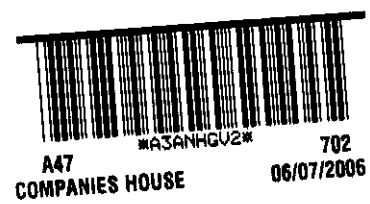


Registered no: 02366661 (England and Wales)

## **Thames Water Utilities Limited**

Annual Report and Financial Statements

For the year ended 31 December 2005



# Thames Water Utilities Limited

## Annual report for the year ended 31 December 2005

	Pages
Directors and Secretary	2
Chairman's review	3 - 10
Corporate governance	11 - 15
Directors' remuneration report	16 - 18
Directors' report	19 - 25
Report of the independent auditors	26 - 27
Profit and loss account	28
Balance sheet	29
Cash flow statement	30
Notes to the cash flow statement	31
Notes to the financial statements	32 - 56

# Thames Water Utilities Limited

## Directors and Secretary at 31 December 2005

### Directors

J D Pelczer	Chairman
W U Böttcher	Managing Director
R J Aylard	External Affairs and Environment Director
S J Buck	Finance Director
J M England	Chief Operating Officer
S C Walker	Investment & Technology Director

### Independent non-executive directors

C Bowe	Deputy Chairman
J C Gains	
S Slipman	

(See page 20 for changes in directors since 31 December 2004).

### Company Secretary and registered office

K G Johnson  
Clearwater Court  
Vastern Road  
Reading  
Berkshire  
RG1 8DB

# Thames Water Utilities Limited

## Chairman's review

Thames Water Utilities Limited, serving London and the Thames Valley, is the largest water and wastewater company in the United Kingdom, based on the number of customers served.

The Company's operating environment in London presents some unique challenges. The nation's capital has some of the oldest infrastructure serving the largest and most densely populated city in the country, with very high concentrations of traffic and economic activity all round the clock. The population is steadily increasing, inevitably putting greater demands on the water and sewer network, whose maintenance costs have accelerated in recent years. While there has been progress in 2005 in tackling leakage and sewer flooding, it is acknowledged that more needs to be done.

At the beginning of the year, the Board of Directors accepted the Final Determination by the Director General of Water Services for the regulatory price review for the period 2005-10. Although it presents some challenges, this will enable Thames Water to increase its programme of investment. Prices have needed to rise, but the review demonstrated that this is necessary to improve the essential infrastructure on which our customer service relies. The Company and its employees are fully committed to serving the needs of its customers, the communities within which it operates and the environment, in an increasingly efficient and effective way.

## Water resources

At the time of writing this report, the Thames Water region is in the midst of one of the most severe droughts since records began in 1897. Since the start of November 2004, we have seen only two months of above average rainfall, and 2005 was the third driest year for over a century. While we expect to see less rainfall in the summer, the situation in our area is particularly severe as a result of two consecutive dry winters. It is only during winter that rainfall has the chance to sink down through the soil to refill the underground aquifers, which feed the rivers and boreholes on which we depend for supplies.

The lack of substantial rainfall over the last two winters has led to very low ground water levels across the region, resulting in flows in local rivers at between a half and a third of their normal levels. Unless we have significant rainfall through the spring and summer, the low ground water levels and low river flows will mean that water levels in our reservoirs will start to fall much earlier and faster than usual.

As from 3 April 2006, this serious situation has led us to introduce the first hosepipe and sprinkler ban in our region for 15 years. This is not a decision we have taken lightly. We are reluctant to restrict the amount of water our customers can use - but we have had to impose these restrictions as a prudent measure to protect the environment and lessen the likelihood of further restrictions at a later date.

We are working hard to increase supplies and save water. We are committed to reducing leakage, which remains unacceptably high, as rapidly as possible. We are spending on average more than £500,000 per day on this and are fixing an average of 200 leaks a day. We have more than 1,000 people working on our ambitious project to replace our oldest and leakiest mains in London.

We are also encouraging customers to think carefully about their use of water, and have launched a series of radio and newspaper adverts highlighting how people can conserve supplies in the home and garden. In addition, we have joined forces with other water companies in the South-East to create a cinema advert promoting careful use of water, and to spread the message further on a jointly-run website, [www.beatthedrought.com](http://www.beatthedrought.com). We thank customers for their response to date, and will continue to stress the need to limit water use in order to conserve resources throughout the summer.

# Thames Water Utilities Limited

## Chairman's review (continued)

Even without the drought, climate change, new housing, development pressure and changing land use would place increasing pressure on water resources in the South East of England. The sustainable management of water resources is a key challenge facing the business.

One proposed resource scheme is an innovative water treatment plant in Newham, East London. A pilot plant has been constructed and, if planning permission is obtained, a full-scale plant will be completed utilising the latest desalination technology to treat brackish water from the Thames Estuary. Despite support from the local planning authority, the application for planning approval for the plant was refused following direction from the Mayor of London. We are appealing this decision, which will be referred to the Secretary of State following a Public Inquiry in 2006. We respect the views of the Mayor but remain convinced of the need for the plant and its role in securing water supplies to the capital.

Using water more efficiently is an important contribution to safeguarding supplies. During 2005 we distributed well in excess of 100,000 water saving cistern devices, 1.8 million self-audit questionnaires and a series of tips over the radio and through other advertising to help customers reduce their water use.

### Customer service

We are committed to providing all of our customers with a high quality service at all times. With this in mind, one of our principal aims is to respond quickly and positively to enquiries and service requests from our customers.

The Spring of 2005 saw the implementation of significant increase to prices as a result of the Office of Water Services' (Ofwat) Periodic Review. One impact of this was an increase in customer contacts in April 2005; with peak call volumes some 15% higher than during annual billing in 2004 and an overall increase of 3% in the volume of contacts in 2005. Against this background, our service performance in 2005 improved, with a reduction in the number of customers abandoning their calls, and the number of calls answered within 30 seconds improving.

However, despite these improvements we did not believe that we were able to offer every customer the level of service we would have liked. In response we implemented a number of initiatives to improve our performance. These included a systematic review of our operations to improve both efficiency and effectiveness, and the recruitment of additional staff to support key areas such as customer complaints. We will continue to invest in service improvements in the forthcoming year.

Throughout 2005, we continued to offer a range of different payment methods and instalment plans to make payment of bills as easy as possible and our Customer Service Advisers were on hand 24 hours a day to offer advice and assistance. For those customers in need of extra help we continued to provide a range of additional services. Large print, Braille and talking bills were included for those with impaired vision and textphone, typetalk and sign language for the hard of hearing. A multi language facility and the nomination of a friend or relative to speak on behalf of a customer were also available.

We will continue to invest in service improvements in the forthcoming year. Bills will rise to cover this and other essential investments, but in 2005 we were still able to offer the lowest average combined bills for water and wastewater in England and Wales.

### Operations

A high quality water supply is a high priority for our customers and we deliver this through our investment programme and operating practices. In 2005, the Drinking Water Inspectorate introduced

# Thames Water Utilities Limited

## Chairman's review (continued)

new ways of reporting compliance with regulations. We achieved 99.9% compliance with water quality standards at customers' taps, matching our performance in 2004 and maintained our position in the upper quartile of all water companies for this measure.

Our wastewater treatment works are required to meet some of the highest standards in the United Kingdom. We operate 349 works, treating wastewater from around 13 million people and a wide range of industries. Unfortunately, our 2005 year end Wastewater Treatment Works (WWTW) compliance position was 99.22% (2004: 99.86%) (based on the standard Environment Agency measure of pollution load in terms of the population equivalent served by each WWTW). This was a disappointing result, which we are determined to improve and remedial work is in hand.

Performance against Ofwat levels of Service for sewer flooding was affected by an exceptional severe storm in September 2005, which flooded several hundred properties. This is the fifth severe storm event in a four-year period, all of which occurred in the Greater London area. Classification of the severity and intensity of the storms range from a 1 in 130 year through to a 1 in 500 year rainfall return period. These types of storms significantly impact the normal operation of our sewerage systems and its ability to cope under these conditions. We apologise to those customers who were affected by these incidents.

During the period of 2000-2005 we spent £82m to provide flood alleviation schemes to reduce the risk of flooding to 2000 properties from overloaded sewers. We are determined to continue to invest and ensure that we reduce the risk of sewer flooding to our customers. At the last Periodic Review, we were supported by the Consumer Council for Water, Government Ministers and Local Councillors and secured funding to the value of £323m for the period 2006 – 2010. We will continue to give priority to this investment, refining the process which we have developed over the last few years and which assesses the frequency and customer impact of flooding.

Over the period we have continued our programme of network improvements and worked closely with local authorities in London to ensure that further reconfiguration and water pressure management could take place in harmony with the initiatives and priorities of London Boroughs. Where, following pressure management initiatives, pumps are required inside tall buildings to maintain pressure over and above our levels of service, we offered to contribute 50% towards the owner's costs of installation.

At the end of March 2005, we submitted our leakage figures to Ofwat for the period April 2004 to March 2005. We achieved the leakage target in our Thames Valley water supply area but missed the overall company target by 10 Mega litres per day. We continued to focus on proactively finding and fixing leaks and repaired 14% more detectable leaks in 2005 (45,596) than in the previous year (2004: 40,055). A cold spell in February resulted in an increase in leakage, particularly in London. Thereafter, leakage levels fell consistently after the spring and reached a low point in early November with leakage in the Thames Valley at the lowest level since we began reporting figures for this area separately.

In the long-term our strategy of delivering a sustainable leakage reduction is dependent upon our Victorian Mains Replacement programme. In 2005 we accelerated this work and replaced over 150 km of the oldest water mains in London. This replacement of old cast iron pipes with plastic ones is, over time, a more effective way to combat leakage than the 'find and fix' approach.

In the UK, enforcement of the law governing discharges to the water environment applies tests of 'strict liability'. When pollution incidents occur, this is often due to exceptional weather conditions, or to blockages in our sewers due to the illegal presence of cooking fat and grease and unsuitable solid items of refuse which should be disposed of in other ways. Our incident prevention, control and response arrangements remain under regular review and significant improvements have been introduced. All incidents are carefully examined and appropriate steps are taken to reduce the risk of

# Thames Water Utilities Limited

## Chairman's review (continued)

failure in the future. In 2005 the number of serious Category 1 and 2 Pollution Incidents excluding those relating to the Tideway Operating Agreement decreased by 35% in comparison with 2004.

Nonetheless, we regret that pollution incidents, some of which had occurred in previous years, resulted in the Company being fined on four occasions in 2005. Of these, one was caused by a sewer blockage, one resulted from a leak of heating oil and the remaining two from alarm management failure. The fines for these last two convictions accounted for over 80% of the fines incurred. We will continue to work in conjunction with Ofwat and the Environment Agency to establish ways in which preventative procedures can be further improved. The Environment Agency introduced the Compliance Classification Scheme (CCS) in January 2005. The purpose of the CCS was to classify discharge non-compliance, and any resulting enforcement action, in a nationally consistent manner. The categories, and resulting enforcement actions, mirror the scheme already in place for pollution incidents. The two schemes differ on how the impact of incidents is measured. This makes it difficult to forecast how the Environment Agency will treat compliance with the CCS and, as at end of 2005, there has been no enforcement action based on CCS categorisation.

Maintenance and operations of water and waste networks on the public highway is becoming increasingly difficult. Road users have rising expectations, traffic congestion is on the increase and there are skilled labour shortages. We also face greater enforcement activity by Highway Authorities, driven by the requirements of the Traffic Management Act 2004. This legislation will continue to have a significant impact on our street works as new requirements for the issue of notices and permits are introduced together with a greater imposition of penalties. A major programme is being developed to meet the new requirements.

### Corporate responsibility, environment and conservation

As a supplier of water and wastewater services, we provide a public service and this means that corporate responsibility has to be an essential part of who we are and the way we work. To us, corporate responsibility embodies a number of issues from providing an efficient and effective service to our customers, meeting the needs of the vulnerable in society, to delivering environmental benefits.

The considerable investment over the coming years to modernise and improve the security and quality of water and wastewater services will lead to higher prices. Ofwat has agreed an investment of £3.1 billion for the period 2005-2010, with customer bills needing to rise by an average of 22%. Although nobody likes increases to bills, given the scale of investment being undertaken, a charge of around 70 pence a day for both water and wastewater services combined continues to represent good value for money. However, we are concerned to ensure that our bills remain affordable for all our customers. Our Customer Assistance Fund made donations totalling in excess of £189,000 during the year helping customers who are unable to pay their bills due to financial difficulty, hardship or distress. More than 1,800 customers are also benefiting from our Vulnerable Tariff Scheme.

We offer educational support to schools through free curricular relevant resources and information through the Company's dedicated education website ([www.waterinschools.com](http://www.waterinschools.com)). New resources in 2005 included development of a CD Rom to encourage young people to save water, and a DVD aimed at nine and ten year olds, which illustrates Thames Water's core business, environmental performance and the Company's association with the international charity WaterAid. We have also continued the successful promotion of our 'Reservoir To Tap: The Network Challenge', which engages students in designing and building a water distribution network.

Employee volunteering builds relationships with the local community, gives employees the chance to develop new skills and adds balance to everyday working life. Our 'Time to Give' scheme, launched in April 2005, offers employees the chance to take two days volunteering leave a year, to support three organisations - WaterAid, Royal Society for the Protection of Birds (RSPB) and Age Concern.

# Thames Water Utilities Limited

## Chairman's review (continued)

We are committed to treating people fairly, recognising their abilities and valuing their opinions. By encouraging diversity in our workforce, we will be able to generate the flow of new, valuable ideas that will drive the Company forward. We have appointed a Diversity and Inclusion Manager and established a Diversity Council composed of senior representatives from across the business with the remit to increase the diversity of our workforce through awareness, training and recruitment activities. For example, we are developing targeted recruitment programmes to recruit and retain staff to areas of the business where there are skills shortages and to ensure diversity mix through such schemes.

### Sustainable use of natural resources

By generating renewable energy and being more energy efficient we can reduce the emissions associated with energy generation from fossil fuels. In London and the Thames Valley we generate over 10% of our energy need from renewable sources, principally sewage gas combined heat and power generation and sewage sludge incineration.

Sustainable management of waste helps reduce our use of landfill. We have continued to integrate good waste management practices across our operational and engineering activities. During the year 48% of operational and 57% of capital investment wastes have been reused or recycled. We have also achieved our target of 100% recycling of sewage sludge to beneficial use, with in excess of 70% of sewage sludge going to agriculture, industrial crops, composting and land restoration and the remainder being used to generate energy. In doing this, we achieved 100% compliance with regulations covering the use of sewage sludge in agriculture, for the eleventh consecutive year.

### Safeguarding biodiversity

We are committed to supporting wider local and national biodiversity action plans, as well as protecting and enhancing the biodiversity on our own sites. In 2005, we continued with the implementation of our Biodiversity Action Plan with the completion of a major survey of our sites which has taken several years to carry out. Through this we have identified 284 'Sites of Biodiversity Interest'. In future years we will be developing management plans for each of these sites to ensure their biodiversity value is protected or enhanced.

### Corporate Responsibility Report

Further information on our corporate responsibility and environmental performance can be found in our annual Corporate Responsibility Report. The report is available from our Customer Centre, PO Box 436, Swindon, SN38 1TU and our internet site ([www.thameswateruk.co.uk](http://www.thameswateruk.co.uk)).

## Looking to the future

### The 2012 Olympics

On 6 July 2005 London was chosen to host the 2012 Olympic & Paralympic Games. The events will take place predominantly in Thames Water's area, with the Olympic Park (including the main stadium and athletes' village) situated in east London. One of the key objectives embedded in the London 2012 Bid was to make these the most environmentally friendly Games in history. This provides Thames Water with the opportunity of not only being involved in the biggest sporting event to take place in the UK, but also to develop and implement sustainable water technologies that will benefit all our customers in the long term.



# Thames Water Utilities Limited

## Chairman's review (continued)

We have established a project team to manage all aspects of our activities associated with the London Olympics, and they will be working with our staff, customers and stakeholders to ensure we respond to any demands placed on the business, and that we make best use of the opportunities that arise from being involved in such a major event with its global coverage.

### Water resources

We continue to plan for the future on the basis of a twin track approach, a combination of demand management measures and resource development schemes to maintain the balance between supply and demand and ensure a reliable supply of water to our customers. In looking ahead we take into account future trends, which will affect either the demand exerted by our customer base, or the supply system on which we rely. These include climate, demographic, behavioural and legislative change. On the basis of these predictions we plan the introduction of demand management measures or resource development schemes as appropriate. Our current predictions show substantial supply demand deficits developing in both the Swindon and Oxfordshire and London Water Resource Zones by the 2020's.

Studies to date have concluded that both significant increases in demand management activity, principally by reducing leakage, and major resource development are needed to meet the deficit.

Previous studies have shown that the one of the best ways of meeting the need for a major resource is to build a dual function direct-supply and river-regulating reservoir, obtaining its water from the river Thames. Such a reservoir would meet the longer term predicted deficit between supply and demand in both the Swindon and Oxfordshire and London Water Resource Zones. A river-regulating reservoir would release water back into the river at times of low river flow. The water released would travel downriver to London where it would be pumped into the existing reservoir system. *The reservoir would be filled at times of high river flows, normally in the winter. The preferred site for a dual function reservoir is to the southwest of Abingdon.*

Work has started on the preparatory studies necessary for the development of a major resource. As the time now available for the promotion of a large scale project is very short, the original studies, investigating need and site selection, are currently being re-evaluated at the same time as preparatory environmental, engineering and planning studies are being undertaken.

### Improving the Water Quality of the Tidal Thames

As an environmentally responsible operator we are continuously working to improve our standards across our water and wastewater practices in ever challenging times of increased demand and legislation. The high profile incident in August 2004, when intense storms led to major discharges of untreated sewage to the River Thames, led to an agreement with Ofwat to carry out a £400 million investment programme at London's three principal wastewater treatment works (WWTW): Beckton, Crossness and Mogden. This work will increase the treatment capacity of the sites so that a greater volume of sewage can be treated as flows rise due to rainfall, and so reduce the potential for storm discharges of partially treated sewage to the River Thames. We are also making improvements to the standards of wastewater treatment at Beckton and Crossness works, which will improve the quality of treated effluent entering the river during summer months, when it is most susceptible to pollution.

This will help boost oxygen levels in the river, improving the habitat it offers for fish and other aquatic life and in combination with the capacity increases, will produce a major benefit to the water quality of the tidal Thames. Planning applications will be submitted in autumn 2006.

Discharges of storm sewage to the tidal Thames come from our WWTW and from overflow points on

# Thames Water Utilities Limited

## Chairman's review (continued)

London's combined sewer system, both of which have a finite capacity which limits the amount of heavy rainfall they can handle. Although regrettable, these discharges help prevent the excess rainfall and sewage from flooding homes, businesses and streets in London. The improvements we are proposing will reduce discharges of storm sewage arising from the WWTW, but not from the sewer system.

The impact of these sewer system discharges has been examined by the independently chaired Thames Tideway Strategic Study, a group which includes ourselves, Ofwat, the Department for Environment, Food and Rural Affairs (Defra), the Environment Agency and the Greater London Authority. The group published a report detailing its preferred solution to discharges from the sewers: a storage and transfer tunnel which would transport storm sewage to East London for treatment.

Measuring 35km in length (equal to London Underground's Jubilee Line) and 7.2m wide, the Tideway Tunnel would be a major feat of engineering. Running underneath the Thames, it would capture the diluted sewage (mixed with rainwater), which currently overflows into the Thames when the existing sewer network becomes overloaded following rainfall.

We recognise the case for building the proposed Tideway Tunnel. We have the capability to build the tunnel but the size of the project would be such that it could expose the Company to significant cost and delivery timing risks. In order to proceed, we would need to agree with Government and Ofwat on how these issues would be addressed.

We have also greatly reduced the amount of sewage litter entering the river during storms by installing litter screens at Abbey Mills pumping station in East London. In 2006 we are commissioning specially designed 'skimmer' boats that will remove surface litter from the river after storm discharges to reduce the aesthetic pollution of the river.

## Our employees

The employees of Thames Water Utilities Limited have again shown huge commitment and dedication in what has been a very demanding year. Despite suffering below average rainfall for 11 consecutive months, customers within the Thames Valley and London did not experience any water restriction throughout 2005. This was an outstanding achievement, and was due to the skill and experience of all those individuals who were involved in the Water Resources project. As 2006 continues, the drought arising from two consecutive dry winters and continuing below average rainfall means that the Thames Water workforce continues to face challenging times. I would like personally to thank all employees for their ongoing commitment to the provision of water services to the public.

In July 2005, our then chairman, Bill Alexander, was awarded a CBE in recognition of his services to the water industry. He retired from the Board on 16 November 2005, after 16 years of service to the Company as a Director, ten of which were as Chairman. I speak for all of us in thanking him for his sterling service over the years, and passing on our very best wishes for the future.

## The divestment of RWE Thames Water plc

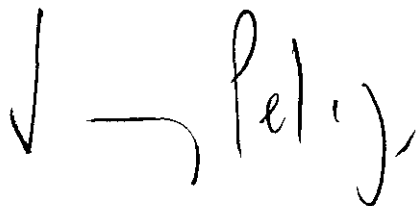
On 4 November 2005, RWE AG announced its decision to divest RWE Thames Water plc in order to concentrate on its core businesses of electricity and gas supply. This has the potential to be an unsettling time for employees, who needed to be kept informed on progress. I launched a series of regular update meetings at key sites for any member of staff who wished to attend, supported by email and intranet updates. The Company shares a number of common services with other RWE AG companies in the UK, notably with RWE npower plc. Following the announcement, a working party has been meeting to ensure a smooth separation of these services with the minimum of

# Thames Water Utilities Limited

## Chairman's review (continued)

disruption.

The divestment of our parent company will take some time to happen and day-to-day business must continue. It remains as essential as ever, that all of us at Thames Water Utilities Limited remain focused on customer service and our regulatory obligations.

A handwritten signature in black ink, appearing to read 'J Pelzer'.

**Jeremy Pelzer**  
Chairman  
21 June 2006

# Thames Water Utilities Limited

## Corporate governance

The Company is committed to high standards of corporate governance. Although the Company's shares are not listed, in conducting the regulated water and wastewater business the directors pay particular regard to the principles of good governance set out in the Combined Code on Corporate Governance 2003 (the "Combined Code"), as approved for the purposes of the Listings Rules of the Financial Services Authority. In this report it has been our aim to *maintain* a level of disclosure in keeping with those Combined Code provisions as appropriate to the Company's status as a wholly owned subsidiary.

### The Board

The primary responsibility of the Board is to consider the strategic direction of the Company and to promote good corporate governance. To this end, it monitors the executive management and reviews operating and financial performance. The Board has adopted a schedule of matters reserved to it, which is reviewed annually. In reaching decisions the Board takes account of the interests of its shareholder, customers and employees, as well as the Company's responsibilities to the environment. In the year, the Board met nine times.

The shareholder appoints directors. The Directors' Remuneration Report gives further details as the terms of their engagement. A copy of the terms and conditions of appointment of non-executive directors is available for inspection from the Company Secretary at the Company's registered office during normal business hours.

C Bowe, J C Gains, S Slipman and the former director P T Warry, are all considered to be or to have been independent non-executive directors. The Deputy Chairman of the Board, C Bowe, is regarded as the senior independent non-executive director.

J C Gains joined the Board on 1 April 2005 as an independent non-executive director and underwent an induction programme, which included visits to the Company's main operating sites. In November 2005, J D Pelczer joined the Board. He had an existing executive role within the RWE Thames Water plc group, and only induction activities tailored to his additional responsibilities as a Board member were provided. The Chairman has delegated responsibility for the induction of Directors to the Company Secretary.

The current Chairman, J D Pelczer, and the independent non-executives met without the executive directors present on two occasions in the period. The independent non-executives have not met on their own to appraise the Chairman's performance as he is a recent appointment.

The former Chairman, W J Alexander, held the outside appointment of non-executive Chairman of Xansa plc. Both the former and current Chairmen held or hold other appointments as director within the RWE AG group. Neither the current Chairman nor any executive director holds any external appointment as a non-executive director.

The Board engaged the external consultants Independent Audit Ltd (IA) during the year to review the effectiveness of the Audit Committee. IA reported in November 2005 that a sound basis was already in place for the role of the Committee and that it added value to the governance process. However, IA suggested improvements could be made, and these are being considered by the Committee and by the Board.

In late 2005, the Board commenced an evaluation of its own effectiveness, also with the assistance of IA. IA conducted interviews and discussions with members of the Board and senior management, supported by a review of the Board process and papers. In addition, they observed a Board meeting in progress. IA's report will be considered carefully by the Board.

# Thames Water Utilities Limited

## Corporate governance (continued)

The Company Secretary is responsible for advising the Board on governance matters and ensuring that Board procedures are followed. All directors have access to his advice and services. Through him, the directors may obtain independent professional advice at the Company's expense. The appointment and removal of the Company Secretary is a matter for the Board as a whole.

### Roles of the Chairman and Managing Director

There was a clear division of responsibility between the former and current Chairmen and the former Managing Directors of the Company up to 20 January 2006, set out and agreed by the directors in the Board's Terms of Reference. Although each Chairman was or is a director of the parent company, RWE Thames Water plc, and thus not independent within the meaning of the Combined Code, the role was one of a non-executive director of the Company. On 20 January 2006, the Board decided that, given the almost exclusive focus of RWE Thames Water plc and its subsidiaries on operations in the UK, it was appropriate to combine the roles of Chairman and Managing Director. Accordingly, the Chairman took over the role of Managing Director. Although this is not in line with best practice as recommended in the Combined Code, the Board believes that it is acceptable in the current circumstances.

### Board Committees

The Board has formally delegated specific responsibilities to board committees. These include Audit, Nomination and Remuneration Committees. Their terms of reference are available on request from the Company Secretary at the Company's registered office during normal business hours.

### Audit Committee

The primary objective of the Audit Committee is to assist the Board of Directors in fulfilling its responsibilities relating to the adequacy and effectiveness of the Company's systems of internal control. This includes reviewing the Company's interim and annual financial statements, its accounting policies, the management of its financial and business risks, the effectiveness of the internal audit function; and the independence, objectivity and effectiveness of the Company's external auditors. It makes recommendations to the Board in relation to the external auditors' appointment and remuneration. The Committee reviews arrangements by which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The Audit Committee's objective is to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.

The Audit Committee is composed exclusively of the independent non-executive directors. It meets with executive directors and management and privately with the external and internal auditors. In the period, it met five times.

External audit services are pre-approved by the Audit Committee each year. In the year, the auditors provided limited additional audit-related services to the Company, in support of claiming grants and debt issuance. They also provided limited amount of tax advice. Monks Partnership, a subsidiary of the auditors, supplies remuneration data. In the opinion of the Committee, these additional services are compatible with the role of an independent auditor.

# Thames Water Utilities Limited

## Corporate governance (continued)

C Bowe, Deputy Chairman of the Board and senior independent non-executive director, has held significant executive positions with bodies in the finance industry. The Board is satisfied that she has recent and relevant financial experience.

**Members:** C Bowe (Chairman), J C Gains (from 1 April 2005), S Slipman, P T Warry (to 21 January 2005).

### Remuneration Committee

The Remuneration Committee determines the salaries and other remuneration of the executive directors whose roles are dedicated to the Company. That of other executive directors is dealt with by the parent company RWE Thames Water plc, reflecting their wider role within the RWE Water Division.

The independent non-executive directors make up the membership of the Remuneration Committee. It is authorised to obtain external professional services, or consultants' advice. Members do not participate in decisions concerning their own remuneration. The Chairman of the Board or his delegate attends meetings, but is not a member, cannot vote on recommendations and would not attend if any business relating to his role were to be considered. In the period the Committee met twice.

The Board approves the Directors' Remuneration Report for inclusion in the Company's Annual Report.

**Members:** S Slipman (Chairman), C Bowe, J C Gains (from 1 April 2005), P T Warry (to 21 January 2005).

### Nominations Committee

A Nominations Committee, made up of the independent non-executive directors and the Chairman of the Board, by whom it is chaired, met twice in the year. In April 2005, J C Gains was recommended to the Board for appointment as an independent non-executive director. In making this decision, the Committee had the assistance of Russell Reynolds Associates and reports from interviews between J C Gains and two of the directors, W J Alexander and W U Böttcher. Russell Reynolds Associates has no other connection with the Company.

In November 2005 the Committee met without either the former or the future Chairman present, to consider and recommend to the Board that J D Pelczer be elected Board Chairman. No external consultant or advertising was used to assist in this matter as his appointment was recommended by the parent company. At the time, the Committee and the Board were aware of his significant commitment to a wider role within the RWE AG group of companies. Notably, he was Chairman and President of American Water Works Company Inc. He relinquished the post of President on 31 December 2005 while retaining the role of Chairman. In addition, he was on appointment and remains to date, an executive director of the Company's parent company, RWE Thames Water plc.

**Members:** J D Pelczer (from 17 November 2005), W J Alexander (to 16 November 2005), C Bowe, J C Gains (from 1 April 2005), S Slipman, P T Warry (to 21 January 2005).

# Thames Water Utilities Limited

## Corporate governance (continued)

### Attendance at meetings

Attendance details for Board and committee meetings are given below:

	<b>Board.</b>		<b>Committee:</b>		<u>Audit</u>		<u>Remuneration</u>		<u>Nomination</u>	
	Possible	Actual			Possible	Actual	Possible	Actual	Possible	Actual
<u>Current Directors:</u>										
J D Pelcer	2	2	-	-	-	-	-	-	-	-
R J Aylard	9	8	-	-	-	-	-	-	-	-
C Bowe	9	9	5	5	2	2	2	2	2	2
S J Buck	8	8	-	-	-	-	-	-	-	-
J M England	9	9	-	-	-	-	-	-	-	-
J C Gains	8	8	4	4	2	2	2	2	1	1
S Slipman	9	8	5	4	2	2	2	2	2	2
S C Walker	9	9	-	-	-	-	-	-	-	-
<u>Former Directors:</u>										
W J Alexander	8	7	-	-	-	-	-	-	1	0
C Anderson	1	1	-	-	-	-	-	-	-	-
W B Böttcher	9	8	-	-	-	-	-	-	-	-
J R Sexton	1	1	-	-	-	-	-	-	-	-
P T Warry	1	1	0	0	0	0	0	0	0	0

### Internal Control

The Board has overall responsibility for maintaining a sound system of internal control, including financial, operational and compliance controls and risk management and for reviewing its effectiveness. The internal control system is designed to manage, rather than eliminate, the risk of failure to meet business objectives and can only provide reasonable, not absolute, assurance against material misstatement or loss. The system has been in place for the year under review and up to the date of approval of the annual report and accounts and accords with the Turnbull Guidance on Internal Control.

The directors routinely review the effectiveness of the system of internal control and risk management, principally by means of:

- Regular presentations to the Board and to the Executive Committee by directors of individual business units and functional heads, describing their risk management strategies and detailing the status of significant business risks.
- Quarterly reports to the Risk Management Committee. Significant changes to the Company's overall risk profile are reported to the Audit Committee and the Board.
- Regular reports to the Audit Committee from the internal audit department.

# **Thames Water Utilities Limited**

## **Corporate governance (continued)**

In addition, the directors have conducted an annual review of the effectiveness of the Company's system of internal control, which includes the period up to the date of this annual report.



# Thames Water Utilities Limited

## Directors' Remuneration Report

The Company seeks to ensure that its remuneration arrangements attract and retain persons of the right calibre as executive and non-executive directors.

The Chairman determines the non-executive directors' fees, after considering the advice of the Human Resources Director and independent benchmarking information. The Chairman may take external advice. The Company's policy on independent non-executive directors is to pay annual fees that reflect the level of responsibilities placed on them. Fees are reviewed every two years and take account of those paid in companies of a similar size and complexity. C Bowe's fees reflect her additional responsibilities as Deputy Board Chairman and Chairman of the Audit Committee.

In February 2005, the then Chairman reviewed the fees of C Bowe and S Slipman with the assistance of the Director of Human Resources. No external advice was taken, other than benchmarking information. That information was supplied by the Monks Partnership, which also provides the Company with other pay and benefits benchmarking and related services.

Independent non-executive directors do not participate in any annual bonus scheme, incentive plan, pension arrangement or healthcare arrangement. The Company repays their reasonable expenses incurred in the performance of their duties. This is in line with their status under the Combined Code.

Where any executive director was employed in a wider role within RWE Thames Water plc, (other than J D Pelczer, the present Chairman and Managing Director), the Company is or was recharged in respect of a portion of their services. The Remuneration Committee approved all elements of the remuneration of executive directors whose responsibilities relate exclusively to the Company. Membership of the Remuneration Committee during the period is shown in the Corporate Governance Report on page 13. The policy was:

- To establish firm links between an executive director's performance and remuneration and between the Company's performance and the executive's total remuneration.
- To position base pay to take account of individual contribution and experience and have regard to the market so that the Company would attract and retain the required calibre of business leader.

Roles are evaluated using the Hay Guide Chart Profile method of evaluation and external advice from the Hay Group. The Hay Group also supply the Company and other companies within the RWE Thames Water plc group with similar services and advice. The remuneration package includes salary, performance-related bonus, a long-term incentive plan and pension provision and these are benchmarked against external market data from remuneration consultants Monks Partnership, a division of PricewaterhouseCoopers LLP and from Towers Perrin. (PricewaterhouseCoopers also act as auditors to the Company). To date executive director salaries have been typically positioned between the median and upper quartiles. Base pay was reviewed in April 2005, although the Committee has the authority to review remuneration at any time in exceptional circumstances.

The Company's bonus scheme aims to reward significant improvement in the Company's performance and recognises the executive's personal contribution to that performance. Other performance measures are the Company's financial targets and operational and customer service targets.

Top-up pension schemes are provided by way of an Inland Revenue approved pension scheme and a funded unapproved retirement benefit scheme. Only basic salary is pensionable.

As an element of retention strategy, in 2005 all the Company's directors, except J R Sexton and the independent non-executive directors, participated in the RWE AG Long-Term Incentive Plan (LTIP) "Beat" scheme. This scheme aims to encourage, reward, recognise and retain key people. Under the LTIP, executives are awarded a number of phantom or "Performance" RWE shares based on the performance of RWE AG against a comparator group of companies known as the Dow Jones Stoxx

# Thames Water Utilities Limited

## Directors' Remuneration Report (continued)

Utilities index.

The value of each performance share is determined at the end of the three-year performance period. There is no automatic right to participate in the LTIP and each year executives are selected at the discretion of the RWE AG Board. Awards are based on individual performance. The Remuneration Committee takes note of the details and decisions of the LTIP scheme when it approves and oversees the remuneration of executive directors. The operation of the LTIP will undergo change in 2006 with the planned demerger of RWE Thames Water Plc from the RWE AG group of companies, prior to sale or initial public offering.

In 2005, both the Company's previous and present Chairman along with W U Böttcher, participated in an alternative LTIP: the RWE AG Stock Appreciation Rights Plan (the "Plan"). The Plan awards stock appreciation rights in RWE AG. The Plan is operated by the ultimate parent company, RWE AG and lies outside of the role of the Committee.

No executive director was paid, either during 2005 or up to the date of this Report, for acting as director outside of the RWE AG group of companies and therefore there is no external remuneration arising to comment on. No third party outside of the RWE AG group was in receipt of any payment for the services of any person who served during year as a director of the Company. All recharges of proportions of directors' salaries by the parent company are done at cost.

Details of contracts of directors who served during the year are set out at the end of this report. The independent non-executive directors each have or had contracts of service with the Company. They are appointed for terms of three years, and are usually expected to serve for six years. All other directors, including the Chairmen, have or had contracts of employment with either the Company or another company within the RWE Thames Water group, but not separate contracts of service as a director of the Company. There is no explicit provision for compensation upon early termination (other than payment for outstanding holidays and pay in lieu of notice). However, the Company operates a redundancy policy, which may apply to executive directors. The notice period for all directors is a rolling period of 12 months.

# Thames Water Utilities Limited

## Directors' Remuneration Report (continued)

### Directors' length of service or employment contract details:

	Date of contract	Unexpired term
<b>Current</b>		
J D Pelczer	17 November 2005	Indefinite
R J Aylard	21 January 2005	Indefinite
S J Buck	1 February 2005	Indefinite
J M England	7 June 2004	Indefinite
S C Walker	20 September 2001	Indefinite
C Bowe	3 July 2001, extended for three years on 1 July 2004	1 year 6 months from 31 December 2005
S Slipman	1 January 2002, extended for three years on 1 July 2004	1 year 6 months from 31 December 2005
J C Gains	1 April 2005	2 yrs 3 months from 31 December 2005
<b>Previous</b>		
W J Alexander	6 November 1989	Resigned 16 November 2005
C Anderson	20 September 2001	Resigned 31 January 2005
W U Böttcher	19 September 2003	Resigned 20 January 2006
J R Sexton	31 July 1992	Resigned 31 January 2005
P T Warry	3 July 2001	Resigned 21 January 2005

Approved by the Board of Directors and signed on its behalf by



**S Slipman**  
Remuneration Committee Chairman  
**21 June 2006**

# Thames Water Utilities Limited

## Directors' report for the year ended 31 December 2005

The directors present their report and the audited financial statements for the year ended 31 December 2005.

### Principal activities

The principal activities of the Company are the supply of water to over 3.6 million premises and the collection and treatment of sewage from over 5.5 million premises, serving around 13 million customers in London and the Thames Valley.

Details of the progress made and information relating to the various activities of the Company during the year, important events since the end of the financial year, and plans for the future are given in the Chairman's Review on pages 3 to 10.

Details of subsidiaries are given in note 10 on page 44 to the financial statements. The Company has no branches outside of the United Kingdom.

### Financial review of the year

The results for the year are set out in the profit and loss account on page 28.

Turnover of £1,333.5m for the year (2004: £1,173.8m), was up 13.6% on the same period in 2004. Real increases in price, as agreed with Ofwat for the regulatory year 2005/06, had a 10.5% impact on turnover for the year ended December 2005. Additionally, 3.4% of turnover growth was due to price increases linked to the Retail Price Index (RPI) and the remaining 0.3% decrease in turnover was predominantly due to the switching of customers from unmeasured to metered water supplies.

Profit on ordinary activities before taxation was £322.7m for the year (2004: £284.3m). Results continue to be adversely affected by increased pension costs to the Company and costs associated with continuing focus on leakage reduction and security of customer supplies. These increased costs have been offset by continuing operational efficiency programmes.

The FRS 17 pension cost for the year was £22.6m (2004: £20.7m). To ensure our future pension obligations to employees are met, the Company pension scheme contribution rate has been increased. Other information about the Company's pension schemes is set out in note 23 on page 53 of these accounts.

Capital investment in the period has been particularly targeted towards security of drinking water supplies to our customers, leakage reduction, water and wastewater quality programmes and the alleviation of sewer flooding. Gross capital investment of £558.8m (2004: £554.9m), including net infrastructure renewal expenditure of £41.8m (2004: £20.4m), was made during the year. This continuing substantial investment programme is reflected in the depreciation charge of £293.6m (2004: £221.2m).

During the year, the Board of Directors accepted the Final Determination by the Director General of Water Services for the regulatory price review for the period 2005-09, which has seen us embark upon a record £3.1 billion investment programme (based on 02/03 prices). Prices have needed to rise, but the review demonstrated that this is necessary in order to make essential improvements to the infrastructure on which our customer service relies. The Company and its employees are fully committed to delivering these improvements over the next few years.

# Thames Water Utilities Limited

## Directors' report for the year ended 31 December 2005 (continued)

### Dividends

The Company paid dividends of £95.4m and of £59.6m in the year (2004: £91.4m and £45.8m respectively).

### Board of directors

The directors of the Company who served during the year are:

J D Pelczer	Chairman (non-executive); appointed 17 November 2005
W J Alexander	Chairman (non-executive); resigned 16 November 2005
J R Sexton	Managing Director; resigned 31 January 2005
W U Böttcher	Managing Director
C Anderson	Finance Director; resigned 31 January 2005
S J Buck	Finance Director; appointed 1 February 2005
R J Aylard	External Affairs and Environment Director; appointed 21 January 2005
J M England	Chief Operating Officer
S C Walker	Investment and Technology Director

Independent non-executive directors who served during the year are:

C Bowe	Deputy Chairman
J C Gains	Appointed 1 April 2005
S Slipman	
P T Warry	Resigned 21 January 2005

W U Böttcher, an existing director, was appointed Managing Director on 1 February 2005. On 20 January 2006, he resigned from the Board and J D Pelczer became Managing Director. On the 25 January 2006, S C Walker undertook additional, executive, duties such that he ceased to be a non-executive director.

### Directors' interests

None of the directors has any interest in the shares of RWE Thames Water plc, or its subsidiary companies. In accordance with Statutory Instrument 1985/802 the directors' interests in shares of the ultimate parent company, RWE AG, have not been disclosed.

### Significant contracts

During the year under review none of the directors had significant contracts with RWE AG, RWE Thames Water plc, or any other group company other than their contracts of service.

### Policy on payment of suppliers

The Company supports a number of initiatives to promote a payment culture consistent with agreed terms, including those supported by the Construction Round Table and the Confederation of British Industry (CBI). All payments to suppliers, service providers and contractors are made on the basis of mutually agreed terms and conditions. During 2005 a major review of our contracts with our main service providers and contractors was undertaken. The average amount due to trade creditors represented 64 days (2004: 68 days) purchases received from these creditors.

# Thames Water Utilities Limited

## Directors' report for the year ended 31 December 2005 (continued)

### Employees

For an organisation such as Thames Water, employees are critical. We recognise the need to invest in their ongoing development and to provide relevant training and career opportunities with appropriate pay and benefits. Following a restructure in the Learning and Development department, the Company offered a more focused and sophisticated approach to training in 2005. Within each business area, detailed plans were developed to give the training to carry out jobs more efficiently and competently.

A "Recruit to Train" project was operated to increase the number of graduates and apprentices entering the organisation and ensure a broader range of skills. Through the "Ambition Energy" project, the Company also successfully targeted the long-term unemployed, offering them the opportunity to join Thames Water and train as leakage or network engineers.

Thames Water is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995. We believe diversity is important for the growth and success of our company. We want Thames Water to be a place where people really want to work, where people listen, where people are trusted, and where we have colleagues who can be relied on.

Our recruitment principles and our approach to diversity and our disability policy, are there to ensure that both job applicants and employees with disabilities have equality of opportunity, are treated fairly and have a safe and practical workplace, free from discrimination, bullying, harassment or victimisation.

Through our disability and attendance management policies, we provide appropriate support and training for employees who become disabled during the course of their employment so that they continue to work in a position appropriate to their experience and abilities.

In 2006 we will again be reviewing our disability policy and will be working with our people and external organisations to ensure that Thames Water becomes an employer of choice for people with disabilities.

A Development Needs Analysis programme was launched in September 2004. 169 Directors and Managers underwent a one-day assessment, which focused on identifying individual levels of competence against a range of leadership criteria. Having reviewed the assessments, it became clear that at an organisational level, Thames Water needed to improve training in certain areas including Stakeholder Engagement and Performance Management. A Stakeholder Engagement workshop was launched and a new Coaching framework set up. The Development Needs Analysis programme also assisted the succession planning process. Individuals identified as being of high potential were moved into more challenging roles.

STEP<sup>UK</sup>, a company wide change programme, raised the profile of the "Employee Lifecycle" work stream. Five key projects were identified to improve Human Resource (HR) activities and further enable the workforce. These were:

- To address staff resourcing needs and put into place staffing plans for the future.
- A Reward Strategy Review to develop flexible benefits and track industry trends.
- A Performance Management Scheme with coaching and a consistent appraisal process.
- A review of HR processes in line with the introduction of HR systems software.
- To identify the core skills and knowledge required for each job in order to give managers and employees a clear understanding of the skills required and to provide the necessary training.

The employee feedback survey "Pulse" was sent to every employee in the organisation and allowed us to gain a comprehensive view of the key issues for the workforce. We achieved a 64% return rate, the highest to date. (2004: 33%). There was a significant improvement in four key areas: development, leadership, performance management and line management. We met our 2005 target of a 5% improvement in our favourability score. Data collected was broken down into 14 business units and allowed managers and employees to respond in respect of their particular area.

# Thames Water Utilities Limited

## Directors' report for the year ended 31 December 2005 (continued)

Formal consultation with employees in the Company happens through a partnership agreement. We work closely with our Trade Union colleagues and employees to heighten awareness of partnership principles and we champion a co-operative and collaborative approach to problem solving. We are committed to sharing information with employees on key business issues and our communications framework is subject to continual review and development. We have in operation a variety of communication channels, including an employee magazine, team briefings and regular e-mail updates, together with the team building conferences and events.

In April 2005, to encourage employee participation in the performance of the RWE AG group, the immediate parent company, RWE Thames Water plc, launched a Share Incentive Plan (SIP) giving Company employees the opportunity to purchase shares in RWE AG out of pre-tax pay. The Company supported the SIP by matching employee purchases on the basis of one additional share for every four purchased by the employee out of the first £30 of each month's contribution.

### Research and development

Expenditure on research and development totalled £5.3m in 2005. (2004: £5.8m).

The Company's research and development programme is a balanced portfolio of projects to address short, medium and long term technical needs across the range of water cycle activities managed by the business. The portfolio of research and development projects engaged in during the year delivered solutions for current business needs and prepared the Company for future scenarios.

Short-term projects in 2005 sought to apply previous research knowledge to driving better performance from existing assets and operational processes. An example was the development of a computer model to predict variation in leakage rates with seasonal water temperatures to enable better scheduling of repair resources. Other projects included pilot trials of improved filtration options for London's largest water treatment plant (Hampton) and successful field trials of sensors and wireless telemetry for individual sewer manholes to prevent sewer flooding.

Medium term research and development projects focused on developing technical solutions to optimise capital investment during the current 5-year regulatory contract period. The largest such project in this sector sought to increase the biological treatment capacity of existing wastewater treatment plants to meet growth in flow and more stringent effluent quality goals. Following successful pilot trials, a full-scale plant operated at Henley wastewater treatment works (WWTW) for more than one year and another started construction at Oxford WWTW. The ultimate application would be to upgrade in a cost-effective manner the very large wastewater treatment plants in London to meet new Thames Tideway quality goals.

Other medium term research focused on water resources and customer usage and on developing improved techniques for assessing condition and deterioration rates of buried network assets, for example, by the use of innovative "in-pipe" sensor devices.

Population growth and potential climate change impacts are driving an increase in research into alternative and innovative ways of balancing future water supply and demand needs in the River Thames Basin. The research includes more detailed customer usage studies, including advanced metering options, evaluation of more water efficient home appliances and behaviour during "request to conserve" media campaigns. A district of some 1,800 metered properties in London started development as a long-term trial of advanced metering, water usage and leakage control options.

# Thames Water Utilities Limited

## Directors' report for the year ended 31 December 2005 (continued)

On the supply side, research increased on indirect water reuse and recycling options ranging in scale from substituting tap water for non-potable use in new developments and large buildings, to municipal scale applications.

Longer-range research focused on potential technical issues and opportunities beyond the current 5-year regulatory time horizon. Identifying the potential impact of a range of climate change scenarios on all aspects of the water cycle remains a major long-range research topic. A combination of modelling to adapt current design standards and carbon emission mitigation through improved energy efficiency and renewable energy sources was and continues to be studied. The potential impact of the new European Water Framework Directive on water catchment quantity and quality planning was another major study area.

Much of the longer-range research was funded and supported by the Company through universities and national and international research organisations such as UK Water Industry Research, which also attracts funding from other utilities and government agencies.

### Financial risk management

The Company's operations expose it to a variety of financial risks that include the effects of changes in debt market prices, price risk, liquidity risk and interest rate risk.

Treasury operations are managed centrally by a specialist team. The operation of the Treasury function is governed by specific policies and procedures that set out specific guidelines for the management of interest rate risk and foreign exchange risk and the use of financial instruments. Treasury policy and procedures are incorporated within the financial control procedures of the Company.

The Company has a Risk Management Committee, which met 4 times during 2005. This committee receives regular reports from all areas of the business to enable prompt identification of financial and other risks so that appropriate actions can be taken. Further information on the Company's financial risk accounting policy is contained in note 1 on page 36 of these accounts.

### Health and safety

The Company continues to have a proactive commitment to effective health and safety risk management and has in place the necessary policies and arrangements that establish our values and standards and monitor their application. Competence in managing health and safety is an essential part of professional management, relying upon co-operative effort and effective communication at all levels.

Our overall health and safety objectives are to:

- Prevent injury to employees and others affected by our work.
- Prevent damage to plant, equipment and buildings.
- Control accident potential and occupational ill health through attention to our well established health and safety standards and procedures.
- Ensure co-operation and effective communication at all levels.
- Continually improve health and safety management.



# Thames Water Utilities Limited

## Directors' report for the year ended 31 December 2005 (continued)

The primary health and safety risks that the business manages on a day-to-day basis are:

- Work on, or near deep water
- Construction and tunnelling
- Machinery
- Streetworks
- Confined space work
- High voltage electricity
- Occupational health hazards
- Chemicals and gases

The necessary risk assessments, standards and training programmes continue to be put in place to effectively control such risks and are subject to continual review.

In 2005, a number of initiatives were implemented to progress our health and safety goals. Key areas included:

- The completion of a Senior Executive's Training Programme which focused on Directors' health and safety responsibilities.
- Completion and submission to the Health and Safety Executive of plans for two major sites under the Control of Major Accident Hazards Regulations.
- *Implementation of an audit programme for Operations with an anticipated completion date of May 2006.*
- The successful introduction and promulgation of Thames Water's ten health and safety principles, during European Week for Health and Safety in October.
- The development of action plans for Clean Water Operations, Waste Water Operations and Customer Services, focusing on health and safety issues relevant to these parts of the business.

### Health and safety performance

There have been no fatal accidents, prosecutions or enforcement notices during the year affecting the Company directly.

There were 70 reportable accidents in 2005 (2004:63) resulting in 1,508 lost working days (2004:1,811). With regard to the number of reportable accidents, this equates to an incidence rate, (the number of reportable accidents per 1,000 employees) of 14.45 (2004:14.27). Lost days reported and recorded are in accordance with statutory requirements and do not include the long-term absence due to industrial injuries, of a small number of employees during the year.

### Initiatives for 2006

In 2006, the Company is committed to a range of initiatives, which include:

- Return to work interviews for all lost time accidents.
- A review of lifting procedures in all operational areas.
- The development and scheduling of a health and safety 'away day'.
- The development and implementation of a formal health and safety communications plan.
- The development and implementation of a programme of senior management site safety tours.
- The development of a pilot site for behavioural and employee led safety interventions, building on and using the experience gained at a neighbouring RWE npower power station.
- The introduction of a "Positive. Immediate. Certain." safety campaign.

# Thames Water Utilities Limited

## Directors' report for the year ended 31 December 2005 (continued)

### Directors' responsibilities

Company law requires the directors to prepare financial statements for each financial period that give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. The directors are required to prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Company will continue in business.

The directors confirm that suitable accounting policies have been used and applied consistently. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 December 2005 and that applicable accounting standards have been followed.

The directors are responsible for keeping proper accounting records that disclose, with reasonable accuracy, at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for ensuring that arrangements are in place for the maintenance and integrity of the Thames Water website, subject to the legal notice declared thereon.

Legislation in the UK concerning the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

### Auditors

A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the Company will be proposed at the annual general meeting.

Approved by the Board of Directors and signed on its behalf by

  
**K G Johnson**  
Company Secretary

21 June 2006

# Thames Water Utilities Limited

## Independent auditor's report to the members of Thames Water Utilities Limited.

We have audited the financial statements of Thames Water Utilities Limited for the year ended 31 December 2005, which comprise the profit and loss account, the balance sheet, the cash flow statement, the statement of total recognised gains and losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

### Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. This other information comprises only the chairman's review, corporate governance statements, report on remuneration policy and remuneration and the directors' report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

### Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

# Thames Water Utilities Limited

## Independent auditor's report to the members of Thames Water Utilities Limited (continued)

### Opinion

In our opinion the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the Company's affairs as at 31 December 2005 and of its profit and cash flows for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

*PricewaterhouseCoopers LLP*

**PricewaterhouseCoopers LLP**  
**Chartered Accountants and Registered Auditors**  
**Reading**

*21<sup>st</sup> June 2006*

# Thames Water Utilities Limited

## Profit and loss account for the year ended 31 December 2005

	Note	2005 £m	Restated 2004 £m
Turnover	2	1,333.5	1,173.8
Operating costs	3	<u>(883.9)</u>	<u>(781.3)</u>
<b>Operating profit</b>		<b>449.6</b>	<b>392.5</b>
Profit on sale of fixed assets	4	9.1	6.7
Net interest payable and similar charges	6	(142.9)	(133.4)
Other finance income		<u>6.9</u>	<u>18.5</u>
<b>Profit on ordinary activities before taxation</b>		<b>322.7</b>	<b>284.3</b>
Taxation on profit on ordinary activities	7	<u>(94.3)</u>	<u>(82.0)</u>
<b>Profit for the year</b>		<b>228.4</b>	<b>202.3</b>
Dividends	8	<u>(155.0)</u>	<u>(137.2)</u>
<b>Retained profit for the year</b>	19 & 20	<u><b>73.4</b></u>	<u><b>65.1</b></u>

All amounts above relate to continuing operations.

There is no difference between the profit on ordinary activities before taxation and the profit for the years stated above and their historical cost equivalents.

## Statement of total recognised gains and losses

	Note	2005 £m	Restated 2004 £m
Profit for the year		228.4	202.3
Actuarial gain/(loss) on pension scheme		34.9	(80.2)
Deferred tax relating to actuarial gain/loss		<u>(10.5)</u>	<u>24.1</u>
<b>Total recognised gains for the year</b>		<u><b>252.8</b></u>	<u><b>146.2</b></u>
<i>Prior year adjustment in respect of a change in accounting policy - Pensions (FRS 17)</i>	1(a)	<u>(74.2)</u>	
<b>Total gains recognised since last report</b>		<u><b>178.6</b></u>	

# Thames Water Utilities Limited

## Balance sheet at 31 December 2005

	Note	2005 £m	Restated 2004 £m
<b>Fixed assets</b>			
Tangible assets	9	5,446.7	5,220.5
Investments	10	0.1	0.1
		<u>5,446.8</u>	<u>5,220.6</u>
<b>Current assets</b>			
Stocks and work in progress	11	6.2	5.9
Debtors	12	466.4	417.1
Cash at bank and in hand		10.3	1.5
		<u>482.9</u>	<u>424.5</u>
<b>Creditors: amounts falling due within one year</b>	13	(864.8)	(1,311.0)
<b>Net current liabilities</b>		<u>(381.9)</u>	<u>(886.5)</u>
<b>Total assets less current liabilities</b>		<u>5,064.9</u>	<u>4,334.1</u>
<b>Creditors: amounts falling due after more than one year</b>	14	(2,435.2)	(1,806.3)
<b>Provisions for liabilities and charges</b>	16	(887.5)	(861.9)
<b>Net assets excluding pension</b>		<u>1,742.2</u>	<u>1,665.9</u>
Pension scheme in surplus		36.8	16.2
Pension scheme in deficit		(88.7)	(89.6)
Total pension liability	23	(51.9)	(73.4)
		<u>1,690.3</u>	<u>1,592.5</u>
<b>Net assets</b>		<u>1,690.3</u>	<u>1,592.5</u>
<b>Capital and reserves</b>			
Called up share capital	17	1,029.0	1,029.0
Share premium	18	100.0	100.0
Profit and loss account	19	561.3	463.5
		<u>1,690.3</u>	<u>1,592.5</u>
<b>Equity shareholder's funds</b>	20	<u>1,690.3</u>	<u>1,592.5</u>

The notes on pages 31 to 56 form part of these financial statements.

The financial statements were approved by the Board of Directors and signed on its behalf by:



**S J Buck**  
Finance Director  
21 June 2006

# Thames Water Utilities Limited

## Cash flow statement for the year ended 31 December 2005

	Note	2005 £m	Restated 2004 £m
<b>Net cash inflow from operating activities</b>	(a)	<b>781.2</b>	580.9
<b>Returns on investments and servicing of finance</b>			
Interest received		-	2.7
Interest paid		(125.2)	(121.0)
Interest element in finance lease payments		<u>(13.4)</u>	<u>(11.8)</u>
<b>Net cash outflow from returns on investments and servicing of finance</b>		<b>(138.6)</b>	(130.1)
<b>Taxation</b>		<b>(48.8)</b>	(16.3)
<b>Capital expenditure and financial investment</b>			
Gross cost of purchased fixed assets		(488.7)	(556.7)
Infrastructure renewals expenditure		(49.4)	(16.2)
Receipt of grants and contributions		63.1	95.4
Sale proceeds of fixed assets		<u>9.1</u>	<u>8.7</u>
<b>Net cash outflow for capital expenditure and financial investment</b>		<b>(465.9)</b>	(468.8)
<b>Equity dividends paid</b>		<b>(155.0)</b>	(137.2)
<b>Net cash outflow before financing</b>		<b>(27.1)</b>	(171.5)
<b>Financing</b>			
Capital element in finance lease payments		(8.1)	(6.6)
New loans		737.0	675.9
Repayment of loans		<u>(693.0)</u>	<u>(496.3)</u>
<b>Net cash inflow from financing</b>	(b) & (c)	<b>35.9</b>	173.0
<b>Increase in cash</b>	(b) & (c)	<b>8.8</b>	1.5

# Thames Water Utilities Limited

## Notes to the cash flow statement for the year ended 31 December 2005

### (a) Reconciliation of operating profit to net cash inflow from operating activities

	Note	2005 £m	Restated 2004 £m
Operating profit		449.6	392.5
Depreciation (infrastructure)	3	86.0	24.4
Depreciation (non-infrastructure)	3	207.6	196.8
Difference between pension charge and cash contributions		11.1	8.0
Increase in stocks and work in progress		(0.3)	(0.1)
(Increase)/Decrease in debtors and prepaid expenses		(46.2)	16.0
Increase/(Decrease) in creditors and accrued expenses		84.1	(49.4)
Release of deferred income		(10.7)	(7.3)
<b>Net cash inflow from operating activities</b>		<b>781.2</b>	<b>580.9</b>

### (b) Reconciliation of net cash flow to movement in net debt

	Note	2005 £m	2004 £m
Increase in cash in the period		8.8	1.5
Cash inflow from movement in net debt and financing		(35.9)	(173.0)
Increase in net debt resulting from cashflows		(27.1)	(171.5)
Non-cash increase in net debt		(5.7)	(4.9)
Total increase in net debt		(32.8)	(176.4)
Opening net debt		(2,365.4)	(2,189.0)
<b>Closing net debt</b>	(c)	<b>(2,398.2)</b>	<b>(2,365.4)</b>

Non-cash changes comprise the carrying value uplift by RPI, of an RPI index-linked bond. This adjustment is in accordance with FRS 4 'Capital instruments', which requires the carrying value of such index-linked loans to be recalculated at each balance sheet date.

### (c) Analysis of net debt

	As at 1 Jan 05 £m	Cashflow £m	Non-cash £m	As at 31 Dec 05 £m
Cash at bank and in hand	1.5	8.8	-	10.3
Debt due within 1 year	(690.9)	576.3	-	(114.6)
Debt due after 1 year	(1,442.5)	(620.3)	(5.7)	(2,068.5)
Finance leases	(233.5)	8.1	-	(225.4)
	<u>(2,366.9)</u>	<u>(35.9)</u>	<u>(5.7)</u>	<u>(2,408.5)</u>
	<u>(2,365.4)</u>	<u>(27.1)</u>	<u>(5.7)</u>	<u>(2,398.2)</u>



# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 1 Principal accounting policies

A summary of the more important accounting policies, which have been applied consistently, is set out below.

#### (a) Basis of preparation

The financial statements have been prepared on a going concern basis and in accordance with the historical cost convention and with applicable Accounting Standards in the United Kingdom and, except for the treatment of certain capital contributions, with the Companies Act 1985. An explanation of the departure from the requirements of the Act is given in note 1(d) below.

The Company has not prepared consolidated Group financial statements, as permitted under section 228 of the Companies Act 1985. The Company and its subsidiaries are included in the consolidated accounts of its parent company RWE Thames Water plc, a company registered in the United Kingdom.

#### Changes to accounting policies

The same accounting policies used for the year ended 31 December 2004 have been applied with the following exceptions:

#### FRS 17 Retirement Benefits

From 1 January 2005, the Company has adopted the requirements of FRS 17 'Retirement Benefits'.

The majority of the Company's employees belong to RWE Thames Water Group pension schemes, which are funded by both employer's, and employees' contributions and which are of the defined benefit type.

The Company's pension arrangements are of the group multi-employer scheme nature, such that the Company's pension scheme assets and liabilities are included with those of other companies in the RWE Thames Water Group. The Company contributes the vast majority of the contributions into the Scheme (2005: 79%, 2004: 82 %), and any consequence of there being a surplus or a deficit in the schemes is felt by the Company. Accordingly, the Directors have decided it is appropriate to recognise the total surplus and deficit of the two Group pension schemes within these financial statements. The FRS17 defined benefit disclosures have been provided in note 23 to these financial statements. The FRS17 Service cost of the Company, as included with these financial statements, represents the net of the total service cost of the Group schemes and the pension contributions made by the other group companies into the schemes in the financial year.

The adoption of this new standard represents a change in accounting policy and the comparative figures have been restated accordingly.

The effect of the change in accounting policy to adopt FRS 17 was to decrease the brought forward profit and loss reserves by £74.2m (2004: £31.0m) and to increase the profit for the period by £0.3m (2004: £12.9m increase) and to recognise a £24.4m net actuarial gain in the year (2004: £56.1m actuarial loss) directly in reserves.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 1 Principal accounting policies (continued)

#### (a) Basis of preparation (continued)

##### **FRS 21 (IAS 10) Events after the Balance Sheet Date**

From 1 January 2005, the Company has adopted the full requirements of FRS 21 (IAS 10) 'Events after the Balance Sheet Date'.

In accordance with FRS 21, dividends declared after the balance sheet date are no longer recognised as a liability at the balance sheet date and are now recorded in the financial statements on a cash paid basis.

The adoption of this new standard represents a change in accounting policy and the comparative figures have been restated accordingly.

The effect of the change in accounting policy to adopt FRS 21 was to increase the brought forward profit and loss reserves by £95.4m (December 2004: £91.4) and to decrease the retained profit for the period by £4.2m (December 2004: increase of £4.0m).

##### **Infrastructure renewals expenditure**

From 1 April 2005, certain expenditure in respect of leakage previously classified as infrastructure renewals expenditure per FRS 15, is now classified as other operating costs. The impact of this change is to increase other operating costs and to reduce both fixed asset additions and the infrastructure depreciation charge by the same amount.

This change in classification follows discussion with Ofwat, who were seeking a consistent accounting treatment of these costs across the water industry following the last periodic review.

The effect of this change in accounting policy was to increase other operating costs by £47.4m (December 2004: £47.7m) and reduce fixed asset additions and the infrastructure depreciation charge by £47.4m (December 2004: £47.7m). This change in accounting policy has nil net effect on the brought forward profit and loss reserves (2004: nil) and the current year retained profit.

##### **FRS 25 Financial instruments: disclosure and presentation**

From 1 January 2005 the Company has adopted the presentational requirements of FRS 25 'Financial instruments: disclosure and presentation' in the financial statements. The Company has not adopted the disclosural requirements of FRS 25, from which the Company is exempt in the current financial year. The adoption of this standard is a change in accounting policy but has no effect on current year or prior year results.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 1 Principal accounting policies (continued)

#### (b) Turnover

Turnover, which excludes value added tax, represents the income receivable in the ordinary course of business, for goods and services provided.

#### (c) Tangible fixed assets

Tangible fixed assets comprise:

##### (i) Infrastructure assets:

Infrastructure assets comprise a network of systems consisting of mains and sewers, impounding and pumped raw water storage reservoirs and sludge pipelines.

Expenditure on infrastructure assets is treated as additions to tangible fixed assets. Expenditure on maintaining the operating capability of the network in accordance with defined standards of service is charged as an operating cost and is classified as depreciation.

##### (ii) Other assets:

Other assets include properties, over ground plant and equipment.

Other assets are included at cost less accumulated depreciation. Interest is not capitalised as part of the cost of an asset. Freehold and long leasehold land is not depreciated. Assets in the course of construction are not depreciated until they are commissioned. Employee costs incurred in implementing the capital schemes of the Company are included within the cost of fixed asset additions.

Other assets are depreciated evenly over their estimated economic lives, which are principally as follows:

Operational structures	40 - 80 years
Other buildings	20 - 60 years
Fixed and mobile plant	7 - 40 years
Vehicles, computers, fixtures and fittings	3 - 10 years

#### (d) Capital contributions

Capital contributions received in respect of infrastructure assets have been deducted from the cost of fixed assets. This is not in accordance with Schedule 4 to the Companies Act 1985, which requires fixed assets to be stated at their purchase price without deduction of contributions, which are accordingly accounted for as deferred income. This departure from the requirement of the Act is, in the opinion of the directors, necessary for the financial statements to give a true and fair view because infrastructure assets do not have a finite life. Accordingly related capital contributions would not be recognised in the profit and loss account. The effect of the departure on the value of tangible fixed assets is disclosed in note 9.

Where material, contributions received towards the cost of other assets are accounted for as deferred income and released to the profit and loss account over the estimated economic lives of the assets.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 1 Principal accounting policies (continued)

#### (e) Leased assets

Where assets are financed by leasing arrangements which transfer substantially all the risks and rewards of ownership of an asset to the lessee (finance leases), the assets are treated as if they had been purchased and the corresponding capital cost is shown as an obligation to the lessor. Leasing payments are treated as consisting of a capital element and finance costs, the capital element reducing the obligation to the lessor and the finance charges being written off to the profit and loss account over the period of the lease in relation to the assets' written down values. The assets are generally depreciated over the shorter of their estimated economic lives and the lease period.

All other leases are regarded as operating leases. Rental costs arising under operating leases are expensed in the year in which they are incurred.

#### (f) Investments

Investments held as fixed assets are stated at cost less provisions for impairment in value. Investments held as current assets are stated at the lower of cost and net realisable value.

#### (g) Stocks

Stocks are valued at the lower of cost and net realisable value.

#### (h) Foreign currencies

All transactions denominated in foreign currencies are translated into sterling at the actual rate of exchange ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at rates of exchange ruling at the balance sheet date. All exchange differences arising are dealt with in the profit and loss account.

#### (i) Research and development

Research and development expenditure is charged to the profit and loss account in the year in which it is incurred.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 1 Principal accounting policies (continued)

#### (j) Taxation

The charge for taxation is based on the profit for the year as adjusted for disallowable and non-taxable items.

Provision is made for deferred tax liabilities, and assets only to the extent that the directors consider it more likely than not that there will be suitable taxable profits from which the future reversal of the timing differences can be deducted, in accordance with FRS 19.

Deferred tax is measured at the average tax rates that are expected to apply to the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

#### (k) Related party disclosures

The Company is exempt under the terms of FRS 8 from disclosing related party transactions with entities that are part of the RWE AG Group.

#### (l) Financial risk management

The Company's operations expose it to a variety of financial risks that include the effects of changes in debt market prices, price risk, liquidity risk and interest rate risk.

Treasury operations are managed centrally by a specialist team. The operation of the Treasury function is governed by specific policies and procedures that set out specific guidelines for the management of interest rate risk and foreign exchange risk and the use of financial instruments. Treasury policy and procedures are incorporated within the financial control procedures of the Company.

The Company has a Risk Management Committee, which met 4 times during 2005. This committee receives regular reports from all areas of the business to enable prompt identification of financial and other risks so that appropriate actions can be taken.

##### (i) Price risk

The Company is exposed to commodity price risk as a result of its operations. The Company aims to manage its risk by fixing contract prices for where possible.

##### (ii) Liquidity risk

The Company actively maintains a broad portfolio of debt, diversified by source and maturity designed to ensure the Company has sufficient available funds for operations. The current maturity profile of debt is shown in note 15 (page 49).

##### (iii) Interest rate risk

The Company is not exposed to any significant currency risk after taking the effects of its cross currency swaps into consideration. Interest rate swaps are used to manage the interest charge arising from the Company's primary financial instruments. The objective of treasury operations is to ensure the availability of a timely flow of funds at a cost, which reflects the credit standing of the Company. Treasury is managed as a cost centre and not as a profit centre and no material open or speculative positions are taken. The financing arrangements of the Company are further described in note 15 (page 47) of these accounts.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 2 Segmental analysis

The directors consider that the Company has one class of business and this is conducted wholly within the United Kingdom.

### 3 Operating costs

Analysis of operating costs by type of expense:

	Note	2005 £m	Restated 2004 £m
Staff costs	5	177.7	161.2
Materials and consumables		28.4	23.7
Other operating charges		428.5	412.8
Depreciation:			
- owned asset (infrastructure)		86.0	24.4
- owned assets (non-infrastructure)		198.0	187.2
- assets held under finance leases		9.6	9.6
Rentals under operating leases:			
- hire of plant and machinery		3.8	3.1
- other		5.6	7.7
Auditors' remuneration:			
- for statutory audit work		0.3	0.3
- for regulatory audit work		0.1	0.1
Research and development		5.3	5.8
		<u>943.3</u>	<u>835.9</u>
Own work capitalised		<u>(59.4)</u>	<u>(54.6)</u>
		<u>883.9</u>	<u>781.3</u>

The auditors received remuneration of £36,300 in respect of non-audit work (2004: £30,000).

### 4 Profit on sale of fixed assets

	2005 £m	2004 £m
Profit on disposal of fixed assets	<u>9.1</u>	<u>6.7</u>
Taxation attributable, included in the charge for the year	<u>1.0</u>	<u>1.4</u>

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 5 Information regarding directors and employees

Aggregate directors remuneration:

	2005 £000	2004 £000
Salary	952	706
Bonus	123	615
Other benefits	494	38
Total aggregate emoluments	<u>1,569</u>	<u>1,359</u>

Retirement benefits are accruing to 7 directors (2004: 3) under a defined benefit scheme.

Aggregate remuneration of each of the directors:

	2005 £000	2004 £000
J R Sexton	468	415
W U Böttcher	457	351
C Anderson	20	391
J M England	217	102
R Aylard	62	-
S Buck	170	-
S Walker	75	-
Total aggregate emoluments	<u>1,469</u>	<u>1,259</u>

Included in the above, is compensation for loss of office £460,920 paid to J R Sexton (2004: nil).

Aggregate remuneration of each of the independent non-executive directors:

	2005 £000	2004 £000
C Bowe	42	40
P T Warry	2	30
S Slipman	33	30
J Gains	23	-
Total aggregate emoluments	<u>100</u>	<u>100</u>

#### Highest paid director

The highest paid director was W U Böttcher. In addition to the aggregate emoluments disclosed above, W U Böttcher had accrued pension benefits of £2,267 at 31 December 2005. The highest paid director in 2004 was J R Sexton. In addition to the aggregate emoluments disclosed above, J R Sexton had accrued pension benefits of £100,707 at 31 December 2004.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 5 Information regarding directors and employees (continued)

#### Chairman and Executive directors' remuneration

The former and present Chairman and executive directors with the exception of J M England and S J Buck were and are remunerated by RWE Thames Water plc in respect of their services to the Water Division of RWE AG as a whole. The remuneration disclosed above represents the appropriate proportion of their remuneration in respect of services to the Company.

#### Transactions with directors and officers

There are no transactions or arrangements, which are required to be disclosed under the provisions of the Companies Act 1985.

#### Employee information

The average number of persons employed by the Company, including executive directors, during the year was:

	2005 Number	2004 Number
Average monthly number of employees	<u>4,748</u>	<u>4,696</u>

Employment costs including executive directors' remuneration were:

	2005 £m	Restated 2004 £m
Salaries and wages	145.0	131.1
Social security costs	13.0	12.6
Pension costs (note 23)	<u>22.6</u>	<u>20.7</u>
Total	180.6	164.4
Employment costs included within research and development costs	<u>(2.9)</u>	<u>(3.2)</u>
Net employment costs	<u>177.7</u>	<u>161.2</u>



# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 6 Net interest payable and similar charges

	2005 £m	2004 £m
Bank loans, overdrafts and other loans:		
- group loans	(102.9)	(91.1)
- bank loans	(25.1)	(32.5)
- other loans	(7.6)	(3.1)
Finance charges in respect of finance leases	<u>(10.5)</u>	<u>(10.2)</u>
Interest payable and similar charges	(146.1)	(136.9)
Interest receivable	<u>3.2</u>	<u>3.5</u>
Net interest payable and similar charges	<u>(142.9)</u>	<u>(133.4)</u>

### 7 Taxation

#### (a) Analysis of charge in year

	Note	2005 £m	Restated 2004 £m
Current year:			
Amounts payable in respect of corporation tax for the year		74.6	33.3
Adjustments in respect of previous periods		<u>(4.6)</u>	<u>(19.4)</u>
Total current tax	7(b)	<u>70.0</u>	<u>13.9</u>
Deferred tax:			
Origination and reversal of timing differences	16	23.1	49.2
Pension cost charge in excess of pension cost relief	23	(1.3)	3.2
Adjustments in respect of previous periods	16	<u>2.5</u>	<u>15.7</u>
Total deferred tax		<u>24.3</u>	<u>68.1</u>
Taxation on profit on ordinary activities		<u>94.3</u>	<u>82.0</u>

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 7 Taxation (continued)

#### (b) Factors affecting tax charge for year

The tax charge for the year is lower (2004: lower) than the standard rate of corporation tax in the UK (30%). The differences are explained below:

	2005 £m	Restated 2004 £m
Profit on ordinary activities before tax	<u>322.7</u>	<u>284.3</u>
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2004: 30%)	96.8	85.3
Effects of:		
Income not taxable (intra-group disposals of property)	(1.8)	(0.8)
Capital allowances for period in excess of depreciation	(22.2)	(49.5)
Disallowable expenditure	0.5	1.5
Net pension cost charge in excess of pension contribution	1.3	(3.2)
Adjustments to tax charge in respect of previous periods	<u>(4.6)</u>	<u>(19.4)</u>
Current tax charge for the year	<u>70.0</u>	<u>13.9</u>

### 8 Dividends

	2005 £m	Restated 2004 £m
Final paid: 9.3p (2004: 8.9p) per ordinary share	95.4	91.4
Interim paid: 5.8p (2004: 4.5p) per ordinary share	<u>59.6</u>	<u>45.8</u>
	<u>155.0</u>	<u>137.2</u>

In addition to the above, the directors have proposed a second interim dividend in respect of the financial year ending 31 December 2005 of £29.8m (2.9p per ordinary share) and a third interim dividend of £91.2m (8.9p per ordinary share), both to be paid in the first quarter of 2006. Total dividends payable in respect of the year ended 31 December 2005 of £180.6m compare with total dividends of £141.2m payable in respect of the year ended 31 December 2004.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 9 Tangible fixed assets

	Land and buildings £m	Plant and equipment £m	Restated Infrastructure assets £m	Restated Total £m
<b>Cost</b>				
At 1 January 2005	2,030.3	2,817.5	2,799.5	7,647.3
Additions	61.7	260.1	237.0	558.8
Disposals	-	(47.4)	-	(47.4)
<b>At 31 December 2005</b>	<b>2,092.0</b>	<b>3,030.2</b>	<b>3,036.5</b>	<b>8,158.7</b>
<b>Capital contributions</b>				
At 1 January 2005	-	-	414.2	414.2
Additions	-	-	39.0	39.0
<b>At 31 December 2005</b>	<b>-</b>	<b>-</b>	<b>453.2</b>	<b>453.2</b>
<b>Depreciation</b>				
At 1 January 2005	472.7	1,151.2	388.7	2,012.6
Provided during the year	34.6	173.0	86.0	293.6
Disposals	-	(47.4)	-	(47.4)
<b>At 31 December 2005</b>	<b>507.3</b>	<b>1,276.8</b>	<b>474.7</b>	<b>2,258.8</b>
<b>Net Book Value</b>				
<b>At 31 December 2005</b>	<b>1,584.7</b>	<b>1,753.4</b>	<b>2,108.6</b>	<b>5,446.7</b>
At 31 December 2004	1,557.6	1,666.3	1,996.6	5,220.5

The net book value of land and buildings is analysed as follows:

	2005 £m	2004 £m
Freehold land and buildings	1,561.1	1,534.3
Leasehold - over 50 years	9.4	8.9
- under 50 years	14.2	14.4
	<u>1,584.7</u>	<u>1,557.6</u>

Depreciation has not been charged on freehold and leasehold land stated in the accounts at cost of £30.1m (2004: £30.0m).

Tangible fixed assets at 31 December 2005 include assets in the course of construction of £718.7m (2004: £820.5m).

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 9 Tangible fixed assets (continued)

Details of the Company's tangible fixed assets, which are held under finance leases are:

	Cost		Net book value	
	2005	2004	2005	2004
	£m	£m	£m	£m
<b>Plant and equipment</b>	<b><u>272.5</u></b>	<b><u>272.5</u></b>	<b><u>176.9</u></b>	<b><u>186.5</u></b>

In June 2005 the London Borough of Newham, following a direction from the Mayor of London, formally refused planning permission for the Company's proposed Thames Gateway Water Treatment Plant, employing desalination technology at Beckton in East London. The site is operational land owned by the Company. An appeal has been lodged and a public inquiry began in May 2006. A duplicate application for planning permission has also been submitted. The works carried out to date are a combination of site preparation, for which planning permission is not considered a requirement, a pilot plant constructed on the site to prove the technology, for which planning permission has been granted and some preliminary construction works in readiness for the permanent plant which has been refused planning permission. The works on site have ceased pending the outcome of the appeal with the exception of work required to make the site safe and to fulfil contractual obligations. To 31 December 2005 the Company has spent £64m, of which £15m is in respect of site preparation and the pilot plant. The Company is strongly of the opinion that this plant is an essential element in securing future adequate supplies of water to the population of London, in view of the projected imbalance between supply and demand in a drought year and that the desalination plant is the most appropriate solution for the Company to take at this time. The current position reflects the best estimate of the outcome of the appeal. If it emerges at any stage that the current judgement needs to be revised, then a reappraisal of the amounts capitalised may become necessary.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 10 Fixed asset investments

	2005 £m	2004 £m
Cost of shares in subsidiaries	<u>0.1</u>	<u>0.1</u>

At 31 December 2005 the Company held more than 10% of the allotted share capital of the following undertakings:

Name of undertaking	Nominal value and class of shares held	Proportion of nominal value of issued shares held	Activity
Gemwel Limited	£1 Ordinary	50%	Water and Sewerage Services
Thames Water Drainage Services Limited	£1 Ordinary	100%	Sewerage Management
Thames Water Procurement Limited	£1 Ordinary	100%	Procurement
Thames Water Utilities Finance plc	£1 Ordinary	100%	Finance company
County Wide Collections Limited	£1 Ordinary	100%	Debt collection

All of the above companies were incorporated and are registered in Great Britain.

At 31 December 2005 and 31 December 2004 the net asset values of Thames Water Drainage Services Limited and Thames Water Utilities Finance plc were £2 and £50,000 respectively. No profits or losses have been made in either of the periods concerned.

County Wide Collections Limited was incorporated on 12 May 2005. At 31 December 2005 the company had net assets of £1. No profits or losses have been made.

Thames Water Procurement Limited had a deficit on reserves of £1,523,000 at 31 December 2005 (2004: £1,524,000). Profit for the year ended 31 December 2005: £1,000 (2004: £1,000).

Gemwel Limited has a statutory accounting reference date of 31 March. At 31 March 2005 there were net assets of £Nil (2004: deficit £2,000). Profit for the year ended 31 March 2005: £2,000 (2004: £73,000).

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 11 Stocks and work in progress

	2005 £m	2004 £m
Raw materials and consumables	<u>6.2</u>	<u>5.9</u>

### 12 Debtors: amounts falling due within one year

	2005 £m	Restated 2004 £m
Trade debtors	191.4	174.5
Amounts owed by group undertakings	26.2	32.5
Other debtors	34.8	19.4
Insurance claims receivable	36.0	50.9
Prepayments and accrued income	<u>178.0</u>	<u>139.8</u>
	<u>466.4</u>	<u>417.1</u>

### 13 Creditors: amounts falling due within one year

	2005 £m	Restated 2004 £m
Bank loans	14.3	15.0
Obligations under finance leases	9.8	8.1
Trade creditors:		
- Operating	110.0	33.3
- Capital	141.4	120.5
Amounts owed to group undertakings	156.9	732.6
Insurance claims payable	36.0	50.9
Amounts payable in respect of corporation tax	32.4	7.6
Amounts payable in respect of group relief	2.8	6.4
Other taxation and social security payable	4.8	4.4
Accruals and deferred income	<u>356.4</u>	<u>332.2</u>
	<u>864.8</u>	<u>1,311.0</u>

Amounts owed to group undertakings include interest bearing loans, which are described in more detail in note 14.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 14 Creditors: amounts falling due after more than one year

	2005 £m	2004 £m
Bank loans	396.7	409.6
Obligations under finance leases	215.6	225.4
Amounts owed to group undertakings (see below)	1,671.8	1,032.9
Accruals and deferred income	<u>151.1</u>	<u>138.4</u>
	<u>2,435.2</u>	<u>1,806.3</u>

#### Amounts owed to group undertakings are:

	2005 £m	2004 £m
Inter company loans:		
- Within one year	100.3	675.9
- After more than one year	<u>1,671.8</u>	<u>1,032.9</u>
	1,772.1	1,708.8
Non-loan amounts due within one year	<u>56.6</u>	<u>56.7</u>
	<u>1,828.7</u>	<u>1,765.5</u>

Loan amounts owed to group undertakings, are comprised of:

- £225.0m (2004: £225.0m) owed to RWE Finance BV, a subsidiary of RWE AG, the ultimate parent undertaking, in respect of a fixed rate loan, due for repayment in 2021.
- £1,460.2m (2004: £807.9m) owed to Thames Water Utilities Finance plc, a subsidiary undertaking, of which £13.4m (2004: £Nil) is included within creditors due within one year and £1,446.8m (2004: £807.9m) within creditors due after more than one year.
- £86.9m (2004: £675.9m) due to RWE Thames Water Plc, the immediate parent undertaking, in respect of a floating rate loan wholly repayable within one year.

The loan from Thames Water Utilities Finance plc relates to Guaranteed Bonds that it has in issue, the net proceeds of which have been loaned to Thames Water Utilities Limited under the same commercial terms. Thames Water Utilities Limited has guaranteed the principal and interest payments of the subsidiary undertaking due under the terms of the bonds.

RWE Thames Water plc has guaranteed the principal and interest payments of certain bank loans of the Company. The principal amount guaranteed as at 31 December 2005 was £404.2m (2004: £421.1m).

#### Other loans and finance leases, as disclosed in more detail in note 15, are:

	2005 £m	2004 £m
Inter company loans (as above)	1,772.1	1,708.8
Finance leases:		
- Within one year	9.8	8.1
- After more than one year	<u>215.6</u>	<u>225.4</u>
	<u>1,997.5</u>	<u>1,942.3</u>

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 15 Financial instruments

FRS 13 requires the disclosure of the funding and treasury policy together with further details on financial assets and liabilities.

#### Funding and treasury policy

The Company's funding policy is to maintain a broad portfolio of debt. The debt arranged via Thames Water Utilities Finance plc is diversified by source and maturity in order to protect profits against risks arising from adverse movements in interest rates and currency exposures.

Derivative financial instruments, including cross currency swaps and interest rate swaps, are employed to manage the interest rate and currency risks arising from the primary financial instruments used to finance the Company's activities.

The Company's treasury operations are managed centrally by a small specialist team within the RWE Thames Water Division and are managed as a cost centre, not a profit centre; no material open or speculative positions are taken.

Short-term debtors and creditors have been excluded from the financial instruments' disclosures.

#### Interest rate risk profile of financial liabilities and assets

After taking into account the Company's interest rate and currency swaps, the interest rate risk profile of the Company's financial liabilities and assets is as follows:

#### Financial liabilities

	Total at floating rates		Total at fixed rates		Total at book value		Fixed rate liabilities			
							Weighted average interest rate		Weighted average period until maturity for which rate is fixed	
	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m	2005 %	2004 %	2005 Years	2004 Years
Bank loans & overdrafts										
- £ Sterling	106.5	54.0	304.5	370.6	411.0	424.6	7.7	7.2	4.3	6.2
Other loans & finance leases										
- £ Sterling	504.6	1,096.0	1,492.90	846.3	1,997.5	1,942.3	5.3	6.2	14.4	20.5
<b>Total</b>	<b>611.1</b>	<b>1,150.0</b>	<b>1,797.4</b>	<b>1,216.9</b>	<b>2,408.5</b>	<b>2,366.9</b>	<b>5.8</b>	<b>6.5</b>	<b>12.6</b>	<b>16.1</b>

The Company's interest rate swaps convert £50.4m (2004: £53.4m) of floating rate borrowing to fixed rate and £26.9m (2004: £24.7m) of fixed rate borrowing to floating rate. Cross currency swaps hedge currency risk on £94.8m (2004: £91.3m) of foreign currency borrowing through conversion to Sterling.

Short term lending bears interest at rates linked to LIBOR.



# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 15 Financial instruments (continued)

#### Financial assets

	Total at floating rates		Total at fixed rates		Total at book value	
	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m
Cash at bank and in hand						
- Sterling	10.3	1.5	-	-	10.3	1.5
Total	10.3	1.5	-	-	10.3	1.5

Base rate is the benchmark rate for all cash at bank.

#### Currency risk

The Company is not exposed to any significant currency risk after taking the effects of its cross currency swaps into consideration.

#### Fair values

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced or liquidation sale. The table below sets out a comparison of the book and fair values of the Company's financial instruments.

	Book value 2005 £m	Book value 2004 £m	Fair value 2005 £m	Fair value 2004 £m
<b>Primary financial instruments</b>				
Financial assets				
- Cash at bank and in hand	10.3	1.5	10.3	1.5
Financial liabilities				
- Bank loans	(404.1)	(421.1)	(427.7)	(447.7)
- Other loans & finance leases	(1,997.5)	(1,942.3)	(2,317.5)	(2,084.1)
<b>Derivative financial instruments</b>				
- Interest rate swaps	-	-	(7.8)	(7.9)
- Cross currency swaps	(6.9)	(3.5)	0.3	(2.6)
Total	(2,398.2)	(2,365.4)	(2,742.4)	(2,540.8)

Primary financial instruments include bonds, which are traded on a public market. Fair values for these have been calculated using the 31 December 2005 quoted prices. Mark to market techniques (discounting expected cash flows at prevailing interest and exchange rates) are employed in computing fair values for the remaining fixed rate borrowing and all derivative financial instruments. Floating rate liabilities have fair values, which approximate to book value.

Book values of primary financial instruments are shown gross of the effect of any hedging instrument. Therefore, the effect of revaluing foreign currency borrowing at closing rates is included in the fair valuation.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 15 Financial instruments (continued)

<b>Maturities</b>	<b>2005</b>	<b>2004</b>
	<b>£m</b>	<b>£m</b>
Bank loans and overdrafts		
- Within one year	14.3	15.0
- Between one and two years	59.4	13.6
- Between two and five years	236.8	149.9
- After more than five years	<u>100.5</u>	<u>246.1</u>
	<u>411.0</u>	<u>424.6</u>
Other loans and finance leases		
- Within one year	110.1	684.0
- Between one and two years	11.8	23.9
- Between two and five years	372.0	113.5
- After more than five years	<u>1,503.6</u>	<u>1,120.9</u>
	<u>1,997.5</u>	<u>1,942.3</u>
<b>Total borrowing</b>	<u><b>2,408.5</b></u>	<u><b>2,366.9</b></u>

Loans are repayable between 2006 and 2032.

- Loans wholly repayable after more than five years are:

	<b>2005</b>	<b>2004</b>
	<b>£m</b>	<b>£m</b>
Bank loans	100.5	246.1
Other loans	<u>1,356.0</u>	<u>949.6</u>
	<u><b>1,456.5</b></u>	<u><b>1,195.7</b></u>

- Other loans include:
  - £330m 6.75% MTN Eurobonds due 2028.
  - £200m 6.57% MTN Eurobonds due 2032.
  - £175m 3.38% index-linked bond due 2021.
  - £225m 6.60% inter-company loan from parent undertaking due 2021.
  - £250m 4.75% inter-company loan from subsidiary of parent undertaking due 2010.
  - £200m 4.90% inter-company loan from subsidiary of parent undertaking due 2015.
  - £200m 5.05% inter-company loan from subsidiary of parent undertaking due 2020.

- Loans repayable by instalments after more than five years hence are:

	<b>2005</b>	<b>2004</b>
	<b>£m</b>	<b>£m</b>
Finance leases	<u>147.6</u>	<u>171.3</u>

- The ranges of interest rates on outstanding bank loans are 1.0% to 10.9% (2004: 2.3% to 11.5%) and other loans and finance leases are 1.7% to 6.8% (2004: 1.7% to 6.8%).

These interest rates are those contracted on the underlying borrowing before taking account of interest rate protection. There are no interest free loans.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 15 Financial instruments (continued)

#### Borrowing facilities

The Company has a committed borrowing facility with RWE AG of £150m, expiring as follows:

Expiring:	2005 £m	2004 £m
Within one year	<u>150.0</u>	<u>150.0</u>

At 31 December 2005 and 31 December 2004, no funds have been borrowed under the committed facilities referred to above.

Thames Water Utilities Finance plc also has a US\$ 4 billion (2004: US\$ 4 billion) uncommitted Euro-Medium Term Note programme, which provides the Company with access to the capital markets in a range of currencies and maturities. At 31 December 2005, outstanding debt obligations of Thames Water Utilities Finance plc were £1,460.1m (2004: £807.8m), with a weighted average term of 15 years (2004: 22 years) at a weighted averaged rate of 5.49% (2004: 6.10%).

### 16 Provisions for liabilities and charges

Provisions for liabilities and charges consist entirely of a provision for deferred taxation. There are no amounts of deferred tax unprovided for (2004: £nil).

#### The movement in the provision was as follows:

	Note	2005 £m
Provision brought forward at 1 January 2005		861.9
Deferred tax charge:		
- Current year	7(a)	23.1
- Prior year	7(a)	<u>2.5</u>
Provision carried forward at 31 December 2005		<u>887.5</u>

#### An analysis of amounts provided at current tax rates is as follows:

	2005 £m	2004 £m
Accelerated capital allowances	892.3	866.3
Other timing differences	<u>(4.8)</u>	<u>(4.4)</u>
	<u>887.5</u>	<u>861.9</u>

#### Total deferred tax provision:

	Note	2005 £m	2004 £m
Included above		887.5	861.9
Deferred tax provided on pension liability	23	<u>22.3</u>	<u>31.5</u>
		<u>909.8</u>	<u>893.4</u>

The pension asset/liability per note 23 is shown net of deferred tax.

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 17 Share capital

	2005 £m	2004 £m
<b>Authorised</b>		
1,029,050,000 (2004: 1,029,050,000) ordinary shares of £1 each	<u>1,029.0</u>	<u>1,029.0</u>
<b>Allotted, called up and fully paid</b>		
1,029,050,000 (2004: 1,029,050,000) ordinary shares of £1 each	<u>1,029.0</u>	<u>1,029.0</u>

### 18 Share premium reserve

	£m	£m
At 1 January and 31 December	<u>100.0</u>	<u>100.0</u>
Premium of 25p on issue of 400 million £1 ordinary shares		

### 19 Profit and loss account reserve

	Note	2005 £m	Restated 2004 £m
At 1 January as previously reported		442.3	394.1
Restatement - FRS 17	1(a)	(74.2)	(31.0)
Restatement - FRS 21	1(a)	<u>95.4</u>	<u>91.4</u>
At 1 January - Restated		463.5	454.5
Profit for the year		228.4	202.3
Dividends	8	<u>(155.0)</u>	<u>(137.2)</u>
Retained profit		73.4	65.1
Actuarial gain/(loss) on pension scheme	23	34.9	(80.2)
Movement on deferred tax relating to pension scheme		<u>(10.5)</u>	<u>24.1</u>
<b>As at 31 December including total pension liability</b>		<u>561.3</u>	<u>463.5</u>
Total pension liability	23	51.9	73.4
As at 31 December excluding pension liability		<u>613.2</u>	<u>536.9</u>

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 20 Reconciliation of movements in shareholder's funds

	2005 £m	Restated 2004 £m
Profit for the financial year	228.4	202.3
Dividends	<u>(155.0)</u>	<u>(137.2)</u>
<b>Net movement in shareholder's funds</b>	<b>73.4</b>	<b>65.1</b>
Shareholder's funds at the beginning of the year as previously reported	1,571.3	1,523.1
Restatement - FRS 17	(74.2)	(31.0)
Restatement - FRS 21	<u>95.4</u>	<u>91.4</u>
<b>Shareholder's funds at the beginning of the year as restated</b>	<b><u>1,592.5</u></b>	<b><u>1,583.5</u></b>
Actuarial gain/(loss) on pension scheme (note 23)	34.9	(80.2)
Movement on deferred tax relating to pension scheme (note 16)	<u>(10.5)</u>	<u>24.1</u>
<b>Shareholder's funds at the end of the year including pension liability</b>	<b><u>1,690.3</u></b>	<b><u>1,592.5</u></b>

### 21 Capital commitments

	2005 £m	2004 £m
Contracted for but not provided	<u>155.9</u>	<u>196.3</u>

In addition to these commitments, the Company has long-term capital investment plans to provide for future growth.

### 22 Operating leases

At 31 December 2005 the Company was committed to making the following payments during the next year in respect of non-cancellable operating leases:

	2005		2004	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
<b>Leases which expire:</b>				
Within one year	0.2	0.3	-	0.3
Between one and two years	-	0.6	0.1	0.3
Between two and five years	0.8	0.2	0.1	-
After more than five years	<u>4.3</u>	<u>-</u>	<u>5.0</u>	<u>-</u>
	<b><u>5.3</u></b>	<b><u>1.1</u></b>	<b><u>5.2</u></b>	<b><u>0.6</u></b>

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 23 Pension schemes

Pension arrangements for the majority of the Company's employees are of the defined benefit type, funded through pension schemes covering employees within the RWE Thames Water Group, whose assets are held separately from those of the Group in independently administered funds. In addition, there are unfunded defined benefits provided for directors and senior employees affected by the cap on earnings, which cannot be provided through approved arrangements.

The Company's pension arrangements are of the group multi-employer scheme nature, such that the Company's pension schemes assets and liabilities are included with those of other companies in the RWE Thames Water Group. The Company contributes the vast majority of the contributions into the Scheme and any consequence of there being a surplus or a deficit in the schemes is felt by the Company. Accordingly, the Directors have decided it is appropriate to recognise the total surplus and deficit of the two Group pension schemes within these financial statements.

The Service cost of the Company, as included with these financial statements, represents the net of the total service cost of the Group schemes and the pension contributions made by the other group companies into the schemes in the financial year.

In addition to the ongoing cost of the UK Pension arrangements, the Company operates discretionary arrangements under which it augments benefits on retirement. These augmentations are funded by way of additional employer contributions to the schemes. In the year ended 31 December 2005 payments amounted to £1.8m (2004: £2.7m).

The latest full actuarial valuation was undertaken as at December 2004. This valuation has been updated at 31 December 2005 by Hewitt, Bacon and Woodrow using revised assumptions that are consistent with the requirements of FRS 17 and shown in the table below.

The next full actuarial valuation as at 31 December 2007 will be undertaken by Hewitt, Bacon and Woodrow (the independent and professionally qualified consulting actuaries to the schemes) during 2008.

RWE Thames Water Group has taken advice from Hewitt, Bacon and Woodrow in respect of the funding position of the Group pension schemes. With consideration of the funding position of the schemes, the Company contribution rate has been increased where necessary in accordance with Hewitt, Bacon and Woodrow recommendations.

The main financial assumptions used for FRS 17 purposes are as follows:

	2005	2004	2003
Price inflation	2.9%	2.9%	2.8%
Salary increases	3.9%	3.9%	3.8%
Pension increases	2.9%	3.0%	2.7 -2.9%
Discount rate for scheme liabilities	4.8%	5.3%	5.4%

# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 23 Pension schemes (continued)

The fair value of the assets held by the pension schemes, the long-term expected rate of return on each class of assets and the value of the schemes' liabilities assessed on the assumptions described above are shown in the following table:

	2005		2004		2003	
	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m
Equities	8.0%	525.7	8.0%	445.0	8.3%	789.0
Bonds	4.5%	63.8	4.5 – 5.0%	477.0	5.3%	66.0
Gilts	3.8 – 4.8%	445.1	-	-	-	-
Property	8.0%	118.0	8.0%	87.0	8.3%	52.0
Other assets	4.5%	2.3	4.0%	-	4.3%	9.7
Total market value of assets		<u>1,154.9</u>		<u>1,009.0</u>		<u>916.7</u>
Present value of schemes liabilities		<u>(1,229.1)</u>		<u>(1,113.9)</u>		<u>(951.9)</u>
Deficit in the schemes		<u>(74.2)</u>		<u>(104.9)</u>		<u>(35.2)</u>
Related deferred tax asset		<u>22.3</u>		<u>31.5</u>		<u>10.5</u>
Net pension deficit		<u>(51.9)</u>		<u>(73.4)</u>		<u>(24.7)</u>

This can be analysed as follows:

	2005 £m	2004 £m
Thames Water Mirror Image Pension Scheme	36.8	16.2
Thames Water Pension Scheme	<u>(88.7)</u>	<u>(89.6)</u>
	<u>(51.9)</u>	<u>(73.4)</u>

Analysis of amount charged to operating profit:

	2005 £m	2004 £m
Current service cost	<u>(22.6)</u>	<u>(20.7)</u>
Total operating charge included in operating profit	<u>(22.6)</u>	<u>(20.7)</u>

Analysis of amount credited to other finance income:

	2005 £m	2004 £m
Expected return on pension scheme assets	65.4	70.1
Interest on pension scheme liabilities	<u>(58.5)</u>	<u>(51.6)</u>
Net finance income included within net interest payable	<u>6.9</u>	<u>18.5</u>

# Thames Water Utilities Limited

## Notes to the financial statements for the year ended 31 December 2005

### 23 Pension schemes (continued)

#### Analysis of amount recognised in statement of recognised gains and losses:

	2005 £m	2004 £m
Actual return less expected return on pension scheme assets	98.4	37.0
Experience gains and losses arising on the scheme liabilities	24.7	(39.1)
Changes in assumptions underlying the present value of scheme liabilities	<u>(88.2)</u>	<u>(78.1)</u>
<b>Actuarial gain/(loss) recognised in STRGL</b>	<b><u>34.9</u></b>	<b><u>(80.2)</u></b>

#### The movement in the deficit during the year to 31 December 2005 was as follows:

	2005 £m	2004 £m
Deficit in scheme at start of year	(104.9)	(35.2)
Operating charge	(22.6)	(20.7)
Employer contributions	11.5	12.7
Other finance income	6.9	18.5
Actuarial gain/(loss)	<u>34.9</u>	<u>(80.2)</u>
<b>Deficit in scheme at end of year</b>	<b><u>(74.2)</u></b>	<b><u>(104.9)</u></b>

#### The details of experience gains and losses for the year to 31 December 2005 are as follows:

	2005 £m	2004 £m	2003 £m
Difference between the expected gains and losses on scheme assets:			
Amount	98.4	37.0	96.9
Percentage of scheme assets	<u>8.5%</u>	<u>3.7%</u>	<u>10.6%</u>
Experience gains and losses on scheme liabilities:			
Amount	24.7	(39.1)	4.6
Percentage of the present value of the scheme liabilities	<u>2.0%</u>	<u>3.5%</u>	<u>0.5%</u>
Total amount recognised in statement of total recognised gains and losses:			
Amount	34.9	(80.2)	28.5
Percentage of the present value of the schemes liabilities	<u>2.8%</u>	<u>7.2%</u>	<u>3.0%</u>



# Thames Water Utilities Limited

## Notes to the financial statements (continued)

### 24 Ultimate parent company and controlling party

The ultimate parent company and controlling party is RWE AG, a company incorporated in Germany.

Copies of the consolidated financial statements of the immediate parent company, RWE Thames Water plc may be obtained from The Company Secretary, RWE Thames Water plc, Clearwater Court, Vastern Road, Reading, Berkshire, RG1 8DB.

Copies of the ultimate parent company's accounts may be obtained from RWE Aktiengesellschaft, Opernplatz 1, D-45128 Essen, Germany.