



THAMES WATER UTILITIES CAYMAN FINANCE LIMITED

(incorporated with limited liability in the Cayman Islands with registered number MC-187772)

£10,000,000,000

**Multicurrency programme for the issuance of
Guaranteed Wrapped Bonds unconditionally and irrevocably guaranteed as to scheduled
payments of principal and interest pursuant to financial guarantees issued by
a Relevant Financial Guarantor
and Guaranteed Unwrapped Bonds
financing
Thames Water Utilities Limited**

(incorporated in England and Wales with limited liability with registered number 2366661)

This Supplement (the “**Supplement**”) to the Prospectus (the “**Prospectus**”) dated 11 March 2014, which comprises a base prospectus, constitutes a supplementary prospectus for the purposes of Section 87G of the Financial Services and Markets Act 2000 (the “**FSMA**”) and is prepared in connection with the multicurrency programme for the issuance of up to £10,000,000,000 Guaranteed Wrapped Bonds and Guaranteed Unwrapped Bonds (the “**Programme**”).

The payment of all amounts owing in respect of the bonds (the “**Bonds**”) will be unconditionally and irrevocably guaranteed by Thames Water Utilities Limited (“**TWUL**”), Thames Water Utilities Holdings Limited (“**TWH**”), Thames Water Utilities Cayman Finance Holdings Limited (“**TWUCFH**”) and Thames Water Utilities Finance Limited (“**TWUF**”). TWUL, TWUF, TWUCFH, the Issuer and TWH are together referred to herein as the “**Obligors**”. Terms defined in the Prospectus have the same meaning when used in this Supplement.

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

This Supplement is supplemental to, and should be read in conjunction with, the Prospectus.

The purpose of this Supplement is to supplement the disclosure in the Prospectus to reflect: (i) material and significant new information and detail (including additional risk factors) in respect of the proposed delivery model in respect of the Thames Tideway Tunnel Project; and (ii) TWUL’s recent launch of a STID Proposal (dated 22 April 2014) requesting the consent of Majority Creditors to certain amendments proposed to the Finance Documents to accommodate the legal and accounting impact of the proposed delivery model in respect of the Thames Tideway Tunnel Project.

This Supplement describes a proposed delivery model for the Thames Tideway Tunnel Project; such description is based on the understanding of TWUL (as at the date of this Supplement) of the proposed delivery model developed with Defra, Ofwat and Her Majesty's Treasury. However, the model has not received final authorisations or approvals (including from such parties) and is therefore subject to change and amendment.

CHAPTER 1 RISK FACTORS

Completion risk

The TTT Project as described in the section entitled “*Description of the TTT Project*” is based on a description of the statutory and contractual structure for the delivery of the TTT Project envisaged by TWUL. A number of items remain outstanding: (i) the contractual documents in respect of the TTT Project have not yet been entered into; (ii) the TTT Project has not yet been specified under the SIP Regulations; (iii) final approvals, authorisations and consents have yet to be given; and (iv) the IP has yet to be procured, designated and granted a project licence. Any one of these elements could mean that the TTT Project is not delivered as described in the section entitled “*Description of the TTT Project*”. However, the Proposals are sought on the basis of certain Key Characteristics, which are explained in more detail under the heading “*Proposed amendments to the Finance Documents*” below.

Risk the TTT Project is not specified

The current intended delivery option is to utilise the SIP Regulations and the infrastructure provider model to deliver the TTT Project in a way which will ensure TWUL is insulated from the majority of the construction risk in respect of the TTT Project.

The entry into such a delivery model requires the consent of the Secured Creditors. On 22 April 2014, TWUL issued a STID Proposal to seek the consent of the holders of Qualifying Class A Debt to certain proposed amendments to the Finance Documents in connection with the TTT Project. The content of such STID Proposal is as set out in the section entitled “*Proposed amendments to the Finance Documents*”. Secured Creditors have been requested to respond to the STID Proposal by no later than 2 June 2014. If the STID Proposal is approved by the Majority Creditors, the amendments to the Finance Documents will be implemented, subject to satisfaction of the Amendment Conditions, and will be binding on all Secured Creditors (including Bondholders).

If the Proposals are not approved, the TTT Project is unlikely to be specified and in such a circumstance TWUL may, therefore, be required to carry out the TTT Project with insufficient funding and/or insufficient insulation from the risks inherent in the delivery of the Thames Tideway Tunnel and may have to make capital investment during the AMP6 Period in addition to the capex expenditure already forecast to be spent during this period. In this event, or analogous events, there is a significant risk that TWUL’s financial condition and its ability to carry out and finance its regulated business will be materially adversely affected and the rating of the Bonds may be downgraded accordingly.

Risk associated with the procurement of the IP

There is a risk that, notwithstanding the agreement of the Secretary of State or Ofwat as to the preferred delivery model and specification of the TTT Project, there are no (or no compliant) bids during the procurement process for the infrastructure provider and therefore that there is no private sector party who can be appointed to act as the infrastructure provider, or who can be designated by Ofwat as the infrastructure provider or granted a project licence.

In such a circumstance TWUL may, therefore, be required to carry out the TTT Project with insufficient funding and/or insufficient insulation from the risks inherent in the delivery of the Thames Tunnel and may have to make capital investment during the AMP6 Period in addition to the capex expenditure already forecast to be spent during this period. In this event, or analogous events, there is a significant risk that TWUL’s financial condition and its ability to carry out and finance its regulated business will be materially adversely affected and the rating of TWUL and of the Bonds may be downgraded accordingly.

These risks are mitigated by the consideration that Ofwat has a primary duty under the WIA to exercise and perform its duties under the WIA in the manner they consider best calculated to, amongst other primary duties, secure that regulated companies are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of their functions.

Procurement risks

There is a risk that TWUL fails to carry out the procurement of the IP, or the main works contractors in accordance with the requirements of the relevant regulations and legislation, or that an aggrieved bidder for any of the relevant procurements challenges the terms on which the procurements have been carried out by TWUL, including in respect of the decision to require the IP in its base bid to utilise the services of CH2M Hill as the IP's project manager and the successful contractors as the IP's main contractors for the purposes of carrying out the IP's works. Any challenge would be likely to involve TWUL in lengthy court proceedings and claims by aggrieved economic operators which may not be fully remunerated under the terms of TWUL's regulatory settlement with Ofwat. If successful, these claims could also have the effect of delaying the procurement of the IP, the main contractors or the appointment by the IP of the project manager which could in turn delay completion of the TTT Project, or result in TWUL having to fund the ongoing development of the TTT Project prior to the appointment of an IP, which may not be fully remunerated in the PR14 settlement from Ofwat.

Enforcement risk

The IP will have a primary duty (set out at the front of the IP Project Licence) to design, construct, finance, test, commission, operate, maintain, and achieve acceptance of the TTT Project by a longstop date, and to ensure that the relevant infrastructure is then available for use and capable of being operated in accordance with the operating techniques agreed with TWUL and the EA.

If Systems Acceptance of the TTT Project is delayed past the longstop date, or if the infrastructure cannot be operated in accordance with the agreed operating techniques, this will amount to a breach of the IP Project Licence.

Section 18 of the WIA (as has effect under the SIP Regulations) requires Ofwat to enforce against a company where Ofwat is satisfied that the company:

- (a) is contravening, or is likely to contravene, its own licence or related statutory requirements; or
- (b) is causing or contributing to, or is likely to cause or contribute to, a contravention of another company's licence or related statutory requirements.

The effect of this provision is that, if Ofwat is satisfied that TWUL actions are causing or contributing to, or are likely to cause or contribute to, a contravention of the IP Project Licence, Ofwat is required to take regulatory enforcement action against TWUL in the ordinary way.

Ofwat's statutory enforcement regime is supplemented by Ofwat's published guidance on enforcement which provides that regulatory enforcement action taken by Ofwat against TWUL or the IP may include informal enforcement measures, such as quarterly reporting and informal undertakings, and/or formal enforcement measures, such as formal undertakings and financial penalties. The final resort is special administration (for breaches so serious that Ofwat considers the licence should be revoked). As noted above, it is currently anticipated that the enforcement regime which applies to the TTT Project will be further explained in a separate enforcement guidance note issued jointly by Ofwat and the EA.

The risk of enforcement against TWUL in this scenario is mitigated to some extent by section 19 of the WIA (as has effect under the SIP Regulations), which provides an exemption to the section 18 duty to enforce where Ofwat is satisfied that its statutory duties preclude that enforcement. Relevantly, Ofwat is required by

section 2(2A) of the WIA (as has effect under the SIP Regulations) to perform its duties in the manner best calculated to secure that the functions of the company are carried out. The effect of this exemption is that, even where it is satisfied that TWUL's actions have caused a breach of the IP Project Licence, Ofwat is not required to enforce against TWUL if Ofwat considers that to do so would not be acting in the manner best calculated to secure the carrying out of TWUL's functions.

Risks associated with PR14 settlement

TWUL has made an application to Ofwat in respect of the costs which it considers will be incurred by TWUL in respect of the delivery of the Cat 2 and Cat 3 works and other activities required to be carried out by TWUL in accordance with the terms of the Regulation 5 notice issued by the Secretary of State in respect of TWUL's obligations for the TTT Project. TWUL has also put forward certain proposals in respect of bad debt (see below) and tax to reflect the additional IP Charges. There is a risk that Ofwat will not allow the costs put forward in the PR14 business plan in respect of the TTT Project, or that such costs will have underestimated the costs which will be incurred by TWUL in carrying out the TTT Project due to changes in the Project Specification Notice and Regulation 5 notice which are issued by the Secretary of State in respect of the TTT Project. There is no assurance that the determination pursuant to the periodic review will provide adequate revenue compensation to TWUL; therefore, TWUL would have to bear any additional cost from its own resources.

Risks associated with the DCO

TWUL has applied for the Development Consent Order in respect of the TTT Project (a "DCO"). This is currently under review by PINS. There is a risk that PINS does not recommend the award of the DCO in its current draft form, or imposes additional conditions in respect of the TTT Project, or requires the drive sites to be changed or imposes additional consultation requirements on TWUL in respect of those sites. There is furthermore a risk that the current timetable for the grant of the DCO is delayed due to changes in the funding structure which is not yet finalised, or due to other third party factors (including the risk of judicial review), or delays by the planning authorities, such that the DCO is not granted by IP Project Licence award to the IP. These delays or changes in conditions to the DCO may result in TWUL having to bear additional costs from its own resources or to fund compensation to third parties which is in excess of the regulatory settlement allowed by Ofwat, resulting in cash flow issues for TWUL unless and until such costs can be logged up at (and recoverable following) a subsequent periodic review.

Reputational risks

The current envisaged delivery model will result in the delivery of the TTT Project being carried out by the IP. However, due to the consultation process and the planning processes carried out by TWUL in advance of the appointment of the IP, and due to the fact that London customers are accustomed to receiving their bills from Thames Water, there is a risk that delays and problems during construction will be considered to be the delays and defaults of TWUL. This could lead to adverse publicity and increases in customer complaints for matters for which TWUL is not responsible under contract, regulation and or statute.

Bad debt risk

The expected economic regulatory settlement on behalf of the IP would allow for annual increases in the revenues due to the IP, which in turn will feed through to annual increases on TWUL customers above the RPI indexation threshold. TWUL will not be in charge of such increases and these will feed through automatically to TWUL charges to customers. This could result in the charges to customers going up more rapidly than has previously been communicated to customers not due to any fault on the part of TWUL, but instead due to the way in which the IP manages the TTT Project and is entitled to its allowed revenue under the IP Project Licence.

For TWUL, the bad debt risk will be dealt with under PR14 according to Ofwat's PR14 methodology. TWUL has proposed that the impact of the IP on its bad debt should be taken into account at PR14. However, there is a risk that Ofwat will not allow TWUL the protection in respect of bad debt which have been proposed in the PR14 settlement. In addition there is the further risk that if TWUL exercises the protections under those mechanisms, Ofwat will not allow TWUL to recover the impact.

There is furthermore the risk that customers may refuse to pay TWUL the increased costs which TWUL is charging in order to enable the IP to implement the TTT Project. Customers could, for example, choose to deduct from the payments they make to TWUL the notified costs associated with the TTT Project in protest at being so charged. This could materially increase the risk to TWUL associated with bad debt.

The increase in customer bills may impact TWUL (and TWUL's costs) by increasing bad debt; resulting in higher collection costs related to existing commercial arrangements with Local Authorities, Housing Associations and other water companies; and resulting in a greater degree of customer dissatisfaction.

With respect to enforcement, an undertaker's power to charge is based on statutory authority provided by the relevant section of the statute (section 142(1) of the WIA in respect of the water and sewerage charges), and hence any action for a failure to pay will be brought as an action for failure to pay a statutory charge.

TWUL has raised the issue of the potential for adverse customer reaction with Ofwat; however, the regulator has not currently granted any special protection in respect of the risk.

Furthermore future changes in legislation (including that relating to retail competition in the current Water Bill) may adversely affect the arrangements for the collection and payment of the IP Charges to the IP under the terms of the Revenue Agreement, including by isolating bad debt risk in the retail business.

Operational risk

There are a number of operational risks to TWUL arising from the TTT Project which are summarised below. these include:

- (a) damage caused to TWUL's network by or as a result of the IP Works, causing additional costs to repair the damage (to the extent not covered by the asset protection agreement between TWUL and the IP or insurance);
- (b) damage to existing pumping station assets and/or disruption to the normal operation of TWUL systems during the duration of the IP Works caused by the IP and its contractors, causing TWUL to incur additional costs and causing reputational damage to TWUL;
- (c) exposure of the sewerage system to the atmosphere during construction or operation, resulting in additional nuisance complaints regarding odour from third parties, causing TWUL to incur additional costs and claims from third parties in respect of nuisance;
- (d) failure to maintain existing CSO's functionality during the duration of the IP Works, causing potential upstream flooding and additional river discharges, resulting in claims against TWUL for damage to third party property and environmental damage, including enforcement action by the EA;
- (e) collapse of/damage to a TWUL strategic asset as a result of IP Works causing damage to third party assets and claims made against TWUL in respect of such third party damage;
- (f) multiple downstream diversions or possessions reducing system capacity and potentially leading to backing-up and flooding of upstream interception works or catchments, resulting in claims against TWUL for damage to third party property and environmental damage, including enforcement action by the EA (to the extent not covered by the limited indemnity given to TWUL from the IP);

- (g) removal of bulkhead and installation of secondary tunnel lining at the Lee Tunnel interception point exceeding the EA-approved shut down of the Lee Tunnel and extending the time that the Abbey Mills CSO discharges to the river, resulting in enforcement action by the EA; and
- (h) potential siltation of existing CSOs which would not be used as frequently following construction (due to reduced discharges into the Thames), potentially resulting in additional opex and/or capex requirements.

Costs overruns/construction risk in relation to TWUL

There is a risk that the sums allowed in the PR14 settlement for the TWUL works, including the Cat 2 and Cat 3 works, are less than the amount necessary to carry out the works due to delays and disruption to the works being caused by the IP Works, resulting in TWUL having greater capex expenditure than previously envisaged. To mitigate against the risk of disruption or delay (and associated cost increases) resulting from interfaces between the IP Works and TWUL Works, TWUL will have a dedicated team working with the IP delivery team working to ensure knowledge transfer and the co-ordination of activities.

Design risk

The specification for the TTT Project and the hydraulic design has been developed by TWUL, with input from the EA on the modelling of future flows and approval of the CSOs which are to be intercepted, actively managed or impacted by the new sewer system. The EA has confirmed its satisfaction that the scheme, if constructed and designed in accordance with the specification, will deliver the required environmental outcomes. There is a risk that the IP and contractors do not develop the detailed design of the TTT Project in accordance with the specification and the system cannot be operated in accordance with the environmental permits, and a third party or the EA enforces against TWUL in respect of the breach of the environmental permits. In the event that the design inputs agreed with the EA and stakeholders are incorrect, resulting in a constructed output that is incapable of meeting the environmental permits, modifications may be required to TWUL's existing network, subject to further agreement with the EA and stakeholders. The costs of any such modifications may not be fully recoverable from TWUL's customers under TWUL's regulatory regime.

Fines

There is a risk that, under the Localism Act 2011, the UK government brings forward regulation which allows for the passing on of fines levied against government to water undertakers. In such an event, there is a risk government may seek to fine TWUL for any failure by TWUL to comply with the UWWTR or its s.94 duty.

Service standards

On 1 April 2010, Ofwat introduced a new performance assessment called the service incentive mechanism ("SIM"). It is based on two consumer experience measures, namely a quantitative measure based on the number of complaints and unwanted contacts an undertaker receives and a qualitative indicator measuring how satisfied consumers are with the quality of service they receive, based on a survey of consumers who have had direct contact with their undertaker. These two measures aim to capture both the number of times a company fails to meet the expectations of its consumers, as well as the experience of those consumers. The SIM is designed to provide an incentive for companies to deliver the level of service their consumers want by using SIM scores as a basis for adjusting price limits, subject to a maximum reduction of 1% of revenue.

Pursuant to the terms of the TWUL Licence, TWUL will continue to be responsible directly to customers/consumers for its services. There is a risk that complaints raised against the performance of the TTT Project will be included in the statistics and annual assessment of serviceability by the undertakers, although TWUL will be entitled to make representations to Ofwat concerning the responsibility for such underperformance, should the underperformance relate to the TTT Project.

Discontinuation, Despecification, De-designation or special administration of the IP

In certain circumstances following the appointment of an IP, either the IP or the TTT Project could face difficulties and ultimately fail. There are four possible scenarios where the IP or the TTT Project could fail:

- (a) special administration of the IP;
- (b) discontinuation of the government contingent financial support;
- (c) revocation of the Project Specification Notice; or
- (d) revocation of the designation of the IP (with no replacement IP being appointed).

In each case, the IP will no longer be required to complete the TTT Project. Where the Project Specification Notice has been revoked, TWUL will be required to put forward proposals in order to meet the requirements of the UWWTR, subject to funding by Ofwat. Whilst there are protections for TWUL in respect of the mechanisms set out in the new Condition T of the TWUL Licence, there remains a risk that TWUL will suffer reputational damage or additional costs or that it will be unable to agree an appropriate funding mechanism for the new proposal leading to continued delays in the implementation of a scheme to meet the requirements of the UWWTR.

Future amendments to Finance Documents

As the proposed delivery model for the TTT Project has not received final consents and authorisations, and therefore is subject to change, the Proposals include a requirement for the Security Trustee to consent to future amendments to the Finance Documents to which the Security Trustee is a party if TWUL certifies, *inter alia*, that the amendments are necessary or desirable in order to deliver the TTT Project. Although this is subject to certain creditor protections, including the requirement that TWUL obtains a ratings affirmation (or equivalent) and that the relevant amendment, modification, waiver and/or consent does not give rise to a Default or (as certified by TWUL) a Material Adverse Effect, a change in the parameters of the TTT Project may nevertheless result in the Security Trustee being obliged to agree amendments, modifications, waivers and/or consents in respect of the Finance Documents to which the Security Trustee is a party without the specific approval of Secured Creditors.

Because the development of the TTT Project is at an early stage (see “*Completion risk*” above) there can be no assurances that the TTT Project will be implemented in the manner described herein or that further amendments, modifications, waivers and/or consents will not be required to the Finance Documents. The implementation of the Proposals will mean that the Security Trustee is obliged to consent to such amendments, modifications, waivers and/or consents, even though they cannot currently be anticipated and notwithstanding that Bondholders or other Secured Creditors may not necessarily agree with such future changes once they have been identified.

The key protection offered to Bondholders in this regard is that the consent is sought on the basis that the TTT Project will meet the Key Characteristics (see the section entitled “*TTT Project Key Characteristics*”). The key characteristics set out, in TWUL’s opinion, the key creditor protection features of the IP delivery model structure. Majority Creditor consent will be required in the event that a future amendment, waiver or consent is requested that would result in such key characteristics not being observed.

Tax risks

As described in more detail in the section headed “*Tax Impact*”, TWUL has received advice that in consequence of the nature of the arrangements for the recovery of the IP Charges from customers, the charging arrangements between the IP and TWUL and the anticipated accounting treatment of those arrangements, implementation of the TTT Project is likely to result in an increase in the UK corporation tax liabilities of TWUL during the period prior to Acceptance. TWUL estimates this incremental tax liability to be

approximately £83 million (based on anticipated IP Charges of £415 million in that period). This estimate has been calculated on the basis of prudent assumptions as to the tax treatment of TWUL. This additional amount in respect of corporation tax is expected to be built into TWUL's regulatory charging settlement for the period 2016 to 2020 and, therefore, funded in full through customer charges. It is possible that the incremental tax cost to TWUL could be greater or less than the amount included in TWUL's charging settlement, to the extent that actual IP Charges differ from their expected amount (for example, because of the IP's credit rating being lower than anticipated or the IP incurring greater expenditure than expected over this period). Consequently, it is possible that implementation of the TTT Project could result in additional corporation tax liabilities for TWUL which are not fully funded through the charges it makes to customers, which could have a negative effect on the financial position of TWUL.

TWUL has modelled the effect of different IP Charges on its corporation tax position, based on a range of scenarios and believes that the potential incremental tax cost for TWUL in connection with the Project for which TWUL is not funded through customer charges, in all realistic scenarios, is unlikely to be a material amount over the period 2016 to 2020.

TWUL has also proposed to Ofwat that any difference between the actual incremental tax cost of the TTT Project and the cost reflected in TWUL's regulatory charging settlement for the period 2016 to 2020 should be reflected in TWUL's regulatory charging settlement for the following period, 2021 to 2025. However, there is no guarantee that Ofwat will agree to this proposal.

The arrangements between TWUL and the IP in relation to the land on which the Thames Tideway Tunnel will be situated are yet to be finalised. The parties intend to work together to ensure that those arrangements are structured, so far as possible, so as to minimise any associated tax costs and it is anticipated that confirmation from HMRC as to the appropriate tax treatment will be sought. However, it is possible that incremental tax costs to TWUL could arise as a result of these arrangements.

It is anticipated that any such incremental tax costs would be fully funded by customer charges, through either a determination by Ofwat or the Competition and Markets Authority pursuant to the regulatory settlement process. However, this cannot be guaranteed. Any unfunded tax costs to TWUL arising from the land arrangements with the IP could have a negative effect on the financial position of TWUL.

In addition, changes in applicable tax laws or tax rates or in applicable accounting practice could result in changes to the anticipated accounting and/or tax treatment of TWUL in relation to the TTT Project. This could result in additional unfunded tax costs, which could have a negative effect on the financial position of TWUL.

EU Savings Directive Risk

EC Council Directive 2003/48/EC on the taxation of savings income (the "EU Savings Directive") requires Member States to provide to the tax authorities of other Member States details of payments of interest and other similar income paid by a person established within its jurisdiction to (or for the benefit of) an individual or certain other persons in that other Member State, except that Austria and Luxembourg will instead impose a withholding system for a transitional period (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) unless during such period they elect otherwise. The Luxembourg government has announced its intention to elect out of the withholding system in favour of an automatic exchange of information with effect from 1 January 2015. A number of third countries (including Switzerland) and certain dependent or associated territories of certain Member States have adopted similar measures to the EU Savings Directive.

On 24 March 2014, the Council of the European Union adopted a Directive amending the EU Savings Directive which, when implemented, will amend and broaden the scope of the requirements described above. In particular, the amending Directive broadens the circumstances in which details of payments must be

provided or tax withheld. Member States have until 1 January 2016 to adopt national legislation necessary to comply with the amending Directive.

CHAPTER 2

DESCRIPTION OF THE TTT PROJECT PROPOSED DELIVERY MODEL

Given the size and scale of the Thames Tideway Tunnel and its importance to UK infrastructure, TWUL have been in dialogue with Defra, Ofwat and Her Majesty’s Treasury as to the preferred way to deliver the TTT Project. TWUL, Defra, Ofwat and Her Majesty’s Treasury have together developed a proposal whereby the TTT Project is delivered by an independent infrastructure provider (the “IP”). Such infrastructure providers were specifically introduced by recent legislation to deliver projects (i) that are of such a size and complexity that they threaten the incumbent undertaker’s ability to provide services for its customers and (ii) where “specifying” the infrastructure project is likely to result in better value for money than would be the case if the infrastructure project was not specified. Projects meeting these criteria can be specified as such by Ofwat or the Secretary of State.

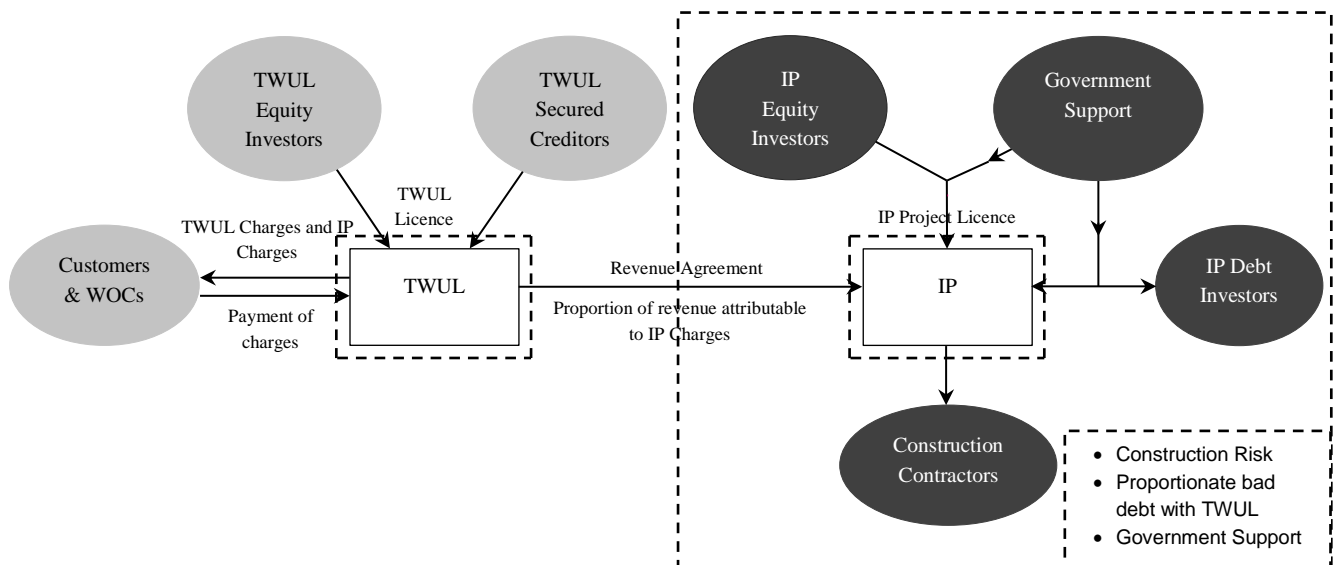
The IP will not be owned by TWUL but will instead be an independent entity with its own licence and separately regulated by Ofwat. The IP will also be responsible for raising its own capital. The IP will by law and by regulation be required to design, construct, finance, operate and maintain the Thames Tideway Tunnel as specified.

TWUL will collect additional revenues from customers which it will pass to the IP and the Licence will be amended to include the ability and obligation to collect such additional revenues. TWUL will only be required under the Revenue Agreement with the IP to pass such revenues to the IP on a “pay when paid” basis i.e. TWUL will only be required to pass to the IP the relevant proportion of its revenues (commensurate with the proportion of the IP Charges to TWUL’s total wastewater charges) when it has collected them.

In addition to the collection of revenues, TWUL will be involved in the procurement of the IP, ensuring that the Thames Tideway Tunnel connects correctly to TWUL’s existing sewer network and the completion of certain preparatory works.

Set out below is an overview of the proposed delivery model:

Overview of the proposed delivery model



- (a) The Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 (the “**SIP Regulations**”) came into force on 28 June 2013. The SIP Regulations (and the underlying primary legislation permitting their creation) were specifically enacted in order to provide for the delivery of projects such as the Thames Tideway Tunnel.
- (b) If the TTT Project is specified under the SIP Regulations, TWUL will be prohibited from undertaking the majority of the works in connection with the TTT Project, including almost all of the construction works. TWUL will instead procure an IP to undertake the TTT Project.
- (c) The IP will be separately licensed and will be controlled by different shareholders from TWUL. The IP will by law and regulation be required to design, construct, finance, operate and maintain the Thames Tideway Tunnel Project as specified and will own, operate and maintain the Thames Tideway Tunnel, associated tunnels and shafts (“**IP Owned Structures**”) and the majority of the risks associated with such construction will be ring-fenced from TWUL.
- (d) TWUL’s Licence will be amended to increase its allowed charges to its customers in respect of the IP’s allowed revenue (the “**IP Charges**”). IP Charges will form part of TWUL’s overall charges, and therefore a single bill will be given to TWUL’s customers.
- (e) The Revenue Agreement will govern the relationship between TWUL and the IP with regard to payment of the IP Charges. As described above, TWUL will be able to charge additional amounts to its customers under its amended Licence.
- (f) The Revenue Agreement will provide that TWUL is only required to pass on to the IP the proportion of revenue collected from customers or the WOCs which the IP Charges represent as a proportion of TWUL’s wastewater charges.
- (g) TWUL’s obligation to pay the IP is on a pay when paid basis.
- (h) Under the Revenue Agreement, there will not be any situations in which a failure to pay to the IP the IP Charges when received by TWUL could result in a right to accelerate such charges by the IP. In this situation, the IP may be entitled to default interest only (in respect of the period from when such amount was due and payable to the IP but remains unpaid). In extremis the IP may elect to terminate the Revenue Agreement and directly charge customers who are directly or indirectly connected to the IP’s assets.

Additionally, there will not be any events of default within the IP debt documentation which would lead to the IP debt investors having any rights to claim any accelerated amounts from TWUL.

Description of the TTT Project

This section sets out a detailed summary of how TWUL, following discussions with the Secretary of State, Ofwat and HM Treasury, envisages the delivery model for the TTT Project. However, the delivery model is not final and is subject to change and final authorisation and approvals. This summary does not purport to be complete and is subject to final consents, approvals and documentation. Statements that are made or implied as to the future, including the use of the word “will”, in this description are as to current intent as understood at the date of this Supplement only and not representative as to any future state, circumstance, happening or commitment.

The Thames Tideway Tunnel Project (the “**TTT Project**”) is required to enable the UK government to satisfy the requirements of the Urban Waste Water Treatment Directive (see further detail below in *Part 1 – Background and overview*). In order to deliver the TTT Project, the UK government has passed new legislation in the form of the Flood and Water Management Act 2010 (which inserted provisions into the

Water Industry Act 1991) and the SIP Regulations which provides for the delivery of specified infrastructure projects by way of an infrastructure provider.

The infrastructure provider structure has been developed both in legislation and in regulation in order to ring-fence the incumbent undertaker from the risk associated with carrying out of major complex infrastructure and to ensure that the incumbent undertaker, in this case TWUL, is able to continue to deliver its core services. There is a risk that the delivery of a major complex infrastructure project could otherwise undermine this.

TWUL will transfer the design, construction and financing scope and risks to the IP. TWUL will remain as the specifier and integrator of the Thames Tideway Tunnel and will be responsible for controlling the flows into the Thames Tideway Tunnel. The effect of the IP delivery model is to leave TWUL in a position which is similar to its current position with the obligation to manage its water and sewerage business within the current regulatory framework for water and sewerage undertakers.

TWUL will review and comment on the detailed design of the TTT Project as it is developed by the IP.

TWUL will assume responsibility for operating and maintaining the moveable assets, including penstocks, flap-valve and interception chambers, air management systems, MEICA and SCADA systems. TWUL will also operate the overall Thames Tideway Tunnel system (not including the IP Owned Structures) as part of TWUL's sewer network (including inlet gates, SCADA systems and pumping stations) and ensure compliance with the environmental permits. By operating such assets, TWUL will thereby effectively control the flow of storm sewage into and out of the Thames Tideway Tunnel.

This section sets out further information regarding TWUL's role in the TTT Project, the interaction with the IP and the implications of an IP delivery model on TWUL's existing core business. In particular, this section sets out:

- (a) TTT Project background and overview (Part 1);
- (b) Legislative and regulatory overview of the SIP Regulations and the IP delivery model (Part 2);
- (c) Implementation of the TTT Project within the legal and regulatory regime (Part 3); and
- (d) Impact on TWUL of the IP delivery model (Part 4).

Part 1 – Background and overview

Overview

General Overview

London's Victorian sewerage system was designed to collect sewage and rainfall from a city with a population of four million. To prevent the combined sewage backing up and flooding people's homes and businesses, the sewers were designed to discharge sewage and rainwater to the tidal River Thames through combined sewer overflows ("CSOs") when the capacity in the main system was exceeded.

London's CSOs now discharge about 39 million cubic metres of untreated combined sewage and rainwater into the tidal River Thames in a typical year. Discharges can occur over 50 times in a year. The increase in discharges arises from the population increase (now in excess of 7 million people) and changes to the city layout through new buildings, roads and other infrastructure. The level of sewage discharge is having a detrimental impact on the environment and the tidal River Thames, and the system has been found to be in breach of EU environmental legislation.

The Urban Waste Water Treatment Directive (the “UWWTD”) is the European legal directive which specifies certain requirements for the collection and treatment of municipal wastewater which apply in all EU member states in all but “exceptional” situations.

Pursuant to Article 3 of the UWWTD, Member States are required to ensure that all urban agglomerations in excess of a certain minimum size are provided with urban wastewater collecting systems. Article 4 of the UWWTD states that urban wastewater entering collecting systems must be subject to secondary treatment or an equivalent treatment before discharge. Article 10 of the UWWTD states that the deadline for member states of the European Union to comply with Articles 3 and 4 of the UWWTD was 31 December 2000.

In 2004, the European Commission initiated infraction proceedings against the UK Government pursuant to Article 258 of the Treaty on the Functioning of the European Union, alleging that the UK Government had failed to discharge its obligations under Articles 3, 4 and 10 of the UWWTD.

The CJEU determined on 18 October 2012 that the European Commission had been correct in finding that the collecting and treatment system put in place in London did not meet the obligations laid down in Article 3 of the UWWTD and that, by failing to make urban wastewater from the agglomeration of London subject to secondary treatment or an equivalent treatment, in accordance with Articles 4 and 10 of the UWWTD, the UK had failed to fulfil its obligations under the UWWTD.

The European Commission is entitled to seek from the CJEU the right to levy fines from the UK Government in respect of its failure to implement the UWWTD. The UK Government has notified the European Commission that it will support the implementation of the Thames Tideway Improvement Scheme (as detailed below) in order to rectify the UK Government’s lack of compliance with the UWWTD. Implementation of the Thames Tideway Improvement Scheme within a reasonable time will have the effect of staying any application by the European Commission to the CJEU for permission to fine the UK Government. The CJEU has the power to impose fines of up to 0.1% of GDP.

Section 94 of the WIA

Sewerage undertakers, including TWUL, have a duty under section 94 of the WIA to:

- (a) provide, improve and extend a system of public sewers and to cleanse and maintain those sewers so as to ensure that that area is and continues to be effectually drained (s.94(1)(a)); and
- (b) make provision for the emptying of those sewers and such further provision as is necessary from time to time for effectually dealing, by means of sewage disposal works or otherwise, with the contents of those sewers (s.94(1)(b)).

The UWWTR (which implemented the UWWTD into English law) supplements section 94 with specific duties regarding urban waste water treatment.

Schedule 2 of the UWWTR requires that:

- (a) collecting systems shall take into account waste water treatment requirements; and
- (b) the design, construction and maintenance of collecting systems shall be undertaken in accordance with the best technical knowledge not entailing excessive costs, notably regarding volume and characteristics of urban waste water, prevention of leaks, and limitation of pollution of receiving waters due to storm water overflows.

Section 4 of the UWWTR specifies that:

- (a) the duty imposed by s.94(1)(a) of the WIA shall include a duty to ensure that collecting systems which satisfy the UWWTR requirements set out at Schedule 2 of the UWWTR are provided:

- (i) by 31 December 1998 for every agglomeration with a population equivalent of more than 10,000 where the urban waste water discharges into receiving waters which are a sensitive area; and, otherwise
 - (ii) by 31 December 2000 for every agglomeration with a population equivalent of more than 15,000; and
 - (iii) by 31 December 2005 for every agglomeration with a population equivalent of between 2,000 and 15,000;
- (b) the UWWTR requirements do not apply where the EA has certified that the establishment of a collecting system would produce no environmental benefit, or if the Secretary of State has certified that the establishment of a collecting system is not justified because it would involve excessive cost, as long as individual systems or other appropriate systems are provided and the EA has certified that those systems achieve the same level of environmental protection; and
- (c) the duty imposed by s.94(1)(b) of the WIA shall include a duty to ensure that, *inter alia*:
- (i) urban waste water entering collecting systems is, before discharge, subject to treatment provided in accordance with the UWWTR;
 - (ii) plants built in order to comply with the UWWTR standards are designed (account being taken of seasonal variations of the load), constructed, operated and maintained to ensure sufficient performance under all normal local climatic conditions; and
 - (iii) disposal routes for treated waste water and sludge minimise the adverse effects on the environment.

Absent specification of the TTT Project as a specified infrastructure project, responsibility for compliance with section 94 of the WIA rests with an incumbent undertaker, provided that Ofwat has allowed sufficient funding to carry out such functions.

However, in respect of the TTT Project, the UK Government has formed the view that delivery of the TTT Project should not rest with the incumbent undertaker. Instead, the UK Government has indicated that it intends to specify the TTT Project under the new specified infrastructure projects regime which applies to projects of a size or complexity that would threaten the ability of an undertaker to provide services for its customers.

As part of the specification consultation process, the “*Thames Tideway Tunnel: Draft Reasons for Specifying the Project as a Specified Infrastructure Project*” notice was published on the Defra website in December 2013. This notice sets out the UK Government’s draft reasons for specifying the TTT Project and acknowledges that should the Project not be specified, and TWUL was expected to deliver the TTT Project, TWUL would bear significant regulatory and financial risk, and recognises that “unless adaptations to the regulatory regime were made, TWUL would need to commit to a substantial proportion of the investment without knowing what return it could expect”.

The Localism Act 2011

As described above, it is possible that the UK Government could be fined if further proceedings are initiated against the UK Government in respect of the CJEU judgment handed down on 18 October 2012. While it is difficult to predict the level of any fine that might be imposed, Defra has estimated that the European Commission may seek fines upwards of £100 million a year. Fines are calculated based on the duration and seriousness of the infringement and the individual Member State’s capacity to pay.

These fines could be passed down to a public authority pursuant to section 48 of the Localism Act 2011 (the “**Localism Act**”). The Localism Act gives Ministers of the Crown discretionary power to require a public authority to pay all, or part, of a financial sanction imposed on the UK by the CJEU. This discretion is restricted to public authorities which have been designated in relation to the specific EU infraction case in question and subject to certain notice requirements.

Section 52 of the Localism Act gives Ministers the power to designate one or more named public authorities, identify the specific infraction case to which the designation relates, and describe the activities of the authority covered by the designation. Only acts or omissions which occur post designation can be taken into account when passing a financial sanction. Prior to making a designation order, the Minister must consult with the public authority concerned.

The Government has stated that the default position would be to use any existing regulatory framework first to resolve issues relating to infractions. The Government would only seek to designate a private company under the Localism Act if they had such public functions and had caused or contributed to an active infraction case and any existing regulatory bodies had not been able to effectively incentivise compliance.

Any attempt to pass fines on to TWUL would first require that the Secretary of State designate TWUL as a public authority for the purposes of section 52 of the Localism Act. In doing so, the Secretary of State would need to demonstrate that TWUL carries out functions of a public nature. As at the date of this Supplement, the Secretary of State has not designated TWUL as a public authority for this purpose.

The term “functions of a public nature” is not defined under the Localism Act nor is it a term of art at law. Case law does not point to a clear definition and notes that the meaning of the term varies according to statutory context and factual circumstances.

The London Tideway Improvements

In 2005, the independently-chaired Thames Tideway Strategic Study, which included technical teams from TWUL, the EA, Defra and the Greater London Authority recommended three integrated solutions to solve the problem of London’s overloaded sewers:

- (a) Sewage Treatment Upgrade Works at Mogden, Beckton, Crossness, Long Reach and Riverside that discharge treated flows into the tidal River Thames (“**Sewage Treatment Upgrades**”);
- (b) the Lee Tunnel – a 6.9km sewage tunnel through the London Borough of Newham for which construction began in 2010; tunnelling work commenced in early 2012 and has now been completed, with commissioning scheduled for late 2015 (the “**Lee Tunnel Project**”); and
- (c) the Thames Tideway Tunnel – the most significant part of the overall scheme.

Collectively, these works are known as the “**London Tideway Improvements**”.

TWUL is in the process of carrying out the Sewage Treatment Upgrades and Lee Tunnel Project. Following the construction of the Lee Tunnel and the Sewage Treatment Upgrades, the combined sewage discharges into the River Thames are estimated to reduce to about 18 million cubic metres. It is these remaining discharges which the Thames Tideway Tunnel is designed to address.

The EA reiterated its continuing support for the Thames Tideway Tunnel in a letter to TWUL dated 4 July 2012, stating that “*the proposed system operating strategy will control CSOs to a level that is compliant with the [Thames Tideway Strategic Study (published in 2005)]and thereby meets the requirements of that part of the UWWTD.*”

The EA has further confirmed in a report dated October 2013 that the Thames Tideway Tunnel, if and to the extent it performs as modelled, will meet the objectives of the UWWTD.¹

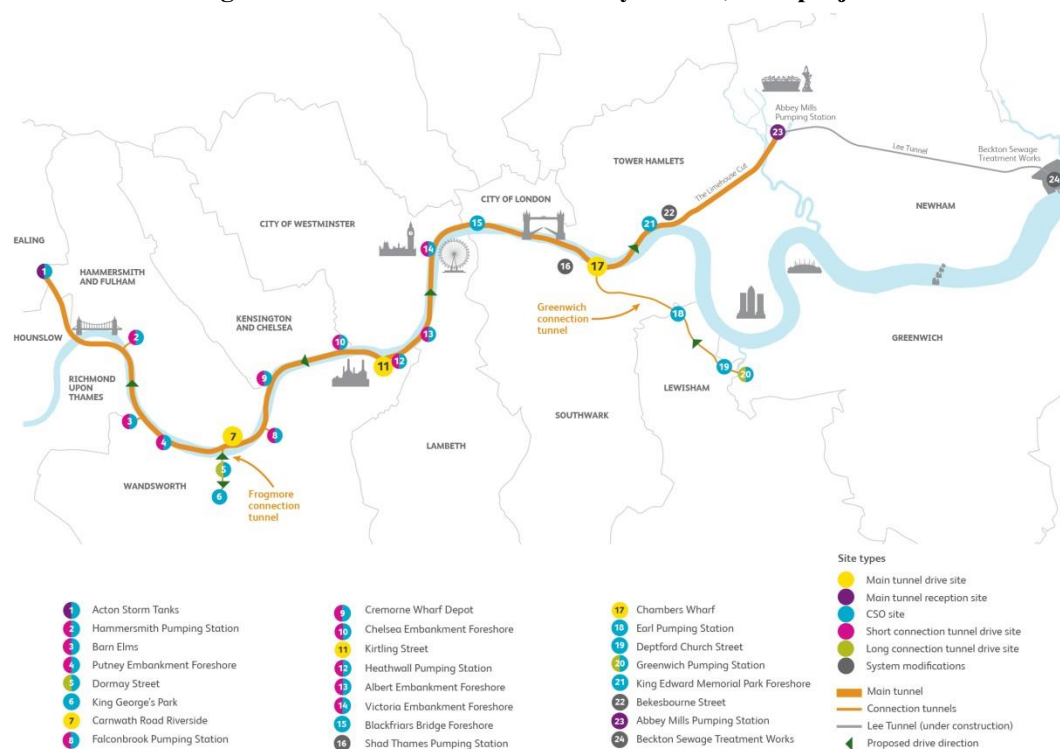
The proposed tunnel solution was supported by Government in written Ministerial Statements in 2010² and 2011.³

The Thames Tideway Tunnel Project

The 25km long Thames Tideway Tunnel (the “**Thames Tideway Tunnel**”) will intercept the remaining unsatisfactory discharges from 34 CSOs on the north and south banks of the tidal River Thames and transfer the flow for treatment at Beckton and Common Sewage Treatment Plants.

The Thames Tideway Tunnel will run from Acton Storm Tanks in West London to the Lee Tunnel at Abbey Mills in East London. The CSO flow from multiple locations will be intercepted and dropped down from the existing sewers and connected into the main tunnel where it will flow by gravity to the connection with the Lee Tunnel before continuing down to the pumping station where it will be pumped to Beckton Sewage Treatment Plant for treatment. The Thames Tideway Tunnel will start 30m deep in Acton and finish 65m beneath ground level at Abbey Mills.

Illustration showing the route of the Thames Tideway Tunnel, with project sites



The TTT Project will require works to be carried out at 24 separate construction sites to make system modifications, drive the tunnel using tunnel boring machines and to intercept the CSOs themselves and

¹ “Output from the compliance test procedure shows that up to 4 spills from CSOs take place with the tunnel option. This is deemed to satisfy the requirements of the UWWTD (to collect spills under normal conditions), and the DO standards.” P10, *An assessment of evidence on Sustainable Drainage Systems and the Thames Tideway Standards. A report by the Environment Agency for the Department for Environment, Food and Rural Affairs*. Final October 2013.

² Daily Hansard. Written Ministerial Statements. 7 September 2010: Column 10WS.

³ Daily Hansard. Written Ministerial Statements. 3 November 2011: Column 41WS.

connect them to the main Thames Tideway Tunnel. Along with the main tunnel there will be several connection tunnels to connect intercepted CSOs to the main tunnel. The main tunnel will be approximately 6.5 to 7.2m in diameter and the two principal connection tunnels will be 2.6m and 5.0m in diameter.

When the Thames Tideway Tunnel is completed as part of the London Tideway Improvements, the volume of CSO discharge should reduce by over 90% and the number of CSO events should reduce from over 50 to three or four per year during a typical year.

Part 2 – Legislative and regulatory overview of the SIP Regulations and the IP delivery model

The Specified Infrastructure Projects Regime

Part 2A of the WIA

Part 2A of the WIA was inserted by the FWMA. It gives the Secretary of State the power to make regulations (the “**Regulations**”) in respect of the provision of projects of a size or complexity that threatens the ability of the undertaker to provide services for its customers. Under these Regulations, the Secretary of State or Ofwat could require that such projects (once specified) be put out to tender to be financed and delivered by a third party IP rather than the undertaker. The provisions of the FWMA and the SIP Regulations were enacted in order to provide a potential delivery model for projects such as the TTT Project.

Part 2A of the WIA is largely permissive with regard to the degree and nature of the Regulations and is sufficiently broad to encompass an IP which is licensed and directly regulated (including economic and non-economic regulation) by Ofwat.

Part 2A of the WIA provides as follows:

- (a) The Regulations may:
 - (i) confer regulatory functions on Ofwat;
 - (ii) apply provisions of Part 2 of the WIA with or without modification; and
 - (iii) make provisions similar to a provision of Part 2 of the WIA.

The provisions of Part 2 of the WIA include such matters as appointment of undertakers, enforcement orders and the special administration regime, each as described below.

- (a) The Regulations must specify the activities to which they apply, which may include designing, constructing, owning and operating infrastructure.
- (b) The Regulations may permit or require an undertaker to carry out certain preparatory work.
- (c) The Regulations must:
 - (i) make provisions about the extent to which companies associated with an undertaker are permitted to bid in a tender process;
 - (ii) specify the procedure to be followed in a tender process;
 - (iii) provide for the undertaker responsible for the tender process to determine which bid to accept (if any); and
 - (iv) specify criteria to be used by the Secretary of State or Ofwat in determining whether to specify that a project must be put out to tender.
- (d) An IP can be designated such that it is directly regulated by Ofwat. The Regulations may:

- (i) confer powers and impose duties on designated IPs (including any power or duty that is the same as or similar to a power or duty conferred or imposed under or by virtue of the WIA on undertakers);
- (ii) confer powers and impose duties on Ofwat, the Secretary of State or any other body with public functions;
- (iii) relieve undertakers of specified duties to a specified extent;
- (iv) provide for designation to be conditional;
- (v) provide, or enable the provision of, limits on powers and duties conferred on the designated IPs;
- (vi) include provisions about enforcement; and
- (vii) include provisions for variation or revocation of designation.

The SIP Regulations Consultation Paper

In the SIP Regulations Consultation Paper, Defra noted that the SIP Regulations may offer benefits through:

- (a) ring-fencing the delivery and financing of an individual project and its risks from the delivery and funding of other capital projects, thereby reducing the risk that the project may affect the undertaker's ability to provide other services to customers;
- (b) increasing competition in relation to the delivery of the infrastructure by enabling new entrants to participate in the delivery of water and sewerage infrastructure;
- (c) revealing the level of risk the investors are willing to bear;
- (d) incentivising a market-tested project cost of financing and single project focus thereby reducing the risk of major project overruns; and
- (e) introducing strategic and innovative approaches.

SIP Regulations

The Flood and Water Management Act 2010 amended the WIA by inserting a new Part 2A, which conferred powers on the Secretary of State to make regulations about the provision of infrastructure for the use of water undertakers or sewerage undertakers.

Pursuant to the above powers, the SIP Regulations were made on 27 June 2013 and came into force on 28 June 2013. Regulation 4(1) of the SIP Regulations allows the Secretary of State or Ofwat to specify by notice an infrastructure project as a "specified infrastructure project". An infrastructure project is a project or part of a project in connection with designing, constructing, owning or operating infrastructure. It is a project which an incumbent water or sewerage undertaker must ordinarily undertake to fulfil its statutory duties under section 37 (general duty to maintain water supply system etc.) or section 94 (general duty to provide sewerage system) of the Act.

Regulation 4(3) of the SIP Regulations provides that the Secretary of State or Ofwat may only exercise the power to specify an infrastructure project if he is of the opinion that:

- (a) the infrastructure project is of a size or complexity that threatens the incumbent undertaker's ability to provide services for its customers (referred to herein as the "**Size or Complexity condition**"); and
- (b) specifying the infrastructure project is likely to result in better value for money ("**VfM**") than would be the case if the infrastructure project was not specified, including taking into account:

- (i) the charges fixed or likely to be fixed under Chapter 1 of Part 5 of the WIA (financial provisions, charges); and
- (ii) the powers of the Secretary of State under section 154B of the WIA (financial assistance for major works).

(The condition in paragraph (b) above is referred to herein as the “**VfM condition**”).

In December 2013, the Secretary of State issued a consultation on whether or not he should specify the Thames Tideway Tunnel as a specified infrastructure project, setting out his reasons for so specifying as required by the SIP Regulations. A draft of the specification notice which describes the scope of the infrastructure project was also made available as part of the consultation.

In approaching the Size or Complexity condition, the Secretary of State has, in his draft reasons, discounted the ability of the incumbent undertaker, subject to price review control by Ofwat, to pass on the costs of the TTT Project to customers. He has also discounted the availability of financial support being made available under section 154B of the Act. Otherwise, in the Secretary of State’s opinion, there would be no project which would threaten the incumbent undertaker’s ability to provide services for its customers and the condition in Regulation 4(3)(a) would be rendered ineffective.

In his draft reasons, the Secretary of State expresses the view that determining whether the Size or Complexity condition is satisfied in any particular circumstances is a matter of fact and degree. A variety of risks may affect whether an incumbent undertaker will have the ability to provide services to its customers if it undertakes an infrastructure project. The Secretary of State has identified the following risks as being particularly relevant to the TTT Project:

- (a) scale risk, arising from the size of the TTT Project in the context of the whole of the incumbent undertaker’s business;
- (b) construction risk, arising from the nature of the TTT Project’s construction works in the context of the works usually undertaken by the incumbent undertaker;
- (c) management risk, arising from the type and scale of management resource necessary to manage the TTT Project in the context of the management resources necessary to manage the rest of the incumbent undertaker’s business; and
- (d) regulatory risk, arising from the duration of the TTT Project in the context of the usual duration of capital works in the incumbent undertaker’s business.

Scale risk

The Secretary of State considered (in his draft reasons) TWUL’s investment programme for 2010 to 2015. This programme had a cost of £5.5bn, leading to a regulated capital value (“**RCV**”) for TWUL at the end of this period of £11bn, funded approximately 75% by debt and 25% by equity. The largest single project (the Lee Tunnel Project at £635m) was 12% of the overall capital expenditure in that period and 6% of TWUL’s total RCV. If the Lee Tunnel Project were to have failed, it is likely that TWUL’s balance sheet could have accommodated the failure.

The Secretary of State noted (in his draft reasons) in contrast that the TTT Project would form 30% of RCV, with peak annual expenditure of £500m to £900m. Such a concentration of risk in a single project would increase the risk profile of TWUL by comparison with the normal profile in an undertaker, with a portfolio of projects that are significantly smaller than the TTT Project and which would spread the risk.

Construction risk

The Secretary of State also considered (in his draft reasons) the TTT Project against the capital programmes of water and sewerage companies (“WASCs”) which typically involve assets of lesser scale than the TTT Project, and with limited and well understood technical risks. While the evidence of tunnel works being delivered on time and to cost is mixed, and tunnelling techniques have improved over the years, underground construction carries higher risks than construction above ground. The Secretary of State concluded (in his draft reasons) this is partly due to the consequences to above-ground structures if things go wrong and partly due to the difficulty of assessing all of the geological risks before tunnelling starts.

The Secretary of State considers (in his draft reasons) that the TTT Project (which is approximately 25km long, passes through central London and goes under a large number of both underground and above-ground assets) has a construction risk profile which is higher than TWUL’s normal construction works, and is higher – both in total and per km of construction – than the Lee Tunnel Project, whose course takes it under fewer valuable assets. If delivered by an IP, this risk is concentrated in the £2.8bn of work that is proposed for the IP, rather than in TWUL.

Management risk

The Secretary of State also concludes (in his draft reasons) that the size of the TTT Project is also likely to lead to increased management risk, as the size and rapidity of expansion of capital expenditure would put significant stress on TWUL’s management and governance. The Secretary of State recognises that TWUL would have to seek increased management capacity and its governance structures would need to ensure it gave sufficient attention to the TTT Project. Given the very different nature of a construction project from its normal business, the Secretary of State has concluded that these requirements would pose an increased risk to TWUL’s ability to manage its business to a satisfactory standard.

Regulatory risk

The Secretary of State also considered (in his draft reasons) typical capital works in the sector, which can usually be completed within any one five-year price review period. However, the duration of construction of the TTT Project will extend beyond a single regulatory period. The Secretary of State noted in his draft reasons that this would mean that unless adaptations to the regulatory regime were made, TWUL would need to commit to a substantial proportion of the investment without knowing what return it could expect.

The Secretary of State considers in his draft reasons that if the TTT Project were to be undertaken within TWUL, the foregoing factors would increase the company’s risk profile to the extent that it would threaten its ability to provide services to its customers. The Secretary of State considers that the likely consequence for TWUL’s credit rating should it undertake the TTT Project would be that TWUL’s rating would be downgraded, with a significant risk that it could lose its investment-grade rating in the absence of mitigating action. The Secretary of State also notes that this downgrade would take place at the time TWUL was trying to access the markets for the large quantities of capital required to build the TTT Project. Without remedial action to restore TWUL to investment grade, those capital markets would almost certainly be closed to TWUL. The market for sub-investment grade would be unlikely to meet the need.

The Secretary of State also notes in his draft reasons that in this situation (i.e. credit rating downgrade) it is likely that TWUL would breach an appointment condition (such as the requirement to use reasonable endeavours to ensure that it maintains an investment-grade credit rating) or statutory duty, which could, in turn, lead to its being placed in special administration. The Secretary of State further considers in his draft reasons that the reasonable possibility that undertaking the TTT Project within an established WASC could lead to special administration illustrates one threat to TWUL’s continued ability to provide services to its customers, which leads to him concluding in his draft reasons that the scale and risk profile of the TTT Project make it unlikely that if it were undertaken by TWUL without Government intervention, TWUL would

have its credit rating downgraded, probably to sub-investment grade, and would be unlikely to be able to raise sufficient finance to remedy this and meet its TWUL Licence conditions at a cost that would be acceptable to customers. In his draft reasons, the Secretary of State has therefore concluded that the TTT Project is of a size or complexity that threatens TWUL's ability to provide services to its customers and so meets the Size or Complexity condition set out in the Regulations.

The VfM condition

The VfM condition, set out above, requires the Secretary of State to compare the likely VfM of the TTT Project delivered within TWUL with the likely VfM of the TTT Project delivered by an Infrastructure Provider. It requires the Secretary of State to take into account the likely costs to customers and the likely costs to taxpayers.

In his draft reasons, the Secretary of State concludes that it is likely that delivery of the TTT Project through an Infrastructure Provider would lead to better value for money for customers than if the TTT Project were delivered through TWUL. The main reason for him reaching this conclusion is that if the TTT Project were delivered through TWUL, the TTT Project's higher than usual risks would affect the entirety of TWUL's business and so would increase the cost of financing for all of TWUL's investments. This risk is concentrated in the works associated with the £2.8bn of costs proposed to enable up to £1.4bn of the TTT Project to be undertaken by TWUL through a Preparatory Work Notice. It is also likely that delivery of the TTT Project through either scenario would require the taxpayer to taken on similar contingent liabilities. But the consequences of those risks materialising would be likely to be greater if the TTT Project were delivered through TWUL with the taxpayer exposed to greater costs.

The Secretary of State therefore concludes in his draft reasons that specifying the infrastructure project is likely to result in better value for money than would be the case if the infrastructure project were not specified, including taking into account:

- (a) the charges fixed or likely to be fixed under Chapter 1 of Part 5 of the WIA (financial provisions, charges); and
- (b) the powers of the Secretary of State under section 154B of the WIA (financial assistance for major works).

Specification notices and Regulation 5 notices

As part of the specification consultation, the Secretary of State has published a draft specification notice and a draft Regulation 5 Notice (also known as a "**Preparatory Work Notice**"). Once specified, the incumbent undertaker is prohibited under Regulation 5 from undertaking that infrastructure project, although the Secretary of State or Ofwat may permit or require it to undertake such preparatory work as they may set out by notice in writing. Alongside the specification consultation the Secretary of State also consulted on his draft reasons for issuing a Regulation 5 Notice and published a draft Regulation 5 Notice setting out the preparatory works. The Secretary of State and Ofwat may vary or revoke notices issued by them under Regulations 4 or 5.

Obligation to tender

Regulation 6 requires the incumbent water or sewerage undertaker to put a specified infrastructure project out to tender. The ordinary procurement rules may apply to such a tender. Where those rules do not apply or in certain other circumstances, the SIP Regulations apply (with modifications) certain provisions of the Utilities Contracts Regulations 2006 (S.I. 2006/6) for that tender process. Those provisions are set out in Schedule 2 to the SIP Regulations.

Associated companies

Regulation 7 limits companies associated with the water or sewerage undertaker from bidding in the tender process except where agreed by the Secretary of State or Ofwat by notice in writing. The Secretary of State and Ofwat may vary or revoke any notice issued by them under Regulation 7. The power to issue notices is subject to certain procedural requirements and transitional provisions.

Designation of the Infrastructure Provider

Regulation 8 gives the Secretary of State and Ofwat power to designate by notice in writing a person wholly or partly responsible for a specified infrastructure project which has been put out to tender in accordance with the SIP Regulations. The “infrastructure provider” may then be licensed and regulated as set out in Schedule 1 of the SIP Regulations. The Secretary of State and Ofwat may vary or revoke any notice issued by them under regulation 8. The power to issue a designation notice and to grant an IP Project Licence is subject to certain procedural requirements.

Information requirements

Regulation 9 requires water and sewerage undertakers and infrastructure providers to provide the Secretary of State with such information as may be reasonably required for the purposes of carrying out their functions under the SIP Regulations.

Enforcement

Regulation 10 provides that duties on an undertaker or licensed infrastructure provider under the SIP Regulations are enforceable under the enforcement regime in WIA (as applied by the SIP Regulations).

Review of effectiveness

Regulation 11 requires the Secretary of State to review the operation and effect of the SIP Regulations and publish a report within five years after the SIP Regulations come into force. Following the review it will fall to the Secretary of State to consider whether the SIP Regulations should be allowed to expire as Regulations 1(2) and (3) provide, be revoked early, or continue in force with or without amendment. A further instrument would be needed to continue the SIP Regulations in force with or without amendments or to revoke them early.

Ring-fencing

As set out above, once a project is specified under the SIP Regulations, the incumbent undertaker must put it out to tender to a third party IP and the incumbent undertaker is prohibited from undertaking the TTT Project.

In particular, SIP Regulation 5 prohibits an incumbent undertaker from undertaking an infrastructure project which has been specified by the Secretary of State under Regulation 4(1) of the SIP Regulations. The prohibition is subject to an exception whereby the Secretary of State may, by notice, permit or require the incumbent undertaker to undertake preparatory works set out in a notice issued by the Secretary of State. The effect of this prohibition is to preserve TWUL’s ability to provide its core services in accordance with the TWUL Licence and water industry legislation and to shield TWUL from risks arising from the carrying out of the TTT Project.

Regulation 5 of the SIP Regulations does allow the Secretary of State to permit or require an incumbent undertaker to undertake certain preparatory works. The Secretary of State has issued a draft Regulation 5 notice as part of the consultation process which covers acquisition of land, carrying out of surveys, utilities diversions, obtaining DCO, completing the specification, procurement activities and site preparation.

Thus the effect of this TTT Project being a specified infrastructure project under the SIP Regulations would be to prohibit TWUL from undertaking the TTT Project, effectively ring-fencing risks associated with the design, construction and financing of the TTT Project in the IP vehicle.

WIA section 94 obligations

As set out above, section 94 of the WIA sets out a general obligation on sewerage undertakers to comply with the provisions of the UWWTR by providing, maintaining, emptying and disposing of the contents of the sewerage system owned by the undertaker.

Provided TWUL complies with its obligations to ensure all necessary arrangements are made in relation to the TTT Project, as set out in the SIP Regulations (which gives effect to section 94 of the WIA with modifications) and under the relevant contracts, it should discharge its obligations under section 94 of the WIA in respect of the TTT Project by entering into the arrangements with the IP. A description of the works necessary to give effect to the TTT Project from TWUL's perspective are set out below.

When the TTT Project is specified, TWUL will “ensure all necessary arrangements are made” by putting the TTT Project out to tender, running the procurement process in accordance with the SIP Regulations, entering into the contractual framework with TTT Project stakeholders, and performing the emptying and treatment of sewage during the operational period of the TTT Project (through the London Tideway Improvements).

Enforcement of obligations

With regard to the TTT Project tendered to the IP, enforcement of the IP's regulatory obligations to carry out the TTT Project will be carried out by Ofwat and not by TWUL. If the IP fails to deliver the TTT Project in accordance with IP Project Licence, enforcement action would be taken directly against the IP. Where Ofwat fails to take enforcement action against the IP and the impacts of the IP's failure would cause TWUL to be in breach, for example, of its environmental permits, it is judged unlikely that Ofwat or the EA would be able to enforce against TWUL. This is because enforcement against TWUL would probably not be best calculated to ensure that the functions of the IP are properly carried out, and would be in contravention of Ofwat's general duties set out in section 2(2A)(c) of the WIA. To ensure that the IP functions are carried out, Ofwat would need to take enforcement against the IP. For this reason, it is currently anticipated that a separate enforcement guidance note will be issued jointly by Ofwat and the EA.

However, TWUL remains liable where it has an obligation to perform part of the works or where it has contractual obligations or regulatory outputs to perform on its own account. In such circumstances, Ofwat or the EA, as the case may be, may take enforcement action against TWUL in the ordinary way as this would be best calculated to ensure that the functions of the water and the sewerage undertaker were performed.

Planning

Under the Planning Act 2008, a DCO is required to authorise the construction and use of nationally significant infrastructure projects (a “**NSIP**”). Developments relating to the transfer of water resources and the construction of waste treatment plants which will exceed specified thresholds are included in the list of NSIPs. Under the Localism Act 2011, the functions of the Infrastructure Planning Commission transferred to the Planning Inspectorate (“**PINS**”) on 1 April 2012, and to whom applications for DCOs must now be made.

The TTT Project has been designated as a NSIP and an application was made to the PINS on 28 February 2013. The application is currently subject to a planning inquiry hearing which is expected to last until March 2014. A DCO grant is currently anticipated to occur in August 2014. See “*Risk Factors – Risks associated with the DCO*”.

Part 3 - Implementation of the TTT Project within the legal and regulatory regime

TWUL's obligations

TWUL is the licensed water and sewerage undertaker for the London region pursuant to the Water Industry Act 1991 (the "WIA").

TWUL will undertake a number of activities during the life of the TTT Project, including:

- (a) preparing the concept and specification works and appointment of specialist consultants in respect of such works as part of its regulatory obligations pursuant to the PR09 final determination;
- (b) conducting preliminary site investigation works as preparatory work pursuant to the proposed Regulation 5 Notice;
- (c) agreeing with Ofwat the strategy for acquisition of freehold and/or leasehold land and the terms on which such land is acquired and disposed as part of its regulatory obligations pursuant to the PR09 final determination and the TWUL Licence;
- (d) prior to the appointment of the IP, negotiating Asset Protection Agreements with affected parties for the protection and preservation of existing third party assets which are, or are likely to be, affected by the construction of the TTT Project as preparatory work pursuant to the proposed Regulation 5 Notice;
- (e) agreeing the strategy for obtaining planning consents as preparatory work pursuant to the proposed Regulation 5 Notice;
- (f) as preparatory work pursuant to the proposed Regulation 5 Notice, developing and applying for the DCO (i.e. planning permission);
- (g) as preparatory work pursuant to the proposed Regulation 5 Notice during the procurement phase, developing the procurement strategy and undertaking the procurement of the IP and initiating (on behalf of the IP) the procurement of construction works;
- (h) procuring and financing enabling works and certain interface works, including appointment of appropriate contractors to carry out those works in accordance with the terms of the Interface Agreement as more fully described below in Cat 2 and Cat 3 works;
- (i) agreeing the scope of the TTT Project with the Environment Agency and Ofwat as part of its regulatory obligations pursuant to the PR09 final determination;
- (j) collecting revenue from customers and paying the IP Charges to the IP in accordance with the terms of the Revenue Agreement;
- (k) reporting to the Liaison Committee as required under the terms of the Liaison Agreement;
- (l) recognising its role in operating the Thames Tideway Tunnel following construction and its responsibility for complying with the environmental permits, playing a role in the commissioning of the Thames Tideway Tunnel to assess the ability of the Thames Tideway Tunnel in meeting the environmental permits as part of TWUL's ongoing obligations pursuant to s94 of the WIA;
- (m) following completion of construction of the Thames Tideway Tunnel, operating the overall system (i.e. the entire sewerage network), of which the Thames Tideway Tunnel forms a part and ensuring compliance with the environmental permits; and
- (n) following completion of construction, maintaining the plant and equipment within the Thames Tideway Tunnel and the Lee Tunnel in accordance with the terms of the O&M Agreement.

Role of the Infrastructure Provider

The IP will be responsible for the design, construction and financing of the IP Works and the financing, operation and maintenance of the Thames Tideway Tunnel civil structures (being the tunnels and shafts) but not the other Thames Tideway Tunnel assets such as the penstocks, valves, pumps and other operational plant (for which TWUL will retain operation and maintenance responsibility).

The IP will be a special purpose vehicle set up for the purposes of delivering the TTT Project, and the TTT Project will be its regulated business. The IP will be controlled by different shareholders (even though some shareholders may be common to both) from TWUL, and TWUL will have no direct or indirect corporate control over the IP's activities, although it is proposed that there will be contractual interfaces between IP and TWUL. The IP will have no recourse to TWUL other than the contractual relationship between the two.

It is envisaged that the IP will be directly regulated by Ofwat pursuant to the SIP Regulations and the WIA and the terms of the IP Project Licence.

In order to deliver the TTT Project, the IP will need to enter into a number of contracts for works and services. For example, contracts for construction (the “**Main Works Contracts**”) and for operation and maintenance of the Thames Tideway Tunnel. It will also enter into an Alliance Agreement which is intended to govern the way in which the relevant project parties will work together and incentivise behaviours to promote the overall success of the TTT Project. It will further enter into certain contracts in connection with UK Government contingent financial support, as described further below.

The IP will be responsible for raising debt and equity financing for the TTT Project. UK Government contingent financial support will be provided by the Secretary of State to both the IP shareholders and its debt providers. Furthermore, the IP will be required to maintain appropriate commercial insurance cover.

Part 4 – Impact on TWUL of the IP delivery model

TTT Project management structure

Management Structure

A discrete, dedicated Thames Tideway Tunnel co-ordination team is required within TWUL during the construction phase of the TTT Project to represent TWUL's interests and oversee the meeting of TWUL's obligations in the core contracts. The intention is to have a separate and dedicated management team to minimise management distraction of the core TWUL management in respect of the TTT Project.

Capability of TWUL to deliver TWUL obligations in connection with the TTT Project

TWUL is experienced in managing large infrastructure projects and has been investing in comprehensive and complex capital works programmes to upgrade and create new assets since privatisation 23 years ago. TWUL's ongoing capital works programme comprises a capital investment of approximately £1 billion worth of works each year.

TWUL is currently in the process of delivering the Lee Tunnel as part of its AMP5 capex programme. The Lee Tunnel and current enhancements to the Beckton Sewage Treatment Works (Europe's largest) being undertaken by TWUL are themselves a £1 billion investment at one site.

The TWUL Thames Tideway Tunnel co-ordination team will be responsible for matters such as TWUL transition; Cat 2 works (which are enabling works which need to be completed before the IP has been appointed); Cat 3 works (which are interface works which need to be completed after the DCO has been issued); land acquisition; regulatory funding; and management of the core contracts.

The interface works with the existing sewerage system can be complex especially at pumping station sites and TWUL's operational and asset knowledge is considered key to managing the design and construction of those elements and protecting existing assets. This will be achieved by a combination of TWUL corporate resources, the TWUL capital delivery team and the Thames Tideway Tunnel co-ordination team. In particular, the Cat 3 works (interface works) will be overseen by the TWUL capital delivery team who will procure the works under the newly formed AMP6 Alliance it has established. The AMP6 Alliance is an alliance comprising seven experienced industry contractors (Atkins, Balfour Beatty, Costain, IBM, MWH, Skanska and Veolia) who, together with TWUL, may deliver a significant proportion of TWUL's capital investment programme during AMP6 (2015 to 2020) and potentially into AMP7 (2020 to 2025).

Support from CH2M Hill on the TWUL works

In 2008, following a competitive tender, TWUL appointed CH2M Hill as its project management adviser for the TTT Project and to perform programme management and performance management services, including programmatic design management, value engineering, design reviews and constructability reviews.

As programme manager, CH2M Hill is contracted to provide support through all phases of the TTT Project, including planning consents, preliminary and final design, construction management, stakeholder communication, commissioning and start-up of new facilities.

CH2M Hill has been operating in the UK for more than 22 years and has experience acting on a range of similar projects around the world, including Thames Tideway Tunnel sister project, the Lee Tunnel, in East London, and to which the Thames Tideway Tunnel will connect. The four mile Lee Tunnel is London's deepest ever tunnel and will link Abbey Mills Pumping Station to Europe's largest sewage treatment works in Beckton.

In addition to the Lee Tunnel, CH2M Hill has recent experience on the following projects:

- (a) Singapore Deep Tunnel Sewerage System – tunnelling beneath an urban environment with a wide range of geology to deliver 30 miles of sewer tunnels up to 6m in diameter and 50m deep;
- (b) Milwaukee Pollution Abatement Programme – the first successful city-wide deep-tunnel combined sewer overflow system implemented in the United States; and
- (c) Abu Dhabi Sewerage Services Company's Strategic Tunnel Enhancement Programme.

Notwithstanding its role as the project manager for the IP Works, it is currently envisaged that CH2M Hill will continue to deliver the project management services for the Cat 2 works.

TWUL Licence amendments to accommodate TTT Project – Overview

In order to give effect to a TTT Project delivered using an IP, the conditions in the TWUL Licence will require some amendments.

It is anticipated that amendments will be made to:

- (a) allow TWUL to pass through revenues collected in respect of the IP Charges collected from TWUL's wastewater customers;
- (b) allow TWUL to pass through to TWUL customers the cost of any land acquisition or lease on the basis of no pain/no gain;
- (c) exclude the IP assets from TWUL's asset management plans;

- (d) exclude the revenue in respect of the IP Charges from TWUL's revenues for the purposes of determining the level of any fines or the materiality threshold in any IDoK or substantial adverse effect or substantial favourable effect application; and
- (e) provide for a mechanism to deal with revocation of the Project Specification Notice.

TWUL Licence amendments – Detail

The TWUL Licence will be modified in order to facilitate the SIP Regulations, the specification and performance of the TTT Project and the designation and licensing of the IP. These modifications are being agreed as between TWUL and Ofwat and will be made by way of insertion of a new Condition T into the TWUL Licence. Broadly, Condition T (Thames Tideway Tunnel Project) will set out:

- (a) the modifications to existing Condition A (Interpretation and Construction), Condition B (Charges), Condition D (Charges Scheme) and Condition L (Underground Asset Management Plans); and
- (b) new provisions which will apply on revocation of the Project Specification Notice.

These modifications, which will apply from the commencement of the TTT Project, are described in further detail below.

Condition A – Interpretation and Construction

Condition A sets out the defined terms and the rules of interpretation for the TWUL Licence conditions.

The definition of “Regulated Activities” in paragraph 3 of Condition A will be amended to expressly carve out the functions of the IP in carrying out and completing the TTT Project and maintaining the TTT Project assets as set out in the Project Specification Notice.

The purpose of this modification is to ensure that TWUL's obligations in respect of its “Regulated Activities”, for example in relation to accounting and reporting or payment of fees to Ofwat, do not apply in respect of the activities the IP undertakes pursuant to the IP Project Licence.

Condition B – Charges

Condition B sets out the charges regime whereby Ofwat conducts periodic reviews every five years to set price controls for the charges to be levied by TWUL to its customers.

Condition B will be amended to enable TWUL to collect from its sewerage customers the IP Allowed Revenue and to then automatically pass that revenue on to the IP.

Specifically, the modifications will:

- (a) enable TWUL to levy charges for the purpose of collecting the IP Allowed Revenue calculated pursuant to the IP Project Licence for the relevant charging year and to be paid by TWUL to the IP pursuant to the Revenue Agreement;
- (b) provide for the amount which TWUL must collect to automatically update for any change in the IP Allowed Revenue under the IP Project Licence;
- (c) require TWUL to pass the relevant amounts to the IP on a monthly basis in accordance with the Revenue Agreement;
- (d) require Ofwat to direct TWUL as to how to treat any IP Allowed Revenue which TWUL cannot pass on to the IP, for example due to Discontinuation or special administration (as discussed below); and
- (e) ensure that collection of the IP Allowed Revenue shall not be deemed to constitute funding for TWUL to carry out the TTT Project.

Condition B will also be amended to ensure that it reflects the arrangements for disposals of land as required by the TTT Project (including the agreed principle of “no pain/no gain”, whereby both gains and losses arising from acquisition, rental or disposal of TTT Project land are not borne by TWUL but are instead passed to customers).

Condition D – Charges Schemes

Condition D relates to the charges scheme which TWUL is required to produce under section 143 of the WIA in order to give effect to TWUL’s charging powers under section 142 of the WIA. Among other things, Condition D requires TWUL to ensure that its charges scheme “fixes the charges to be paid for the drainage of premises for domestic purposes” (unless TWUL already has agreements in place with all the customers being charged).

A new paragraph 2.1(3) will be inserted into Condition D to enable TWUL’s charges scheme to also fix the charges to be collected by TWUL in respect of the IP Allowed Revenue.

Condition L – Underground Asset Management Plans

Condition L requires TWUL to prepare and submit an Asset Management Plan to Ofwat showing an estimate of the required expenditure on “Network Assets” for each year as is necessary to enable TWUL to carry out the Regulated Activities (as defined in Condition A).

The definition of “Network Assets” in Condition L will be amended to expressly carve out the TTT Project structures which are owned, operated and maintained by the IP (including the tunnels and shafts) under the terms of the Project Specification Notice and the O&M Agreement.

The purpose of this modification is to ensure that TWUL’s obligations with respect to its Asset Management Plan do not extend to TTT Project structures owned by the IP.

Additional new provisions

In addition to the modifications to existing Conditions outlined above, the new Condition T will also set out new provisions which will apply in certain TTT Project failure scenarios, namely Discontinuation, special administration, and/or revocation of the Project Specification Notice, IP Designation Notice or IP Project Licence.

The purpose of these new provisions is to clarify TWUL’s obligations in a TTT Project failure scenario (and in particular, the cessation of the modification to Condition B which requires TWUL to collect the IP’s allowed revenue, described above).

Specifically, these new provisions in Condition T will provide that:

- (a) if the TTT Project is Despecified:
 - (i) the modifications to the TWUL Licence which relate to the TTT Project (as outlined above) automatically fall away, including TWUL’s obligation to collect the IP Allowed Revenue; and
 - (ii) Ofwat will, having consulted TWUL, direct TWUL as to the treatment of any IP Allowed Revenue collected by TWUL which TWUL has not already passed on to the IP;
- (b) if the TTT Project is not Despecified, but a Discontinuation Notice is issued or the IP is De-designated and/or placed into special administration (without either rescue as a going concern or transfer to a new replacement infrastructure provider), Ofwat will, having consulted TWUL, direct TWUL as to:
 - (i) the extent to which the modifications to the TWUL Licence which relate to the TTT Project (as outlined above) still apply; and

- (ii) if necessary, the treatment of any IP Allowed Revenue collected by TWUL which TWUL has not already passed on to the IP; and
- (c) if the Project Specification Notice is revoked, TWUL must:
 - (i) secure the IP Works and TWUL Works (and TWUL is entitled to funding through its price control to do this); and
 - (ii) present a proposal to the Secretary of State and Ofwat:
 1. which addresses the issue of sewerage discharges into the River Thames with a view to securing compliance with the UWWTR;
 2. which must consider, and be considered in view of, specified factors, including the obligations of TWUL, Ofwat and the Secretary of State pursuant to the WIA and the TWUL Licence, and the need for TWUL to finance its functions; and
 3. which may include elements of the TTT Project as TWUL deems appropriate,

the implementation of which is subject to TWUL having been awarded additional funding through either a determination by Ofwat or following a reference to the Competition and Markets Authority pursuant to Condition B.

TWUL Works

PR14 Settlement

TWUL is currently involved in the business planning cycle for PR14. TWUL submitted its business plan to Ofwat in December 2013. TWUL has included all of the TWUL Works set out in this section in its PR14 business plan submission. It is currently engaging with Ofwat on the feedback from Ofwat's risk-based review, and expects to provide an update to various elements of its business plan, including those for the TTT Project, in June 2014.

The procurement and delivery of the works are divided between TWUL and the IP each of whom will be responsible for the associated financing of those works.

Development of the TTT Project and procurement

The construction works to be delivered have been divided into three categories:

- (a) Category 1 (“**Cat 1**”) works will be delivered by the IP and comprise the main works to be undertaken by the IP. This is predominantly the drop shafts, main tunnel, connection tunnels and associated works. These works will be funded by the IP. The Cat 1 works will be delivered by the IP via three Main Works Contracts (design and build contracts using the NEC3 form of contract) – East, Central and West. A MEICA framework contractor acts as a sub-contractor to each Main Works Contractor to ensure standardisation across all sites and a SCADA contractor will be responsible for integrating each of the sites into a single CSO control system.
- (b) Category 2 (“**Cat 2**”) works will be delivered by TWUL and are enabling works which do not require the DCO to be granted. These works will be funded by TWUL under its PR14 Business Plan and are business as usual works. The Cat 2 works are predominantly utility diversions and will be delivered via contracts let by TWUL and subsequently novated to the IP if not completed by the date of IP Project Licence award.
- (c) Category 3 (“**Cat 3**”) works will be delivered by TWUL and are mainly interface works with the existing TWUL infrastructure which require the DCO to be granted. These works will be funded by

TWUL under its PR14 Business Plan and are business as usual works. The Cat 3 works are predominantly works which interface with TWUL's existing assets and are likely to be delivered via TWUL's AMP6 Alliance arrangements.

Enabling Works – Cat 2 Works

The enabling works are those works required to be undertaken by TWUL prior to the commencement of the main and interface works, and include such activities as site preparation (including getting power to the sites), demolition, remediation, utility works (diversion and supply) and surveys. As stated above, these are business as usual works.

The enabling works are currently required or permitted to be performed by TWUL under the draft Regulation 5 notice which specifies the preparatory works an incumbent undertaker is able to carry out in respect of a specified project. The draft Project Regulation 5 Notice sets out the preparatory works TWUL is permitted or required to carry out.

Enabling works to be procured and financed by TWUL (through the regulatory settlement mechanism in the TWUL Licence) are expected to include:

- (a) key utility diversions (assuming utility companies are willing and able to carry out such works under their powers of permitted development);
- (b) power supply to main tunnel drive sites (Carnwath Road Riverside; Kirtling Street; Chambers Wharf) and the long connection tunnel drive site at Greenwich Pumping Station;
- (c) surveys (e.g. archaeological; asbestos; heritage; condition);
- (d) site preparation (minor demolition, clearance work and access roads within TWUL operational sites) pending compliance with planning legislation; and
- (e) protection of third party infrastructure (Thames Water Ring Main & Lee Raw Water Tunnel, National Grid assets).

It should be noted that the Cat 2 works will be commenced by TWUL but some (such as ongoing survey requirements and power supply) may be passed to the IP when it takes control of the sites.

These works are currently scheduled to commence in April 2014 and to complete in October 2019 and they are the types of works which TWUL is accustomed to deliver as part of its core business.

Interface Works – Cat 3 Works

Cat 3 works are modifications to TWUL's assets at sites where the IP will not be working. The works required at each of the sites are different, depending on the conditions within and surrounding the relevant interface point.

The works to be procured and financed by TWUL (through the AMP6 Alliance) are discrete packages, readily separable and/or independent from the main works, typically on land owned by or accessible to TWUL, and/or able to be progressed independently of the main works. The AMP6 Alliance that will be contracted to carry out these works will be monitored by the TWUL capital delivery team who will assist in planning the Cat 3 works and monitor and review execution to ensure they are completed to the required standard and will enable the acceptance tests to be passed. TWUL will procure and finance various aspects of the interface works in order to facilitate and enable the main construction works. These aspects include:

- (a) works at Shad Thames Pumping Station – including diversion, protection or abandonment of existing TWUL assets and diversion of other utilities and privately owned services;

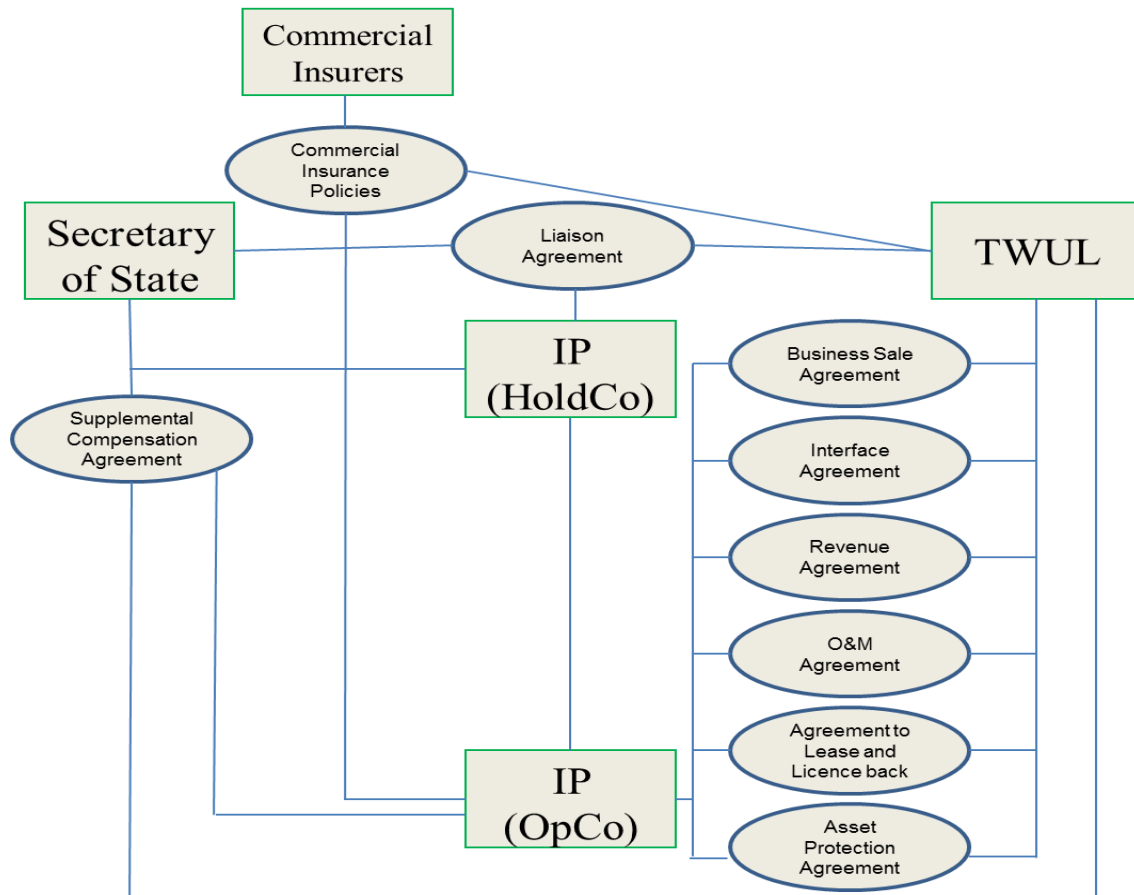
- (b) works at Bekesbourne Street – works to modify the existing sewer, including installation of a new chamber and hydraulic structures within the sewer, installation of an electrical control kiosk and ventilation works;
- (c) works at Beckton Sewage Treatment Works – these works encompass a significant element of Mechanical Electrical Instrumentation Controls Automation (“MEICA”) to enable flows to be transferred to the head of Beckton sewage treatment works and/or the tunnel from the existing Lee Tunnel pumping station;
- (d) Sewerage system CSO weir adjustments at eight sites;
- (e) Western Pumping Station operational adjustments; and
- (f) relocation of river boats at Victoria Embankment Foreshore and Blackfriars Bridge Foreshore and related work.

In addition to the works set out above, TWUL will also be providing services to assist in the delivery of the Thames Tideway Tunnel Project, such as the procurement of the construction contracts, the DCO planning application and the land acquisition services, which are described more fully below. As for TWUL Works, TWUL has included the costs of providing such services within its PR14 Business Plan.

Summary of the TTT Project contractual structure

In order to facilitate the IP delivery model, TWUL will need to enter into the following contracts as set out in the diagram below.

TTT Project – Overview of Contractual Structure



A short summary of the contents of those agreements is contained below.

Business Sale Agreement

In order to maximise the competition for the infrastructure provider or IP, TWUL has set up a separate division for the IP procurement and a special purpose vehicle owned by the Kemble Group (to manage certain transition activities and avoid conflicts of interest in the transition phase). As part of the procurement of the IP, the Kemble Group is in the process of enabling a smooth transition to the incoming infrastructure provider by setting up a number of systems, including IT and payment systems, employment of key staff for the IP and employment of a management team. In order to transfer the benefit of these arrangements to the IP, TWUL or the Kemble Group (as appropriate) will enter into a business sale agreement to transfer over to the IP any assets held by the TWUL division or Kemble Group which are necessary for the IP in order to enable it to continue to develop the project and which are not required by TWUL. The nature and extent of the assets is limited in scope to information, systems, employment contracts and the lease of the current office premises of the TTT Project.

Interface Agreement

TWUL will manage the operational interface of the TTT Project with the rest of the sewerage system. This will be relevant during construction, commissioning and operation, as the works as well as the completed asset will connect to the live sewerage network and thus will involve an element of operational interface. The IP will procure the main tunnelling works and TWUL provides certain enabling and interface works.

The interface agreement (the “**Interface Agreement**”) requires the IP to develop a commissioning plan and TTT Project Acceptance plan setting out how it will establish that the completion and TTT Project Acceptance tests have been satisfied. The IP and TWUL will each conduct the “dry tests” in respect of their respective works prior to the IP conducting “wet testing” to establish that Handover has been achieved. TWUL will then be responsible for conducting the TTT Project Acceptance tests.

The “Access Protocol”, to be set out in a schedule to the Interface Agreement, will set out the protocol between TWUL, the IP and contractors for agreeing on the timing of works which will require access to sites in relation to which there are operational interface issues.

In addition, the Interface Agreement will allow each of TWUL and the IP to suspend the works and instruct the other or the Main Works Contractors to pull their employees and sub-contractors out of the relevant working areas if this is required due to an emergency, health and safety or as a result of an operational requirement. For example:

- (a) where flows are diverted from one sewer to another (including storm relief sewers) for operational reasons to gain access for minor and capital work and regular maintenance of fixed assets;
- (b) where flows are diverted or held back for surveys and inspections (for TWUL and third parties); and
- (c) where flows are to be diverted for the installation of optic fibre cabling (such diversions may be implemented for several days and sometimes for weeks).

The Interface Agreement and O&M Agreement will each contain indemnities granted by each of TWUL and the IP in favour of the other. These indemnities protect:

- (a) TWUL against loss or damage caused to TWUL’s assets arising from or in relation to the performance or non-performance of the IP’s works;
- (b) TWUL against loss or damage to TWUL’s works to the extent caused, or contributed to, by the IP’s default, negligence or breach of duty; and

- (c) the IP against loss or damage caused to the IP Works arising from or in relation to the performance or non-performance of the TWUL Works,

in each case to the extent that the party suffering the loss has not been able to recover under the TTT Project insurances or the Supplemental Compensation Agreement. TWUL is an indirect beneficiary of the Supplemental Compensation Agreement (see below). There is a risk that damage caused is uninsurable and therefore not covered by the Government contingent financial support.

The Asset Protection Agreement

TWUL will also be the beneficiary of an asset protection agreement from the IP (the “**Asset Protection Agreement**”), in which the IP will agree to indemnify TWUL for damage caused to its existing assets caused by the IP and the IP Works.

The Alliance Agreement

The Alliance Agreement will be entered into by TWUL, the IP and each of the contractors for the Eastern Main Works Section, the Central Main Works Section, the West Main Works Section, SCADA and MEICA and will set out the basis on which the parties will co-ordinate work schedules to perform, and manage the interfaces between, their respective activities in accordance with the TTT Project master programme.

The Alliance Agreement also provides, in the Alliance Board, a mechanism for the parties to manage the risks involved in performing the IP Works and TWUL Works, and in the payment of the Alliance Fee, a mechanism to ensure that Handover is achieved on time.

Liaison Agreement

The Liaison Agreement is an agreement between TWUL, the IP and the Secretary of State and governs the relationship between the various TTT Project documents to be entered into by the parties. TWUL, the IP and the Secretary of State form the “**Liaison Committee**” and Ofwat and the EA may be invited to attend its meetings.

The Liaison Agreement sets out the framework for the Liaison Committee; a forum through which stakeholders can engage on issues affecting the TTT Project. TWUL and the IP are required to report, at least quarterly, to the Liaison Committee on a wide variety of matters affecting the TTT Project, including, amongst other things, expenditure on the works predicted cost overruns; any delays to timetable; and claims.

The Liaison Agreement sets out the role of the independent technical adviser in scrutinising the IP’s submissions to the Liaison Committee and stipulates the mechanism for dealing with any predicted cost overruns on the IP Works.

The Liaison Agreement also describes the circumstances in which the TTT Project may be Discontinued.

Operation and Maintenance – O&M Agreement

The O&M Agreement is an agreement between TWUL and the IP and grows the relationship between TWUL and the IP during the operational period (the “**O&M Agreement**”). The O&M Agreement commences on Handover and sets out which entity has responsibility for operating and maintaining the Thames Tideway Tunnel assets from that time.

It is proposed that the IP will operate and maintain the civil structures of the Thames Tideway Tunnel (being the tunnels and shafts) in such manner as to keep them free from sediment and allow flows to pass along the tunnel up to the connection with the Lee Tunnel whilst maintaining the total storage volume in the tunnel and shafts.

The principal maintenance activity undertaken by the IP will be the inspection of the Thames Tideway Tunnel (generally on a 10-year cycle). Inspection of the Thames Tideway Tunnel will generally comprise:

- (a) isolation and lockdown of tunnel system from existing network;
- (b) confirmation of lockdown via site visits and control system; and
- (c) provision of access man-riders and cranes; temporary site compounds; excavation (where necessary) and removal and subsequent replacement of access covers; ventilation and atmosphere monitoring system; determination of sediment accumulation amounts and plan for removal; inspection vehicles; inspection team and support staff; cameras, survey and recording equipment; and inspection report and supporting documentation.

TWUL will assume responsibility for operating and maintaining all other Thames Tideway Tunnel assets other than those operated and maintained by the IP. TWUL will also undertake the operation of the overall London Tideway Improvements (including inlet gates, SCADA systems and pumping stations etc.) and ensure compliance with the environmental permits.

Revenue Agreement

The Revenue Agreement is an agreement between TWUL and the IP. Under the provisions of the SIP Regulations, the IP is entitled to fix the IP Charges for any services provided in the course of carrying out its functions, demand and recover those charges from two potential customers, namely:

- (a) any undertaker which has an agreement with the IP for the supply of sewerage services or works or any undertaker which has the use of any infrastructure which the licensed infrastructure provider owns or operates; or
- (b) following construction of the Thames Tideway Tunnel, the occupiers of premises which:
 - (i) are drained by a sewer or drain connecting, either directly or indirectly, with infrastructure which is owned or operated by the licensed infrastructure provider; or
 - (ii) benefit from facilities that drain to a sewer or drain connecting, either directly or indirectly, with infrastructure which is owned or operated by the licensed infrastructure provider,

unless this is excluded by any agreement to which the licensed infrastructure provider is a party.

These charges can be effected through either a charges scheme approved by Ofwat or by agreement with the persons to be charged.

For the purposes of this TTT Project, it has been agreed that the IP will charge by agreement and will do so by entering into the Revenue Agreement with TWUL pursuant to which:

- (a) the IP will charge TWUL for the services it provides;
- (b) TWUL will recover those charges from wastewater customers (whether directly or through its arrangements with the water only companies (the “WOCs”)); and
- (c) TWUL will only be liable to pay the IP under the Revenue Agreement to the extent it has received those charges from customers or WOCs.

As set out above, the TWUL Licence will be amended to include pass-through provisions which allow TWUL to recover the IP Charges from customers.

Once the TWUL Licence is amended, it is anticipated that TWUL will be allowed to raise a sum equivalent to the IP Charges in addition to charges for its own services, and therefore any increase in the IP Charges

payable by TWUL under the Revenue Agreement will result in an automatic and commensurate increase in the amount TWUL will be entitled to charge wastewater customers under the TWUL Licence.

In any given month under the terms of the Revenue Agreement, TWUL's liability will be to pay a proportion of the revenue collected from customers or the WOCs to the IP. The proportion will be that in any year the proportion which the IP Charges bears to the Total Charges (being the IP Charges and the TWUL wastewater charges together).

As stated above, the IP Charges will be collected by TWUL on behalf of the IP, and passed through on a monthly basis. The IP Charges will be included in TWUL's bills; there will be no separate bills. Accordingly, each month, TWUL will pay to the IP its share of any invoices paid by its wastewater customers in that month. Since the revenue will be passed proportionally to the IP the arrangement currently envisaged in the proposed Revenue Agreement means that bad debt arising from wastewater customers will be split proportionally between TWUL and the IP.

Supplemental Compensation Agreement

The Supplemental Compensation Agreement sets out the basis on which the Secretary of State will support the TTT Project where the limits of indemnity under project insurances are insufficient in terms of quantum.

The Supplemental Compensation Agreement will require that the IP procures the commercial insurances specified in a schedule of approved insurances. If one of the specified insurances becomes commercially unavailable (except to the extent due to certain conduct or claims record), the Secretary of State will provide supplemental compensation protection on an excess of loss basis.

A fee will be charged for supplemental compensation protection, based on a percentage of the aggregate relevant commercial premium rate.

TWUL will be an indirect beneficiary of a Supplemental Compensation Agreement. In the event of damage to TWUL assets caused by the IP, TWUL may claim under the Asset Protection Agreement and the IP may meet such claims from its commercial insurances or, to the extent that the claims were beyond commercial insurances, from its rights under the Supplemental Compensation Agreement.

Overview of Land agreements

The IP will require interests in certain land in order to carry out its functions. TWUL will also need certain land interests in order to carry out its functions. The necessary land interests (both surface and subsoil) will be acquired by TWUL either by compulsory acquisition pursuant to the DCO or by private agreement. Ahead of the issue of the DCO, TWUL is in the process of acquiring necessary land interests by private agreement. These land interests are being acquired by a combination of freehold, leasehold and by obtaining temporary rights depending on a best value for money acquisition strategy.

To secure land pursuant to the compulsory purchase powers, it must be demonstrated that the land or land interest is required for the construction and, where applicable, the future operation of the TTT Project. In addition, the land or interest to be acquired must be no more than, in respect of no greater interest than, nor acquired for any longer than, is reasonably necessary for the TTT Project.

Proposed structure of land interests

Subject to confirmation from Her Majesty's Revenue and Customs as to the tax treatment in respect of the following structure, it is currently envisaged that the land interests will be structured as follows:

- (a) During the construction phase in respect of the surface land where TWUL has a freehold interest, TWUL will retain the freehold interest of the titles and grant a licence to the IP during the construction phase of the project. Where TWUL has only a leasehold interest in the land, TWUL will grant a licence

to the IP during the construction phase of the TTT Project. Where TWUL only has a temporary right to occupy granted under the terms of the DCO, TWUL will grant a partial transfer of powers to the IP to occupy temporarily together with other powers necessary for construction during the construction phase of TTT Project as part of the general transfer of necessary DCO powers to the IP.

- (b) During construction in respect of the subsurface land, TWUL will grant a partial transfer of powers to the IP to occupy temporarily together with other powers necessary for construction during the construction phase of the project as part of the general transfer of necessary DCO powers to the IP. This will not include the power to vest the land in the IP, which will remain with TWUL.
- (c) Following construction completion, TWUL and the IP will identify excess land not required for operation and the exact land required for operation. The excess land will be disposed of by TWUL in accordance with its regulatory obligations.
- (d) In respect of the operational land, TWUL will grant an Agreement for Lease, which will provide for the requirement to grant a long-term lease to the IP once:
 - (i) completion of the construction of the assets has occurred; and
 - (ii) TWUL has the necessary interests vested in it using the vesting powers granted under the DCO.The lease to be entered into will be for a long period (999 years) with the ability to break if the IP's RCV has been fully depreciated within that time. The lease will be terminable if the IP Project Licence is revoked, or the TTT Project is Discontinued or Despecified or if the IP is De-designated.
- (e) TWUL will transfer the DCO powers necessary for operation other than the vesting powers (unless already captured in the construction phase transfer).
- (f) The IP will grant a licence back (sub-licence) to TWUL to enable TWUL to carry out its maintenance activities and to operate the sewerage system as required by statute and regulation.

Protected Land

All land associated with the TTT Project will be protected land within Condition K of the TWUL Licence or the IP Project Licence. This means that the land cannot be dealt with except with regulatory and statutory consents.

Land acquisition costs go to TWUL's RCV and are recovered from TWUL's customers on a "no pain/no gain" basis. The principle of no pain/no gain which has already been agreed between the parties will be captured in an amendment to the TWUL Licence.

Third party liabilities

Asset Protection Agreements

TWUL and the IP will be party to Asset Protection Agreements ("APAs") entered into with affected parties for the protection and preservation of existing third party assets which are, or are likely to be, affected by the construction of the TTT Project. TWUL and the IP will also be party to an APA for the protection and preservation of the assets comprising TWUL's operational network.

It is intended that, on appointment of the IP, TWUL will novate the APAs (other than the agreement in respect of TWUL's assets) to the IP and will not retain any residual liability in respect of such APAs. The APAs are being drafted to automatically provide for such novation, thereby removing the risk that counterparties do not consent to the novation, leaving TWUL with risks and liabilities associated with the APAs.

Land Compensation Claims

Third parties whose interest in land is affected by the TTT Project may be entitled to compensation. Compensation will be available in respect of certain properties:

- (a) which are acquired (either all or in part) for TTT Project purposes;
- (b) whose value is reduced due to the construction works, subsequent use of the Thames Tideway Tunnel or interference with an owner's right associated with the property;
- (c) where mitigation works are deemed necessary to provide additional protection from construction works in close proximity; and
- (d) whose owners suffer loss or damage other than diminution of property value due to the TTT Project e.g. disturbance due to noise, dust or vibration which is beyond that normally expected for a major construction operation.

These costs will be borne by TWUL or the IP and are recoverable through the regulatory regime. TWUL has included an estimate of the possible costs in its PR14 application. All properly incurred expenditure is expected to be reflected in either TWUL or the IP's RCV.

Third Party Damage

TWUL and the IP will each grant comprehensive indemnities commensurate with the required TTT Project insurances and risk profile in favour of the other. These indemnities will be set out in the Interface Agreement and the O&M Agreement and will include indemnities for personal injury and loss of or damage to property owned by third parties, to the extent such injury or damage is caused by the negligence or breach of duty of a party. Indemnities for claims due to pollution caused by, or emanating from the assets of, a party will also be provided. All such indemnities are intended to be backed by the insurances set out below subject to deductibles, limits and exclusions.

Insurance

TWUL will be named as co-insured with the IP and thereby have the benefit of coverage under a range of TTT Project insurance policies, including in respect of:

- (a) contractors all risks which will cover: permanent and temporary works (including materials to be incorporated); existing structures for which the TTT Project is responsible but which is not third party property; the insured's equipment, temporary buildings and contents; and constructional plant and equipment;
- (b) third party liability which will cover: bodily injury; property loss or damage; nuisance; compensation, costs and legal expenses of successful claimants; sudden and accidental seepage, pollution and contamination; and cross-liability;
- (c) terrorism; and
- (d) marine cargo/delay in start-up which will cover: plant and equipment shipped from overseas; additional costs in finance; additional costs of working associated with limiting the financial loss; and loss of incentive payments.

Impact on TWUL of IP failure

In certain circumstances following the appointment of an IP, either the IP or the TTT Project could face difficulties and ultimately fail. This section of Part 4 sets out four possible scenarios where the IP or the TTT Project could fail:

- (a) special administration of the IP;
- (b) discontinuation of the Government contingent financial support;
- (c) revocation of the Project Specification Notice; or
- (d) revocation of the IP Designation Notice.

In each case there are clear mechanisms for how TWUL is protected in such circumstances, which are set out below.

Special administration of the IP and impact on TWUL

The regulatory protections and the Government contingent financial support in place for the IP are intended to make IP special administration remote and/or mitigate the consequences of special administration for such entity. In the event that the IP becomes insolvent for whatever reason or where Ofwat takes enforcement action for breach by the IP of a principal duty, in each case, the IP may become subject to a Special Administration Order.

- (a) If the IP enters into special administration, there are four potential exit options:
 - (i) resolution exit where the IP exits as a going concern;
 - (ii) a transfer exit where the ownership of the IP is transferred to new equity providers by way of a share sale or a transfer of the IP's assets to a new entity which would then be designated as the IP and awarded an IP project licence;
 - (iii) the Secretary of State determines that the project is no longer economically or technically viable and pursuant to the Government contingent financial support discontinues the project by paying compensation to the equity participants and senior debt providers of the IP; or
 - (iv) the Secretary of State purchases the IP while in special administration and the Government contingent financial support falls away.
- (b) If the IP is put into special administration, the form of exit will ultimately be determined by the special administrator appointed by the court, pursuant to the WIA as supplemented by the SIP Regulations.
- (c) Where there is a resolution exit, TWUL should not be affected if the IP continues and the TTT Project continues as a specified infrastructure project in accordance with the terms of the Project Specification Notice. In such scenario, TWUL will have comfort that there can be no amendments to its contracts or to the other TTT Project documents without its consent. Where there is a transfer exit through a share sale, the incoming shareholders should continue to be bound by all of the contracts between the IP and TWUL and the TTT Project will continue as a specified infrastructure project in accordance with the terms of the specification notice. As above, TWUL will be protected because there can be no amendments made to its contracts or the other TTT Project documents without TWUL's consent, subject to any order granted in the special administration.
- (d) Where there is a transfer exit and the assets of the IP are transferred to a new IP entity, it is assumed that all of the obligations of the IP under the TTT Project documents will also be transferred to the new entity although the terms of any transfer arrangements will need to be approved by the Secretary of State.
- (e) Where the IP has been in special administration for more than 18 months, the Secretary of State can either:
 - (i) make an offer to the special administrator to purchase the shares; or

- (ii) choose to discontinue the TTT Project.
- (f) Where the Secretary of State does make an offer to purchase the shares, any of the following outcomes is possible:
 - (i) the Secretary of State could continue the TTT Project, acting as the infrastructure provider until such time as the TTT Project is fully built out and then seek to exit by way of a sale of the shares to a third party purchaser thereby recovering any additional costs incurred; or
 - (ii) if the Secretary of State later determines that the TTT Project was no longer economically or technically viable and it could either:
 - (a) discontinue the TTT Project (a “**Discontinuation**”);
 - (b) despecify the TTT Project (a “**Despecification**”); or
 - (c) de-designate the IP (a “**De-designation**”).

Discontinuation scenarios and impact on TWUL

The Secretary of State and Ofwat have indicated in correspondence that there will be a presumption in favour of continuing the TTT Project to completion unless:

- (a) the TTT Project is no longer technically viable; or
- (b) continuation of the TTT Project is economically unviable (for example, cost of a predicted overrun or an insurance event makes continuation of the TTT Project economically unviable).

Triggers for Discontinuation

The Secretary of State is entitled to issue a Discontinuation Notice in the following circumstances:

- (a) where the Liaison Committee has determined that the TTT Project is no longer viable. All decisions of the Liaison Committee are required to be unanimous;
- (b) where a Special Administration Order has been made in respect of the IP;
- (c) where the IP has made a claim under the Contingent Equity Support Agreement and rather than put in any or any more contingent equity, the Secretary of State chooses to discontinue the TTT Project; or
- (d) where the IP has made a claim under the Supplemental Compensation Agreement in excess of the amount specified as cover or has a claim record which would cause a prudent insurance provider to withdraw cover under the commercial insurances, albeit that the Secretary of State would be obliged to pay out the current claim.

Discontinuation Notice

Where the Secretary of State has first issued a Discontinuation Notice in accordance with the Discontinuation Agreement:

- (a) the Secretary of State (or Ofwat) may, subsequent to such Discontinuation having been effected, revoke the designation notice and the Project Specification Notice in accordance with the SIP Regulations, subject to reasons and consultation with TWUL; and
- (b) the other TTT Project documents will terminate in accordance with their terms.

Project Specification Notice following Discontinuation

It should be noted that neither the Secretary of State nor Ofwat is entitled to revoke a Project Specification Notice pursuant to Regulation 4(7) unless one or both of the conditions in Regulation 4(3) cease to be satisfied. Those conditions include that the Secretary of State or Ofwat are of the opinion that:

- (a) the infrastructure project is of a size or complexity that threatens the incumbent undertaker's ability to provide services for its customers; or
- (b) specifying the infrastructure project is likely to result in better value for money than would be the case if the infrastructure project was not specified, including taking into account the charging regime and the powers of the Secretary of State under section 154B of the WIA (i.e. the power to provide financial assistance).

In effect, in order to despecify the TTT Project or to revoke a Project Specification Notice, the Secretary of State or Ofwat would have to be of the opinion that either the remaining parts of the uncompleted project following revocation would not affect core services or that it would be better value for TWUL to carry out or complete those remaining parts of the TTT Project.

In drafting its reasons for Despecifying or revoking the Project Specification Notice, the Secretary of State would have to take into account the fact that there is a subsisting project licence in respect of the TTT Project with the IP. He would also have to consult TWUL and publish draft reasons for revocation. If TWUL did not agree that the Project Specification Notice should be revoked, it would have the right to bring an action for a judicial review, if the Secretary of State was acting beyond his powers, illegally, unfairly, irrationally or disproportionately.

Despecification

As set out above, the Secretary of State may at any time revoke the Project Specification Notice, if and to the extent that:

- (a) he has consulted Ofwat and TWUL and such other person he considers appropriate;
- (b) he has taken into account the existence of a project licence in respect of the TTT Project; and
- (c) he considers that either of the limbs set out in SIP Regulation 4(3) are no longer applicable, namely:
 - (i) that the TTT Project is no longer of a size or complexity that would threaten TWUL's ability to provide core services; or
 - (ii) that it is no longer value for money having regard to the charging regime or the Secretary of State obligations s154B of the WIA.

Whilst it is understood that revocation of a Project Specification Notice would most likely occur when there is a Discontinuation, there is no fetter on the Secretary of State's discretion to revoke the Project Specification Notice, providing the test set out in SIP Regulation 4(7)(b) applies. Equally the Secretary of State could vary a specification notice providing the same tests continue to be satisfied in relation to the varied specified infrastructure project.

It has, however, been confirmed by the Secretary of State and Ofwat that it is the intention of the Secretary of State and Ofwat that revocation of the Project Specification Notice relating to this TTT Project will not occur after the Commencement Date without a prior or concurrent Discontinuation.

Effect of revocation

Where the Project Specification Notice is revoked, the provisions set out above will apply. In addition, where there has been a revocation of a Project Specification Notice, and there is no longer a licensed and designated IP:

- (a) the IP Charges which are passed through to TWUL's customers will be discontinued and TWUL will no longer have the power or the obligation to collect revenue in respect of the IP Charges from its customers;
- (b) if and to the extent that the TWUL Licence has ceased to provide for the IP Charges (or their equivalent), Ofwat will confirm that TWUL will not be obliged to pay IP Charges revenue to the IP; and
- (c) in consultation with TWUL, Ofwat shall determine how any revenue collected by TWUL with respect to the IP Charges which has not already been passed on to the IP prior to revocation of the Project Specification Notice shall be treated.

In circumstances where the Project Specification Notice is not revoked but:

- (a) there has been a revocation of an IP Designation Notice and no new IP has been designated by the Secretary of State or Ofwat (as the case may be); and/or
- (b) a Discontinuation Notice has been issued in accordance with the Discontinuation Agreement; and/or
- (c) a designated IP becomes subject to a Special Administration Order pursuant to paragraph 7 of Schedule 1 of the SIP Regulations (a "**Special Administration Order**") and:
 - (i) the IP has not been preserved as a going concern;
 - (ii) the IP has not transferred to a new replacement IP; or
 - (iii) the assets of the IP have not been transferred to a new IP within 18 months of the commencement of IP's special administration,

then Ofwat, in consultation with TWUL, shall determine how the IP Charges will continue to be implemented (if at all) and how any revenue collected by TWUL with respect to the IP Charges that had not already been passed on to the IP shall be treated.

Consequences of there no longer being an IP

If the Secretary of State revokes the Project Specification Notice:

- (a) TWUL shall, subject to the below, protect the IP Works and the TWUL Works;
- (b) TWUL shall be entitled to funding from customers through the regulatory settlement process for TWUL to secure the IP Works and the TWUL Works;
- (c) the IP shall do all things necessary so that:
 - (i) the IP Works can be secured; and
 - (ii) all of the TTT Project assets, documents and data can be transferred to TWUL unless otherwise required by the TTT Project documents or directed by the Secretary of State or Ofwat;
- (d) within six months, or such period as shall be agreed between TWUL, the Secretary of State and Ofwat, of the relevant event, TWUL shall present a proposal to the Secretary of State and Ofwat to address the issue of sewage discharges into the River Thames to secure compliance with the UWWTR. Such

proposal shall consider (and be considered in view of) the obligations of each of TWUL, Ofwat and the Secretary of State pursuant to the WIA and the TWUL Licence and:

- (i) the need for TWUL to finance its functions (including the delivery of the proposal);
 - (ii) the circumstances resulting in the TTT Project being Discontinued;
 - (iii) the fact that the TTT Project had been designated under SIP Regulations;
 - (iv) the bespoke regulatory regime; and
 - (v) the Government contingent financial support developed in order to deliver the TTT Project;
- (e) TWUL may include any elements of the TTT Project as appropriate;
- (f) TWUL shall not be required to implement its proposed solution (referred to above) without a determination by Ofwat pursuant to the regulatory settlement process as to TWUL's funding requirement for such implementation; and
- (g) the agreements between TWUL and the IP terminate on Discontinuation subject to their terms.

Tax Impact

TWUL has taken external advice on the anticipated tax consequences for TWUL of the delivery of the TTT Project by the IP. This advice is based on the anticipated accounting treatment set out below in the section headed "*Description of the TTT Project Accounting Impact - Accounting analysis*".

It is expected that amounts invoiced to customers on behalf of the IP and recognised by the TWUL in its income statement will be brought into account as taxable income for corporation tax purposes. However, IP Charges paid by TWUL during the period prior to Acceptance are expected to be treated as pre-payments under a long funding finance lease and are not expected to be deductible for corporation tax purposes (under either alternative accounting analysis).

Following Acceptance, IP Charges are expected to be deductible to the extent reflected in TWUL's income statement as a finance charge under a finance lease and capital allowances are expected to be available, broadly, on the principal amount of the finance lease liability shown in TWUL's balance sheet.

Alternatively, if the Revenue Agreement is not treated as a finance lease, and the payments to the IP are accounted for as a construction contract, no corporation tax relief is expected to be available in respect of IP Charges prior to Acceptance. After Acceptance TWUL is expected to obtain corporation tax relief in respect of IP Charges, broadly in line with depreciation recognised in respect of the asset in TWUL's accounts. No capital allowances would be available to TWUL in respect of expenditure incurred by the IP.

TWUL is therefore expected to be subject to corporation tax broadly on the profit recognised in its income statement in relation to the Revenue Agreement and IP Charges, subject to any relief for capital allowances. This is likely to result in an incremental increase in TWUL's corporation tax liability during the period prior to Acceptance, and possibly beyond that period if construction accounting was to apply.

Capital allowances may be available for all or part of the expenditure incurred directly by TWUL on the design, enabling and other preparatory works for the construction of the asset. The entitlement to allowances is expected to be confirmed in a clearance application to HMRC. No capital allowances or other corporation tax reliefs will be available in relation to the acquisition of land by TWUL.

Incremental corporation tax of £83 million in relation to the Revenue Agreement (based on IP Charges of £415 million) has been included in TWUL's business plan used to arrive at revenue requirements for the 2015 to 2020 period for the purposes of the regulatory charging regime. TWUL considers that corporation tax has

been modelled for these on a prudent basis; in particular, it has been assumed that no capital allowances will be available on expenditure incurred directly by TWUL.

Accordingly, it is expected that TWUL will be fully funded through customer charges in respect of any incremental corporation tax arising as a result of the TTT Project and TWUL considers that the risk of any material underfunding of TWUL's corporation tax liabilities in relation to the TTT Project (e.g. as a result of materially higher IP Charges) is low.

Furthermore, TWUL has proposed to Ofwat that any under or overfunding of tax related to IP revenues or IP Charges for the 2015 to 2020 period should be subject to a "true up" in the period 2021 to 2026. If this proposal is accepted, it should eliminate entirely the risk of any underfunding of TWUL's overall corporation tax liability as a result of the TTT Project.

IP Charges are expected to be subject to VAT. However, TWUL expects to recover such VAT in full.

The acquisition of land or interests in land by TWUL in connection with the TTT Project may give rise to stamp duty land tax ("SDLT") charges for TWUL. The cost of such SDLT charges is expected to be fully funded through TWUL's regulatory charging mechanism.

The arrangements between TWUL and the IP in relation to the land on which the Thames Tideway Tunnel will be situated are yet to be finalised. The parties intend to work together to ensure that those arrangements are structured, so far as possible, so as to minimise any associated tax costs and it is anticipated that confirmation from HMRC as to the appropriate tax treatment will be sought. However, it is possible that incremental tax costs to TWUL could arise as a result of these arrangements.

It is anticipated that any such incremental tax costs would be fully funded by customer charges, through either a determination by Ofwat or the Competition and Markets Authority pursuant to the regulatory settlement process. However, this cannot be guaranteed.

No other significant tax issues have been identified in relation to the TTT Project.

Description of the TTT Project Accounting Impact

As described in further detail above (see the section entitled "*Description of the TTT Project*"), if the TTT Project is delivered by the IP (as is currently envisaged), a contractual relationship will arise between TWUL and the IP under the Revenue Agreement. Additionally, TWUL will have the right to charge customers additional amounts in respect of IP Charges.

CHAPTER 3

LEGAL AND ACCOUNTING IMPACT

Legal analysis

The legal relationship between the two entities will be as set out in the Revenue Agreement as described in more detail above in the section entitled “*Description of the TTT Project*”. In summary, TWUL will be under an obligation to pay a proportion of its Total Charges actually received from customers and WOCs to the IP. The IP will not be entitled to claim against TWUL for an accelerated payment of those amounts, nor for any amounts in excess of those which TWUL actually receives.

Accounting analysis

TWUL has sought the advice of accountants as to how the relationship between it and the IP would be treated in TWUL’s accounts. The accountants considered the proposed delivery model for the TTT Project as described in the section above entitled “*Description of the TTT Project*”, in particular considering the split of risk and responsibilities between TWUL and the IP for the TTT Project.

The accountants have advised TWUL that, based on their understanding of the legal relationship between the two entities, the key over-riding factors in determining the financial accounting treatment are whether:

- (i) TWUL would be considered as acting as an agent or principal from an accounting perspective (under IAS 18 Revenue). In this regard, the accountants’ over-riding considerations were that:
 - (a) TWUL will be seen to have the primary responsibility for providing “end to end” services relating to the disposal of waste from its customers. Customers will continue to receive bills from TWUL for the end to end service and amounts in respect of the IP Charge will not be separately reflected on customers’ bills; and
 - (b) TWUL will be the sole user of the Thames Tideway Tunnel and arguably has the ability to operate the Thames Tideway Tunnel through the overall sewerage system.

As a result of the above considerations, TWUL was advised by its accountants that it would be considered to be acting as “principal” from an accounting perspective (notwithstanding the legal analysis);

- (ii) the arrangement between TWUL and the IP includes a lease back to the TWUL from an accounting perspective under IFRIC 4. In this regard, the accountants’ over-riding considerations were that:
 - (a) the Thames Tideway Tunnel will constitute a single specific asset;
 - (b) TWUL will have control of physical access to the Thames Tideway Tunnel while controlling a significant proportion of its output;
 - (c) no other party can use the Thames Tideway Tunnel and cash passed from TWUL to the IP is neither a market price per unit of output nor a fixed price per unit of output at inception;
 - (d) the lease of the sub-surface land from TWUL to the IP for 999 years is considered to be economically similar to the IP having purchased the land and the tunnel; and
 - (e) TWUL will make payments to the IP as principal (TWUL is not acting as a collection agent on behalf of the IP), which the accountants judged to be “lease payments”.

As a result of the above considerations, TWUL was advised by its accountants that the arrangements with the IP would be considered as a deemed lease; and

- (iii) such a deemed lease constitutes a finance lease during the operational phase under IAS 17 Leases. In this regard, the accountants' over-riding considerations were that:
 - (a) the arrangement is for the major part of the economic life of the Thames Tideway Tunnel;
 - (b) the present value of the minimum payments to the IP under the Revenue Agreement is expected to be at least equal to substantially all of the fair value of the Thames Tideway Tunnel at Acceptance; and
 - (c) the Thames Tideway Tunnel is of a specialised nature such that it can only be used by TWUL without major modifications.

As a result of the above considerations, TWUL was advised by its accountants that once the Thames Tideway Tunnel has been completed and is ready for use by TWUL (Acceptance being the latest point at which this would happen), the arrangements with the IP would be considered as a finance lease.

Therefore, the transactions with the IP would be treated in TWUL's accounts as follows:

- (i) in the period prior to Acceptance, from an accounting perspective this is the construction phase, when TWUL is considered to be making prepayments to the IP contributing to the overall cost of the asset:
 - (a) in the income statement:
 - (A) the additional revenues of TWUL (received as a result of the amounts allowed to be charged in respect of IP Charges) will be recorded as additional revenues of TWUL in the income statement; and
 - (B) no amounts will be included to reflect the amounts paid to the IP under the Revenue Agreement, meaning that TWUL's profits and retained profits will increase on the face of the accounts, although this increase in profits is not considered realised and therefore is not distributable; and
 - (b) on the balance sheet:
 - (A) a debit amount in respect of either (I) pre-funding in favour of a future finance lease or (II) property, plant and equipment under construction; and
 - (B) a credit amount in respect of increased retained earnings; and
 - (c) in the cash flow statement:
 - (A) a cash inflow included within net cash from operating activities of TWUL (received as a result of the amounts allowed to be charged in respect of IP Charges); and
 - (B) a cash outflow included within net cash used in investing activities; purchases of leased property, plant and equipment, for the amounts paid to the IP under the Revenue Agreement.
- (ii) at Acceptance, from an accounting point of view this being the latest point at which TWUL recognises the IP element of the Thames Tideway Tunnel as an asset, TWUL would make the following accounting entries on the balance sheet:
 - (a) the accumulated prepayment recognised under section (i)(a)(A) above would be de-recognised; and

- (b) the finance lease liability is recognised, being the present value of the minimum lease payments. Therefore, a calculation will need to be performed to provide the interest rate implicit in the lease arrangement and the repayment schedule. The interest rate is constant over the life of the leasing arrangement; and
 - (c) a finance leased asset within property, plant and equipment is recognised, being the difference between the amount de-recognised as a prepayment under section (a) above and the amount recognised as a liability under section (b) above.
- (iii) in the period post Acceptance, from an accounting perspective this is the operational phase and the transactions with the IP are treated as a finance lease arrangement by TWUL:
- (a) in the income statement:
 - (A) the additional revenues of TWUL (received as a result of the amounts allowed to be charged in respect of IP Charges) will be recorded as additional revenues of TWUL in the income statement; and
 - (B) TWUL will record a depreciation charge for the finance lease asset recognised within leased property, plant and equipment, writing the asset off over 120 years on a straight line basis; and
 - (C) for the amounts paid to the IP under the Revenue Agreement there are up to two entries recorded in TWUL's income statement:
 - 1. an annual interest charge as calculated in section (ii)(b) above; and
 - 2. any amount paid to the IP under the Revenue Agreement in any financial year that is greater than the sum of the interest charge and the amount of the repayment of the finance lease liability for that year;
 - (b) on the balance sheet:
 - (A) a credit amount equal to the depreciation charge in (iii)(a)(B) above as accumulated depreciation against the finance lease asset recorded within property, plant and equipment; and
 - (B) a credit amount increasing the finance lease liability for the annual interest charge as calculated in section (ii)(b) above; and
 - (C) a debit amount recorded reducing the finance lease payable liability, being the repayment for the financial year as calculated in section (ii)(b) above;
 - (c) in the cash flow statement:
 - (A) a cash inflow included within net cash from operating activities of TWUL (received as a result of the amounts allowed to be charged in respect of IP Charges); and
 - (B) a cash outflow included within net cash from operating activities of TWUL for any amount paid to the IP under the Revenue Agreement in any financial year that is greater than the sum of the interest charge and the amount of the repayment of the finance lease liability for that year; and
 - (C) a cash outflow included within interest paid for the annual interest charge as calculated in section (ii)(b) above; and

- (D) a cash outflow included within financing activities, repayments of obligations under finance lease arrangements for the repayment as calculated in section (ii)(b) above; and
- (d) It should be noted that the additional profit recognised by TWUL prior to Acceptance of the IP element of the Thames Tideway Tunnel will reverse over the 120 year operational phase of the Thames Tideway Tunnel.

Impact of accounting analysis on financial covenants

TWUL calculates the following financial ratios in each of its Compliance Certificates:

- (i) Class A ICR, Class A Adjusted ICR, Senior Adjusted ICR, Class A Average Adjusted ICR and Senior Average Adjusted ICR (together the “**ICR Covenants**”); and
- (ii) Class A RAR and Senior RAR (together the “**RAR Covenants**”).

The covenants are used in the Trigger Events, Events of Default and covenants in relation to indebtedness and disposals. The ICR Covenants calculate the ratio of Net Cash Flow to debt interest payable either on Class A Debt plus any unsecured Permitted Financial Indebtedness only or on all Senior Debt plus any unsecured Permitted Financial Indebtedness (depending on the ratio). “Net Cash Flow” includes the aggregate of net cash flow from operating activities subject to various adjustments which are not relevant for these purposes.

As described in “*Accounting analysis*”, the accounting treatment of the additional cash flows received as a result of the additional charges in respect of the IP Charges will be recognised as cash from operating activities and as such Net Cash Flow will be higher as soon as these IP Charges revenues begin to be received (the payment of which will continue both prior to and post Acceptance). The payments out to the IP are not in the nature of interest or fees payable in respect of either Senior Debt nor Class A Debt or any unsecured Permitted Financial Indebtedness, but instead will be classed as operating expenditure. As such, as a result of the accounting treatment described above, TWUL will gain additional headroom on its ICR Covenants during the construction phase notwithstanding that the money it receives in respect of the IP Charges must be paid to the IP in accordance with the Revenue Agreement.

The Senior RAR covenant calculates the ratio of Senior Net Indebtedness to RCV. “Senior Net Indebtedness” includes, by its reference to Senior Debt, all Financial Indebtedness which ranks in priority to Subordinated Debt. TWUL’s payments to the IP will rank as operating expenditure of TWUL, payable directly from its operating accounts. “Financial Indebtedness” includes (at limb (e) of such definition) “*any finance or capital lease [...] which would, in accordance with Applicable Accounting Principles, be treated as such*”.

As described in the “*Accounting analysis*”, the accounting treatment of the relationship between TWUL and the IP will recognise a finance lease in TWUL’s accounts following Acceptance. The nominal amount of this finance lease as recorded in the accounts will be an amount to reflect the accounting value of the asset. As a result, notwithstanding that TWUL will not be contractually required to pay this nominal amount to the IP, it will be treated as Senior Debt and included in the definition of “Senior Net Indebtedness” in the calculation of the Senior RAR covenant. As a result, TWUL would be unable to meet this covenant following Acceptance. The Class A RAR covenant will not be affected by the TTT Project.

As shown in this section, as a result of the IP delivery model and the accounting treatment of such arrangements, the financial covenant calculations will be affected, but not consistently, rendering neither ratio an appropriate test of TWUL’s financial health. The Proposals described in the section entitled “*Proposed amendments to the Finance Documents*”, which were submitted to Secured Creditors for approval on 22 April 2014, seek to neutralise the effect of the accounting treatment of the IP arrangements on TWUL’s financial ratios.

CHAPTER 4
PROPOSED AMENDMENTS TO THE FINANCE DOCUMENTS

1 The Proposals

1.1 New financial ratios

In order to ensure that Secured Creditors benefit from financial covenants that are fit for purpose (providing the same protection that Secured Creditors currently enjoy), TWUL has proposed by way of a STID Proposal dated 22 April 2014 to add new financial covenants set at the current levels, but which take into account the Accounting Effect of the IP arrangements on the financial covenants as described in the section entitled “*Description of the TTT Project Accounting Impact*”. Setting the levels at the current levels for these conformed covenants is intended to ensure a “no better, no worse” position for Secured Creditors. Secured Creditors should note that the Class A RAR covenant is not affected by the Accounting Effect of the IP arrangements and, as such, no new financial covenant is proposed in respect of this.

TWUL has proposed the following covenants (the following drafting would be entirely new covenants in addition to the existing covenants; for information purposes they are shown below highlighting how these covenants have been drafted from the current financial covenants with deletions shown in blue strikethrough and additions shown in red underline):

- (i) an amendment to paragraph 2(a) (Compliance Certificate) of Part 1 (Information Covenants) of Schedule 4 (Covenants) to the CTA to replace the letter “g” in the phrase “items (a) to (g) of Paragraph 2” with the letter “m”, so that it reads “items (a) to (m) of Paragraph 2”;
- (ii) an amendment to paragraph 2 (Cover Ratios) of Part 2 (Financial Covenants) of Schedule 4 (Covenants) to the CTA, so that the word “and” and the full stop are deleted at the end of limbs (f) and (g), respectively, and the following are added as new limbs (h) to (m):
 - “(h) the Conformed Class A ICR for each Test Period;
 - (i) the Conformed Class A Adjusted ICR for each Test Period;
 - (j) the Conformed Senior Adjusted ICR for each Test Period;
 - (k) the Conformed Class A Average Adjusted ICR for each Test Period;
 - (l) the Conformed Senior Average Adjusted ICR for each Test Period; and
 - (m) the Conformed Senior RAR for each Test Period.”;
- (iii) an amendment to paragraph 1 (Financial Ratios) of Part 1 (Trigger Events) of Schedule 5 (Trigger Events) to the CTA so that the word “or” and the full stop are deleted at the end of limbs (e) and (f), respectively, and the following are added as new limbs (g) to (k):
 - “(g) the Conformed Senior RAR for any Test Period is estimated to be more than 0.90:1;
 - (h) the Conformed Class A Adjusted ICR for any Test Period is or is estimated to be less than 1.3:1;
 - (i) the Conformed Senior Adjusted ICR for any Test Period is or is estimated to be less than 1.1:1;
 - (j) the Conformed Class A Average Adjusted ICR for any Test Period is estimated to be less than 1.4:1; or

- (k) the Conformed Senior Average Adjusted ICR for any Test Period is or is estimated to be less than 1.2:1.”;
- (iv) an amendment to paragraph 1 (Financial Ratios) of Part 3 (Trigger Event Remedies) of Schedule 5 (Trigger Events) to the CTA so that the word “or” and the full stop are deleted at the end of the second limb (d) (which shall be renumbered as limb (e)) and limb (e) (which shall be renumbered as limb (f)), respectively, and the following are added as new limbs (g) to (k):
- “(g) the Conformed Senior RAR for each Test Period is estimated to be less than 0.90:1;
- (h) the Conformed Class A Adjusted ICR for each Test Period is or is estimated to be greater than 1.3:1;
- (i) the Conformed Senior Adjusted ICR for each Test Period is or is estimated to be greater than 1.1:1;
- (j) the Conformed Class A Average Adjusted ICR is estimated to be greater than 1.4:1; or
- (k) the Conformed Senior Average Adjusted ICR is or is estimated to be greater than 1.2:1.”;
- (v) an amendment to paragraph 17 (Ratios) of Part 2 (Events of Default (TWUL, TWUF and the Issuer)) of Schedule 6 (Events of Default) to the CTA so that the words “and/or” and the full stop at the end of limbs (b) and (c) are each replaced with the word “or” and the following are added as new limbs (d) to (f):
- “(d) the Conformed Class A ICR is less than 1.60:1; or
- (e) the Conformed Senior RAR is more than 0.95:1; and/or
- (f) the Conformed Class A Adjusted ICR is less than 1:1.”;
- (vi) an amendment to paragraphs 2(a) and 4 of Schedule 9 (Form of Compliance Certificate) and paragraphs 1 and 3 of Schedule 10 (Form of Investors Report) to the CTA so that the following ratios are added to the table in paragraph 2 of Schedule 9 and paragraph 1 of Schedule 10, and as additional limbs (h) to (m) in paragraph 4 of Schedule 9 and paragraph 3 of Schedule 10:
- “(h) the Conformed Class A ICR;
- (i) the Conformed Class A Adjusted ICR;
- (j) the Conformed Senior Adjusted ICR;
- (k) the Conformed Class A Average Adjusted ICR;
- (l) the Conformed Senior Average Adjusted ICR; and
- (m) the Conformed Senior RAR.”; and
- (vii) an amendment to the MDA to add the following new definitions (please note that, for Bondholders’ ease of review, the below definitions are shown as comparisons against the current relevant definitions used in the calculation of the existing financial ratios with additions shown in red underline and deletion shown in blue strikethrough; these definitions will be entirely new, however, and in addition to the existing definitions):
- “**Conformed Senior RAR**” means, on any Calculation Date, the ratio of:
- (i) **Conformed** Senior Net Indebtedness;

to

- (ii) RCV:
 - (a) as at such Calculation Date; or
 - (b) in the case of any forward-looking ratios for Test Periods ending after such Calculation Date, as at 31 March falling in such Test Period;

“**Conformed Senior Net Indebtedness**” means, as at any date:

the aggregate of:

- (i) the Issuer’s, TWUF’s and TWUL’s nominal debt outstanding (or, in respect of a future date, forecast to be outstanding) under and in connection with any Senior Debt on such date;
 - (a) including accretions by indexation to the notional amount under any RPI Linked Hedging Agreement;
 - (b) excluding any un-crystallised mark-to-market amount relating to any Hedging Agreement; and
 - (c) excluding any Financial Indebtedness in respect of the IP Liability;

and

- (ii) the nominal amount of any Financial Indebtedness pursuant to paragraphs (e) and (f) (which, for the avoidance of doubt, does not include any Financial Indebtedness in respect of the IP Liability) of the definition of Permitted Financial Indebtedness which is outstanding (or, in respect of a future date, forecast to be outstanding) on such date together with all indexation accrued on any such liabilities which are indexed less
- (iii) the value of all Authorised Investments and other amounts standing to the credit of any Account (other than an amount equal to the aggregate of any amounts which represent Deferrals of K or Distributions which have been declared but not paid on such date),

where such debt is denominated other than in pounds sterling, the nominal amount outstanding will be calculated:

- (i) *in respect of debt with associated Currency Hedging Agreements, by reference to the applicable hedge rates specified in the relevant Currency Hedging Agreements; and*
- (ii) *in respect of debt with no associated Currency Hedging Agreements, by reference to the Exchange Rate on such date.*

“**Conformed Senior Adjusted ICR**” means, in respect of a Test Period, the ratio of:

- (i) Conformed Net Cash Flow less the aggregate of CCD and IRC during such Test Period;
- to
- (ii) Conformed Senior Debt Interest during such Test Period.

“**Conformed Senior Average Adjusted ICR**” means the sum of:

- (i) the ratios of:

- (a) Conformed Net Cash Flow less the aggregate of CCD and IRC;
to
- (b) Conformed Senior Debt Interest,
for each of the Test Periods comprised in a Rolling Average Period
- (ii) divided by three;

“**Conformed Senior Debt Interest**” means, in relation to any Test Period, and without double counting, an amount equal to:

the aggregate of:

- (i) all interest, fees or commissions paid, due but unpaid or, in respect of forward-looking ratios, payable, on the Issuer’s, TWUF’s and/or TWUL’s obligations under or in connection with:
 - (a) all Senior Debt excluding any Financial Indebtedness in respect of the IP Liability; and
 - (b) any Permitted Financial Indebtedness which is unsecured (including all Unsecured TWUF Bond Debt) (other than any Intra-Group Loans) (which, for the avoidance of doubt, does not in any case include any Financial Indebtedness in respect of the IP Liability);
- (ii) all fees paid, due but unpaid or, in respect of forward-looking ratios, payable, to any Financial Guarantor of Wrapped Bonds; and
- (iii) Adjusted Lease Reserve Amounts or Lease Reserve Amounts (which, for the avoidance of doubt, are not applicable to any Financial Indebtedness in respect of the IP Liability) paid, due but unpaid or, in respect of forward-looking ratios, payable, on the Issuer’s, TWUF’s and/or TWUL’s obligations under and in connection with all Senior Debt,

in each case during such Test Period (after taking account of the impact on interest rates of all related Hedging Agreements then in force) (excluding all indexation of principal amortisation of the costs of issue of any Senior Debt or Unsecured TWUF Bond Debt within such Test Period and all other costs incurred in connection with the raising of such Senior Debt or Unsecured TWUF Bond Debt),

less

- (iv) all interest received or, in respect of forward-looking ratios, receivable, by any member of the TWU Financing Group from a third party during such period (excluding any interest received or receivable by TWUL under any Intra-Group Loan or any loan or other forms of Financial Indebtedness to Associates);

“**Conformed Class A Adjusted ICR**” means, in respect of a Test Period

the ratio of

- (i) Conformed Net Cash Flow less the aggregate of CCD and IRC during such Test Period
to
- (ii) Conformed Class A Debt Interest during such Test Period;

“**Conformed Class A Average Adjusted ICR**” means the sum of:

- (i) the ratios of:
 - (a) **Conformed** Net Cash Flow less the aggregate of CCD and IRC during such Test Period
 - to
 - (b) **Conformed** Class A Debt Interest,for each of the Test Periods comprised in a Rolling Average Period,
- (ii) divided by three;

“**Conformed Class A ICR**” means the ratio of:

- (i) **Conformed** Net Cash Flow for each Test Period
- to
- (ii) **Conformed** Class A Debt Interest for each of the same Test Periods;

“**Conformed Class A Debt Interest**” means, in relation to any Test Period, and without double counting, an amount equal to:

the aggregate of:

- (i) all interest and recurring fees or commissions paid, due but unpaid or, in respect of forward-looking ratios, payable, on the Issuer’s and/or TWUF’s and/or TWUL’s obligations under or in connection with:
 - (a) all **Class A Debt**; and
 - (b) any Permitted Financial Indebtedness which is unsecured (including all Unsecured TWUF Bond Debt) (which, for the avoidance of doubt, does not in any case include any Financial Indebtedness in respect of the IP Liability);
- (ii) all fees paid, due but unpaid or, in respect of forward-looking ratios, payable, to any Financial Guarantor of Class A Wrapped Bonds; and
- (iii) **Adjusted** Lease Reserve Amounts or Lease Reserve Amounts (which, for the avoidance of doubt, are not applicable to any Financial Indebtedness in respect of the IP Liability) paid, due but unpaid or, in respect of forward-looking ratios, payable, on the Issuer’s and/or TWUF’s and/or TWUL’s obligations under and in connection with all Class A Debt,

in each case during such Test Period (after taking account of the impact on interest rates of all related Hedging Agreements then in force) (excluding all indexation of principal, amortisation of the costs of issue of any Class A Debt or Unsecured TWUF Bond Debt within such Test Period and all other costs incurred in connection with the raising of such Class A Debt or Unsecured TWUF Bond Debt),

less

- (iv) all interest received or in respect of forward-looking ratios receivable by any member of the TWU Financing Group from a third party during such period (excluding any interest

received or receivable by TWUL under any Intra-Group Loan or any loan or other forms of Financial Indebtedness to Associates);

“**Conformed Net Cash Flow**” means:

(i) in respect of any historical element of a Test Period,

the aggregate of:

(a) net cash flow from operating activities as shown in the TWUL financial statements (such net cash flow to take into account both the IP Related Revenue and IP Related Payments);

(after adding back, without double counting, and to the extent that such items are included in net cash flow from operating activities:

(b) any exceptional items (including the initial transaction fees payable on the Initial Issue Date) to the extent such items represent expenditure of TWUL and/or are included in the net cash flow from operating activities as shown in TWUL’s financial statements;

(c) any recoverable VAT;

(d) any Capital Expenditure;

(e) any movement in debtors and/or creditors relating to Capital Expenditure; and

(f) any Deferrals of K),

minus:

(g) any exceptional items to the extent such items represent receipts of TWUL and/or are included in the net cash flow from operating activities as shown in TWUL’s financial statements; and

(h) corporation tax paid (other than in respect of interest received on the Intra-Group Loan between TWUL and TWH) which shall exclude payments in respect of a Permitted Tax Loss Transaction as part of any Intra-Group Debt Service Distribution;

during such Test Period, and

(ii) in respect of any forward-looking element of a Test Period,

the aggregate of:

(a) anticipated net cash flow from operating activities (such net cash flow to take into account both the IP Related Revenue and IP Related Payments);

(after adding back, without double counting and to the extent that such items are included in the anticipated net cash flow from operating activities:

(b) any exceptional items to the extent such items represent expenditure of TWUL and/or are included in the net cash flow from operating activities as shown in TWUL’s financial statements;

(c) any recoverable VAT;

- (d) any Capital Expenditure;
- (e) any movement in debtors and/or creditors relating to Capital Expenditure; and
- (f) any Deferrals of K,

in each case anticipated to occur during such Test Period)

minus:

- (g) any exceptional items to the extent such items represent receipts of TWUL and/or are included in the net cash flow from operating activities as shown in TWUL's financial statements; and
- (h) corporation tax (other than in respect of interest received on the Intra-Group Loan between TWUL and TWH) which shall exclude payments in respect of a Permitted Tax Loss Transaction as part of any Intra-Group Debt Service Distribution); and

less:

- (i) any anticipated net cash flow from operating activities of its business other than its Appointed Business (for the avoidance of doubt, the collection of the IP Related Revenue and the IP Related Payments shall be Appointed Business for these purposes); and

after adding back:

- (j) corporation tax (which shall exclude payments in respect of a Permitted Tax Loss Transaction as part of any Intra-Group Debt Service Distributions anticipated to be paid during such Test Period) anticipated to be paid (other than in respect of interest received on the Intra-Group Loan between TWUL and TWH) as a result of such businesses during such Test Period;

“IP Liability” means any liability:

- (a) in respect of a historical period, which is shown in the financial statements of TWUL (delivered to the Security Trustee pursuant to paragraph 1 (Financial Statements) of Part 1 (Information Covenants) of Schedule 4 (Covenants) to the CTA) arising as a result of the treatment of the Thames Tideway Tunnel in the financial statements of TWUL and described as such in the notes to the financial statements; or
- (b) in respect of a forward looking period, which is anticipated to arise as a result of the treatment of the Thames Tideway Tunnel in the financial statements of TWUL and which is anticipated to be described as such in the notes to the financial statements.

In each case, the IP Liability shall not include any financial liability which arises (or is anticipated to arise) from amounts being overdue for payment or which represents (or is anticipated to represent) a legal repayment obligation of TWUL.

“IP Related Payments” means such payment made or, in respect of a forward looking period, anticipated to be made in respect of amounts of the IP Charges.

“IP Related Revenue” means such revenue collected or, in respect of a forward looking period, anticipated to be collected in respect of customer charges permitted under the IP Project Licence.”

1.2 Levels of the current financial ratios

The coming into force of the SIP Regulations has resulted in a material change in the regulation of the water and sewerage industry in the United Kingdom. Pursuant to the CTA, TWUL is permitted (subject to certain conditions including affirmation by the Rating Agencies then rating the Bonds that the ratings of the Bonds will be at least those set out in the definition of Rating Requirement) to amend the levels of its financial covenants following such a material change in the regulation of the industry. TWUL wishes to amend the levels of its current financial covenants in order to enable it to enter into the TTT Project as envisaged and to neutralise the unintended consequences produced by the accounting treatment as explained in greater detail in the section entitled “*Description of the TTT Project Accounting Impact*”.

As a result of the proposed amendments, Secured Creditors should look solely to the new covenants (as introduced above and once they become effective) to test the financial condition of the Obligors (with the exception of the Class A RAR covenant which, as described above, is not affected and therefore the level of which will not be amended). Once the project documents are signed and the Accounting Effect occurs, these new covenants will be the appropriate means of testing the financial health of TWUL.

As such, TWUL has requested an amendment to the Finance Documents as follows:

- (i) an amendment to paragraph 1 (Financial Ratios) of Part 1 (Trigger Events) of Schedule 5 (Trigger Events) to the CTA so that the current limbs (b) to (f) are amended to read (deletions shown in blue strikethrough; additions shown in red underline):
 - (b) the Senior RAR for any Test Period (i) prior to the Ratio Step Date is estimated to be more than ~~0.75:1~~2:1; and (ii) from and including the Ratio Step Date is estimated to be more than ~~0.90:1~~2:1;
 - (c) the Class A Adjusted ICR for any Test Period is or is estimated to be less than ~~1.3:1~~0.1:1;
 - (d) the Senior Adjusted ICR for any Test Period is or is estimated to be less than ~~1.1:1~~0.1:1;
 - (e) the Class A Average Adjusted ICR for any Test Period is estimated to be less than ~~1.4:1~~0.1:1; or
 - (f) the Senior Average Adjusted ICR for any Test Period is or is estimated to be less than ~~1.2:1~~0.1:1.”;
- (ii) an amendment to paragraph 1 (Financial Ratios) of Part 3 (Trigger Event Remedies) of Schedule 5 (Trigger Events) to the CTA so that the current limbs (b) to (f) are amended to read (deletions shown in blue strikethrough; additions shown in red underline):
 - (b) the Senior RAR for each Test Period (i) prior to the Ratio Step Date is estimated to be less than ~~0.75:1~~2:1; and (ii) from and including the Ratio Step Date is estimated to be less than ~~0.90:1~~2:1;
 - (c) the Class A Adjusted ICR for each Test Period is or is estimated to be greater than ~~1.3:1~~0.1:1;
 - (d) the Senior Adjusted ICR for each Test Period is or is estimated to be greater than ~~1.1:1~~0.1:1;
 - (e) the Class A Average Adjusted ICR is estimated to be greater than ~~1.4:1~~0.1:1; or

- (f) the Senior Average Adjusted ICR is or is estimated to be greater than ~~1.2:1~~0.1:1.”; and
- (iii) an amendment to paragraph 17 (Ratios) of Part 2 (Events of Default (TWUL, TWUF and the Issuer)) of Schedule 6 (Events of Default) to the CTA so that the current limbs (a) to (c) are amended to read (deletions shown in blue strikethrough; additions shown in red underline):
 - (a) “The Class A ICR is less than ~~1.60:1~~0.1:1; or
 - (b) The Senior RAR is more than (i) prior to the Ratio Step Date, ~~0.85:1~~2:1; or (ii) from and including the Ratio Step Date, ~~0.95:1~~2:1); and/or
 - (c) The Class A Adjusted ICR is less than ~~1:1~~0.1:1.”.

1.3 Consequential amendments

In order to: (x) ensure consistency across the Finance Documents; and (y) (in the case of paragraph (iv) below) to ensure that TWUL is able to give ordinary course of business indemnities which may be required as part of the delivery of the TTT Project, TWUL has also sought amendments to the Finance Documents as follows:

- (i) an amendment to the definition of “Permitted Disposal” in Schedule 2 (Common Definitions) to the MDA so that the current limb (d) is amended to read:
 - (d) “would not result in the Senior RAR ~~or the Conformed Senior RAR~~, calculated for each Test Period by reference to the most recently occurring Calculation Date (adjusted on a pro-forma basis to take into account the proposed disposal), being more than or equal to, prior to the Ratio Step Date, ~~0.75:1~~ or 0.75:1 (respectively) and from and including the Ratio Step Date, ~~0.90:1~~ or 0.90:1 (respectively).”);
- (ii) an amendment to the definition of “Permitted Financial Indebtedness” in Schedule 2 (Common Definitions) to the MDA so that:
 - (A) the following words are added to limb (f) after the words “Unsecured TWUF Bond Debt”:
 “and unsecured debt under limb (m) of this definition”;
 - (B) the current limbs (j)(v) and (vi) are amended to read:
 - (v) “if such further Financial Indebtedness is Class A Debt or Class B Debt then the Senior RAR ~~and the Conformed Senior RAR~~ (taking into account the proposed incurrence of such debt) must be less than or equal to (i) prior to the Ratio Step Date, ~~0.75:1~~ and 0.75:1 (respectively); and (ii) from and including the Ratio Step Date, ~~0.90:1~~ and 0.90:1 (respectively) for each Test Period calculated by reference to the then most recently occurring Calculation Date;
 - (vi) if such further Financial Indebtedness is Class A Debt then the Class A RAR (taking into account the proposed incurrence of such debt) must be less than or equal to 0.75:1 and the Class A Adjusted ICR ~~and the Conformed Class A Adjusted ICR~~ must be greater than or equal to ~~1.30:1~~ and 1.30:1 (respectively) for each Test Period calculated by reference to the then most recently occurring Calculation Date.”;
 - (C) the word “or” is deleted at the end of limb (k) and inserted at the end of limb (l); and
 - (D) a new limb (m) is added which shall read:

“(m) any Financial Indebtedness or other financial liability shown in the accounts of TWUL arising (in either case) from the IP Liability;”;

- (iii) an amendment to the proviso to the definition of “RCV” set out in the MDA so as to add the following words after the word “Senior RAR”:

“, Conformed Senior RAR”;

- (iv) an amendment to paragraph 16(a) (Loans and Credit) of Part 3 (General Covenants) of Schedule 4 (Covenants) to the CTA to add the following words to the end of that paragraph before the full stop:

“in respect of Financial Indebtedness;” and

- (v) an amendment to paragraph 37.1.2(c)(ii)(B) (Restricted Payments) of Part 3 (General Covenants) of Schedule 4 (Covenants) to the CTA so the levels set out in such covenant are deleted and replaced as follows (additional wording is shown in red underline and deletions are shown in blue strikethrough):

“(B) in respect of any Calculation Date falling after the Ratio Step Date, the Senior RAR and the Conformed Senior RAR, as certified by the Issuer, TWUL and TWUL in the Compliance Certificate most recently delivered to the Security Trustee and each Rating Agency, is less than or equal to ~~0.82~~:1 and 0.82:1 (respectively) or, following the occurrence of the Permitted Unsecured Financial Indebtedness Trigger, ~~0.85~~:1 and 0.85:1 (respectively) in each case for each Test Period (after deducting an amount equal to the proposed payment(s) (the “Proposed Payment Amount”) from available cash);”.

1.4 Additional Secured Creditor protections

TWUL is also seeking to give Secured Creditors additional covenant protections in the CTA to give Secured Creditors comfort that TWUL will provide Secured Creditors with information relating to the TTT Project which is relevant to TWUL and that TWUL is restricted from entering into or agreeing to any amendment of the principal documents in respect of the TTT Project which would have a material adverse effect on TWUL or its Secured Creditors.

As such, TWUL has proposed amendments to the Finance Documents as follows:

- (i) amendments to the MDA to add in new definitions to Schedule 2 (Common Definitions) which read:

“IP” means the entity designated by the Secretary of State or Ofwat to deliver the TTT Project.

“IP Charges” means the amount which the IP is allowed to charge to TWUL in accordance with the IP Project Licence.

“IP Project Licence” means the project licence granted to the IP pursuant to section 17FA of the WIA (as given effect by SIPR).

“SIPR” means the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 (S.1.2013/1582).

“TTT Core Project Documents” means any agreement to which TWUL and the IP (or any permitted successor or assign of the IP) are both party or any deed poll or other document under which TWUL incurs an obligation in favour of the IP (or any permitted successor or assign of the IP) by unilateral declaration.

“TTT Project” means the project to deliver the tunnelling project and associated works known as the Thames Tideway Tunnel.

“TTT Project Key Characteristics” means [*definition will be inserted as the words extracted from paragraph 3 (Key Characteristics) below*].

“TTT Project Specification Notice” means the notice which may be issued by the Secretary of State or Ofwat in accordance with Regulation 4(1) of the SIP Regulations in respect of the TTT Project.

(ii) an amendment to the CTA so that the following are added:

(A) as a new paragraph in Part 1 (Information Covenants) of Schedule 4 (Covenants):

“10. TTT Project

(a) TWUL shall include in each Investor Report an update on the progress of the TTT Project including:

- (i) any significant developments and material changes to the delivery model in respect of the TTT Project from that disclosed in the Supplementary Prospectus issued in April 2014; and
- (ii) a brief description of the entry into, or any amendment or modification, or consent or waiver given in respect of, a TTT Core Project Document, other than the entry into, or any amendment, modification, waiver or consent given in respect of, a TTT Core Project Document which is (x) of a formal, minor or technical nature, or (y) entered into or given with the consent of the Security Trustee in accordance with paragraph 55 (TTT Project) of Part 3 (General Covenants) of this Schedule 4 (Covenants),

unless, in each case, previously disclosed in an Investor Report.

(b) TWUL must supply to the Security Trustee, as soon as reasonably practicable upon becoming aware of such information, information in relation to the TTT Project of which TWUL is aware which would be reasonably likely to be materially adverse:

- (i) in relation to the creditworthiness of TWUL; or
- (ii) to TWUL’s ability to perform its duties under the Instrument of Appointment.

(c) TWUL must notify the Security Trustee as soon as reasonably practicable upon becoming aware of such event, details of:

- (i) any Proceedings (as defined in paragraph 7(b) above) in respect of any of the TTT Core Project Documents which are current, threatened or pending and would be reasonably likely, if adversely determined, to have a Material Adverse Effect; and
- (ii) any Proceedings (as defined in paragraph 7(b) above) in respect of any of the TTT Core Project Documents which had not previously been considered would be reasonably likely to have a Material Adverse Effect if at any time the circumstances of the Proceedings change such that they would be reasonably likely to have a Material Adverse Effect, and set out the action to be taken with respect to such matters.

- (d) TWUL must notify the Security Trustee as soon as reasonably practicable upon becoming aware of such event, if any of the following circumstances occur:
 - (i) the TTT Project Specification Notice is revoked or the TTT Project is in any other way de-specified;
 - (ii) the IP is placed in Special Administration;
 - (iii) the Secretary of State for Environment, Food and Rural Affairs (or any successor thereof in respect of the TTT Project) has issued a discontinuation notice in respect of the TTT Project or the UK Government has publically stated that contingent financial support provided by it to the IP is discontinued; and/or
 - (iv) the IP designation notice is revoked,
 including, in each case a short explanation of the nature of the event and (to the extent known to TWUL) the reasons for its occurrence.
- (e) TWUL must notify the Security Trustee as soon as reasonably practicable upon TWUL becoming aware of the same of any event or occurrence giving rise to any aggregate loss or liability of TWUL which is (x) in excess of 0.25 per cent. of RCV in any 12 month period and (y) in relation to the TTT Project.
- (f) Following any event or occurrence under paragraph (e) above, TWUL must notify the Security Trustee as soon as reasonably practicable upon TWUL becoming aware of the same of any claim under:
 - (i) any Insurance;
 - (ii) any supplemental compensation agreement or similar arrangement with the UK Government; and/or
 - (iii) any indemnity or similar arrangement with the IP.
- (g) Nothing in paragraphs (a) to (f) above shall require TWUL to breach any applicable law or binding confidentiality undertaking required to be given or considered by TWUL, acting in good faith, to be necessary for it to give, in connection with the TTT Project.”; and
- (B) as a new paragraph in Part 3 (General Covenants) of Schedule 4 (Covenants):

“55. TTT Project

 - (a) TWUL will not enter into, amend, modify or waive, or consent to the entry into, modification, amendment or waiver of a TTT Core Project Document if such entry into, modification, amendment or waiver could reasonably be expected to have a Material Adverse Effect without the consent of the Security Trustee acting on the instructions of the Majority Creditors.
 - (b) All transactions with the IP and its Affiliates will be on arm’s length terms and subject to Condition K(3) (the financial ring-fencing provisions) of the Instrument of Appointment.”

1.5 Project consents

TWUL has sought an additional amendment to clause 8.2.3 of the STID to authorise the Security Trustee to make such amendments as are necessary to the Finance Documents in order to implement the TTT Project, subject to such amendments maintaining the Key Characteristics and respecting existing protections for Secured Creditors (including Entrenched Rights and the ratings level) as follows (new wording shown in red underline):

“8.2.3 [the Security Trustee] shall, without any requirement to obtain the consent or sanction of any other Secured Creditor other than those listed in the proviso in 8.2.3(a) below, concur with any proposed modification, amendment, consent or waiver to:

- (a) an Authorised Credit Facility (other than any TWUF/TWUL Loan Agreement), provided that:
 - (i) each Contracting Secured Creditor under the relevant Authorised Credit Facility (or, to the extent that the relevant Authorised Credit Facility requires only a specified majority of the relevant Contracting Secured Creditors to consent to or sanction the proposed modification, amendment, consent or waiver, at least the specified majority of the relevant Contracting Secured Creditors under the relevant Authorised Credit Facility) has provided written consent to such modification, amendment, consent or waiver; and
 - (ii) the requested modification, amendment, consent or waiver does not impose any additional obligations or liabilities on the Security Trustee; or
- (b) any Finance Document (other than an Authorised Credit Facility or, in respect of the CTA, paragraph 55 (*TTT Project*) of Part 3 (*Covenant*) of Schedule 4 (*Covenants*) to the CTA or, in respect of the MDA, the definitions of TTT Core Project Documents, TTT Project and TTT Project Key Characteristics in Schedule 2 (*Common Definitions*) to the MDA) to which the Security Trustee is a party which is necessary to implement the TTT Project (but only to the extent that the TTT Project is complying with the TTT Project Key Characteristics), **provided that** TWUL delivers a certificate to the Security Trustee signed by two Authorised Signatories of TWUL setting out the terms of the proposed modification, amendment, consent or waiver and certifying that:
 - (i) the amendment, modification, consent and/or waiver does not give rise to an Entrenched Right or Reserved Matter;
 - (ii) the then current ratings of the Bonds have been affirmed by all Rating Agencies then rating the Bonds or, in circumstances where a Rating Agency is not willing to issue a rating affirmation due to its then prevailing policy regarding the issue of rating affirmations, TWUL has made a public announcement of its proposed modification, amendment, consent and/or waiver and within 30 calendar days of such announcement, no Rating Agency has made any public comment that such a modification, amendment, consent and/or waiver would cause the then current ratings of the Bonds to be downgraded or the Bonds being placed on credit watch with negative implications;
 - (iii) at the time of the implementation of such modification, amendment, consent and/or waiver, no Default is continuing or would result from such implementation;
 - (iv) the modification, amendment, consent and/or waiver is necessary to implement the TTT Project (but only to the extent that the TTT Project is complying with the TTT Project Key Characteristics; and
 - (v) the modification, amendment, consent and/or waiver is not reasonably likely to have a Material Adverse Effect.

and the Security Trustee shall rely absolutely, without further enquiry, on the certificate provided to it pursuant to this Clause 8.2.3(b) without liability to any person therefor. The Security Trustee shall notify each Secured Creditor that it has received a certificate pursuant to this Clause 8.2.3(b) and inform Secured Creditors that they may request a copy of such certificate from TWUL.

provided that, any modification agreed, waiver granted or consent given by the Security Trustee without exceeding the scope of its discretionary powers as specified herein and in accordance with the provisions of this Deed shall be binding on all Obligor, all Secured Creditors and all Secondary Market Guarantors and each of the Obligors, the Secured Creditors and the Secondary Market Guarantors shall be bound to give effect to it, and **provided further that**, without prejudice to Clause 8.1.1, the Security Trustee is hereby authorised by each Secured Creditor and each Secondary Market Guarantor to execute and deliver on its behalf all documentation required to implement any modification or the terms of any waiver or consent granted by the Security Trustee in respect of any such Finance Document and such execution and delivery by the Security Trustee shall bind each Secured Creditor and each Secondary Market Guarantor as if such documentation had been duly executed by it.

For the avoidance of doubt, no amendment, modification, consent and/or waiver to either the Bond Trust Deed or the Bonds may be proposed or made pursuant to clause 8.2.3(b) above.”

1.6 Entrenched Rights

In addition to the additional Secured Creditor protections described at paragraph 1.4 above, TWUL wishes to grant certain of its Secured Creditors additional Entrenched Rights in relation to any amendment of this additional covenant protection and the associated TTT Project-related definitions.

TWUL has requested an amendment to clauses 8.3 and 8.4 of the STID as follows:

- (i) the word “or” is deleted at the end of clauses 8.3.12 and 8.4.12;
- (ii) the comma at the end of clauses 8.3.13 and 8.4.13 is deleted and replaced with “;or); and
- (iii) the following is added to clauses 8.3 and 8.4 (square brackets and numbering deleted as required):

“8.[3]/[4].14 would relate to Paragraph 55 (*TTT Project*) of Part 3 (*General Covenants*) of Schedule 4 (*Covenants*) to the CTA; or

8.[3]/[4].15 would relate to the definitions of TTT Core Project Documents, TTT Project and TTT Project Key Characteristics in Schedule 2 (*Common Definitions*) to the MDA,”.

2 Amendment Conditions

Implementation of the STID Proposal is conditional on:

- (a) the issue of the Project Specification Notice; and
- (b) the affirmation of the relevant ratings set out in the definition of Rating Requirement by all Rating Agencies then rating the Bonds,

(the “**Amendment Conditions**”). The Issuer will announce satisfaction of the Amendment Conditions as soon as practicable thereafter.

3 TTT Project Key Characteristics

Consent to the Proposals is sought on the basis that the TTT Project will demonstrate the following key characteristics which TWUL considers to be the key benefits of the structure to Secured Creditors:

1. Specification of the TTT Project

The Secretary of State or Ofwat specifies the TTT Project under the SIP Regulations.

For so long as the Project Specification Notice is not revoked, the SIP Regulations prohibit TWUL from undertaking the TTT Project (as specified), subject to any preparatory works which TWUL is required or permitted to undertake should the Secretary of State or Ofwat give a notice pursuant to Section 5(3) of the SIP Regulations.

2. Revocation of the Project Specification Notice

If the Project Specification Notice is revoked:

- (i) TWUL will have an obligation under the TWUL Licence to put forward a proposal to meet the requirements of the UWWTR and make the existing IP assets safe;
- (ii) in respect of any works to secure the IP assets and/or the TWUL assets in relation to the TTT Project TWUL will be entitled under the TWUL Licence to the economic and efficient costs for securing the IP assets and the TWUL assets through either a determination by Ofwat or the Competition and Markets Authority pursuant to the regulatory settlement process;
- (iii) in respect of any works to implement any proposal with a view to securing compliance with the requirements of the UWWTR, TWUL will only be obliged, under the TWUL Licence, to implement such works to the extent that the additional funding has been awarded to TWUL through either a determination by Ofwat or the Competition and Markets Authority pursuant to the regulatory settlement process; and
- (iv) the IP shall have no right under any agreement with TWUL to claim any sum from TWUL in respect of any IP assets which may transfer to TWUL in these circumstances.

3. An entity that is separate from TWUL is designated to deliver the TTT Project

An entity that is separate from TWUL is designated by the Secretary of State or Ofwat as an infrastructure provider to deliver the TTT Project as specified in the Project Specification Notice.

4. IP Project Licence award

Following designation, the IP is awarded a licence by Ofwat (the “**IP Project Licence**”), pursuant to which the TTT Project will be its regulated business.

5. TWUL Licence modified to allow pass-through of IP Charges

TWUL Licence is modified to include provisions which allow TWUL to charge customers in respect of the IP Charges.

6. Pay when Paid only

In respect of the IP Charges, under the revenue agreement TWUL does not enter into or accept any obligation to pass to the IP amounts other than the IP’s proportion of any sums received from wastewater customers in that period in respect of wastewater charges.

7. No Payment Acceleration

Neither the revenue agreement nor any other document entered into by both TWUL and the IP permits the payment profile of IP Charges to be accelerated for default.

These are known as “**Key Characteristics**”.

Secured Creditors have been requested to respond to the STID Proposal by no later than 2 June 2014. If the STID Proposal is approved by the Majority Creditors, the amendments to the Finance Documents will be implemented, subject to satisfaction of the Amendment Conditions, and will be binding on all Secured Creditors (including Bondholders).

CHAPTER 5 GLOSSARY OF DEFINED TERMS

“Acceptance” means the date on which the IP Liability is recognised in TWUL’s accounts which TWUL, on the advice of its accountants, currently expects to be between Handover and Systems Acceptance.

“Assets” means the sewerage assets to be constructed and maintained by the IP in accordance with the Project Specification Notice.

“Commencement Date” means the date on which the IP is awarded the IP Project Licence.

“CSO” means combined sewerage overflows.

“DCO” means development consent order.

“Discontinuation Agreement” means the agreement between, among others, the Secretary of State, and the IP of that name dated on or around the Commencement Date.

“Discontinuation Notice” means a notice issued by the Secretary of State in accordance with the Discontinuation Agreement.

“FWMA” means the Flood and Water Management Act 2010.

“Handover” means the completion of construction and commission of the Assets and the sewerage assets.

“IP” means the company designated by the Secretary of State or Ofwat under the SIP Regulations to deliver the TTT Project.

“IP Designation Notice” means a notice issued by the Water Services Regulation Authority in accordance with Regulation 8(1) of the SIP Regulations.

“IP Liability” means any financial liability in the financial statements of TWUL arising in respect of the TTT Project and noted as such in the financial statements (other than any amounts which are overdue for payment).

“IP Project Licence” means the project licence to be granted to the IP pursuant to section 17FA of the WIA (as given effect by the SIP Regulations).

“IP Works” means the design, construction, commission and commencement of the TTT Project (including all necessary permanent and temporary works) and any other works carried out the IP in accordance with the TTT Project documents, excluding the TWUL Works.

“Project Specification Notice” means the notice which may be issued by the Secretary of State or Ofwat in accordance with Regulation 4(1) of the SIP Regulations in respect of the TTT Project.

“Proposals” means the proposed amendments to the Finance Documents set out in the section entitled “*Proposed amendments to the Finance Documents*”.

“Revenue Agreement” means the revenue agreement as described in the section entitled “*Description of the TTT Project – Part 4 – Revenue Agreement*”.

“SCADA” means supervisory, control and data acquisition.

“Secretary of State” means the Secretary of State for Environment, Food and Rural Affairs.

“SIP Regulations” the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 (as amended from time to time).

“Systems Acceptance” means the acceptance of all of the Assets in accordance with the Interface Agreement.

“TTT Project” means the project to deliver the tunnelling project and associated works known as the Thames Tideway Tunnel.

“TWUL Works” means those works set out in the schedule to the Interface Agreement.”

To the extent there is any inconsistency between any statement in this Supplement and any other statement in or incorporated by reference in the Prospectus, the statements in this Supplement will prevail.

Save as disclosed in this Supplement, no other significant new factor, material mistake or inaccuracy relating to information included in the Prospectus has arisen or been noted, as the case may be, since the publication of the Prospectus.

Investors should be aware of their rights under Section 87Q(4) of the FSMA.

If documents which are incorporated by reference to this Supplement themselves incorporate any information or other information therein, either expressly or implicitly, such information or other documents will not form part of this Supplement for the purposes of the Prospectus Directive except where such information or other documents are specifically incorporated by reference or where this Supplement is specifically defined as including such information.

To the extent that there is any inconsistency between (a) any statement in this Supplement and (b) any other statement in or incorporated by reference in the Prospectus, the statements in (a) above will prevail.

Save as disclosed in this Supplement, no other significant new factor, material mistake or inaccuracy relating to information included in the Prospectus has arisen or been noted, as the case may be, since the publication of the Prospectus.