stephen Bird	Operations Director	Director UKWIR (UK Water Industry Research Limited)
Monica Read	Customer Relations and Business Development Director	Director South West Lakes Trust
Matthew Taylor	Non- Executive Director	Director of: <ul style="list-style-type: none"> • Gwithian Chapel Limited • National Housing Federation • National Housing Federation Investments Limited • NHF Property & Services Limited • Taylor & Garner Limited

The business address of each of the directors listed above is Peninsula House, Rydon Lane, Exeter EX2 7HR.

There are no potential conflicts of interest between the duties to the Guarantor of any of the directors listed above and their private interests and/or other duties.

UNITED KINGDOM TAXATION

The following applies only to persons who are the beneficial owners of Bonds and is a summary of the Issuer's understanding of current United Kingdom law and HM Revenue & Customs (HMRC) practice in the United Kingdom relating only to certain aspects of United Kingdom taxation and is not intended to be exhaustive. Some aspects do not apply to certain classes of person (such as dealers and persons connected with the Issuer) to whom certain special rules may apply. The United Kingdom tax treatment of prospective Bondholders depends on their individual circumstances and may be subject to change in the future. Prospective Bondholders who may be subject to tax in a jurisdiction other than the United Kingdom or who may be unsure as to their tax position should seek their own professional advice.

(A) Interest on the Bonds

1. *Payment of interest on the Bonds*

Payments of interest on the Bonds may be made without deduction of or withholding on account of United Kingdom income tax provided that the Bonds continue to be listed on a "recognised stock exchange" within the meaning of section 1005 of the Income Tax Act 2007 (the **Act**). The London Stock Exchange is a recognised stock exchange. Securities will be treated as listed on the London Stock Exchange if they are included in the Official List (within the meaning of and in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000) and admitted to trading on the London Stock Exchange. Provided, therefore, that the Bonds remain so listed, interest on the Bonds will be payable without withholding or deduction on account of United Kingdom tax.

Interest on the Bonds may also be paid without withholding or deduction on account of United Kingdom tax where interest on the Bonds is paid by a company (such as the Issuer) and, at the time the payment is made, the Issuer reasonably believes (and any person by or through whom interest on the Bonds is paid reasonably believes) that, broadly, the beneficial owner is a company within the charge to United Kingdom corporation tax as regards the payment of interest or falls within a list of specific exempt bodies or entities; provided that HMRC has not given a direction (in circumstances where it has reasonable grounds to believe that it is likely that the above exemption is not available in respect of such payment of interest at the time the payment is made) that the interest should be paid under deduction of tax.

In other cases, an amount must generally be withheld from payments of interest on the Bonds on account of United Kingdom income tax at the basic rate (currently 20 per cent.). However, where an applicable double tax treaty provides for a lower rate of withholding tax (or for no tax to be withheld) in relation to a Bondholder, HMRC can issue a notice to the Issuer to pay interest to the Bondholder without deduction of tax (or for interest to be paid with tax deducted at the rate provided for in the relevant double tax treaty).

Bondholders may wish to note that, in certain circumstances, HMRC has power to obtain information (including the name and address of the beneficial owner of the interest) from any person in the United Kingdom who either pays interest to or receives interest for the benefit of a Bondholder who is an individual. Any information so obtained may, in certain circumstances, be exchanged by HMRC with the tax authorities of the jurisdiction in which the Bondholder is resident for tax purposes.

2. *EU Savings Directive*

Under European Council Directive 2003/48/EC on the taxation of savings income (the **Savings Directive**), Member States are required to provide to the tax authorities of another Member State

details of payments of interest (and similar income) paid by a person within its jurisdiction to an individual resident in that other Member State or to certain limited types of entities established in that other Member State. However, for a transitional period, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments, subject to a procedure whereby, on meeting certain conditions, the beneficial owner of the interest or other income may request that no tax be withheld (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have adopted similar measures (a withholding system in the case of Switzerland).

On 15 September 2008 the European Commission issued a report to the Council of the European Union on the operation of the Savings Directive, which included the Commission's advice on the need for changes to the Savings Directive. On 13 November 2008 the European Commission published a more detailed proposal for amendments to the Savings Directive, which included a number of suggested changes. The European Parliament approved an amended version of this proposal on 24 April 2009. If any of the proposed changes are made in relation to the Savings Directive, they may amend or broaden the scope of the requirements described above.

3. *Further United Kingdom Tax Issues*

Interest on the Bonds constitutes United Kingdom source income for tax purposes and, as such, may be subject to income tax by direct assessment even where paid without withholding or deductions.

However, interest with a United Kingdom source received without deduction or withholding on account of United Kingdom tax will not be chargeable to United Kingdom tax in the hands of a Bondholder who is not resident for tax purposes in the United Kingdom unless that Bondholder carries on a trade, profession or vocation through a branch or agency or, in the case of a corporate Bondholder, carries on a trade through a permanent establishment, in the United Kingdom in connection with which the interest is received or to which the Bonds are attributable, in which case tax may be levied on the United Kingdom branch or agency or permanent establishment. There are certain exemptions for interest received by certain categories of agent (such as some brokers and investment managers). The provisions of an applicable double taxation treaty may also be relevant for such Bondholders.

(B) United Kingdom Corporation Tax Payers

4. In general, Bondholders which are within the charge to United Kingdom corporation tax (including non-resident Bondholders whose Bonds are used, held or acquired for the purposes of a trade carried on in the United Kingdom through a permanent establishment) will be charged to tax as income on all returns, profits or gains on, and fluctuations in value of, the Bonds (whether attributable to currency fluctuations or otherwise) broadly in accordance with their statutory accounting treatment.

(C) Other United Kingdom Tax Payers

5. *Taxation of Chargeable Gains*

The Bonds will constitute "qualifying corporate bonds" within the meaning of section 117 of the Taxation of Chargeable Gains Act 1992. Accordingly, a disposal by a Bondholder of a Bond will not give rise to a chargeable gain or an allowable loss for the purposes of the UK taxation of chargeable gains.

6. *Accrued Income Scheme*

On a disposal of Bonds by a Bondholder, any interest which has accrued since the preceding interest payment date may be chargeable to tax as income under the rules of the accrued income scheme as set out in Part 12 of the Income Tax Act 2007, if that Bondholder is resident or ordinarily resident in the United Kingdom for tax purposes or carries on a trade, profession or vocation in the United Kingdom through a branch or agency to which the Bonds are attributable.

(D) Stamp Duty and Stamp Duty Reserve Tax (SDRT)

7. No United Kingdom stamp duty or SDRT is payable on the issue of the Bonds or on a transfer by delivery of the Bonds.

SUBSCRIPTION AND SALE

Deutsche Bank AG, London Branch (the **Lead Manager**) has, pursuant to a subscription agreement (the **Subscription Agreement**) dated 9 July 2010 agreed, subject to the satisfaction of certain conditions to subscribe for the Bonds on the Closing Date.

The Issuer, failing which the Guarantor, will also reimburse the Lead Manager in respect of certain of its expenses, and has agreed to indemnify the Lead Manager against certain liabilities, incurred in connection with the issue of the Bonds. The Subscription Agreement may be terminated in certain circumstances prior to payment to the Issuer.

United States

The Bonds 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 the paragraph have the meanings given to them by Regulation S under the Securities Act.

The 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 of 1986 and regulations thereunder.

The Lead Manager has represented and agreed that, except as permitted by the Subscription Agreement, it has not offered, sold or delivered and will not offer, sell or deliver the Bonds: (a) as part of their distribution at any time; or (b) otherwise until 40 days after the later of the commencement of the offering and the Closing Date within the United States or to, or for the account or benefit of, U.S. persons, and that it will have sent to each dealer to which it sells any 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 meanings given to them by Regulation S under the Securities Act.

In addition, until 40 days after the commencement of the offering, an offer or sale of Bonds within the United States by any dealer that is not participating in the offering may violate the registration requirements of the Securities Act.

United Kingdom

The Lead Manager has represented and agreed that:

- (a) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the United Kingdom Financial Services and Markets Act 2000 (the **FSMA**)) received by it in connection with the issue or sale of the Bonds in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer or the Guarantor; and
- (b) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Bonds in, from or otherwise involving the United Kingdom.

General

No action has been taken by the Issuer, the Guarantor or the Lead Manager that would, or is intended to, permit a public offer of the Bonds in any country or jurisdiction where any such action for that purpose is

required. Accordingly, the Lead Manager has undertaken that it will not, directly or indirectly, offer or sell any Bonds or distribute or publish any offering circular, prospectus, form of application, advertisement or other document or information in any country or jurisdiction except under circumstances that will, to the best of its knowledge and belief, result in compliance with any applicable laws and regulations and all offers and sales of Bonds by it will be made on the same terms.

GENERAL INFORMATION

Authorisation

The issue of the Bonds was authorised by a resolution of the board of directors of the Issuer passed on 15 June 2010 and a resolution of a subcommittee of the board of directors of the Issuer passed on 8 July 2010. The giving of the guarantee by the Guarantor was authorised by a resolution of the board of directors of the Guarantor passed on 15 June 2010 and a resolution of a subcommittee of the board of directors of the Guarantor passed on 8 July 2010.

Listing

It is expected that official listing will be granted on or about 16 July 2010 subject only to the issue of the Temporary Global Bond. Application has been made to the UK Listing Authority for the Bonds to be admitted to the Official List and to the London Stock Exchange for such Bonds to be admitted to trading on the London Stock Exchange's regulated market.

The overall cost of the admission of the Bonds to the Official List and to trading on the regulated market of the London Stock Exchange is expected to amount to approximately £4,425.

Clearing systems

The Bonds have been accepted for clearance through Euroclear and Clearstream, Luxembourg, which are the entities in charge of keeping the records. The ISIN for the Bonds is XS0526755458 and the Common Code is 052675545.

The address of Euroclear is Euroclear Bank SA/NV, 1 Boulevard du Roi Albert II, B-1210 Brussels and the address of Clearstream, Luxembourg is Clearstream Banking, 42 Avenue JF Kennedy, L-1855 Luxembourg.

No significant or material change

There has been no significant change in the financial or trading position of the Issuer or the Guarantor, respectively, and no material adverse change in the prospects of the Issuer or the Guarantor, respectively, in each case, since 31 March 2010.

Litigation

Neither the Issuer, the Guarantor nor any other member of the Group has been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer or the Guarantor is aware) in the 12 months preceding the date of this document which may have, or have in such period had, a significant effect on the financial position or profitability of the Issuer or the Guarantor, as the case may be.

Auditors

The auditors of the Issuer are PricewaterhouseCoopers LLP, Chartered Accountants and Registered Auditors, who have audited the Issuer's financial statements, without qualification, in accordance with generally accepted auditing standards in the United Kingdom for the financial years ended on 31 March 2009 and 31 March 2010.

The auditors of the Guarantor are PricewaterhouseCoopers LLP, Chartered Accountants and Registered Auditors, who have audited the Guarantor's financial statements, without qualification, in accordance with

generally accepted auditing standards in the United Kingdom for the financial years ended on 31 March 2009 and 31 March 2010.

PricewaterhouseCoopers LLP have no material interest in the Issuer or the Guarantor.

U.S. Tax

The Bonds and Coupons will bear the following legend: "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."

Documents available for Inspection

So long as any of the Bonds remains outstanding, copies of the following documents will be available from the offices of the Issuer and the Guarantor and from the specified office of the Principal Paying Agent for the time being in London:

- (a) the Memorandum and Articles of Association of the Issuer and the Guarantor;
- (b) the audited non-consolidated financial statements of the Issuer for the financial years ended 31 March 2009 and 31 March 2010; and
- (c) the audited non-consolidated financial statements of the Guarantor for the financial years ended 31 March 2009 and 31 March 2010.

In addition, this Offering Circular is also available on the website of the Regulatory News Service operated by the London Stock Exchange at www.londonstockexchange.com/rns.

Yield

The yield of the Bonds is 5.917 per cent. per annum, calculated on the basis of the issue price and as at the date of this Offering Circular.

Post-issuance Information

Neither the Issuer nor the Guarantor intends to provide post-issuance information in connection with the issue of the Bonds.

Lead Manager transacting with the Issuer and the Guarantor

The Lead Manager and its affiliates have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform services for, the Issuer, the Guarantor and its affiliates in the ordinary course of business.

Registered Office of the Issuer

Peninsula House
Rydon Lane
Exeter EX2 7HR

Auditors of the Issuer and the Guarantor

PricewaterhouseCoopers LLP
31 Great George Street
Bristol BS1 5QD

Trustee

Deutsche Trustee Company Limited
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London EC2N 2DB

Principal Paying Agent

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