

WATER INDUSTRY ACT 1991 S.13(1)
MODIFICATION OF THE CONDITIONS OF APPOINTMENT OF
SOUTH STAFFORDSHIRE WATER plc

Made on 10 August 2005
Coming into effect on 11 August 2005

The conditions in the Appointment of South Staffordshire Water plc as a Water Undertaker are modified as follows:-

Condition F

1 In paragraph 1, after (4) there shall be inserted:-

"(4A) the transfer of assets (including the provision of financial support) to Associated Companies does not adversely affect the Appointee's ability to carry out its functions as a water undertaker or to finance those activities;"

2 From the subheading which follows sub-paragraph 6.7, the word "Financial" is deleted.

After sub-paragraph 6.7 there shall be inserted the following:-

"6.8 The Appointee shall not, in respect of any Charging Year, make any payments to any Associated Company in respect of the services rendered to the Appointee by that company, which exceeds:

(i) such prices in respect of the service in question which the Appointee has ascertained by market testing in accordance with such arrangements as the Director may have approved for the purpose of this paragraph and as set out in Regulatory Accounting Guideline 5 (Transfer Pricing in the Water and Sewerage Industry) or any revision or modification of it for the time being in force, provided that those arrangements have no prejudicial effect upon the proper carrying out of the Appointee's functions or any of them; or

(ii) if, in the opinion of the Director, the Appointee has demonstrated that market testing as described in (i) above is inappropriate, such proportion as the Director may agree of the Associated Company's costs in providing to the Appointee the service in question (including a reasonable return to the Associated Company).

6.9 Without prejudice to sub-paragraphs 6.1 to 6.7 above, the Appointee shall obtain from any Associated Company referred to in sub-paragraph 6.8, such information about the latter's costs as the Director may reasonably require.

- 6.10 The Appointee shall not, without the consent of the Director (such consent not to be unreasonably withheld or delayed) and otherwise than in compliance with his directions concerning the valuation of the asset and the treatment of the consideration in the Appointee's accounts, transfer to any Associated Company to which sub-paragraph 6.8 applies any right or asset to which paragraph 3 of condition K of these conditions applies.
- 6.11(1) The Appointee shall not, without the consent of the Director (such consent not to be unreasonably withheld or delayed)
- (i) give any guarantee of any liability of any Associated Company; or
 - (ii) make to any such company any loan.
- 6.11(1A) The Appointee shall not, without the consent of the Director (such consent not to be unreasonably withheld or delayed)
- (i) enter into any agreement or incur any commitment incorporating a cross-default obligation; or
 - (ii) subject to (1B) below, continue or permit to remain in effect any agreement or commitment incorporating a cross-default obligation.
- 6.11(1B) Where liability under the cross-default obligation would arise only on a default by a subsidiary company of the Appointee, the Appointee may permit that cross-default obligation to remain in effect for the period for which it was fixed by the instrument which created it, so long as its potential liability is not increased and no changes are made in the terms under which that liability might arise.
- 6.11(2) For the purposes of this sub-paragraph 6.11
- (a) **"liability"** includes the creation of any mortgage, charge, pledge, lien or other form of security or encumbrance, the making of any loan and the undertaking of any other indebtedness;
 - (b) **"loan"** includes the transfer or lending, by any means, of any sum of money or of any rights in respect of that sum; and
 - (c) **"cross-default obligation"** means a term of any agreement or arrangement whereby the Appointee's liability to pay or repay any debt or other sum arises or is increased or accelerated by reason of a default of any person other than the Appointee.
- 6.12 Without prejudice to the application of sub-paragraph 6.2 the Appointee shall declare or pay dividends only in accordance with a dividend policy which, has been approved by the Board of the Appointee and which complies with the following principles –

- (i) the dividends declared or paid will not impair the ability of the Appointee to finance the Appointed Business; and
- (ii) under a system of incentive regulation dividends would be expected to reward efficiency and the management of economic risk .”

3 Paragraph 6A shall be amended as follows:-

Sub-paragraph 6A.2 shall be renumbered 6A.2A.

At the end of sub-paragraph 6A.2A there shall be inserted a semi-colon instead of the full stop, followed by:-

"and

- (3) that in the opinion of the directors, all contracts entered into with any Associated Company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water undertaker."

After sub-paragraph 6A.2A there shall be inserted:-

"6A.2B(1) The Appointee shall, when it complies with sub-paragraph 6A.2A, submit with each certificate a statement of the main factors which the directors have taken into account in giving that certificate.

6A.2B(2) Without prejudice to sub-paragraph 6A.3 below, the directors shall inform the Director in writing as soon as they become aware of any circumstance which causes them to believe that the most recent certificate under sub-paragraph 6A.2A could not be repeated in the light of that circumstance."

In sub-paragraph 6A.3(2) the reference to sub-paragraph 6A.2 shall be amended to refer to sub-paragraph 6A.2A.

In line 1 of sub-paragraph 6A.4 the reference to sub-paragraph 6A.2 shall be amended to refer to sub-paragraphs 6A.2A and 6A.2B.

At the end of sub-paragraph 6A.4 there shall be inserted a semi-colon instead of the full stop, followed by:-

"and

- (3) in the case of each certificate under sub-paragraph 6A.2A, shall be accompanied by a report prepared by the Appointee's Auditors and addressed to the Director, stating whether they are aware of any inconsistencies between that certificate and either the statements referred to in sub-paragraph 9.3 or any information which the Auditors obtained in the course of their work as the Appointee's Auditors and, if so, what they are.

6A.5A The Appointee shall, at all times, conduct the Appointed Business as if it were substantially the Appointee's sole business and the Appointee were a separate public limited company. The Appointee should have particular regard to the following in the application of this condition:-

- (a) the composition of the Board of the Appointee should be such that the directors, acting as such, act independently of the parent company or controlling shareholder and act exclusively in the interests of the Appointee;
- (b) the Appointee must ensure that each of its directors must disclose, to the Appointee and the Director, conflicts between duties of the directors as directors of the Appointee and other duties;
- (c) where potential conflicts exist between the interests of the Appointee as a water undertaker and those of other Group Companies, the Appointee and its directors must ensure that, in acting as directors of the Appointee, they should have regard exclusively to the interests of the Appointee as a water undertaker;
- (d) no director of the Appointee should vote on any contract or arrangement or any other proposal in which he has an interest by virtue of other directorships. This arrangement should be reflected in the Articles of Association of the Appointee;
- (e) the Appointee should inform the Director without delay when:
 - (i) a new director is appointed;
 - (ii) the resignation or removal of a director takes effect; or
 - (iii) any important change in the functions or executive responsibilities of a director occurs.

The Appointee should notify the Director of the effective date of the change and, in the case of an appointment, whether the position is executive or non-executive and the nature of any specific function or responsibility;

- (f) the dividend policy adopted by the Appointee and the implications of sub-paragraph 6.12 of this condition F; and
- (g) the Principles of Good Governance and Code of Best Practice (or any successor document having a similar purposes and content) as may from time to time be incorporated into or approved for the purposes of the Listing Rules of the Financial Services Authority.

6A.5B The Appointee shall, at such times and in such ways as may from time to time be required by the Listing Rules of the Financial Services Authority, publish such Information about its annual final results as is by

those rules required to be announced by a company whose shares are for the time being listed on the London Stock Exchange.

- 6A.6 The Appointee shall use all reasonable endeavours to ensure that it, or any Associated Company as issuer of corporate debt on its behalf, maintains at all times an issuer credit-rating which is an Investment-grade rating.

“Investment-grade rating” means a rating recognised as investment grade by Standard and Poor’s Rating Group (or any of its subsidiaries) or by Moody’s Investors Services Incorporated (or any of its subsidiaries) or by Fitch Ratings Limited, or any other reputable credit-rating agency which has comparable standing in the United Kingdom and the United States of America.

“Issuer credit-rating” means a credit-rating assigned to an issuer of corporate debt by Standard and Poor’s Rating Group (or any of its subsidiaries) or by Moody’s Investors Services Incorporated (or any of its subsidiaries) or by Fitch Ratings Limited, or any other reputable credit-rating agency which has comparable standing in the United Kingdom and the United States of America.”

The Roles of the Appointee’s Owners

4. After Condition O there shall be inserted:-

“Condition P: The Role of the Appointee’s Owners

- 1(1) The Appointee shall, not later than 9 September 2005 (or, in the event of any subsequent change of control of the Appointee, the date on which each such change of control takes effect) procure from AqualInvest Acquisitions Limited (or, if it shall at any time cease to be the UK holding company of the Appointee, from the Appointee’s UK holding company) and from Arcapita Bank B.S.C. (c) (or, if it shall at any time cease to be the Ultimate Controller of the Appointee, from the Appointee’s Ultimate Controller) legally enforceable undertakings in favour of the Appointee in a form specified by the Director and expressed to remain in force for as long as the Appointee retains the Appointment.
- 1(2) The undertakings referred to in (1) above shall provide that –
- (a) those companies providing the undertakings will, and will procure that each of their subsidiaries (other than the Appointee and its subsidiaries) will, give to the Appointee all such information as may be necessary to enable the Appointee to comply with the requirements of the conditions of the Appointment;
 - (b) those companies providing the undertakings will, and will procure that each of their subsidiaries (other than the Appointee and its subsidiaries) will, refrain from any action which would or may cause the Appointee to breach any of its obligations under the Act or the conditions of the Appointment; and

- (c) those companies providing the undertakings will ensure that at all times the Board of the Appointee contains not less than three independent non-executive directors, who shall be persons of standing with relevant experience and who shall collectively have connections with and knowledge of the areas within which the Appointee provides water services and an understanding of the interests of the customers of the Appointee and how these can be respected and protected.
2. The Appointee shall, not later than the date referred to in sub-paragraph 1(1) above, produce to the Director the original of each of the undertakings given to it in accordance with paragraph 1 of this condition and provide to him such certified copies of those undertakings as he may require.
 3. The Appointee shall immediately inform the Director in writing if it becomes aware that either of the undertakings referred to in paragraph 1 of this condition has ceased to be legally enforceable or that there has been any breach of its terms.
 4. The Appointee shall not, except with the written consent of the Director, enter (directly or indirectly) into any contract or arrangement with the UK holding company of the Appointee (or the Ultimate Controller of the Appointee as the case may be) or any Associated Company (other than subsidiaries of the Appointee) at a time when:
 - (i) either one of the undertakings complying with paragraph 1 of this condition does not subsist; or
 - (iii) there is an unremedied breach of either of those undertakings.
 5. For the purposes of this Condition P, "Ultimate Controller" means any person (including, without limitation, a corporate body) who or which (alone or jointly with others and whether directly or indirectly) is (in the reasonable opinion of the Director) in a position to control, or to exercise material influence over, the policy or affairs of the Appointee or of any holding company of the Appointee."

Philip Fletcher