

2366678

# United Utilities Water PLC

## Report and Financial Statements

31 March 2009

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Registered No: 2366678

## **Directors, advisers and other information**

### **Non-executive directors**

R Bird  
DE Morton

### **Executive directors**

PN Green  
IJ McAulay  
JM Perrie  
GL Sims  
TP Weller  
MR Wright

### **Secretary**

DP Hosker

### **Auditors**

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Manchester  
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### **Registered office**

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## Chairman's statement

This has been another year of good progress for the company. We continue to benefit from a robust financing position and have headroom to cover our projected financing needs through to mid-2011.

We continue to concentrate on the three key areas that I highlighted last year: improving operational performance; successfully delivering our 2005-10 regulatory contract and the 2009 water price review. We believe that our strategy and objectives are aligned with our overall goal of delivering benefits for all stakeholders.

### **IMPROVING OPERATIONAL PERFORMANCE**

We continue to work hard on improving operational performance and have made good progress during the year. Although we are measured on many things, we have highlighted five key performance indicators against which our operational performance can be assessed. These are: relative efficiency; security of water supply (leakage); serious pollution incidents; sewer flooding; and overall customer satisfaction in response to enquiries.

We are pleased to report that overall customer satisfaction is at its highest level for many years and that we met our leakage target for the third consecutive year, despite this year's harsher winter which made the target more challenging. We have also halved the number of serious pollution incidents over the last few years. Although we have made good progress, we know that there is more to do and are strongly focused on making further improvements.

### **SUCCESSFULLY DELIVERING OUR 2005-10 REGULATORY CONTRACT**

We have now completed four years out of our current five-year regulated water and wastewater contract in the North West of England. We are investing over £3 billion in our infrastructure between 2005 and 2010, which allows us to maintain and improve the service we provide to our customers and to meet tough environmental standards. We have a clear plan for the final year of this price review period and are confident of meeting our regulatory targets.

### **THE 2009 WATER PRICE REVIEW**

2009 is an important year for the company as the economic regulator, Ofwat, will set price limits for the business for the five years from 1 April 2010 to 31 March 2015. We submitted our draft business plan to Ofwat in August 2008 and our final plan in April 2009, which was welcomed by the Consumer Council for Water. The plan is the first step in our long-term vision for our business as it adapts to the changing climate and demographics in the North West.

The proposed capital investment programme in our plan aims to safeguard existing standards of service, address new, higher quality standards and make provision for the challenge of climate change. We do recognise that we need to maintain the affordability of customer bills, especially in what is a tough economic environment, and this was a key feature of the business plan we submitted to Ofwat. Whilst we expect to continue to fund significant levels of capital investment beyond 2010, we believe that our service, which on average costs domestic households around £1 per day for high quality drinking water and environmentally responsible wastewater collection and treatment, represents excellent value for money. We are also increasing the funding of our Charitable Trust by 67.0 per cent to £5.0 million per year to help more customers who are struggling to pay their water bills.

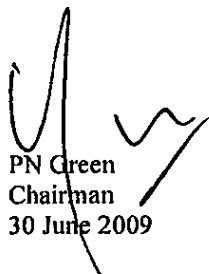
With the proposals in our business plan, independent research indicates that we will support some 15,000 jobs in the North West region and approximately 20,000 jobs across the UK.

Ofwat is expected to set out its initial thoughts on price limits in July 2009 and its final determination is scheduled for November 2009.

## Chairman's statement

### OUTLOOK

We will continue to implement our strategy of focusing on our core skills, with the aim of delivering benefits for all of our stakeholders. I am encouraged by the progress we have made and confident that we can build on this in the year ahead.



PN Green  
Chairman  
30 June 2009

## Business review

### BUSINESS DESCRIPTION

United Utilities Water PLC (“UUW”) is a public limited company registered in England and Wales, providing water and wastewater services in North West England. The company was incorporated in Great Britain on 1 April 1989 under the Companies Act 1985.

United Utilities Water PLC is a subsidiary of United Utilities North West PLC. The ultimate parent company of United Utilities Water PLC is United Utilities Group PLC (which, together with its subsidiaries, constitutes “the group”).

The group is the UK’s largest listed water business. The group owns and manages the regulated water and wastewater network in the North West of England and also applies its core skills to operate water, wastewater, electricity and gas networks in competitive markets, principally in the UK.

#### Key facts

- 95 water treatment works
- 184 reservoirs
- Over 1,400 kilometres of aqueducts
- Over 40,000 kilometres of water pipes
- Over 57,000 hectares of catchment land
- 582 wastewater treatment works
- Over 43,000 kilometres of sewers
- Serving a population of seven million people

The company holds licences to provide water and wastewater services to a population of approximately seven million people in the North West of England.

Almost 2,000 million litres of water is supplied every day to approximately 3.2 million homes and businesses. Water is sourced from catchment land and is collected and stored in reservoirs before being treated and then delivered via a network of pipes to homes and industry. A large proportion of the water supplied flows freely by gravity and does not need to be pumped.

Wastewater is collected using a network of sewers and treated before being returned safely to the environment. A by-product of the treatment of wastewater is sewage sludge, which is treated further to produce an end product suitable for recycling.

The company is regulated in terms of both price and performance by an independent body, Ofwat, which sets price limits every five years for the water sector in England and Wales. Current price limits were fixed in 2004. Ofwat is due to publish its final determination of price limits for the period 1 April 2010 to 31 March 2015 in November 2009. Once Ofwat has published its final determination, water companies have two months to decide whether to accept the determination or instead to have price limits referred to and set by the Competition Commission.

Consistent with the group’s approach to longer-term asset planning, the needs of the North West region to 2035 were considered in UUW’s strategic direction statement, ‘where we are heading’, which sets out its plans for the next price review period (2010-15) in a longer-term context. The six key elements identified in the strategic direction statement are:

- responsible stewardship of water and wastewater networks;
- listening to customers and other stakeholders;

## **Business review (continued)**

### **BUSINESS DESCRIPTION (continued)**

- ensuring water resources are more sustainable and resilient;
- an integrated approach to drainage to reduce the threat of flooding;
- reducing significantly the carbon impact of activities; and
- bills to rise, on average, no faster than incomes.

In the 2005-2010 period, U UW is investing more than £3 billion to improve the water and wastewater infrastructure and the environment across the North West. Further developments in the regulatory regime are expected to take effect in the next few years, in particular as a result of European Union environmental initiatives (including the Water Framework Directive, the Drinking Water Directive and the Environmental Liability Directive).

Since privatisation in 1990:

- water quality in the North West region has improved from 99.6 per cent to 99.9 per cent;
- compliance with bathing water standards across the North West has risen from just over 30.0 per cent to more than 90.0 per cent;
- leakage from the network has halved, supported by ongoing investment in replacing ageing water pipes; and
- the company has invested more than £4,000 for every household in the North West, some £750 above the national average.

### **REGULATORY DEVELOPMENTS**

#### **Efficiency initiatives**

The company is broadly on track to meet its regulatory efficiency targets across the 2005-10 period, although the business is facing ongoing cost pressures in areas such as power and bad debts.

The company's principal efficiency initiatives include an integrated performance management project, which increases remote operational site management and optimises chemical and power usage, and its asset improvement programme which is improving the efficiency of operational pumps. These schemes are key elements of the company's plan to mitigate its carbon emissions, alongside its combined heat and power assets which recycle energy generated from wastewater treatment processes. The company has been awarded the Carbon Trust standard and the business has developed the technology to convert biogas, a by-product of the sludge treatment process, into bio-methane for vehicle fuel and potentially to export into the natural gas distribution network.

Other key initiatives include supply chain management, which has been centralised and is delivering procurement economies, and a workforce management project. There is a strong drive to improve customer service and the business is focusing on reducing the number of customer queries, improving staff productivity and implementing improved cash collection procedures.

The workforce management system is a key initiative in increasing the efficiency of frontline staff, by using real time data across the workforce to enable more effective work scheduling. This project has been successfully implemented on time and below budget and early progress is encouraging. The system should provide the dual benefits of reducing the cost to serve and improving customer satisfaction. Cost savings of approximately £7 million per annum are expected by 2010.

## Business review (continued)

### REGULATORY DEVELOPMENTS (continued)

#### 2009 water price review

The company submitted its draft water and wastewater business plan, covering the 2010-15 period, to Ofwat in August 2008 and submitted its final plan on 7 April 2009, entitled 'Planning for the future'. These submissions form part of the 2009 water price review process and build on the company's strategic direction statement published in December 2007. The business has worked hard to strike the right balance between improvements in the network and the impact on the bills paid by its customers. The final plan was welcomed by the Consumer Council for Water and supported by the company's independent engineering Reporter, Halcrow, which described the capital investment assessment as well considered, comprehensive and robust.

The total capital investment programme contained within the final plan, including infrastructure renewals expenditure, is approximately £3.7 billion (2007/08 prices), comprising £1.3 billion for the water service and £2.4 billion for the wastewater service. This compares with a programme of just over £3 billion in the 2005-10 period. Investment to meet regulatory quality standards, enhance the service to customers and maintain the supply/demand balance is forecast at around £1.8 billion. The remainder relates to essential maintenance of the water and wastewater infrastructure. Having raised over £1 billion of debt finance in the last year, the business would expect to borrow £1.6 billion across the five-year period 2010-15 to finance this plan.

The planned 2010-15 capital investment programme takes account of the geography and industrial legacy of the North West of England. It aims to maintain and improve current service standards and address new tighter quality standards as well as making provision for the challenge of climate change. The total proposed capital expenditure programme in the final plan is £3,704.0 million, compared with £4,035.0 million in the draft plan. The principal reductions are the deferral and removal of outputs (£433.0 million), the impact of recession on growth (£119.0 million) and greater future efficiency (£130.0 million), partly offset by the inclusion of further projects relating to sewer overflows and unsatisfactory intermittent discharges (£351.0 million).

The company expects to improve its efficiency further across the 2010-15 period. The business is aiming for a 1.5 per cent annual improvement in its underlying operating efficiency, although operating expenditure is likely to increase overall due to cost pressures in areas such as property rates and pensions. The company is also targeting an average improvement in efficiency of between four per cent and eight per cent across the five-year period in respect of its capital investment programme.

The company estimates that to finance this plan an average real, fully post-tax return of 4.85 per cent is required, which it believes would support an A3 credit rating. This compares with a cost of capital of 5.1 per cent assumed by Ofwat at the last price review in 2004, reflecting the reduction in the cost of debt finance available to the water sector during the early part of the 2005-10 period. However, this return represents an increase of approximately 0.2 per cent compared with the required return in the draft business plan, following the company's reassessment of its financing costs in light of recent financial market conditions. This reassessment is supported by NERA Economic Consulting's (NERA) recently updated independent research ('Cost of Capital for PR09 – A Final Report for Water UK', January 2009) which has concluded that a higher cost of capital in the range of 4.6 per cent to 5.1 per cent (fully post-tax, real) would be appropriate for the UK water industry. NERA intends to reassess this cost of capital range later in the year.

The company believes that Ofwat should ensure that water companies can at least maintain an A3 credit rating and should consider recent developments in the credit markets. The raising of debt finance is particularly important given the likely scale of investment that is still required in the water industry to replace and refurbish ageing infrastructure, make provision for climate change and deliver further statutory environmental obligations and customer priorities. The board believes this to be an appropriate investment grade rating to allow the company to raise finance to fund its substantial capital investment programmes, particularly in light of conditions in the debt markets over the last 12 months.



## **Business review (continued)**

### **REGULATORY DEVELOPMENTS (continued)**

The company believes that its services, which on average costs households around £1 per day for the supply of high quality drinking water and for environmentally responsible wastewater collection and treatment, represents excellent value for money. Within this plan, average household bills would increase by seven pence per day in real terms by 2015. This equates to an average real price increase of 1.8 per cent across the company's customer base during the 2010-15 period. The business believes this plan is consistent with its aim that bills, on average, should rise no faster than medium-term household income growth.

The next stage of the price review process is publication of the draft determination by Ofwat in July 2009, with the final determination due in November 2009.

### **THE ENVIRONMENT**

The company continues to deliver the plans it set out in 2007 for tackling climate change. Activities have focused on the carbon reduction potential associated with expanding renewable energy generation using sewage gas as a source of energy.

The UK Government's forthcoming Carbon Reduction Commitment will present a significant challenge to the water industry to deliver carbon reductions against an increasing requirement to improve water and wastewater quality. To drive further reductions, the company is continuing to research and invest in more efficient treatment processes and additional renewable energy resources. In recognition of its efforts, United Utilities was awarded the Carbon Trust standard.

Sustainable management of water resources is vital in protecting the environment and ensuring reliable supplies of drinking water. In January the company launched the draft 25-year Water Resources Management Plan and continues to reduce the amount of water needed to be taken from the environment through programmes on leakage, water efficiency and metering. Customers are encouraged to take part in reducing demand. For example, installing a meter typically reduces household water consumption by 10 per cent. Last year 58,240 meters were installed under the company's free meter scheme.

2009 is the final year of a £10.0 million programme to improve the condition of the Peak District and Trough of Bowland estates. Nearly a third of the land is designated Sites of Special Scientific Interest, with over 96 per cent now rated as 'favourable' or 'favourable recovery', ahead of national targets. The scheme is bringing considerable benefits to wildlife habitats as well as improvements to raw water quality.

The company has improved its management of waste, working with partners to ensure compliance with the Site Waste Management Plan regulations that came into force in April 2008. Innovative ways to manage waste, using recycled products, including aggregate and transformer oil, continue to reduce the amount sent to landfill.

A new method of charging for surface and highway drainage services on a site area basis, rather than rateable value, for metered non-household customers was introduced. This method, preferred by Ofwat, spreads the cost of providing this service more fairly across the whole customer base and is designed to encourage more environmental ways of dealing with surface water, for instance by installing 'soakaways'. However, even with a phased introduction, some customer groups have experienced significant increases in their charges. The company has therefore imposed a moratorium for faith buildings, scout and guide associations and community amateur sports clubs pending review of this charging approach, and community partner Groundwork is helping to promote actions that organisations can take to reduce bills.

### **COMMUNITY**

United Utilities' education programme supports the focus on climate change and engineering skills, and promotes water and energy efficiency in schools. Since September 2008, 50 schools have signed up to the programme, which aims to have a measurable impact on how they tackle climate change issues.

## **Business review (continued)**

### **COMMUNITY (continued)**

2009 brings the final year of the company's 25-year partnership with the Mersey Basin Campaign. This has seen improvement in water quality across the region; an example which is now being replicated in Europe.

Partnerships with Hope through Action, Youth Sport Trust and a further commitment to WaterAid have evolved as a result of the group's Executive Leadership Team's Changing Lives Challenge. Around £660,000 was raised by employees, suppliers and partners in support of a team challenge that helped to improve sanitation in Zambia in collaboration with WaterAid.

### **EMPLOYEES**

#### **Benefits and lifestyle**

The company recognises the importance of work-life balance and provides a range of benefits in support of that balance. Policies on maternity, paternity, adoption, personal and special leave go beyond requisite legal obligations as an employer. Pension provision is a particularly valued core benefit and more than 87 per cent of employees are members of pension schemes. A flexible benefits scheme is also open to all employees.

#### **Dignity and equality**

The company's business principles make it clear that in everything it does, the company seeks to act with integrity and fairness and observe legal requirements. Any employee with serious concerns that the company may not be adhering to these principles is encouraged to speak up via their line manager or by using a contact number that can be called in confidence.

#### **Disabilities**

The company is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995 and best practice. As an equal opportunities employer, it gives equal consideration to applicants with disabilities in the employment criteria and will modify equipment and working practices wherever it is safe and practical to do so. The group has retained the 'double tick' positive disabled people award.

#### **Employee relations**

The company and its trade unions continue to strive towards developing an approach of working together under an employee relations framework. This looks not just at what needs to be done but how to enable the development of positive working relationships. Both parties share a commitment to this success and are committed to developing positive working relationships.

#### **Engagement**

The continued engagement of employees is a key factor to the success of the company. Through independently verified annual employee surveys and 'pulse' surveys, progress with engagement and employee feedback upon management's response to it are measured. The factors assessed include: how employees think about the company; how they fit in; how they feel in terms of pride and attachment to the company; and are they motivated to go beyond the requirements of their day job.

#### **Health and safety**

In 2008/09, the company enhanced its approach to health and safety, integrating a new management framework into its business operations, allowing a focus on measuring and reducing risks proactively and improving corporate governance. The reported accident incident rate per 100,000 employees (injuries causing more than one day's absence) increased from 667 to 866. In recognising that this can be improved, a 10 per cent reduction has been targeted by 2010.

## **Business review (continued)**

### **PRINCIPAL RISKS AND UNCERTAINTIES**

The company faces a variety of risks and uncertainties, both foreseeable and unforeseeable which, if materialise, could adversely affect its reputation, profitability or financial position, or the pricing and liquidity of its debt securities. The principal ones are summarised below:

#### **Unfavourable price determination**

##### **Risk**

The company operates in an industry which is substantially influenced by the service levels, regulatory targets and price determinations set by its primary regulator, Ofwat, as well as Ofwat's assessment of its delivery against these.

An adverse outcome to the price determination process (which limits the income the regulated business can receive from its customers) could occur for a number of reasons. These include an inadequate allowed cost of capital, turnover forecasts proving not to be sufficiently accurate, or unforeseen or unforeseeable costs which arise after the determination that cannot be recovered from customers. After a price determination, there is a right of appeal to the Competition Commission, but otherwise the scope to review the outcome within the relevant five-year period is limited.

Review mechanisms can also be invoked by Ofwat to reduce the prices for customers. Furthermore, implicit within the price determination are assumptions by Ofwat concerning the company's future operating expenditure and the achievement of operating cost savings. If these efficiencies are not achieved this may be reflected in less favourable outcomes in Ofwat's future price determinations.

##### **Mitigation**

In April this year, the company submitted its final business plan to Ofwat for the 2009 price review for the regulated business, which will set prices for the five-year period from April 2010. This plan endeavours to ensure that the assumptions and projections underlying Ofwat's price determination are accurate and achievable. The company has committed substantive and qualified resource to ensuring the quality of its submissions throughout the price determination process to give it the best prospect of receiving a satisfactory determination. The submission process includes an assessment of the risks associated with each component of the business to assist Ofwat's understanding of these. Ofwat's draft determination will be published in July 2009 and its final determination of allowable prices is expected to be published in November 2009.

#### **Capital investment programmes**

##### **Risk**

The company requires significant capital expenditure, particularly in relation to new and replacement plant and equipment for water and wastewater networks and treatment facilities. Historically, the company has financed this capital expenditure from operating cashflow and from external debt and equity financing. There can be no assurance that operating cashflows will not decline or that external debt financing and other sources of capital will be available, at similar cost to that assumed by Ofwat, in order to meet these capital expenditure requirements. Delivery of capital investment programmes could also be affected by a number of factors including adverse legacy effects of earlier capital investments or amounts budgeted in prior capital investment programmes proving insufficient to meet the actual amount required. This may affect the company's ability to meet regulatory and other environmental performance standards, which may result in fines imposed by Ofwat of an amount of up to 10 per cent of the company's business turnover or other sanctions.

##### **Mitigation**

In order to minimise the likelihood of funding shortfalls, capital investment programmes are regularly monitored to identify the risk of time, cost and quality variances from plans and budgets and to identify, where possible, any appropriate opportunities for out-performance. Development of the programme for 2010-15 is progressing in line with expectations, as is delivery of the current capital investment programme.

## **Business review (continued)**

### **PRINCIPAL RISKS AND UNCERTAINTIES (continued)**

#### **Current capital market conditions**

##### **Risk**

The global banking crisis continues to impact the debt and equity capital markets. It has resulted in the cost of capital increasing significantly and has made the issuance of new equity and debt capital more expensive and more difficult to secure. A compounding challenge arises from the relationship between the Regulatory Capital Value (RCV) of the regulated business and the Retail Price Index (RPI). The RCV is adjusted annually for inflation so, if RPI decreases, the RCV would be adjusted downward to reflect this. This may lead to pressure on the gearing ratios and credit ratings of the regulated business and the company as a whole and increase the cost or limit the availability of credit in an already difficult market. In the extreme, the company may be required to increase its equity base by either reducing its dividend payments or raising new equity capital. The global economic crisis has also created difficult trading and financing conditions for customers, contractors and suppliers of materials and/or services to the company.

##### **Mitigation**

The company closely monitors its liquidity headroom within the parameters approved by the board, the impact of trends in inflation or deflation on its capital position as well as the potential impact of wider changes in the credit markets. Where possible, the company has sought to issue debt linked to RPI to minimise the extent of its exposure to deflationary (or low inflationary) conditions. The company also monitors the financial position of its key contractors and suppliers and seeks to use its procurement processes to ensure that alternative suppliers can be sourced quickly and, where possible, on similar terms.

#### **Pension scheme obligations**

##### **Risk**

The company participates in a number of pension arrangements, predominantly in the UK. The principal schemes are defined benefit schemes, although these have been closed to new employees since October 2006. The assets of these schemes are held in trust funds independent of company finances, with the funds being well diversified and professionally managed. Reflecting the global economic environment, the company's current schemes had a combined net deficit of £118.1 million as at 31 March 2009, compared with a net deficit of £48.6 million as at 31 March 2008.

##### **Mitigation**

Increases to pension deficits may result in an increased liability for the company, the size of which depends upon the extent to which additional deficits are recoverable through the regulatory price determination process. The regulated business is in ongoing dialogue with Ofwat concerning the allowances for increased pension scheme deficits within the price determination process for the 2010-2015 period. The company monitors the schemes' investment strategy implementation and assesses changes in the company's exposure to liability.

## **Business review (continued)**

### **PRINCIPAL RISKS AND UNCERTAINTIES (continued)**

#### **Failure to comply with applicable law or regulations**

##### **Risk**

The company is subject to various laws and regulations. Regulatory authorities may from time to time make enquiries of companies within their jurisdiction regarding compliance with regulations governing their operations. In addition to regulatory compliance proceedings, the company could become involved in a range of third party proceedings relating to land use, environmental protection and water quality. Amongst others, these may include civil actions by third parties for infringement of rights or nuisance claims relating to odour or other matters. Furthermore, the impact of future changes in laws or regulations or the introduction of new laws or regulations that affect the business cannot always be predicted and, from time to time, interpretation of existing laws or regulations may also change or the approach to their enforcement may become more rigorous. If the company fails to comply with applicable law or regulations, in particular in relation to its water and wastewater licences, or has not successfully undertaken corrective action, regulatory action could be taken that could include the imposition of a financial penalty (of up to 10 per cent of relevant regulated turnover) or the imposition of an enforcement order requiring the company to incur additional capital or operating expenditure to remedy its non-compliance. In the most extreme cases, non-compliance may lead to revocation of a licence or the appointment of a special administrator.

##### **Mitigation**

The company endeavours to comply with all legal requirements in accordance with its business principles and robust processes are in place to seek to mitigate against non-compliance. The company is certified to both ISO 9001 and 14001 standards and the company continually monitors legislative and regulatory developments and, where appropriate, participates in consultations to seek to influence their outcome, either directly or through industry trade associations for wider issues. The company seeks appropriate funding for any additional compliance costs in the regulated business as part of the price determination process.

#### **Increased competition in the water and wastewater industry**

##### **Risk**

The Cave review of competition and innovation in water markets was published in April 2009. If its recommendations are implemented, this would eventually expand the competitive market allowing retail competition to all non-household customers. Ofwat has also taken steps to introduce competition into the water supply market through inset appointments and the water licensing supply regime. Prior to 2007 (with one exception), inset appointees had all been granted to existing regulated companies. Since 2007, Ofwat has granted more inset appointments, two of which are within the company's region. Further inset appointments may be made in the future, resulting in increased competition.

##### **Mitigation**

The company has been fully engaged in the Ofwat consultations on the Cave review, although a relatively small proportion of the company's profits derives directly from non-household retail activities. If competition is expanded, there would be opportunities for the company to participate in a wider market in England and Wales. As far as inset appointments are concerned, these generally relate to new developments or large industrial customers. Furthermore, the regulated business has not received any applications from holders of water supply licences to supply any premises within its region.

## Business review (continued)

### PRINCIPAL RISKS AND UNCERTAINTIES (continued)

#### Events, service interruptions, systems failures, water shortages or contamination of water supplies

##### Risk

The company controls and operates utility networks and maintains the associated assets with the objective of providing a continuous service. In exceptional circumstances, electricity, gas or water shortages or the failure of an asset, an element of a network or supporting plant and equipment could result in the interruption of service provision or catastrophic damage resulting in significant loss of life and/or environmental damage and/or economic and social disruption. The company could be fined for breaches of statutory obligations or held liable to third parties, or be required to provide an alternative water supply of equivalent quality, which could increase costs. The company is also dependent on the ability to access, utilise and communicate remotely via electronic software applications mounted upon corporate information technology hardware and communicating through internal and external networks. The ownership, maintenance and recovery of such applications, hardware and networks are not wholly under its control.

##### Mitigation

The company operates long-standing, well tested and appropriately resourced incident response and escalation procedures. The processes continue to be refined, together with risk management and business continuity procedures, recognising that possible events have varying impacts and likelihoods. While the company seeks to ensure that it has appropriate processes in place, there can be no certainty that such measures will be effective in preventing or, when necessary, managing large-scale incidents to the satisfaction of customers, regulators, government and the wider stakeholder community. The company also maintains insurance cover in relation to losses and liabilities likely to be associated with such significant risks, although potential liabilities arising from a catastrophic event could exceed the maximum level of insurance cover that can be obtained cost effectively. The company's licence also contains a 'shipwreck' clause that, if applicable, may offer a degree of recourse to Ofwat in the event of a major incident.

### BUSINESS OBJECTIVES AND PERFORMANCE

#### Operational performance

Operational performance is a key area of focus and the company is targeting an upper quartile position among UK water companies on key operational measures in the medium-term. The company continues to upgrade its infrastructure, replacing 227 kilometres of water mains during the year and continues to supply a high quality of drinking water, with a mean zonal compliance water quality performance for the year of 99.92 per cent.

The company is making good progress against its key performance indicators:

- **Relative efficiency** – The company has closed the operational efficiency gap to the most efficient water companies over the last three years. This is reflected in Ofwat's most recent (2007/08) assessment of the company as band B for the water service and band C for the wastewater service and represents a one band improvement for both services over the three-year period.
- **Security of water supply** – The company met its economic level of leakage rolling target for the third consecutive year in 2008/09, despite unfavourable winter weather conditions which made this target more challenging. This follows a period where the company had not met this target for five years. In addition, no water restrictions were required during the year.

## Business review (continued)

### BUSINESS OBJECTIVES AND PERFORMANCE (continued)

#### Operational performance (continued)

- **Pollution** – The business has now met or outperformed its medium-term target of a 50 per cent reduction in major pollution incidents in each of the last three years. One water and 10 wastewater Category 1&2 incidents were recorded in 2008 compared with the base position of two water and 21 wastewater incidents in 2005. In addition, the company has more than halved the number of failing wastewater treatment works from 18 works in 2007 to seven works in 2008, and performance so far this year has been encouraging.
- **Sewer flooding** – The company continues to remove properties from the sewer flooding register. Ofwat has published a review of how registers of properties at risk of sewer flooding are compiled and reported in the water sector in England and Wales. The company is currently in discussion with Ofwat regarding its methodology and processes in this area. This is expected to result in a restatement of the number of properties on the company's sewer flooding registers, with a resulting increase in these numbers in terms of both the start point in 2005/06 and the current position. However, it is envisaged that the restated numbers will still demonstrate progress over this period. The company aims to build on the progress achieved over the last three years and will provide a further update when its sewer flooding registers have been reassessed. Following completion of this review, the company expects to restate its historical overall performance assessment (OPA) scores for the three years 2004/05 through 2006/07 in relation to 'flooding other causes' and is in discussion with Ofwat regarding the extent of these restatements.
- **Overall customer satisfaction** – Significant improvements have been delivered. Overall customer satisfaction, in response to enquiries, has improved from less than 50.0 per cent in 2005 to consistently over 70.0 per cent. These satisfaction levels are based upon a comprehensive independent survey conducted on behalf of the company each month. Further progress has been achieved and customer satisfaction is now at its highest levels for many years, with a satisfaction rating of 76.0 per cent for 2008/09. The rating for the final month of the year was 80.0 per cent. The business remains focused on achieving further improvements.

Although the company has delivered real progress, the business recognises that there is more to do. Sewer flooding incidents, influenced by adverse weather, together with environmental underperformance at Fleetwood wastewater treatment works are expected to continue to impact the 2008/09 OPA score. A funded capital investment programme has already been initiated at the Fleetwood works and an improvement in performance is expected in the medium-term.

## Business review (continued)

### BUSINESS OBJECTIVES AND PERFORMANCE (continued)

#### Performance against KPIs

The company monitors a large number of financial and non-financial KPIs, including targets set by Ofwat. Performance in 2008/09 against these measures is set out in the table below, together with the prior year performance data.

	2009	2008
<b>Financial</b>		
Turnover <sup>(1)</sup>	£1,508.2m	£1,426.4m
Operating profit	£711.5m	£651.1m
Profit before tax	£505.0m	£457.5m
RCV gearing <sup>(2)</sup>	64%	52%
Interest cover <sup>(3)</sup>	3.4	3.0
Capital expenditure (net cashflow)	£757.1m	£721.3m
<b>Environment</b>		
Pollution incidents <sup>(4)</sup>	11	9
Water quality – mean zonal compliance <sup>(5)</sup>	99.92%	99.94%
Renewable energy generated <sup>(6)</sup>	100GWh	93GWh
<b>Employees</b>		
Employee engagement – employee opinion survey <sup>(7)</sup>	81%	71%
Health and Safety – incident rate per 100,000 employees	866	667
<b>Customers</b>		
Water – relative efficiency banding <sup>(8)</sup>	Band B	Band B
Wastewater – relative efficiency banding <sup>(8)</sup>	Band C	Band C
Leakage – rolling annual average leakage <sup>(9)</sup>	462Ml/day	462Ml/day
Overall customer satisfaction – water (in response to enquiries)	76%	73%
Overall Performance Assessment (OPA) <sup>(10)</sup>	344 points	341 points

(1) Turnover is the consideration receivable by the company for services provided during the year.

(2) RCV gearing is measured as borrowings, including derivatives, net of cash and short-term deposits divided by the Regulatory Capital Value (RCV). The RCV is a company-specific measure calculated by Ofwat, which is widely used in the investment community as a component of the market value of regulated water businesses.

(3) Interest cover is the number of times the net underlying finance expense is covered by operating profit before exceptional charges. Net underlying interest expense is calculated as the underlying cost of borrowings excluding any pension adjustment and movements in the fair value of debt and derivatives but including the £14.8 million (2008: £31.9 million) interest on swaps and debt under fair value option.

(4) Number of category 1 & 2 incidents during the year as defined by the Environment Agency. Figures stated are for the years ended 31 December 2008 and 2007.

(5) Mean zonal compliance is used as an indicator of the overall quality of water as measured at the consumer's tap. It is constituted from data for 40 parameters with National or European standards. Figures stated are for the years ended 31 December 2008 and 31 December 2007.

(6) In 2008/09 100 GWh of renewable energy was generated, the equivalent of 53,788 tonnes of carbon dioxide.

(7) A record number of employees had their say in the 2008/09 survey. The company achieved an engagement score of 81 per cent, a 10 per cent increase on last year and building towards a target of 85 per cent by 2010.

(8) Relative efficiency is the operating expenditure relative efficiency band as assessed by Ofwat for the years ended 31 March 2008 and 31 March 2007. 2008/09 assessment is due to be published by Ofwat later in the year.

(9) Annual rolling average leakage – figures given are in megalitres per day for the years ended 31 December 2008 and 31 December 2007. The Ofwat Regulatory rolling average leakage target was 465 megalitres per day.

(10) As the Overall Performance Assessment (OPA) at March 2009 has not been confirmed by Ofwat this represents the company's current best estimate. The OPA is a measure used by Ofwat to compare the quality of the overall service that water companies provide to their customers across a basket of measures. The figure now quoted for 2007/08 is the actual assessment.



## Business review (continued)

### BUSINESS OBJECTIVES AND PERFORMANCE (continued)

#### Financial highlights

Turnover increased by 5.7 per cent to £1,508.2 million in 2008/09, principally as a result of allowed price increases of 3.5 per cent plus RPI of 4.3 per cent and an allowance for headroom of 0.3 per cent. This overall increase has been partly offset by volume reductions of 2.4 per cent, due to lower demand in the measured base, reduction in trade effluent sales and increased free meter optants ("FMOs"). The increase in price supports significant investment in UUW's infrastructure which provides vital clean water and wastewater services to customers.

Operating profit increased by 9.2 per cent to £711.5 million in 2008/09, primarily reflecting the allowed price increase and tight cost control, partly offset by higher depreciation and power costs. The higher depreciation charge reflects the high levels of capital spend, in line with the planned profile of the investment programme.

Net interest payable of £206.5 million was £12.9 million higher than the prior year. This expense includes a £15.1 million fair value loss on debt and derivative instruments, compared with a £19.8 million net fair value loss in the previous year. In order to provide a hedge of the interest cost implicit in the regulatory period, the company fixes interest rates for the duration of each five-year review period for the majority of its debt using interest rate swaps. Financial Reporting Standard (FRS) 26 'Financial Instruments: Recognition and Measurement' limits the use of hedge accounting for these commercial hedges, thereby increasing the potential volatility of the profit and loss account. In addition, the impact of changes in credit spread on debt accounted for at fair value through the profit or loss can result in significant additional volatility. However, this volatility in fair values has no cashflow impact. Interest payable on swaps and debt under the fair value option was £14.8 million, £17.1 million lower than the comparative period, primarily due to the derivative contracts associated with a €1 billion 6.625 per cent bond, which matured in November 2007. Indexation of the principal of index-linked debt amounted to a charge of £28.4 million compared with a charge of £54.8 million in the previous year, due to the benefit of lower RPI impacting on the second half of this year.

The current UK mainstream corporation tax charge for 2008/09 reflects the high level of accelerated tax allowances arising from the capital investment undertaken by the company offset partly by the fair value movements in derivatives. These timing differences are matched by equal and opposite movements in deferred tax. The effective current tax charge is 26.0 per cent, compared with a charge of 21.0 per cent in 2007/08. Including discounted deferred tax, there is an effective tax charge of 26.0 per cent, compared with 20.3 per cent in 2007/08.

A significant level of capital investment continues to be made as the company completes the peak phase of the 2005-10 water and wastewater capital investment programme. The 2008/09 net capital investment spend of £757.1 million represents a 5.0 per cent increase over 2007/08. After adjusting for the revised sewage sludge strategy, as agreed with Ofwat, cumulative capital expenditure on water and wastewater assets remains broadly in line with agreed regulatory assumptions. Overall, the business remains on course to meet its capital expenditure regulatory efficiency targets and deliver its outputs across the 2005-10 period.

Borrowings (including derivatives but net of cash and short-term deposits), increased by £907.3 million to £4,720.0 million at 31 March 2009. As expected, RCV gearing, measured as these borrowings divided by the regulatory capital value, increased to 63.8 per cent compared with 51.6 per cent at 31 March 2008, partly due to the special dividend return made to shareholders.

In the 2008/09 financial year, dividends of £845.5 million were recognised. This figure represents a dividend payment relating to the financial year 2007/08 of £770.0 million (including a special dividend of £550.0m) and an interim payment relating to 2008/09 of £75.5 million. The board has not recommended a final ordinary dividend for 2008/09.

## **Business review (continued)**

### **BUSINESS OBJECTIVES AND PERFORMANCE (continued)**

#### **Regulatory accounts measures**

##### **Atypical operating expenditure items**

Atypical items have been identified and disclosed in the regulatory accounts in accordance with the requirements of Regulatory Accounting Guidelines which are different from the requirements of UK accounting standards in relation to 'Exceptional items'.

In the regulatory accounts, the net atypical income in the year amounts to £3.5 million (2008: atypical costs of £12.1 million). This comprises a £6.1 million credit adjustment (2008: £nil) to the wastewater business rates growth accrual covering the period from 1 April 2005. This is partly offset by atypical costs in the year of £1.6 million (2008: £nil) in relation to an accrual for discharge consents to cover potential charges which may be imposed on the company. Restructuring costs of £1.0 million (2008: £4.5 million) (see note 3) have been treated as atypical costs in the regulatory accounts and exceptional charges in the statutory accounts.

In the prior year, atypical costs included customer transition costs of £5.6 million, which represented consultancy costs associated with the Customer Transition Programme. Also included in atypical costs in the prior year was an amount of £2.0 million in respect of Huyton incident costs, related to the insurance excess paid to cover two separate bursts along Liverpool Road.

##### **Significant movements in Infrastructure Renewals Charge and Current Cost Depreciation**

The annual infrastructure renewals charge is based on actual infrastructure renewals spend for the first four years of Asset Management Plan (AMP) 4, Company Business Plan for 2009/10 plus the ten year (2010 to 2020) annual expenditure projections submitted during PR09. The charge for the year ended 31 March 2009 is £139.9 million (2008: £117.4 million).

The current cost depreciation charge (net of deferred credits) for the year of £311.0 million (2008: £305.6 million) compares with the Final Determination assumption of £346.3 million (2008: £327.7 million). This reduction of £35.3 million as at 31 March 2009 is due largely to lower capital expenditure in this and the previous three years combined with a higher level of work in progress assets at 31 March 2009 compared with 31 March 2003.

##### **Donations to charitable trusts assisting customers or similar funds**

During the year, the company has made donations of £3.0 million (2008: £3.0 million) to the United Utilities Trust Fund, an independent charitable trust helping customers in genuine financial difficulty with both water and non-water debts and in addition providing monies to third parties to promote money advice work.

This is in line with the agreed donation profile and has been expensed via the profit and loss account. From next year, this funding will be increased to £5.0 million to help more customers who are struggling to pay their water bills.

### **CAPITAL STRUCTURE**

#### **Overview**

The board has reviewed the business plan and considers that the company has sufficient liquidity to meet its anticipated financial commitments for at least the next twelve months.

## **Business review (continued)**

### **CAPITAL STRUCTURE (continued)**

#### **Overview (continued)**

The company's primary source of liquidity is cash generated from its ongoing business operations. As reflected in the cashflow statement on page 38, in the year ended 31 March 2009, net cash generated from the company's operating activities was £998.5 million, compared with £963.7 million in 2008. The water regulator has established price increase limits, which will provide certainty for the majority of the company's turnover until 2010. The next price review, covering the 2010 to 2015 period, will be marked by the publication of the draft determination by Ofwat in July 2009, with the final determination due in November 2009.

#### **Capital structure and dividend policy**

The company's objective when managing capital is to maintain a capital structure that enables the company to retain a credit rating of A3, which the company believes best mirrors regulatory assumptions in relation to capital structure.

One of Ofwat's primary duties is to ensure that water companies are able to finance their functions, in particular by securing a reasonable return on their capital. Therefore mirroring Ofwat's assumptions for credit ratings (and hence capital structure) should safeguard the company's ability to earn a reasonable return on its capital, securing access to finance at a reasonable cost and enabling the company to continue as a going concern in order to provide returns for shareholders, credit investors and benefits for other stakeholders.

In order to maintain a credit rating of A3, the company needs to manage its capital structure with reference to ratings methodology and measures used by the relevant ratings agencies. The ratings methodology is normally based upon a number of key ratios such as Regulatory Capital Value (RCV) gearing and adjusted interest cover and threshold levels as updated and published from time to time by the rating agencies. Further detail on the precise measures and methodologies used to assess water companies' credit ratings can be found in the methodology papers published by the ratings agencies.

The company's strategy of targeting a credit rating of A3 was announced in November 2007. Consistent with this strategy and in order to adjust the RCV gearing levels in line with the rating agencies' tolerance levels for an A3 credit rating, the company returned £550.0 million to shareholders as a special dividend and reduced dividend per share by 30 per cent with effect from February 2009.

The company's current long-term credit ratings are A3/A- with stable outlooks from Moody's Investors Service and Standard and Poor's Ratings Services respectively.

#### **Liquidity and capital resources**

Short-term liquidity requirements are met from the company's normal operating cashflow and its short-term bank deposits. Further liquidity is provided by committed but undrawn credit facilities. This liquidity supports the company's €2 billion euro-commercial paper programme.

In addition, the company is able to access further liquidity from its ultimate parent United Utilities Group PLC, which as at 31 March 2009 maintained a healthy headroom position of £934.8 million based on cash, short-term deposits and medium-term committed bank facilities, net of short-term debt. This headroom is sufficient to cover United Utilities Group PLC's projected financing needs through to mid-2011.

The company believes that it operates a prudent approach to managing banking counterparty risk. The company does not have any cash (or cash equivalents) invested in money market funds. Its cash is held in the form of short-term (generally no longer than three months) money market deposits with prime commercial banks.

## **Business review (continued)**

### **CAPITAL STRUCTURE (continued)**

#### **Liquidity and capital resources (continued)**

The company operates a bilateral, rather than syndicated, approach to its core relationship banking facilities. This approach spreads maturities more evenly over a longer time period, thereby reducing refinancing risk and providing the benefit of several renewal points rather than a large single refinancing requirement.

The company also has access to the international debt capital markets through its €7 billion medium-term note programme which provides for the periodic issuance of debt instruments on terms and conditions determined at the time the instruments are issued. The programme does not represent a funding commitment, with funding dependent on the successful issue of the debt securities.

The currencies in which borrowings are held are disclosed in note 19 to the financial statements.

#### **Debt financing and interest rate management**

Long-term borrowings are structured or hedged to match earnings and assets, which are largely in sterling, indexed to UK retail price inflation, and in the case of revenues, subject to regulatory price reviews every five years.

Very long term sterling inflation index-linked debt is the company's preferred form of funding as this provides a natural hedge to earnings and assets. At the year end, index-linked debt represented around 27 per cent of the company's regulatory capital value, with an average real interest rate of 1.8 per cent. The long-term nature of this funding also provides a good match to the company's long-life infrastructure assets, and is a key contributor to the company's average term debt maturity profile (including assumptions of future indexation on index-linked debt), which is in excess of 25 years.

Where debt is raised in a currency other than sterling and/or with a fixed interest rate it is generally swapped to create a floating rate sterling liability for the term of the liability. The company's policy is to seek to match the debt service costs to regulatory cashflow, which is impacted by the general interest rate environment at the time of each price control determination and is then fixed for the five year period of that price control. To hedge the exposure to each price control determination, the company enters into interest rate swaps, around the time of each price control determination, to fix interest costs for a substantial proportion of the company's debt for the duration of that price control period.

Further details of the company's borrowings and interest rate management are provided in notes 7, 19 and 20.

#### **Debt capital market conditions**

The global banking crisis continues to impact the debt and equity capital markets. It has resulted in the cost of capital increasing significantly and has made the issuance of new equity and debt capital more expensive and more difficult to secure.

A compounding challenge arises from the relationship between the Regulatory Capital Value (RCV) of the regulated business and the Retail Price Index (RPI). The RCV is adjusted annually for inflation so, if RPI decreases, the RCV would be adjusted downward to reflect this. This may lead to pressure on the gearing ratios and credit ratings and increase the cost or limit the availability of credit in an already difficult market. In the extreme, the company may be required to increase its equity base by either reducing its dividend payments or raising new equity capital.

The company closely monitors its liquidity headroom within the parameters approved by the board, the impact of trends in inflation or deflation on its capital position as well as the potential impact of wider changes in the credit markets. Where possible, the company has sought to issue debt linked to RPI to minimise the extent of its exposure to deflationary (or low inflationary) conditions.

## **Business review (continued)**

### **CAPITAL STRUCTURE (continued)**

#### **Treasury policy**

The company's treasury function operates within the policies approved by the United Utilities Group PLC board. These policies are administered by the treasury committee through delegated authority from the board; it does not act as a profit centre and does not undertake any speculative trading activity.

### **ACCOUNTING ISSUES**

The financial statements for the year ended 31 March 2009 have been prepared under the historical cost convention and in accordance with applicable UK accounting standards and, except for the treatment of certain grants and contributions (see note 1), with the Companies Act 1985.

### **CRITICAL ACCOUNTING POLICIES**

The company prepares its statutory financial statements in accordance with accounting principles generally accepted in the UK (UK GAAP). As such, the company is required to make certain estimates, judgements and assumptions that it believes are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the amounts of turnover and expenses during the reporting periods presented. On an ongoing basis, the company evaluates its estimates using historical experience, consultation with experts and other methods considered reasonable in the particular circumstances. Actual results may differ significantly from the estimates, the effect of which is recognised in the period in which the facts that give rise to the revision become known. The company's accounting policies are detailed in note 1 of the financial statements. The following paragraphs detail the estimates and judgements the company believes to have the most significant impact on the annual results under UK GAAP.

#### **Carrying value of long-lived assets**

The estimated useful economic lives of fixed assets are based on management's judgement and experience. When management identifies that actual useful lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of fixed asset investment to the company, variations between actual and estimated useful lives could impact operating results both positively and negatively, although historically few changes to estimated useful lives have been required.

The company is required to evaluate the carrying values of fixed assets for impairment whenever circumstances indicate, in management's judgement, that the carrying value of such assets may not be recoverable. An impairment review requires management to make subjective judgements concerning the cashflows, growth rates and discount rates of the cash generating units under review.

#### **Renewals accounting**

Under UK GAAP, the depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network, which is based on the company's asset management plan, which has been certified by Halcrow Management Sciences Limited, an independent infrastructure management consultant approved by Ofwat. Variations between actual infrastructure spend and estimated spend are included in the balance sheet, with the principle being to 'equalise' the effect of annual spend variations on the charge to the profit and loss account. Therefore, the independently certified asset management plan has an impact on the company's operating profit and changes in the plan assumptions could give rise to a different operating profit. These assumptions include judgements relating to the condition and performance of infrastructure assets.

## **Business review (continued)**

### **CRITICAL ACCOUNTING POLICIES (continued)**

#### **Revenue recognition**

Under UK GAAP, the company recognises revenue generally at the time of delivery and when collection of the resulting debt is reasonably assured. Should management consider that the criteria for revenue recognition are not met for a transaction, revenue recognition would be delayed until such time as the transaction becomes fully earned or collectibility is reasonably assured. Payments received in advance of revenue recognition are recorded as deferred income.

The company raises bills in accordance with its entitlement to receive revenue in line with the limits established by the periodic regulatory price review processes.

For water and wastewater customers with water meters, the debtor billed is dependent upon the volume supplied including an estimate of the sales value of units supplied between the date of the last meter reading and the year end. Meters are read on a cyclical basis and the company recognises revenue for unbilled amounts based on estimated usage from the last billing through to the end of the financial year.

The estimated usage is based upon historical data, judgement and assumptions; actual results could differ from these estimates, which would result in operating revenues being adjusted in the period that the revision to the estimates is determined. For customers who do not have a meter, the debtor billed is dependent upon the rateable value of the property, as assessed by an independent rating officer.

#### **Provision for doubtful debts**

At each balance sheet date, the company evaluates the recoverability of trade debtors and records provisions for doubtful debts based on experience. These provisions are based upon, amongst other things, customer category and consideration of actual collection history. The actual level of debt collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively.

#### **Accounting for provisions and contingencies**

The company is subject to a number of claims incidental to the normal conduct of its business, relating to and including commercial, contractual and employment matters, which are handled and defended in the ordinary course of business. The company routinely assesses the likelihood of any adverse judgements or outcomes to these matters as well as ranges of probable and reasonably estimated losses.

Reasonable estimates involve judgements made by management after considering information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience. In accordance with UK GAAP, a provision is recognised when it is probable that an obligation exists for which a reliable estimate can be made of the obligation after careful analysis of the individual matter.

The required provision may change in the future due to new developments and as additional information becomes available. Matters that either are possible obligations or do not meet the recognition criteria for a provision are disclosed, unless the possibility of transferring economic benefits is remote.

#### **Pensions**

The company participates in two defined benefit schemes, one of which has a defined contribution section, which are independent of the company's finances. Actuarial valuations of the schemes are carried out as determined by the trustees at intervals of not more than three years. Under UK GAAP, the pension cost under FRS 17 'Retirement benefits' is assessed in accordance with the advice of a firm of actuaries based on the latest actuarial valuation and assumptions determined by the actuary.

## **Business review (continued)**

### **CRITICAL ACCOUNTING POLICIES (continued)**

#### **Pensions (continued)**

The assumptions are based on information supplied to the actuary by the company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note 21 of the financial statements. Profit before taxation and net assets are affected by the actuarial assumptions used. These assumptions include investment returns on the schemes' assets, discount rates, pay growth and increases to pensions in payment and deferred pensions and may differ from actual results due to changing market and economic conditions and longer or shorter lives of participants.

#### **Derivatives and borrowings**

The company's default treatment is for borrowings to be carried at amortised cost, whilst derivatives are recognised separately on the balance sheet at fair value with movements in those fair values reflected through the profit and loss account. This has the potential to introduce considerable volatility to both the profit and loss account and balance sheet.

Therefore, where feasible, the company has taken advantage of the various provisions under FRS 26 'Financial Instruments: Recognition and Measurement' to designate borrowings at fair value to reduce this volatility and better represent the economic hedges that exist between the company's borrowings and related derivative contracts.

In order to apply hedge accounting, it must be demonstrated that the derivative has been, and will continue to be, an effective hedge of the hedged risk within the debt item.

The company applies the fair value through profit or loss option where the complexity of the swaps means that they are disallowed from being accounted for in a hedge relationship despite there being significant fair value offset between the hedged item and the derivative itself. This area is considered to be of significance due to the magnitude of the company's level of borrowings.

Designated borrowings and derivatives valued at fair value are valued using a discounted cashflow valuation model. This model calculates the zero coupon curves for each currency as at the balance sheet date and uses these to determine future floating cashflows. Future fixed and floating cashflows are discounted using discount factors derived from the same zero coupon curves adjusted for credit where appropriate. Cashflows denominated in foreign currencies are determined and discounted back based upon the zero coupon curve for that currency and then converted into sterling at the spot exchange rate observed at the balance sheet date.

The valuation of debt designated as being within a fair value hedged relationship is calculated based upon the risk being hedged in line with FRS 26 'Financial Instruments: Recognition and Measurement'. The company looks to hedge cashflows which represent its floating rate exposure, and it is this portion which is used in the valuation model.

The valuation of debt designated at fair value through the profit or loss incorporates an assumed credit spread in the discount factor. Credit spreads are determined based on indicative pricing data.

#### **Deferred tax**

The company accounts for deferred tax on a discounted basis, as permitted by UK GAAP. The deferred tax provision under UK GAAP as at 31 March 2009 is £363.5 million (2008: £358.2 million). The balance sheet provision is discounted using the rates of interest at the balance sheet date on UK gilts with similar maturity dates and currencies to those of the deferred tax assets and liabilities. Therefore, the company uses 15+ years UK gilt rate to reflect the long-life nature of infrastructure and operational assets. An increase or decrease in applicable discount rates of 0.1 per cent would change the balance sheet provision at 31 March 2009 by approximately £13.0 million and the tax charge, for the year then ended, by the same amount.

## **Business review (continued)**

### **RESEARCH AND DEVELOPMENT**

The company undertakes research primarily to provide improved standards of service to customers, together with continuing improvements in business efficiency. Its intention is to strengthen its understanding of science and technology in relation to its range of wastewater and water treatment processes to ensure that treatment plants are able to meet the required current and future standards of environmental performance.

The company is a member of a number of collaborative research programmes including UK Water Industry Research and Water Research Centre, both of which address common issues that face the UK water industry. The company also undertakes specific projects with these and other research and development providers, manufacturers and with universities. Research and development expenditure incurred by the company was £0.9 million in the year ended 31 March 2009 (2008: £1.0 million).

### **EVENTS AFTER THE BALANCE SHEET DATE**

There were no events arising after the balance sheet date that require recognition or disclosure in the financial statements for the year ended 31 March 2009.

### **CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS**

This report contains certain statements with respect to the financial condition, results of operations and business of the company. Some of these statements are not facts, including those about the board's beliefs and expectations. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential', 'reasonably possible', 'targets' and variations of these words and similar expressions reflect inherent risks and uncertainty. Such statements are based on current plans, estimates and projections, and therefore investors should not rely on them. Further, the company undertakes no obligation to update publicly any of them in light of new information or future events and they are relevant only as at the date made.

The company cautions investors that a number of important factors could cause actual results to differ materially from those anticipated or implied in any forward-looking statements. These factors include:

- (i) the effect of, and changes in, regulation and government policy;
- (ii) the effects of competition and price pressures;
- (iii) the ability of the company to achieve cost savings and operational synergies;
- (iv) the ability of the company to service its future operations and capital requirements;
- (v) the timely development and acceptance of new products and services by the company;
- (vi) the effect of technological changes; and
- (vii) the company's success in managing the risks of the foregoing. The company cautions that the foregoing list of important factors does not address all the factors that could cause results to differ materially.

The directors of the company advise that all the information supplied in the Chairman's statement beginning on page 3 and the business review on pages 5 to 23 is part of the directors' report as incorporated by reference under the heading 'Business review and principal activities'. Any liability for the information is restricted to the extent prescribed in the Companies Act 1985.



## Directors' report

The directors present their report and the audited financial statements of the company for the year ended 31 March 2009.

### Profit and dividends

The results for the year, set out in the profit and loss account on page 35, show that turnover for the year ended 31 March 2009 increased to £1,508.2 million, an increase of 5.7 per cent over the previous year. Profit for the year before tax was £505.0 million (2008: £457.5 million).

Dividends are only recognised in the financial statements if they are declared and approved in that financial year. Dividends declared after the balance sheet date are not recognised as a liability at the balance sheet date. This has resulted in the final ordinary dividend for the year to 31 March 2008 of £770.0 million (including a £550.0 million special dividend), which was declared after 31 March 2008, being recognised in the current year financial statements, along with an interim ordinary dividend of £75.5 million (2008: £103.0 million) which was paid in February 2009.

The directors have not recommended a final ordinary dividend (2008: £220.0 million). The company paid the £550.0 million special dividend last year to enable the company to retain a credit rating of A3, which the company believes best mirrors Ofwat's assumptions in relation to capital structure.

### Regulation

As required by paragraph 3.1 of Condition K of the Instrument of Appointment granted by the Secretary of State for the Environment of the company as a water and sewerage undertaker under the Water Industry Act 1991 ("the Licence"), the directors state that they are satisfied that as at 31 March 2009, if a special administration order had been made under section 23 of the Water Industry Act 1991 in respect of United Utilities Water PLC, the company would have had available to it sufficient rights and assets (not including financial resources) to have enabled the special administrator to manage the affairs, business and properties of the company so that the purpose of the order could have been achieved.

The directors have issued a certificate under Condition F6A of the Licence stating that the company will have available to it sufficient financial and management resources and facilities to enable it to carry out, for at least 12 months, its regulated activities. This certificate also confirms that all contracts entered into with any associated company included all necessary provision and requirements concerning the standard of service to be supplied by the company to ensure that it is able to meet all its obligations as a water and sewerage undertaker.

The contract of appointment with the auditors satisfies the requirements of paragraph 9.2 of Condition F of the Licence, namely that "the auditors will provide such further explanation or clarification of their reports, and such further information in respect of the matters which are the subject of their reports, as the Director General may reasonably require".

### Business review and principal activities

The company is a wholly owned subsidiary of United Utilities North West PLC and the company's principal activities are the management and operation of water and wastewater assets.

The Chairman's statement and the business review on pages 3 to 23 report on the company's activities during the year and on likely future developments. A summary of KPIs can be found in the business review.

The directors of United Utilities Water PLC advise that all the information supplied in the Chairman's statement beginning on page 3 and the business review on pages 5 to 23 is part of the directors' report as incorporated by reference. Any liability for the information is restricted to the extent prescribed in the Companies Act 1985.

## Directors' report (continued)

### Principal risks

The principal risks and uncertainties are commented on within the business review beginning on page 5.

### Research and development

Further details are commented on within the business review beginning on page 5.

### Employment policies

Employees are key to achieving the company's business goals and the company is committed to improving the skills of its people. The company respects the dignity and rights of every employee, supports them in performing various roles in society and challenges prejudice and stereotyping. The company is committed to involving employees through open and regular communications about business changes to allow a free flow of information and ideas.

The company participates extensively in Business in the Community programmes, encourage wider opportunities for women and for people from ethnic minorities and it actively supports employees with disabilities.

Proper attention to health and safety is an indispensable part of the company's commitment to high standards in every aspect of the business.

Further details are commented on within the business review beginning on page 5.

### Supplier payment policy and practice

Payment terms are specific to the type of contract and the relevant commercial arrangements, and are agreed with suppliers in advance.

As at 31 March 2009, the average credit period taken for trade purchases was 27 days (2008: 21 days).

### Financial instruments

The risk management objectives and policies of the company can be found in note 20 to the financial statements.

### Directors

The directors who held office during the year and to date are given below:

#### *Non-executive directors*

R Bird

BM Gray (resigned 30 November 2008)

DE Morton

#### *Executive directors*

JA Barnes (resigned 16 May 2008)

CH Elphick (resigned 27 May 2009)

PN Green\* (appointed 1 May 2008)

IJ McAulay

JM Perrie (appointed 1 April 2008)

GL Sims

TP Weller\*

MR Wright

#### *Company secretary*

DP Hosker

\* Director, United Utilities PLC and United Utilities Group PLC

## Directors' report (continued)

At no time in the year did any director have a material interest in any contract or arrangement, which was significant in relation to the company's business.

### Directors' and officers' insurance

The company maintains an appropriate level of directors' and officers' insurance whereby directors are indemnified against liabilities to third parties to the extent permitted by the Companies Act 1985.

### Disclosure of information to the auditors

Each of the persons who is a director at the date of approval of this report confirms that:

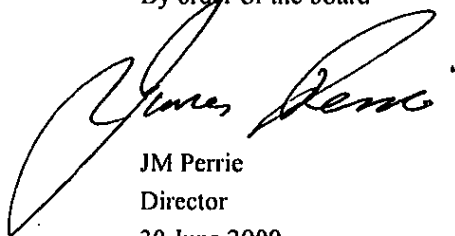
1. so far as he or she is aware, there is no relevant audit information of which the company's auditors are unaware; and
2. he or she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

This confirmation is given, and should be interpreted, in accordance with the provisions of s234ZA of the Companies Act 1985.

### Auditors

On 1 December 2008, Deloitte & Touche LLP changed its name to Deloitte LLP. A resolution to reappoint Deloitte LLP as auditors will be put to the members at the Annual General Meeting.

By order of the board



Handwritten signature of JM Perrie in black ink, appearing as a stylized cursive script.

JM Perrie  
Director  
30 June 2009

## Corporate governance report

### The Combined Code

In August 2008 United Utilities Water PLC (U UW, the company) agreed with its regulator, Ofwat, a Licence amendment that the company should 'have regard to' the Combined Code on Corporate Governance (the code) which was published by the Financial Reporting Council in June 2006.

As a general rule, the board was minded to have regard to the provisions of Section A of the Code ('Directors') in full, subject only to a number of departures which reflect that U UW is a wholly owned subsidiary of a listed company, which itself complies fully with the Code. Any departures from the Code within Section A are fully explained.

The U UW board also considered the Code provisions of Section B ('Remuneration'), Section C ('Accountability and Audit') and Section D ('Relations with Shareholders'). After considerable thought, it was concluded that none of these sections was appropriate for U UW.

The reasons for non-compliance with Sections B, C and D have been notified to Ofwat and are set out at the end of this report. This report gives details of how those principles of the code applicable to U UW have been applied during the year.

### The board of directors

The directors who served during the year are set out on page 2. Ten board meetings are scheduled each year and the board will meet more or less frequently as required. During the year ten meetings were held (2008: 10). The following table shows the attendance of each of the directors at meetings of the board during the year. The figures in brackets show the maximum number of meetings which each of the directors could have attended.

	Board	
JA Barnes	-	(1)
R Bird	10	(10)
CH Elphick	10	(10)
BM Gray	5	(7)
PN Green	8	(9)
IJ McAulay	8	(10)
DE Morton	9	(10)
JM Perrie	8	(10)
GL Sims	9	(10)
TP Weller	9	(10)
MR Wright	9	(10)

- PN Green was appointed to the board on 1 May 2008 and consequently was unavailable for the April 2008 board meeting.
- BM Gray stepped down from the board on 30 November 2008.
- JA Barnes stepped down from the board on 16 May 2008.

### Summary of approach to governance

The board members are fully aware of their responsibilities, both individually and collectively to promote the long-term success of the company as the regulated licence holder within the United Utilities group of companies. The board is responsible for the assessment and management of the key issues and risks impacting the business. In addition to its scheduled meetings, the board met during the year specifically to consider and develop the company's Draft and Final Business Plan submissions to Ofwat as part of the Price Review 2009 process, and its annual June Return to Ofwat. The board has a formal schedule of matters reserved to it, which ensures that it takes all major strategy, policy, regulation and investment decisions affecting the company. Accordingly, the board sets the company's overall direction, reviews management performance and reviews the company's approach to business planning, risk management and development of policies including health and safety.

## Corporate governance report (continued)

### Summary of approach to governance (continued)

The board is responsible for promoting the long-term success of the company and ensuring that the principal goal of the company is to manage its licensed responsibilities, while having regard to other stakeholder interests, including those of its shareholder, United Utilities Group PLC (UUG PLC), whilst always bearing in mind the company's regulatory obligations. Accordingly, the long-term interests of shareholders, together with consideration of the wider interests of stakeholders represented by employees, customers, suppliers, the community and the environment are factored into the company's management processes. Appropriate consideration is also given, within the company's control and risk assessment processes, to social, environmental and ethical issues.

The board has established a governance framework which encourages all directors to bring to bear independent judgement on issues of strategy, performance and resources. Directors have a right to ensure that any unresolved concerns they have about the running of the company or a proposed action which cannot be resolved are recorded in the board minutes. In addition, upon resignation, a non-executive director is asked to provide a written statement addressed to the chairman should he or she have any concerns about the running of the company. Any such statement would then be circulated to the board.

The company's governance structure also seeks to ensure that decisions are made at the appropriate level by employees with the knowledge and skills to do so.

### Principal committees of the board (summary)

The board has formally delegated specific responsibilities to certain committees, including the following: approvals, regulation and treasury. All board committees are provided with sufficient resources to undertake their duties, have authority to seek independent advice, if appropriate, and are supported by the company's secretariat. The board has delegated certain of its powers and functions to the following committees:

**Approvals committee:** This considers and approves expenditure and investment proposals within limits determined by the board and the Internal Control Manual. Its members are all directors.

**Regulation committee:** Within limits determined by the board, this has responsibility for the approval of regulatory policies and strategies and for overseeing interactions with the company's regulators. Its members are all the executive and non-executive directors with the exception of PN Green and TP Weller.

**Treasury committee:** This considers and approves borrowing, leasing, bond and other banking facilities within limits set by the board. Its members are the executive directors.

### Board balance and independence

There are non-executive positions on the board in compliance with the company's Licence obligation and the non-executive directors are determined by the board to be independent in accordance with the Combined Code. The directors have a wide and diverse range of business and other experience and expertise. The board has determined that DE Morton is independent, notwithstanding that she has served on the board for more than nine years due to the extent of her experience, financial independence and other professional areas of interest.

One non-executive role is vacant at present following the resignation during the year of BM Gray. Processes are underway to recruit a replacement and an appointment will be made in due course.

## Corporate governance report (continued)

### Senior independent director

The board does not feel it appropriate to appoint a senior independent director, as the company is a wholly owned subsidiary of UUG PLC, and any concerns would be raised through the board. Additionally, three independent non-executive directors provide channels through which concerns could be raised.

### Conflicts of interest

Since 1 October 2008, directors have been under a statutory duty to avoid any situation in which they have, or can have, a direct or indirect interest which conflicts or possibly may conflict with the interests of the company. The duty is not infringed where a conflict situation has been authorised in advance by the unconflicted directors or the shareholders of the company or where the situation cannot reasonably be regarded as likely to give rise to a conflict of interest. For a public company, the unconflicted directors can only authorise conflict situations if permitted to do so by the company's articles of association.

The company's articles of association contain provisions which permit the unconflicted directors to authorise conflict situations and procedures have been put in place for the disclosure of any conflicts by the directors to the board and for the consideration and, if appropriate, authorisation of such conflicts. The procedures permit any authorisation to be subject to any terms and/or conditions that the unconflicted directors think fit.

Prior to 1 October 2008, each board member completed a comprehensive questionnaire to establish if any director had a conflict of interest under the Companies Act 2006. The results were then assessed by the chairman and the board, who concluded that no director had a conflict that required authorisation. Moving forward, directors are required to notify the chairman and/or company secretary if they believe that a conflict might arise, if so, it would be referred to the board. Conflicts of interest in general will be reviewed annually by the board. Any potential issue of conflict relating to prospective directors is addressed by the chairman and the board prior to the appointment being made.

### Re-appointment of directors

Non-executive directors are appointed for specified terms subject to re-appointment under the company's articles of association and to Companies Acts provisions relating to the removal of directors. Any term beyond six years for a non-executive director will be subject to particularly rigorous review, and will take into account the need for progressive refreshing of the board. Any non-executive director serving for longer than nine years will be subject to annual re-appointment, as is the case for DE Morton.

### Information, support and advice

The chairman is responsible for ensuring that directors receive comprehensive information on a regular basis to enable them to perform their duties properly, supported by the company secretary. As part of the preparation process for board meetings, the chairman undertakes informal briefings with the non-executive directors before the scheduled board meetings.

Board papers are generally distributed five days in advance of scheduled board meetings to enable directors to obtain a thorough understanding of the matters to be discussed, and seek clarification, if required. All directors have access to the advice and services of the company secretary and his team, who are responsible to the board for ensuring that board procedures are complied with. The appointment and removal of the company secretary are matters reserved to the board.

The board has adopted a protocol under which directors have access, through the company secretary, to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors. The company also maintains an appropriate level of directors' and officers' insurance.

## Corporate governance report (continued)

### Induction and training

New directors receive appropriate induction on joining the board, typically including meeting with members of the senior management team and visits to operational sites. During the year, R Bird and BM Gray's inductions were undertaken. Directors are provided with details of seminars and training courses relevant to their role and are encouraged to attend those that meet their development needs. Additionally, training is provided to the whole board on topics such as the Companies Act 2006.

### Performance evaluation

During the year, the board conducted an evaluation of its own performance and that of its committees. The process involved the completion by each director of a confidential questionnaire which was modelled on the 'Chairman's Guide to the Board Performance Review' published by the Chairman's Forum. Each director was required to score the board's performance (and that of the principal committees) on 25 topics, including: contribution to strategy; risk management; financial and operational reporting; matters reserved for the board; communication; company and board advisers; relations with the company's regulators and investors; and board procedures.

The company secretary analysed the completed questionnaires and summarised the findings in a report for the chairman, which highlighted and prioritised the key areas of feedback. The responses to the questionnaires demonstrated a high degree of consistency and the evaluation process affirmed the board's confidence in the company's system of corporate governance. Nevertheless there is always room for improvement and, arising from the 2008/09 exercise, the board has identified a number of actions including that a rolling programme of presentations on board reports for information be established and an annual update on crisis management and business continuity be scheduled.

### Going concern

The directors have a reasonable expectation that the company has adequate resources available to it to continue in operational existence for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements. This approach, taking into account the relatively stable and regulated nature of the business, is based, amongst other matters, upon a review of the company's budget for 2009/10, the company's proposed five-year business plan and investment programme (in line with the plans submitted for the 2009 water price review), together with a review of the cash and committed borrowing facilities available to the company (discussed in further detail in the liquidity and capital resources section on pages 18 and 19) and the debt financing and interest rate management section on page 19. This review shows that the company, at 31 March 2009, had headroom based on cash and short-term deposits, medium-term committed bank facilities and net of short-term debt, which is sufficient to cover the company's projected financing needs through to mid 2011.

The board also took into account potential contingent liabilities and other risk factors as interpreted by the guidance given in 'Going Concern and Financial Reporting: Guidance for Directors of Listed Companies registered in the United Kingdom', published in November 1994, the guidance published in November 2008 'An update for Directors of Listed Companies: Going Concern and Liquidity Risk' and the May 2009 exposure draft updating going concern guidance for directors as published by the Financial Reporting Council.

## Corporate governance report (continued)

### Departures from the Combined Code notified to Ofwat

#### Section B of the Code – Remuneration

The board has concluded that having its own Remuneration Committee is unnecessary and would not improve governance. The company remunerates its directors subject to the confines of UUG PLC's remuneration policy. UUG PLC has its own Remuneration Committee which, with the help of the Reward Director and external consultants, as necessary, reviews the pay of directors and the pay scales applicable to senior management.

#### Section C of the Code – Accountability and Audit

In view of the fact that UUG PLC has an Audit Committee and that the group has a well resourced internal audit function in place (to which the UUG board has access and which reports to the UUG board on a quarterly basis), the board concluded that having a separate Audit Committee for the company would be inappropriate.

#### Section D of the Code – Relations with Shareholders

As the company is a wholly owned subsidiary of UUG PLC, this provision is not relevant to the company. UUG PLC complies fully with this provision and makes a full disclosure on this in its annual report. It should be noted that under Code provision D.1.2. (Understanding the views of major shareholders) all of UUG's directors, including the non-executive directors, if they so wish, have access to the annual shareholder opinion survey which is produced for UUG PLC by Makinson Cowell.



## **Statement of directors' responsibilities in respect of the financial statements**

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to 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. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and to 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 the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

### **Responsibility statement**

The directors confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with United Kingdom accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- the management report, which is incorporated into the directors' report, includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal risks and uncertainties that they face.

## **Independent auditors' report**

to the members of United Utilities Water PLC

We have audited the financial statements of United Utilities Water PLC for the year ended 31 March 2009 which comprise the profit and loss account, the statement of total recognised gains and losses, the reconciliation of movements in shareholders' funds, the balance sheet, the cashflow statement and the related notes 1 to 29. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of directors and auditors**

The directors' responsibilities for preparing the Annual Report, the Directors' Remuneration 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 and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Chairman's statement and the business review that is cross referred from the business review and principal activities section of the Directors' Report.

In addition we report to you if, in our opinion, 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 the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited financial statements. 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 further information outside the Annual Report.

## **Independent auditors' report (continued)**

to the members of United Utilities Water PLC

### **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.

### **Opinion**

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 March 2009 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

*Deloitte LLP*

Deloitte LLP  
Chartered Accountants and Registered Auditors  
Manchester, United Kingdom  
30 June 2009

## Profit and loss account

For the year ended 31 March 2009

	Note	2009 £m	2008 £m
<b>Turnover</b>	1, 2	1,508.2	1,426.4
Net operating expenses (including exceptional charges of £1.0 million (2008: £4.5 million))	3	(796.7)	(775.3)
<b>Operating profit</b>		<u>711.5</u>	<u>651.1</u>
Net interest payable and similar charges	7	(206.5)	(193.6)
<b>Profit on ordinary activities before taxation</b>		<u>505.0</u>	<u>457.5</u>
Tax charge on profit on ordinary activities	8	(131.5)	(93.1)
<b>Profit for the financial year</b>	23	<u><u>373.5</u></u>	<u><u>364.4</u></u>

All of the results shown above relate to continuing operations.

## Statement of total recognised gains and losses

For the year ended 31 March 2009

	2009 £m	2008 £m
Profit for the financial year	373.5	364.4
Actuarial losses relating to the pension schemes (see note 21)	(77.6)	(74.7)
Deferred tax attributable to actuarial losses	21.7	20.9
<b>Total recognised gains and losses since last annual report and financial statements</b>	<u>317.6</u>	<u>310.6</u>

## Reconciliation of movements in shareholders' funds

For the year ended 31 March 2009


	2009 £m	2008 £m
Profit for the financial year	373.5	364.4
Dividends (see note 9)	(845.5)	(299.3)
Actuarial losses on defined benefit pension scheme net of deferred tax	(55.9)	(53.8)
Net (reduction in)/addition to shareholders' funds	<u>(527.9)</u>	<u>11.3</u>
Opening shareholders' funds	2,624.9	2,613.6
Closing shareholders' funds	<u>2,097.0</u>	<u>2,624.9</u>

## Balance sheet

At 31 March 2009

	Note	2009 £m	2008 £m
<b>Fixed assets</b>			
Tangible assets	10	7,589.4	7,178.9
Investments	11	0.2	0.2
		<u>7,589.6</u>	<u>7,179.1</u>
<b>Current assets</b>			
Stocks: raw materials and consumables		3.7	3.4
Debtors: amounts falling due within one year	12a	1,279.8	888.4
Debtors: amounts falling due after more than one year	12b	239.8	44.3
Current asset investments	13	80.0	-
Cash at bank and in hand		1.1	-
		<u>1,604.4</u>	<u>936.1</u>
<b>Creditors: amounts falling due within one year</b>			
Trade and other creditors	14a	(594.9)	(517.1)
Borrowings	14b	(1,152.4)	(971.6)
		<u>(1,747.3)</u>	<u>(1,488.7)</u>
<b>Net current liabilities</b>		<u>(142.9)</u>	<u>(552.6)</u>
<b>Total assets less current liabilities</b>		<u>7,446.7</u>	<u>6,626.5</u>
<b>Creditors: amounts falling due after more than one year</b>			
Trade and other creditors	15a	(88.8)	(111.6)
Borrowings	15b	(4,769.2)	(3,473.3)
		<u>(4,858.0)</u>	<u>(3,584.9)</u>
<b>Provisions for liabilities</b>	17	(373.6)	(368.1)
<b>Net assets excluding pension liability</b>		<u>2,215.1</u>	<u>2,673.5</u>
<b>Pension liability</b>	21	(118.1)	(48.6)
<b>Net assets including pension liability</b>		<u>2,097.0</u>	<u>2,624.9</u>
<b>Capital and reserves</b>			
Called up share capital	22, 23	1,025.3	1,025.3
Share premium account	22, 23	647.8	647.8
Profit and loss account	23	423.9	951.8
<b>Shareholders' funds</b>		<u>2,097.0</u>	<u>2,624.9</u>

The financial statements were approved by the board of directors on 30 June 2009 and signed on its behalf by:

  
 JM Perrie  
 Director

## Cashflow statement

At 31 March 2009

	2009 £m	2008 £m
<b>Net cash inflow from operating activities (see note 25)</b>	998.5	963.7
<b>Returns on investments and servicing of finance</b>		
Interest received	66.9	62.4
Interest paid	(190.0)	(239.2)
Interest element of finance lease payments	(7.3)	(2.4)
Non-equity dividends paid	(13.7)	(4.6)
<b>Net cashflow from returns on investments and servicing of finance</b>	<u>(144.1)</u>	<u>(183.8)</u>
<b>Taxation</b>	(102.3)	(84.2)
<b>Capital expenditure and financial investment</b>		
Purchase of tangible fixed assets	(772.7)	(753.3)
Grants and contributions received	13.5	17.1
Disposal of intangible fixed assets	-	14.9
Proceeds from sale of tangible fixed assets	2.1	-
<b>Net cash outflow for capital expenditure and financial investment</b>	<u>(757.1)</u>	<u>(721.3)</u>
<b>Equity dividend paid</b>	(845.5)	(299.3)
<b>Cash outflow before management of liquid resources and financing</b>	<u>(850.5)</u>	<u>(324.9)</u>
<b>Management of liquid resources</b>		
(Increase)/decrease in short-term deposits	(80.0)	1,307.0
<b>Financing (see note 27)</b>	1,008.8	(1,044.6)
<b>Increase/(decrease) in cash and overdraft in the year</b>	<u>78.3</u>	<u>(62.5)</u>

## Notes to the financial statements

At 31 March 2009

### 1. Accounting policies

The following accounting policies have been applied consistently in respect of the current and prior years in dealing with items which are considered material in relation to the company's financial statements.

#### Basis of preparation of financial statements

The financial statements of United Utilities Water PLC have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards and, except for the treatment of certain grants and contributions (see below), with the Companies Act 1985.

The preparation of financial statements in conformity with generally accepted accounting principles in the United Kingdom requires management to make estimates and assumptions that affect the:

- reported amounts of assets and liabilities;
- disclosure of contingent assets and liabilities at the date of the financial statements; and
- reported amounts of turnover and expenses during the financial year.

Actual results could differ from these estimates.

#### Going concern

The directors have set out factors considered on concluding the appropriateness of the going concern basis of preparation in the going concern section of the corporate governance report.

#### Exemption from preparing group financial statements

The financial statements contain information about United Utilities Water PLC as an individual company and do not contain consolidated financial information as a parent of a group. At 31 March 2009, the company was exempt under section 228 of the Companies Act 1985 from the requirement to prepare consolidated financial statements as it and its subsidiary undertakings were included by full consolidation in the financial statements of its ultimate parent United Utilities Group PLC, a company incorporated in Great Britain and registered in England and Wales.

#### Related party transactions

The company has taken advantage of the exemption contained in Financial Reporting Standard 8 'Related party transactions' not to disclose transactions or balances with entities which form part of the group headed by United Utilities Group PLC.

During the year no transactions were entered into with related parties other than with other group companies in the normal course of business.

#### Turnover

Turnover represents the income receivable in the ordinary course of business for services provided and excludes VAT. This includes an estimate of the sales value of units supplied to customers between the date of the last meter reading and the year end.

#### Research and development

Expenditure on research and development is expensed as incurred.

#### Tangible fixed assets

Tangible fixed assets comprise infrastructure assets (mains, sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) and other assets (including properties and overground plant and equipment). Employee costs incurred in implementing the capital schemes of the company are capitalised within fixed assets.



## Notes to the financial statements (continued)

At 31 March 2009

### 1. Accounting policies (continued)

#### *Infrastructure assets*

Infrastructure assets comprise a network of water and wastewater systems. Expenditure on the infrastructure assets relating to increases in capacity or enhancements of the network are treated as additions, as are asset replacements to maintain the operating capability of the network in accordance with defined standards of service. Repairs to infrastructure assets are treated as operating expenditure.

Additions are included at cost after deducting related grants and contributions. The depreciation charge for infrastructure assets is the estimated level of annual expenditure required to maintain the operating capability of the network, less the estimated level of relevant annual grants and contributions, which is based on the company's independently certified asset management plan covering a five year period.

#### *Other assets*

Additions are included at cost. Freehold land is not depreciated. Other assets are depreciated by writing off their cost less their estimated residual value evenly over their estimated economic lives based on management's judgement and experience, which are principally as follows:

- Buildings 30-60 years
- Operational assets 5-80 years
- Fixtures, fittings, tools and equipment 3-40 years
- Computer software 3-10 years

#### *Carrying value of tangible fixed assets*

The carrying values of tangible fixed assets are reviewed for impairment wherever circumstances indicate that the carrying value of such assets may not be recoverable.

#### **Grants and contributions**

Capital contributions towards infrastructure assets are deducted from the cost of those assets. This is not in accordance with Schedule 4 of the Companies Act 1985 under which the infrastructure assets should be stated at their purchase price or production cost and the capital contributions treated as deferred income and released to the profit and loss account over the useful life of the corresponding assets.

The directors are of the opinion that these assets do not have determinable finite economic lives and the capital contributions would therefore remain in the balance sheet in perpetuity. The treatment otherwise required by the Companies Act 1985 would not present a true and fair view of the company's effective investment in infrastructure assets. The financial effect of this accounting policy is set out in note 10.

Those grants and contributions relating to the maintenance of the operating capability of the infrastructure network are taken into account in determining the depreciation charged for infrastructure assets.

Grants and contributions receivable in respect of other tangible fixed assets are treated as deferred income and released to the profit and loss account over the useful lives of the corresponding assets.

#### **Leased assets**

Leases are classified according to the substance of the transaction. A lease that transfers substantially all the risks and rewards of ownership to the lessee is classified as a finance lease. All other leases are classified as operating leases.

#### *Finance leases*

Finance leases are capitalised in the balance sheet at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability is shown as a finance lease obligation to the lessor. Leasing repayments comprise both a capital and a finance element.

## Notes to the financial statements (continued)

At 31 March 2009

### 1. Accounting policies (continued)

#### Leased assets (continued)

##### *Finance leases (continued)*

Where the lease is of a fixed interest rate nature, the finance element is charged to the profit and loss account so as to produce an approximately constant periodic rate of charge on the outstanding obligation. Where the lease is of a floating interest rate nature, the finance element charged to the profit and loss account reflects the floating interest rate charge incurred during the period on the outstanding obligation. Such assets are depreciated over the shorter of their estimated useful lives and the period of the lease.

##### *Operating leases*

Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease.

#### Fixed asset investments

Fixed asset investments are stated at the lower of cost and recoverable amount.

#### Stocks

Stocks are stated at cost less any provision necessary to recognise damage and obsolescence. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

#### Current asset investments

Current asset investments are stated at the lower of cost and net realisable value.

#### Pensions

The company participates in the following pension schemes sponsored by the United Utilities group of companies: the United Utilities Pension Scheme (UUPS) and the United Utilities Group of the Electricity Supply Pension Scheme (ESPS). UUPS has both a defined benefit section and a defined contribution section. The defined contribution section constitutes around 1.0 per cent of the total asset value of UUPS. ESPS is a defined benefit scheme. Both defined benefit schemes are closed to new employees. Under FRS 17 'Retirement benefits', the current service cost is calculated using the projected unit credit method. The pension schemes are independent of the company's finances.

Actuarial valuations of the defined benefit schemes are performed at intervals of not more than three years and the rates of contribution payable are determined on the advice of the actuaries for each scheme having regard to the results of these actuarial valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates.

Defined benefit assets are measured at fair value whilst liabilities are measured at present value. The difference between the two amounts is recognised as an asset or liability in the balance sheet.

The cost of providing pension benefits to employees relating to the current year's service is included within the profit and loss account within employee costs. The difference between the expected return on scheme assets and interest on scheme liabilities is included in the profit and loss account within net interest payable.

The actuarial assumptions adopted are determined by United Utilities Group PLC after taking advice from their actuarial advisors, Mercer Limited. The actuarial assumptions adopted affect the operating results and profit on ordinary activities before taxation and are disclosed in note 21; they include assumptions for the long-term investment return expected to be achieved on the schemes' assets and the long term increases expected to apply to pensionable earnings, pension increases and deferred pension increases. Actual experience may differ from the assumptions adopted.

## Notes to the financial statements (continued)

At 31 March 2009

### 1. Accounting policies (continued)

#### **Pensions (continued)**

In addition the United Utilities group also operates defined contribution pension schemes. Payments are charged as employee costs as they fall due. The company has no further payment obligations once the contributions have been paid.

The disclosure requirements of FRS 17 'Retirement benefits' are set out in note 21, together with details of pension and funding arrangements.

#### **Financial instruments**

Financial assets and financial liabilities are recognised and derecognised on the company's balance sheet on the trade date when the company becomes a party to the contractual provisions of the instrument.

#### *Cash and short-term deposits*

Cash and short-term deposits include cash at bank and in hand, deposits and other short-term highly liquid investments which are readily convertible into known amounts of cash, have a maturity of three months or less from the date of acquisition and which are subject to an insignificant risk of change in value. In the cashflow statement and related notes, cash is stated net of bank overdrafts.

#### *Financial investments*

Investments (other than fixed deposits) are initially measured at fair value, including transaction costs. Investments are classified as available-for-sale and are measured at subsequent reporting dates at fair value. Gains and losses arising from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the net profit or loss for the period.

#### *Trade debtors and trade creditors*

Trade debtors are measured on initial recognition at fair value, and are subsequently measured at amortised cost, less any impairment for irrecoverable amounts. Estimated irrecoverable amounts are based on historical experience of the debtor balance.

Trade creditors are initially measured at fair value and are subsequently measured at amortised cost.

#### *Financial liabilities and equity*

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the company after deducting all of its liabilities.

#### *Equity instruments*

Equity instruments issued by the company are recorded at the proceeds received, net of direct issue costs.

#### *Borrowing costs and finance income*

All borrowing costs and finance income that are not directly attributable to the acquisition, issue or disposal of a financial asset or financial liability are recognised in the profit and loss account in the period in which they are accrued. Transaction costs that are directly attributable to the acquisition or issue of a financial asset or financial liability are included in the initial fair value of that instrument.

## Notes to the financial statements (continued)

At 31 March 2009

### 1. Accounting policies (continued)

#### Financial instruments (continued)

##### *Borrowings*

Bonds, bank loans and overdrafts are usually recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an amortised cost basis to the profit and loss account using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise. In some cases, borrowings are designated at fair value through profit or loss, or in a fair value hedge.

##### *Derivative financial instruments and hedge accounting*

Interest rate swap agreements and financial futures are used to manage interest rate exposure, while the company enters into cross-currency swaps to manage its exposure to fluctuations in foreign exchange rates. The company does not use derivative financial instruments for speculative purposes. All financial derivatives are recognised in the balance sheet at fair value. Changes in the fair value of all derivative financial instruments are recognised in the profit and loss account within net interest payable as they arise.

##### *Fair value hedges*

For an effective hedge of an exposure to changes in the fair value, the hedged item is adjusted for changes in fair value attributable to the risk being hedged with the corresponding entry in profit or loss. Gains or losses from remeasuring the derivative are recognised in profit or loss.

Where changes in the fair value of a derivative differ from changes in the fair value of the hedged item attributable to the risks being hedged, the hedge ineffectiveness is recorded in the profit and loss account within net interest payable. Hedge accounting is discontinued prospectively when the hedging instrument is sold, terminated or exercised, where the hedge relationship no longer meets the criteria for hedge accounting in accordance with FRS 26 'Financial Instruments: Recognition and Measurement', or where the hedge designation is revoked.

The cumulative fair value adjustment on the hedged instrument is frozen at the date of ineffectiveness, or the date the designation is revoked and is amortised to the income statement based upon a recalculated effective interest rate through to maturity.

##### *Financial assets and liabilities designated at fair value through profit or loss*

Borrowings are designated at fair value through profit or loss at inception where the complexity of the swaps means that they are disallowed from being allocated in a hedge relationship despite there being significant fair value offset between the hedged item and the derivative itself. The otherwise inconsistent accounting treatment that would have resulted allows the company to satisfy the criteria for this designation.

##### *Financial assets and liabilities designated at fair value through profit or loss (continued)*

Financial liabilities at fair value through profit or loss are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised incorporates any interest paid on the financial liability. The treatment of financial liabilities designated at fair value through profit or loss is consistent with the company's documented risk management strategy. Where applicable, hedge accounting will be applied.

## Notes to the financial statements (continued)

At 31 March 2009

### 1. Accounting policies (continued)

#### Environmental remediation

Environmental expenditure that relates to current or future turnover is expensed or capitalised as appropriate. Expenditure that relates to an existing condition caused by past operations and does not contribute to current or future earnings is expensed.

Liabilities for environmental costs are recognised when there is a legal or constructive obligation, environmental assessments indicate clean-ups are probable, and the associated costs can be reasonably estimated. Generally, the timing of these provisions coincides with the commitment to a formal plan of action or, if earlier, on divestment or on closure of inactive sites.

#### Taxation

Current tax, primarily UK corporation tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised in respect of timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred. Timing differences are differences between the company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse based on tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a discounted basis to reflect the time value of money over the period between the balance sheet date and the dates on which it is estimated that the underlying timing differences will reverse. The discount rates used reflect the post tax yields to maturity that can be obtained on government bonds with similar maturity dates and currencies to those of the deferred tax assets or liabilities.

#### Share-based compensation arrangements

The United Utilities group operates equity-settled, share-based compensation plans in the shares of United Utilities Group PLC. In accordance with the transitional provisions, FRS 20 'Share-based Payment' has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 April 2004.

Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on estimates of the number of options that are expected to vest. Fair value is based on both simulation and binomial models, according to the relevant measures of performance.

At each balance sheet date, United Utilities Group PLC revises its estimate of the number of options that are expected to become exercisable with the impact of any revision being recognised in the income statement, and a corresponding adjustment to equity over the remaining vesting period. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised. United Utilities Water PLC is recharged the amount expensed under FRS 20 that relates to the company's employees which is £0.6 million in relation to the year ended 31 March 2009 (2008: £0.5 million).

### 2. Segmental information

The company operates in the United Kingdom in one class of business as stated in the directors' report.

## Notes to the financial statements (continued)

At 31 March 2009

### 3. Net operating expenses

Profit on ordinary activities before taxation is stated after charging/(crediting):

	2009 £m	2008 £m
<b>Employee costs (including directors)</b>		
Wages and salaries	130.1	128.1
Social security costs	10.3	10.1
Pension costs	24.6	25.6
	<u>165.0</u>	<u>163.8</u>
Less: charged to capital schemes	(68.4)	(64.7)
Charged to profit and loss account	<u>96.6</u>	<u>99.1</u>
<b>Depreciation</b>		
Owned non-infrastructure fixed assets	212.0	203.5
Non-infrastructure fixed assets held under finance leases (see note 10)	1.7	1.7
Non-infrastructure depreciation	<u>213.7</u>	<u>205.2</u>
Infrastructure depreciation (see note 10)	<u>109.1</u>	<u>106.5</u>
Total depreciation	<u>322.8</u>	<u>311.7</u>
<b>Other operating expenses</b>		
Hired and contracted services	128.0	135.8
Raw materials and consumables	40.6	36.7
Power	54.6	42.0
Property rates	54.8	59.6
Charge for bad and doubtful debts (see note 12c)	50.3	49.7
Other operating expenses	53.3	43.4
Auditors' remuneration – audit of the company's financial statements	0.2	0.2
Auditors' remuneration – other services (see below)	0.3	0.2
Amortisation of grants and contributions (see note 16)	(6.2)	(5.9)
Research and development	0.9	1.0
Operating leases:		
- plant and machinery	0.5	0.7
- land and buildings	1.7	2.2
Exceptional charges:		
- restructuring costs	1.0	4.5
Other income (see note 4)	(2.7)	(5.6)
	<u>377.3</u>	<u>364.5</u>
<b>Total net operating expenses</b>	<u>796.7</u>	<u>775.3</u>

Fees payable to Deloitte LLP for non-audit services during the year were £0.3 million, primarily relating to regulatory work (2008: £0.2 million).

Non-audit services are allowed under the procurement of an audit and non-audit service policy, where they do not affect the independence of the external auditors, but do require the pre-approval of the audit committee prior to the engagement.

## Notes to the financial statements (continued)

At 31 March 2009

### 3. Net operating expenses (continued)

Exceptional restructuring costs of £1.0 million (2008: £4.5 million) relate to staff severance costs. Employee costs including business restructuring exceptional items, net of charges to capital schemes, amount to £97.6 million (2008: £103.6 million).

### 4. Other income

	2009 £m	2008 £m
Profit on disposal of tangible fixed assets	1.8	5.5
Rents receivable	0.9	0.1
	<u>2.7</u>	<u>5.6</u>

### 5. Directors' emoluments

	2009 £m	2008 £m
Aggregate emoluments in respect of qualifying services	2.1	1.7

	2009 Number	2008 Number
Number of directors who received shares in respect of qualifying services	6	2
Number of directors who exercised share options	-	2
Number of directors accruing benefits under defined benefit schemes	2	6

	2009 £m	2008 £m
<b>In respect of highest paid director</b>		
Aggregate emoluments	0.6	0.3

The highest paid director is a member of the defined contribution pension scheme.

TP Weller and PN Green are remunerated by United Utilities PLC, an intermediate holding company; an allocation of these emoluments is recharged to United Utilities Water PLC.

There were no directors who had incentive plans which vested during the year ended 31 March 2009 (2008: nil).

Details of the employee Sharesave scheme and the executive share option scheme of United Utilities Group PLC are given in that company's financial statements.

## Notes to the financial statements (continued)

At 31 March 2009

### 5. Directors' emoluments (continued)

All executive directors are members of, and contribute to the United Utilities Pension Scheme, which is an exempt approved pension scheme with defined benefit and defined contribution sections of membership. It contains sections which are open to all eligible employees. It provides pensions and other benefits to members within HM Revenue and Customs limits. The scheme provides a pension on normal retirement at age 60 of between 1/45th and 1/60th of pensionable earnings for each completed year of service. The maximum pension is two thirds of pensionable earnings. Early retirement is possible from the age of 50 if the company agrees.

Non-executive directors' appointments are for an initial period of three years. They are subject to re-appointment at the first Annual General Meeting (AGM) after their initial appointment and at an AGM at least every three years thereafter (if they are to be re-appointed). After nine years in office, a non-executive director is required to seek re-appointment each year at the AGM. They have letters of appointment, as opposed to contracts of service. In the event of early termination, for whatever reason, they are not entitled to receive compensation for loss of office.

The non-executive directors' letters of appointment can be inspected at the company's registered office. The letters set out the expected time commitment and non-executives agree to devote sufficient time to meet what is expected of them.

### 6. Employees

	2009 Number	2008 Number
Average number of persons employed during the year:		
Licensed utility operations	3,925	3,906



## Notes to the financial statements (continued)

At 31 March 2009

### 7. Interest payable and similar charges

	2009	2008
	£m	£m
<b>Interest payable and similar charges</b>		
On bank loans, overdrafts and other loans	185.2	222.3
On finance leases	2.7	3.2
On borrowings from parent and fellow subsidiary undertakings	35.4	16.4
	<hr/>	<hr/>
<b>Interest payable before preference share dividends and fair value adjustments</b>	223.3	241.9
Preference share dividends (see note 9)	9.1	9.1
	<hr/>	<hr/>
<b>Total interest payable</b>	232.4	251.0
	<hr/>	<hr/>
<b>Fair value losses/(gains) on debt and derivative instruments <sup>(1)</sup></b>		
Fair value hedge relationships		
- Borrowings	326.5	155.9
- Designated swaps	(225.3)	(88.3)
	<hr/>	<hr/>
	101.2	67.6
Held for trading derivatives – economic hedge	(95.9)	(78.1)
	<hr/>	<hr/>
	5.3	(10.5)
Financial instruments at fair value through the profit and loss		
- Borrowings designated at fair value through the profit and loss <sup>(2)</sup>	56.5	(6.9)
- Held for trading derivatives – economic hedge	(160.6)	(25.0)
	<hr/>	<hr/>
	(104.1)	(31.9)
Held for trading derivatives – 2005-2010 regulatory hedge	63.0	21.0
Held for trading derivatives – 2010-2015 regulatory hedge	31.2	-
Net payments on swaps and debt under fair value option	17.0	41.8
Held for trading derivatives – other <sup>(3)</sup>	26.8	(0.6)
Other	(24.1)	-
	<hr/>	<hr/>
<b>Net fair value losses <sup>(4)</sup></b>	15.1	19.8
	<hr/>	<hr/>
<b>Total interest payable and other similar charges</b>	247.5	270.8
	<hr/>	<hr/>
<b>Investment income</b>		
Interest receivable and similar income		
- Parent and fellow subsidiary undertakings	(34.9)	(22.7)
- External	(3.0)	(40.7)
Net pension interest income	(3.1)	(13.8)
	<hr/>	<hr/>
<b>Total investment income</b>	(41.0)	(77.2)
	<hr/>	<hr/>
<b>Net interest payable and similar charges</b>	206.5	193.6
	<hr/>	<hr/>

1. Fair value losses/(gains) include foreign exchange losses of £211.6 million (2008: £152.4 million losses), excluding those on instruments measured at fair value through profit or loss. These losses will be largely offset by fair value gains on derivatives.

2. Includes gains of £76.6 million (2008: £28.2 million) on the valuation of debt reported at fair value through profit or loss due to changes in credit spread assumptions.

3. Includes fair value movements in relation to other economic hedge derivatives relating to debt held at amortised cost.

4. Includes £14.8 million (2008: £31.9 million) interest on swaps and debt under fair value option.

## Notes to the financial statements (continued)

At 31 March 2009

### 8. Tax charge on profit on ordinary activities

(a) Analysis of charge in the year

	2009 £m	2008 £m
Current tax:		
UK corporation tax at 28% (2008: 30%)	139.1	106.0
Tax on exceptional items	(0.3)	(1.4)
Prior year adjustment	(7.3)	(8.4)
<b>Total current tax charge</b>	<b>131.5</b>	<b>96.2</b>
Deferred tax:		
Origination and reversal of timing differences	1.0	27.2
(Increase)/decrease in discount	(3.8)	63.8
Prior year adjustment	2.8	8.4
Adjustment in respect of the abolition of industrial buildings allowances	-	(78.3)
Effect of change in tax rate to 28%	-	(24.2)
<b>Total deferred tax credit</b>	<b>-</b>	<b>(3.1)</b>
<b>Total tax charge on profit on ordinary activities</b>	<b>131.5</b>	<b>93.1</b>

(b) Factors affecting the current tax charge for the year

	2009 £m	2008 £m
Profit on ordinary activities before taxation	505.0	457.5
UK corporation tax rate	28.0	30.0
Capital allowances in excess of depreciation	(5.8)	(5.9)
Prior year adjustment	(1.4)	(1.8)
Other timing differences	5.6	(0.1)
Net non-taxable income	(0.4)	(1.2)
<b>Actual current tax rate</b>	<b>26.0</b>	<b>21.0</b>

### 9. Dividends

Amounts recognised as distributions to equity holders in the year comprise:

	2009 £m	2008 £m
Final dividend for the year ended 31 March 2008 at 82.6 pence per share (2007: 21.1 pence per share)	770.0	196.3
Interim dividend for the year ended 31 March 2009 at 8.1 pence per share (2008: 11.1 pence per share)	75.5	103.0
	<b>845.5</b>	<b>299.3</b>

## Notes to the financial statements (continued)

At 31 March 2009

### 9. Dividends (continued)

The £770.0 million final dividend for 2008 consisted of a special dividend of £550.0 million and an ordinary dividend of £220.0 million. The company announced its strategy of targeting a credit rating of A3 in November 2007. Consistent with this strategy and in order to adjust the Regulatory Capital Value (RCV) gearing levels in line with the rating agencies' tolerance levels for an A3 credit rating, the company returned £550.0 million to shareholders as a special dividend and reduced the dividend per share by 30.0% with effect from February 2009.

The directors have not recommended a final ordinary dividend for 2008/09 (2008: £220.0 million).

The company's redeemable preference shares are included in the balance sheet as a liability and, accordingly, the dividends payable on them of £9.1 million per annum are included in net interest payable (see note 7, 14b).

### 10. Tangible fixed assets

	Freehold land and buildings £m	Infra- structure assets £m	Operational structures £m	Fixtures, fittings, tools and equipment £m	Assets in course of construction £m	Total £m
<b>Cost</b>						
At 1 April 2008	203.9	4,608.1	4,131.6	539.5	901.0	10,384.1
Additions	4.0	201.2	102.4	63.2	376.2	747.0
Grants and contributions	-	(13.5)	-	-	-	(13.5)
Transfers	5.0	77.9	215.5	49.5	(347.9)	-
Disposals	(6.8)	-	(37.1)	(80.1)	-	(124.0)
<b>At 31 March 2009</b>	<b>206.1</b>	<b>4,873.7</b>	<b>4,412.4</b>	<b>572.1</b>	<b>929.3</b>	<b>10,993.6</b>
<b>Depreciation</b>						
At 1 April 2008	65.3	1,590.3	1,234.5	315.1	-	3,205.2
Charge for the year	7.0	109.1	156.3	50.4	-	322.8
Disposals	(6.7)	-	(37.1)	(80.0)	-	(123.8)
<b>At 31 March 2009</b>	<b>65.6</b>	<b>1,699.4</b>	<b>1,353.7</b>	<b>285.5</b>	<b>-</b>	<b>3,404.2</b>
<b>Net book value</b>						
<b>At 31 March 2009</b>	<b>140.5</b>	<b>3,174.3</b>	<b>3,058.7</b>	<b>286.6</b>	<b>929.3</b>	<b>7,589.4</b>
At 31 March 2008	138.6	3,017.8	2,897.1	224.4	901.0	7,178.9

## Notes to the financial statements (continued)

At 31 March 2009

### 10. Tangible fixed assets (continued)

Grants and contributions received relating to infrastructure assets have been deducted from the cost of fixed assets in order to show a true and fair view (see note 1). As a consequence, the net book value of tangible fixed assets is £164.5 million (2008: £151.0 million) lower than it would have been had this treatment not been adopted.

#### Infrastructure renewals

Expenditure on asset replacements to maintain the operating capability of the water and wastewater network in accordance with defined standards of service is capitalised, and depreciation is charged based on the expenditure set out in the company's independently verified Asset Management Plan for the period 1 April 2005 to 31 March 2010, in accordance with FRS 15 'Tangible Fixed Assets'.

The amount of excess depreciation over expenditure is as follows:

	£m
Excess depreciation over expenditure at 1 April 2008	(21.7)
Expenditure on asset replacements to maintain the network in the year	117.9
Depreciation for the year	(109.1)
Excess depreciation over expenditure at 31 March 2009	<u>(12.9)</u>

#### Operational structures held under finance leases

Within tangible fixed assets are operational structures held under finance leases at the following amounts:

	2009 £m	2008 £m
<b>At 31 March</b>		
Cost	-	81.0
Accumulated depreciation	-	(16.7)
<b>Net book value</b>	<u>-</u>	<u>64.3</u>

On 31 March 2009, the company closed out a finance lease which had a maturity date of 2014.

The depreciation charge for the year for assets held under finance leases is £1.7 million (2008: £1.7 million).

	2009 £m	2008 £m
<b>Capital commitments</b>		
Contracted but not provided for	312.5	484.5

## Notes to the financial statements (continued)

At 31 March 2009

### 11. Fixed asset investments

	Other investments £m
Cost and net book value at 1 April 2008 and 31 March 2009	0.2

Details of other investments, all of which are unlisted, held directly by the company and registered in England and Wales, are:

Other investments	Description of holding	Proportion held	Nature of business
WRc PLC	'A' Ordinary shares of £1.00 each	16.97%	Water and wastewater research
	8.0 per cent convertible unsecured loan stock 2014	28.58%	
Paypoint PLC	Ordinary shares of 0.003 pence each	0.02%	Cash collection service
Lingley Mere Management Company Limited	Ordinary shares of £1.00 each	93.27%	Estate management
United Utilities Water Leasing Limited	Ordinary shares of £1.00 each	100.00%	Non-trading

The company also has an interest in Rivington Heritage Trust and Rossendale Groundwork Trust Limited both of which are limited by guarantee.

### 12. Debtors

#### (a) Amounts falling due within one year

	2009 £m	2008 £m
Trade debtors	97.8	94.0
Amounts owed by parent and fellow subsidiary undertakings – trading balances	11.2	30.3
Amounts owed by parent and fellow subsidiary undertakings – fixed rate loans	745.2	497.5
Amounts owed by parent and fellow subsidiary undertakings – floating rate loans	40.0	40.6
Other debtors	22.0	14.2
Prepayments and accrued income	139.1	114.7
Derivative financial instruments (see note 20)	224.5	97.1
	<u>1,279.8</u>	<u>888.4</u>

The fixed rate loans owed by fellow subsidiary undertakings of £745.2 million (2008: £497.5 million) principally relate to the intercompany funding structure set up during the prior year.

## Notes to the financial statements (continued)

At 31 March 2009

### 12. Debtors (continued)

#### (b) Amounts falling due after more than one year

	2009 £m	2008 £m
Derivative financial instruments (see note 20)	239.8	44.3

#### (c) Allowance for bad and doubtful debts

	2009 £m	2008 £m
At 1 April	(159.0)	(138.6)
Amounts charged to operating expenses (see note 3)	(50.3)	(49.7)
Trade debtors written-off	30.3	29.3
At 31 March	(179.0)	(159.0)

#### (d) Ageing of gross debtors

	Aged less than one year £m	Aged between one year and two years £m	Aged greater than two years £m	Carrying value £m
At 31 March 2009				
Gross trade debtors	104.7	53.0	119.1	276.8
Amounts owed by parent and fellow subsidiary undertakings	796.4	-	-	796.4
Other debtors	22.0	-	-	22.0
Prepayments and accrued income	139.1	-	-	139.1
	<u>1,062.2</u>	<u>53.0</u>	<u>119.1</u>	<u>1,234.3</u>
At 31 March 2008				
Gross trade debtors	106.5	47.6	98.9	253.0
Amounts owed by parent and fellow subsidiary undertakings	568.4	-	-	568.4
Other debtors	14.2	-	-	14.2
Prepayments and accrued income	114.7	-	-	114.7
	<u>803.8</u>	<u>47.6</u>	<u>98.9</u>	<u>950.3</u>

The above analysis in respect of gross trade debtors reconciles to net trade debtors by deduction of the allowance for doubtful debtors of £179.0 million (2008: £159.0 million). The company manages its bad debt risk by providing against gross trade debtors. This allowance is calculated by reference to customer categories rather than on the age profile of gross debtor balances. It is therefore not possible to age the allowance for doubtful debtors.

## Notes to the financial statements (continued)

At 31 March 2009

### 12. Debtors (continued)

#### (e) Analysis of net trade and sundry debtors by category

	2009 £m	2008 £m
Debtors in respect of unmetered water supplies	89.6	74.4
Debtors in respect of metered water supplies	107.8	100.5
Sundry debtors	61.5	48.0
	<u>258.9</u>	<u>222.9</u>

The directors consider that the carrying amount of trade and other debtors approximates to their fair value, at both 31 March 2009 and 31 March 2008.

### 13. Current asset investments

	2009 £m	2008 £m
Short-term deposits	80.0	-
	<u>80.0</u>	<u>-</u>

### 14. Creditors: amounts falling due within one year

#### (a) Trade and other creditors

	2009 £m	2008 £m
Trade creditors	45.8	26.0
Amounts owed to parent and fellow subsidiary undertakings	12.0	25.4
Taxation and social security	101.9	72.8
Deferred grants and contributions (see note 16)	6.0	6.2
Accruals and deferred income	301.5	361.6
Derivative financial instruments (see note 20)	127.7	25.1
	<u>594.9</u>	<u>517.1</u>

#### (b) Borrowings

	2009 £m	2008 £m
Bonds, bank and other term borrowings	230.9	478.4
130,000,000 7 per cent £1.00 redeemable preference shares	130.0	130.0
Bank overdraft	11.2	88.4
Finance lease obligations	-	12.6
Amounts owed to parent and fellow subsidiary undertakings	780.3	262.2
	<u>1,152.4</u>	<u>971.6</u>

## Notes to the financial statements (continued)

At 31 March 2009

### 14. Creditors: amounts following due within one year (continued)

#### (b) Borrowings (continued)

The £130.0 million 7 per cent redeemable preference shares have been presented as amounts falling due within one year as they may be redeemed by not less than 30 days written notice served by the company or the shareholder. Preference shareholders are not entitled to receive notice of, attend or vote at, any general meeting of the company. However, preference shareholders receive priority to other classes of shareholders on a winding up, liquidation or other return of capital to shareholders of the company. The preference shares have a latest redemption date of 1 October 2099. Further information on the company's borrowings is given in note 19.

On 31 March 2009, the company closed out a finance lease which had a maturity date of 2014.

### 15. Creditors: amounts falling due after more than one year

#### (a) Trade and other creditors

	2009 £m	2008 £m
Other creditors	3.8	3.4
Deferred grants and contributions	83.7	86.0
Derivative financial instruments (see note 20)	1.3	22.2
	88.8	111.6

#### (b) Borrowings

	2009 £m	2008 £m
Bonds, bank and other term borrowings	4,244.7	3,002.8
Amounts owed to parent and fellow subsidiary undertakings	524.5	414.2
Finance lease obligations	-	56.3
	4,769.2	3,473.3

Further information on the company's borrowings is given in note 19.

On 31 March 2009, the company closed out a finance lease which had a maturity date of 2014.



## Notes to the financial statements (continued)

At 31 March 2009

### 16. Deferred grants and contributions

	2009 £m	2008 £m
At 1 April	92.2	92.7
Received in the year	3.7	5.4
Credited to the profit and loss account (see note 3)	(6.2)	(5.9)
At 31 March	<u>89.7</u>	<u>92.2</u>
Represented by:		
Amounts falling due within one year	6.0	6.2
Amounts falling due after one year	83.7	86.0
At 31 March	<u>89.7</u>	<u>92.2</u>

### 17. Provisions for liabilities

	Deferred tax: pension (note 21) £m	Deferred tax: other (note 18) £m	Other £m	Total £m
At 1 April 2008	-	358.2	9.9	368.1
At 1 April 2008 – disclosed separately in pensions (see note 21)	(18.9)	-	-	(18.9)
Net profit and loss (credit)/charge	(5.4)	5.3	1.5	1.4
Total movement	<u>(24.3)</u>	<u>363.5</u>	<u>11.4</u>	<u>350.6</u>
Tax on actuarial losses on defined benefit pension schemes	(21.7)	-	-	(21.7)
Utilised in the year	-	-	(1.3)	(1.3)
At 31 March 2009 – disclosed separately in pensions (see note 21)	46.0	-	-	46.0
At 31 March 2009	<u>-</u>	<u>363.5</u>	<u>10.1</u>	<u>373.6</u>

Other provisions include legal claims of £9.2 million (2008: £9.2 million). The timing of the settlement of these legal claims is uncertain but expected to occur after twelve months of the balance sheet date. Other provisions also include obligations for restructuring costs of £0.9 million (2008: £0.7 million) which are expected to be incurred within the next twelve months.

## Notes to the financial statements (continued)

At 31 March 2009

### 18. Deferred tax

Deferred tax is provided as follows:

	2009 £m	2008 £m
Accelerated capital allowances	1,107.5	1,072.9
Short-term timing differences	(43.0)	(17.5)
<b>Undiscounted provision for deferred tax</b>	<b>1,064.5</b>	<b>1,055.4</b>
Discount	(701.0)	(697.2)
<b>Discounted provision for deferred tax (see note 17)</b>	<b>363.5</b>	<b>358.2</b>

### 19. Borrowings

The following analysis provides information about the contractual terms of the company's borrowings. For more information about the company's exposure to interest rate and foreign exchange risk see note 20.

	2009 £m	2008 £m
<i>Non-current liabilities</i>		
Bank and other term borrowings	981.6	502.0
Bonds	3,263.1	2,500.8
Finance lease obligations	-	56.3
Amounts owed to parent and fellow subsidiary undertakings	524.5	414.2
	<u>4,769.2</u>	<u>3,473.3</u>
<i>Current liabilities</i>		
Bank overdrafts	11.2	88.4
Bank and other term borrowings	40.2	5.2
130,000,000 7 per cent £1 redeemable preference shares	130.0	130.0
Bonds	153.2	473.2
Finance lease obligations	-	12.6
Euro-commercial paper	37.5	-
Amounts owed to parent and fellow subsidiary undertakings	780.3	262.2
	<u>1,152.4</u>	<u>971.6</u>
	<u>5,921.6</u>	<u>4,444.9</u>

## Notes to the financial statements (continued)

At 31 March 2009

### 19. Borrowings (continued)

#### Terms and debt repayment schedule

The principal economic terms and conditions of outstanding borrowings were as follows:

	Currency	Year of maturity	Fair value £m	2009 Carrying value £m	Fair value £m	2008 Carrying value £m
<b>Borrowings in fair value hedge relationships</b>						
5.625% 300m bond	GBP	2027	286.1	338.3	281.0	301.1
5.75% 275m bond	GBP	2022	274.7	270.3	-	-
5% 200m bond	GBP	2035	165.1	220.3	171.4	191.6
5.25% 150m bond	GBP	2010	154.1	153.2	150.5	148.5
5.375% 150m bond	GBP	2018	158.8	164.4	149.0	147.4
4.875% 600m bond	EUR	2009	-	-	479.0	473.2
4.25% 500m bond	EUR	2020	425.0	479.7	345.7	373.4
5.02% JPY 10,000m dual currency loan	JPY/USD	2029	76.7	94.5	56.6	62.2
<b>Borrowings designated at fair value through profit or loss</b>						
6.875% 400m bond (owed to immediate parent undertaking)	USD	2028	259.7	259.7	208.7	208.7
1.135% 3,000m bond	JPY	2013	20.0	20.0	14.4	14.4
<b>Borrowings measured at amortised cost</b>						
Amounts owed to parent and fellow subsidiary undertakings	GBP	Various	1,045.1	1,045.1	467.7	467.7
6.125% 375m bond	GBP	2015	405.9	379.1	-	-
Long term bank borrowings- floating	GBP	2010-12	250.3	250.0	200.0	200.0
1.97% + RPI 200m IL loan	GBP	2016	183.7	220.2	194.1	209.0
Preference shares (owed to immediate parent undertaking)	GBP	2099	130.0	130.0	130.0	130.0
1.9799% + RPI 100m IL bond	GBP	2035	83.2	114.2	102.3	108.7
1.7829% + RPI 100m IL bond	GBP	2040	74.4	113.0	95.3	107.6
1.5802% + RPI 100m IL bond	GBP	2042	68.3	112.6	88.9	107.2
1.847% + RPI 100m IL bond	GBP	2056	67.5	106.8	83.4	106.7
1.815% + RPI 100m IL bond	GBP	2056	66.5	106.4	82.4	106.2
1.662% + RPI 100m IL bond	GBP	2056	62.7	106.2	78.0	106.0
1.585% + RPI 100m IL bond	GBP	2057	60.5	102.2	75.7	102.0
3.375% + RPI 50m IL bond	GBP	2032	60.0	60.6	71.3	57.6
1.3258% + RPI 50m IL bond	GBP	2041	32.1	56.4	41.7	53.7
1.397% + RPI 50m IL bond	GBP	2046	30.4	56.3	41.4	53.6
1.5366% + RPI 50m IL bond	GBP	2043	33.8	56.2	44.1	53.5
1.7937% + RPI 50m IL bond	GBP	2049	37.1	56.1	46.4	53.4
1.5865% + RPI 50m IL bond	GBP	2056	30.3	53.1	37.9	53.0
1.556% + RPI 50m IL bond	GBP	2056	30.2	52.8	37.7	52.7
1.435% + RPI 50m IL bond	GBP	2056	28.6	52.6	35.9	52.5
1.702% + RPI 50m IL bond	GBP	2057	31.7	51.5	39.6	51.4
1.61% + RPI 50m IL loan	GBP	2020	42.3	48.5	-	-
1.73% + RPI 50m IL loan	GBP	2020	42.9	48.4	-	-
1.84% + RPI 50m IL loan	GBP	2020	43.7	48.4	-	-
1.88% + RPI 50m IL loan	GBP	2020	43.5	48.2	-	-
1.90% + RPI 50m IL loan	GBP	2020	43.7	48.3	-	-
1.93% + RPI 50m IL loan	GBP	2020	43.8	48.2	-	-
2.10% + RPI 50m IL loan	GBP	2020	44.6	48.1	-	-
2.46% + RPI 50m IL loan	GBP	2020	46.4	48.2	-	-
1.3805% + RPI 35m IL bond	GBP	2056	19.6	36.8	24.6	36.8
1.66% + RPI 35m IL bond	GBP	2037	24.3	35.4	30.1	35.4

## Notes to the financial statements (continued)

At 31 March 2009

### 19. Borrowings (continued)

	Currency	Year of maturity	Fair value £m	2009 Carrying value £m	Fair value £m	2008 Carrying value £m
Commission for the New Towns loan	GBP	2053	45.1	30.8	48.6	31.0
1.591% + RPI 25m IL bond	GBP	2056	15.1	26.5	18.9	26.4
Long term bank borrowings - fixed	GBP	2008	-	-	5.1	5.0
1.3% + LIBOR 5bn (floating) bond	JPY	2017	38.8	35.3	-	-
Euro-commercial paper	GBP	2009	37.5	37.5	-	-
Committed facilities (drawn)	GBP	2009	40.0	40.0	-	-
<b>Other borrowings</b>						
Bank overdrafts	GBP	2009	11.2	11.2	88.4	88.4
Finance lease obligations	GBP	2014	-	-	68.9	68.9
			5,215.0	5,921.6	4,134.7	4,444.9

The amount of unamortised bond discount contained within the company's borrowings amounts to £21.5 million (2008: £18.4 million).

Borrowings are unsecured. Funding raised in currencies other than sterling is generally swapped to sterling to match funding costs to income and assets.

#### Currency

GBP	Pound Sterling
EUR	Euro
USD	United States Dollar
JPY	Japanese Yen

#### Index-linked debt

IL Index-linked debt – this debt is adjusted for movements in RPI with reference to a base RPI established at the trade date.

#### RPI

Retail Price Index – the UK general index of retail prices (for all items) as published by the Office of National Statistics (Jan 1987=100) as published by HM Government.

## Notes to the financial statements (continued)

At 31 March 2009

### 19. Borrowings (continued)

#### Finance lease obligations

Finance lease obligations are payable as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2009 £m	2008 £m	2009 £m	2008 £m
Amounts payable under finance leases:				
- within one year	-	12.6	-	12.6
- in the second to fifth year inclusive	-	55.6	-	45.6
- after five years	-	16.0	-	10.7
	-	84.2	-	68.9
Future finance charges	-	(15.3)	-	-
Present value of lease obligations	-	68.9	-	68.9
Amounts due for settlement within 12 months			-	(12.6)
Amounts due for settlement in more than 12 months			-	56.3

On 31 March 2009, the company closed out a finance lease which had a maturity date of 2014. The carrying value of the lease on 31 March 2009 was £60.9 million.

Finance lease obligations related to operational structures. Interest rates implicit in the minimum lease payments were fixed on completion of the assets when the primary period of the lease commenced. In addition, contingent rentals were either payable or receivable, which adjusted the minimum lease payments to reflect changes in future market rates of interest. These contingent rentals were recognised as a finance income or expense in the year to which they related. Contingent rentals recognised as a reduction in finance expense in the year totalled £2.3 million (2008: £2.6 million). The net finance charge (after adjusting for contingent rentals) for the year was £2.7 million (2008: £3.2 million) and the effective borrowing rate (after adjusting for contingent rentals) for the year was 3.93 per cent (2008: 5.05 per cent). The average lease term was six years as at 31 March 2008.

The company's obligations under finance leases were unsecured as at 31 March 2008.

The directors considered the fair values of the company's finance lease obligations approximate to their carrying values at 31 March 2008.

## Notes to the financial statements (continued)

At 31 March 2009

### 20. Financial instruments

#### Risk management

All of the company's activities involve analysis, management and, in some cases, acceptance of risk or a combination of risks. The most important types of financial risk are credit risk, liquidity risk and market risk. Market risk includes foreign exchange, interest rate and inflation risks.

The company's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls and to monitor the risks and limits continually by means of reliable and up-to-date systems. The company modifies and enhances its risk management policies and systems to reflect changes in markets and products. The board (or as appropriate the group board) formulates the high level company treasury risk management policy. The United Utilities Group PLC's treasury committee is responsible for monitoring the implementation of the policy. The board has approved all of the classes of financial instruments used by the company. The company's treasury function, which is authorised to conduct the day-to-day treasury activities of the company, reports annually to the board and group board and quarterly to the group treasury committee.

The company's exposure to risk and its objectives, policies and processes for managing risk and the methods used for measuring risk have not changed since the prior year.

#### Credit risk

Credit risk is the risk that financial loss arises from the failure of a customer or counterparty to meet its obligations under a contract. It arises principally from trade finance (the supply of services to the public and other businesses) and treasury activities (the investment of essential liquidity). The company has policies and procedures to control and monitor credit risk. The company does not believe it is exposed to any material concentrations of credit risk.

The company looks to manage its risk from trade finance through the effective management of customer relationships. The Water Industry Act 1991 (as amended by the Water Industry Act 1999) prohibits the disconnection of a water supply for non-payment and the limiting of a supply with the intention of enforcing payment for certain premises including domestic dwellings. However, allowance is made by the water regulator in the price limits at each price review for a proportion of debt deemed to be irrecoverable. Concentrations of credit risk with respect to trade debtors are limited due to the company's customer base consisting of a large number of unrelated households and businesses. Due to this, the directors believe there is no further credit risk provision required in excess of the allowance for bad and doubtful debts (see note 12c).

The counterparties in respect of treasury activities consist of financial institutions and other bodies considered to have good credit ratings. Although the company is potentially exposed to credit loss in the event of non-performance by counterparties, such credit risk is measured and controlled through regular review of the credit ratings assigned to the counterparties by credit rating agencies, and by limiting the total amount of exposure to any one party. Management do not expect any counterparty to fail to meet its obligations, and there has not been any such failure during the year, or in the preceding year.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet. At 31 March, the company's maximum exposure to credit risk was as follows:

	2009	2008
	£m	£m
Cash and short-term deposits	81.1	-
Trade and other debtors	1,055.3	791.3
Derivative financial instruments	464.3	141.4
	<u>1,600.7</u>	<u>932.7</u>

## Notes to the financial statements (continued)

At 31 March 2009

### 20. Financial instruments (continued)

Cash, short-term deposits and trade and other debtors are measured at amortised cost. Derivative financial instruments are measured at fair value.

#### Liquidity

Liquidity risk is the risk that the company will not have sufficient funds to meet the obligations or commitments arising from its business operations and its financial liabilities. The company manages the liquidity profile of its assets, liabilities and commitments so that cashflows are appropriately balanced and all funding obligations are met when due. The board approves a liquidity framework within which the business operates. Performance against this framework is actively monitored and reported monthly to the board using a headroom figure.

The company had available committed borrowing facilities as follows:

	2009 £m	2008 £m
Expiring within one year	50.0	25.0
Expiring after one year but in less than two years	175.0	50.0
Expiring after more than two years	275.0	525.0
<b>Total borrowing facilities</b>	<u>500.0</u>	<u>600.0</u>
Facilities drawn	(40.0)	-
<b>Undrawn borrowing facilities</b>	<u>460.0</u>	<u>600.0</u>

In addition to the committed facilities available, the company uses its euro-commercial paper programme to help manage its liquidity position.

#### Maturity analysis

Concentrations of risk may arise if large cashflows are concentrated within particular time periods. The maturity profile in the following table represents the forecast future contractual principal and interest cashflows in relation to the company's financial liabilities and derivatives on an undiscounted basis.

Derivative cashflows have been shown net where there is a contractual agreement to settle on a net basis; otherwise the cashflows are shown gross.

## Notes to the financial statements (continued)

At 31 March 2009

### 20. Financial instruments (continued)

	Total <sup>1</sup>	Adjustment <sup>2</sup>	1 year or less	1-2 years	2-3 years	3-4 years	4-5 years	More than 5 years
	£m	£m	£m	£m	£m	£m	£m	£m
At 31 March 2009								
Bonds	8,854.5	-	275.7	118.3	119.0	119.8	143.3	8,078.4
Bank borrowings and other	1,578.0	-	113.3	73.9	75.5	171.1	20.1	1,124.1
Preference shares	130.0	-	130.0	-	-	-	-	-
Parent and fellow subsidiary borrowings	2,007.8	-	867.4	25.6	27.6	28.6	29.2	1,029.4
Adjustment to carrying value	(6,648.7)	(6,648.7)	-	-	-	-	-	-
Financial liabilities excluding derivatives	5,921.6	(6,648.7)	1,386.4	217.8	222.1	319.5	192.6	10,231.9
Derivatives								
Payable	648.0	-	178.2	100.0	79.7	80.8	51.4	157.9
Receivable	(1,120.6)	-	(335.8)	(109.1)	(92.3)	(116.6)	(97.8)	(369.0)
Adjustment to carrying value	137.3	137.3	-	-	-	-	-	-
Derivatives	(335.3)	137.3	(157.6)	(9.1)	(12.6)	(35.8)	(46.4)	(211.1)
At 31 March 2008								
Bonds	8,372.0	-	589.2	234.5	72.3	76.7	79.2	7,320.1
Bank borrowings and other	898.8	-	116.0	22.6	22.7	72.1	163.3	502.1
Finance lease	84.2	-	12.6	12.9	13.5	14.3	14.9	16.0
Preference shares	130.0	-	130.0	-	-	-	-	-
Parent and fellow subsidiary borrowings	1,283.0	-	289.0	26.8	26.8	26.8	26.8	886.8
Adjustment to carrying value	(6,323.1)	(6,323.1)	-	-	-	-	-	-
Financial liabilities excluding derivatives	4,444.9	(6,323.1)	1,136.8	296.8	135.3	189.9	284.2	8,725.0
Derivatives								
Payable	2,421.7	-	1,099.8	762.0	59.6	60.3	163.3	276.7
Receivable	(2,349.0)	-	(1,109.6)	(770.3)	(56.2)	(52.4)	(120.4)	(240.1)
Adjustment to carrying value	(166.8)	(166.8)	-	-	-	-	-	-
Derivatives	(94.1)	(166.8)	(9.8)	(8.3)	3.4	7.9	42.9	36.6

1. Forecast future cashflows are calculated, where applicable, using forward interest rates based on the interest environment at year-end and are, therefore, susceptible to changes in market conditions. For index-linked debt it has been assumed that RPI will be 2.65 per cent over the life of each bond.

2. The carrying value of debt is calculated following various methods in accordance with FRS 26 'Financial Instruments: Recognition and Measurement' and, therefore, this adjustment converts the undiscounted forecast future cashflows to the carrying value of debt in the balance sheet.



## Notes to the financial statements (continued)

At 31 March 2009

### 20. Financial instruments (continued)

#### Market risk

Market risk is the risk that movements in market rates, including foreign exchange rates, interest rates and inflation will affect the company's profit. The management of market risk is undertaken with risk limits approved by the board (or as appropriate the group board).

The company borrows in the major global debt markets in a range of currencies at fixed and floating rates of interest, using derivatives, where appropriate, to generate the desired effective currency profile and interest basis.

The company uses a variety of financial instruments, including derivatives, when raising finance for its operations in order to manage any exposure arising from funding activity.

#### Interest rate risk

The company's fixed rate borrowings are exposed to a risk of change in their fair value due to changes in interest rates. The company's floating rate borrowings are exposed to a risk of change in cashflows due to changes in interest rates. The company uses interest rate swap contracts and financial futures to hedge these exposures. Short-term debtors and creditors are not exposed to interest rate risk.

The company's policy is to structure debt in a way that best matches the cashflows generated by its underlying assets. Revenues are determined by the real cost of capital fixed by the regulator for each five-year regulatory pricing period. The preferred form of debt, therefore, is sterling index-linked debt which is fixed in real terms also. Where conventional long-term debt is raised in a fixed rate form, the company will swap to floating rate, at inception over the life of the liability, through the use of interest rate swaps.

The company, using a second layer of interest rate swaps, fixes in nominal terms a material proportion of the floating cost of debt for the duration of the five-year regulatory pricing period to match better the fixed nature of the company's revenue stream.

The company assesses any residual floating rate exposure with regard to net debt, after the effect of derivative contracts, to determine whether to hedge using futures contracts.

#### Sensitivity analysis

The sensitivity analysis below has been prepared on the basis of the amount of net debt and the interest rate hedge positions in place as at 31 March 2009 and 31 March 2008, respectively. As a result, this analysis relates to the positions at the balance sheet date and is not indicative of the years then ended, as these factors would have varied throughout the year.

The following assumptions were made in calculating the interest sensitivity analysis:

- all fair value hedge relationships including associated swaps classified as held for trading are fully effective and therefore there is no balance sheet sensitivity to interest rates with regard to these designated debt and swap instruments;
- all borrowings designated at fair value through profit and loss are effectively hedged by associated swaps and therefore there is no balance sheet sensitivity to interest rates (excluding the effect of accrued interest) with regard to the associated debt and swap instruments;
- the main balance sheet sensitivity to interest rates (excluding the effect of accrued interest) is in relation to the regulatory swaps which swap the majority of the company's floating rate exposure to fixed rate for the five-year regulatory period;
- the sensitivity of net finance expense to movements in interest rates is calculated on net floating rate exposures on debt and derivatives; and on deposits. The floating leg of a swap or any floating rate debt is treated as not having any interest rate already set, therefore a change in interest rates will have a full 12 month impact on interest;

## Notes to the financial statements (continued)

At 31 March 2009

### 20. Financial instruments (continued)

- deposits at the balance sheet date are taken and any debt or swaps maturing during the year are disregarded;
- index-linked debt is carried at amortised cost and therefore the balance sheet is not exposed to movements in interest rates. It is assumed that inflation is held constant;
- financial futures contracts entered into by the company to further manage the floating interest rate exposure are excluded from this analysis;
- the analysis excludes the impact of movements in market variables on the carrying value of pensions and other post-retirement obligations;
- management has assessed 100bp as a reasonably possible movement in UK interest rates; and
- all other factors are held constant.

#### Impact on profit before taxation and equity

	2009	2008
	£m	£m
100bp increase in interest rate	63.3	17.7
100bp decrease in interest rate	(67.0)	(23.8)

Brackets denote a reduction in profit.

## Notes to the financial statements (continued)

At 31 March 2009

### 20. Financial instruments (continued)

#### Repricing analysis

The following tables categorise the company's borrowings, derivatives and cash deposits on the basis of when they reprice or if earlier, mature. The £130.0 million redeemable preference shares have been classified as more than five years according to their latest redemption date of 1 October 2099. The repricing analysis demonstrates the company's exposure to floating rate risk prior to the effect of financial futures.

At 31 March 2009	Total £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
<b>Borrowings in hedge relationships</b>							
Fixed rate instruments	1,720.6	153.2	-	-	-	-	1,567.4
Effect of swaps	-	1,567.4	-	-	-	-	(1,567.4)
	<b>1,720.6</b>	<b>1,720.6</b>	-	-	-	-	-
<b>Borrowings designated at fair value through profit or loss</b>							
Fixed rate instruments	279.7	-	-	-	-	20.0	259.7
Effect of swaps	-	279.7	-	-	-	(20.0)	(259.7)
	<b>279.7</b>	<b>279.7</b>	-	-	-	-	-
<b>Borrowings measured at amortised cost</b>							
Fixed rate instruments	1,367.5	827.8	0.2	0.3	0.3	0.3	538.6
Floating rate instruments	591.6	591.6	-	-	-	-	-
Index-linked instruments	1,962.2	1,962.2	-	-	-	-	-
	<b>3,921.3</b>	<b>3,381.6</b>	<b>0.2</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>538.6</b>
Effect of a fixed hedge for the term of the regulatory business plan	-	(1,475.5)	348.4	-	-	-	1,127.1
<b>Total borrowings</b>	<b>5,921.6</b>	<b>3,906.4</b>	<b>348.6</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>1,665.7</b>
At 31 March 2008	Total £m	1 year or less £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
<b>Borrowings in hedge relationships</b>							
Fixed rate instruments	1,697.4	473.2	148.5	-	-	-	1,075.7
Effect of swaps	-	1,224.2	(148.5)	-	-	-	(1,075.7)
	<b>1,697.4</b>	<b>1,697.4</b>	-	-	-	-	-
<b>Borrowings designated at fair value through profit or loss</b>							
Fixed rate instruments	223.1	-	-	-	-	-	223.1
Effect of swaps	-	223.1	-	-	-	-	(223.1)
	<b>223.1</b>	<b>223.1</b>	-	-	-	-	-
<b>Borrowings measured at amortised cost</b>							
Fixed rate instruments	166.0	5.2	0.2	0.2	0.3	0.3	159.8
Floating rate instruments	825.0	825.0	-	-	-	-	-
Index-linked instruments	1,533.4	1,533.4	-	-	-	-	-
	<b>2,524.4</b>	<b>2,363.6</b>	<b>0.2</b>	<b>0.2</b>	<b>0.3</b>	<b>0.3</b>	<b>159.8</b>
Effect of a fixed hedge for the term of the regulatory business plan	-	(1,840.6)	1,392.2	448.4	-	-	-
<b>Total borrowings</b>	<b>4,444.9</b>	<b>2,443.5</b>	<b>1,392.4</b>	<b>448.6</b>	<b>0.3</b>	<b>0.3</b>	<b>159.8</b>

## Notes to the financial statements (continued)

At 31 March 2009

### 20. Financial instruments (continued)

#### Currency risk

The company's assets are principally sterling denominated; however, the company has access to various international debt capital markets and raises foreign currency denominated debt. Where debt is denominated in a currency which is not sterling, the company's policy is generally to swap the foreign currency denominated cashflows into sterling, through the use of foreign currency swaps. As a result, for the majority of foreign currency denominated borrowings, the company has no material exposure to movements in exchange rates.

Under a currency swap, the company agrees with another party to exchange the principal amount of two currencies, together with interest amounts in the two currencies agreed by reference to a specific interest rate basis and the principal amount. The principal of these instruments reflects the extent of the company's involvement in the instruments, but does not represent its exposure to credit risk, which is assessed by reference to the fair value.

As the company has no material exposure to currency risk no sensitivity analysis has been presented.

#### Inflation risk

The company's index-linked borrowings and interest liabilities are exposed to a risk of change in carrying value due to changes in the UK RPI. This form of liability is a good match for the company's regulated assets, which are also linked to RPI due to the revenue price cap imposed by the regulator. This price cap is linked to RPI and limits management's ability to change prices. By matching liabilities to its assets, index-linked debt hedges the exposure to changes in RPI and delivers a cashflow benefit, as compensation for the inflation risk is provided through adjustment to the principal rather than in cash. Management looks to issue index-linked debt wherever possible, but has a limited counterparty base willing to invest in these instruments. As such, the ability to issue this form of debt is limited.

The carrying value of the index-linked debt held by the company is as follows:

	2009	2008
	£m	£m
Index-linked debt	1,962.2	1,533.4

The sensitivity analysis set out below has been prepared on the basis of the amount of index-linked debt in place as at the 31 March 2009 and 31 March 2008, respectively. As a result, this analysis relates to the position at the balance sheet date and is not indicative of the years then ended, as these factors would have varied throughout the year. The following table details the sensitivity of profit before taxation to changes in the RPI, excluding the hedging aspect of the company's regulatory assets, which are not classed as financial assets:

#### Impact on profit before taxation and equity

	2009	2008
	£m	£m
1 per cent increase in RPI	(20.0)	(15.7)
1 per cent decrease in RPI	20.0	15.7

Brackets denote a reduction in profit.

## Notes to the financial statements (continued)

At 31 March 2009

### 20. Financial instruments (continued)

The analysis assumes a one per cent change in RPI having a corresponding one per cent impact on this position over a twelve-month period. It should be noted, however, that there is a time lag by which current RPI changes impact on the profit and loss and the analysis above does not incorporate this factor. The portfolio of index-linked debt is either calculated on a three or eight month lag basis. Therefore, at the balance sheet date the index-linked interest and principal adjustments impacting the income statement are fixed and based upon either the previous three or eight month RPI.

#### Capital structure and dividend policy

The company's objective when managing capital is to maintain a capital structure that enables the company to retain a credit rating of A3, which the company believes best mirrors regulatory assumptions in relation to capital structure.

One of Ofwat's primary duties is to ensure that water companies are able to finance their functions, in particular by securing a reasonable return on their capital. Therefore mirroring Ofwat's assumptions for credit ratings (and hence capital structure) should safeguard the company's ability to earn a reasonable return on its capital, securing access to finance at a reasonable cost and enabling the company to continue as a going concern in order to provide returns for shareholders, credit investors and benefits for other stakeholders.

In order to maintain a credit rating of A3, the company needs to manage its capital structure with reference to ratings methodology and measures used by the relevant ratings agencies. The ratings methodology is normally based upon a number of key ratios such as Regulatory Capital Value (RCV) gearing and adjusted interest cover and threshold levels as updated and published from time to time by the rating agencies. Further detail on the precise measures and methodologies used to assess water companies' credit ratings can be found in the methodology papers published by the ratings agencies.

The company's strategy of targeting a credit rating of A3 was announced in November 2007. Consistent with this strategy and in order to adjust the RCV gearing levels in line with the rating agencies' tolerance levels for an A3 credit rating, the company returned £550.0 million to shareholders as a special dividend and reduced dividend per share by 30 per cent with effect from February 2009.

The company's current long-term credit ratings are A3/A- with stable outlooks from Moody's Investors Service and Standard and Poor's Ratings Services respectively.

## Notes to the financial statements (continued)

At 31 March 2009

### 20. Financial instruments (continued)

#### Fair values

The fair values of financial assets and liabilities, together with the carrying amounts shown in the balance sheet, are as follows:

	2009 Carrying value £m	2009 Fair value £m	2008 Carrying value £m	2008 Fair value £m
<b>Financial assets</b>				
<i>Non-current assets</i>				
Derivative financial instruments:				
Fair value hedge derivatives	239.8	239.8	44.3	44.3
<i>Current assets</i>				
Cash and short-term deposits	81.1	81.1	-	-
Trade and other debtors	1,055.3	1,055.3	791.3	791.3
Derivative financial instruments:				
Held for trading derivatives <sup>(2)</sup>	224.5	224.5	97.1	97.1
<b>Total current assets</b>	<b>1,360.9</b>	<b>1,360.9</b>	<b>888.4</b>	<b>888.4</b>
<b>Financial liabilities</b>				
<i>Non-current liabilities</i>				
Trade and other creditors	(87.5)	(87.5)	(89.4)	(89.4)
Borrowings:				
Financial liabilities designated at fair value through profit or loss				
Financial liabilities in a hedged relationship	(1,567.5)	(1,386.4)	(1,224.2)	(1,154.2)
Financial liabilities measured at amortised cost	(2,922.0)	(2,395.6)	(2,026.0)	(1,779.9)
	(4,769.2)	(4,061.7)	(3,473.3)	(3,157.2)
Derivative financial instruments:				
Fair value hedge derivatives	(1.3)	(1.3)	(22.2)	(22.2)
<b>Total non-current liabilities</b>	<b>(4,858.0)</b>	<b>(4,150.5)</b>	<b>(3,584.9)</b>	<b>(3,268.8)</b>
<i>Current liabilities</i>				
Trade and other creditors	(467.2)	(467.2)	(492.0)	(492.0)
Borrowings:				
Financial liabilities in a hedge relationship	(153.2)	(154.1)	(473.2)	(479.0)
Financial liabilities measured at amortised cost	(999.2)	(999.2)	(498.4)	(498.5)
	(1,152.4)	(1,153.3)	(971.6)	(977.5)
Derivative financial instruments:				
Held for trading derivatives <sup>(2)</sup>	(127.7)	(127.7)	(25.1)	(25.1)
<b>Total current liabilities</b>	<b>(1,747.3)</b>	<b>(1,748.2)</b>	<b>(1,488.7)</b>	<b>(1,494.6)</b>
Adjustment for accrued interest <sup>(1)</sup>	-	(34.5)	-	(26.0)
<b>Net financial liabilities</b>	<b>(5,004.6)</b>	<b>(4,332.5)</b>	<b>(4,140.9)</b>	<b>(3,856.7)</b>

## Notes to the financial statements (continued)

At 31 March 2009

### 20. Financial instruments (continued)

1. Fair values quoted include accrued interest of £34.5 million (2008: £26.0 million) in respect of the associated borrowings. This accrued interest is also included in the fair value of trade and other payables. The impact on the total fair value of financial instruments has been removed in the adjustment for accrued interest.

2. Derivatives forming an economic hedge of the currency exposure on borrowings included in these balances were £181.9 million (2008: £62.3 million).

In order to determine the fair values in the table above, all borrowings and derivatives are valued using a discounted cashflow valuation model. In determining fair values, assumptions are made with regard to credit spreads based upon indicative pricing data.

In respect of the total change during the year in the fair value of financial liabilities designated as at fair value through profit or loss of £56.6 million loss (2008: £6.9 million gain), a £76.6 million gain (2008: £28.8 million gain) is attributable to changes in credit risk. The cumulative impact of changes in credit spread was £107.2 million profit (2008: £30.6 million profit). The difference between the carrying amount and the amount contracted to settle on maturity was a carrying amount increase of £55.5 million (2008: a carrying amount decrease of £41.5 million).

### 21. Retirement benefits

The company participates in the following pension schemes sponsored by the United Utilities group: the United Utilities Pension Scheme (UUPS) and the United Utilities Group of the Electricity Supply Pension Scheme (ESPS). Both schemes are funded defined benefit schemes which are closed to new employees. UUPS also includes a defined contribution section, which constitutes around 1.0 per cent of the total asset value. Under FRS 17 'Retirement benefits', the current service cost is calculated using the Projected Unit Credit Method and will therefore increase as the members of the scheme approach retirement.

The assets of these schemes are held in trust funds independent of the company's finances.

The last actuarial valuation of the UUPS was carried out as at 30 September 2008 and the ESPS was carried out as at 31 March 2008. These valuations have been updated to take account of the requirements of FRS 17 'Retirement benefits' in order to assess the position at 31 March 2009 by projecting forward from the dates of the respective valuations, and have been performed by an independent actuary, Mercer Limited.

On 31 March 2005, the company made lump sum payments of £110.9 million and £2.9 million to UUPS and ESPS respectively. The payments were in lieu of the estimated company contributions that were expected to have been payable for the defined benefit members over the five years from 1 April 2005. The company made £0.9 million of contributions to the defined benefit schemes for the year ended 31 March 2009 (2008: £1.6 million). The company does not expect to make significant contributions over the year to 31 March 2010. Other payments will be made by the company in accordance with the funding agreement between the schemes' trustees and United Utilities Group PLC.

The total defined benefit pension expense for the year was £19.9 million (2008: £11.2 million). A pension liability of £118.1 million, net of deferred tax of £46.0 million, is included in the balance sheet at 31 March 2009 (2008: liability of £48.6 million, net of deferred tax of £18.9 million).

## Notes to the financial statements (continued)

At 31 March 2009

### 21. Retirement benefits (continued)

The main financial assumptions used by the actuary were as follows:

	31 March 2009	31 March 2008	31 March 2007
	%	%	%
Discount rate – UUPS	7.00	6.00	5.20
Discount rate – ESPS	7.00	6.10	5.30
Expected return on assets – UUPS	6.60	6.80	6.50
Expected return on assets – ESPS	6.20	6.50	6.30
Pensionable salary growth – UUPS	4.15	4.35	3.95
Pensionable salary growth – ESPS	4.20	4.40	4.00
Pension increases	3.20	3.40	3.00
Price inflation	3.20	3.40	3.00

The current male life expectancies at age 60 underlying the accrued liabilities for the schemes are:

	2009	2008	2007
	years	years	years
Retired member	24.9	24.9	23.8
Non-retired member	26.0	26.0	25.9

As at 31 March, the fair value of the schemes' assets and liabilities recognised in the balance sheet, and the expected rates of return were as follows:

	Plan assets at 31 March 2009 %	Long-term rate of return expected at 31 March 2009	Value at 31 March 2009 £m	Plan assets at 31 March 2008 %	Long-term rate of return expected at 31 March 2008	Value at 31 March 2008 £m
Equities	55.9	7.0	445.9	69.4	7.5	717.0
Gilts	5.8	4.0	46.3	16.6	4.5	171.6
Bonds	37.8	6.4	301.6	13.1	6.8	135.0
Property	0.1	7.0	0.2	-	-	-
Cash	0.4	0.5	3.0	0.9	4.5	10.1
Total fair value of assets	100.0		797.0	100.0		1,033.7
Present value of liabilities			(961.1)			(1,101.2)
Pension liability			(164.1)			(67.5)
Related deferred tax asset			46.0			18.9
Net pension liability			(118.1)			(48.6)



## Notes to the financial statements (continued)

At 31 March 2009

### 21. Retirement benefits (continued)

Details in connection with 2007 are as follows:

	Plan assets at 31 March 2007	Long-term rate of return expected at 31 March 2007	31 March 2007
	%	%	%
Equities	69.5	7.3	783.5
Gilts	16.4	4.3	184.4
Bonds	13.1	5.1	147.0
Property	1.0	4.3	11.3
Total fair value of assets	100.0		1,126.2
Present value of liabilities			(1,109.4)
Pension asset			16.8
Related deferred tax liability			(5.0)
<b>Net pension asset</b>			<b>11.8</b>

The net pension expense before taxation recognised in the profit and loss account in respect of the defined benefit schemes is summarised as follows:

	2009 £m	2008 £m
Current service cost	(20.9)	(22.4)
Past service cost	(2.1)	(2.6)
Expected return on schemes' assets	68.9	72.0
Interest on schemes' liabilities	(65.8)	(58.2)
	(19.9)	(11.2)

The above amounts are all recognised in employee costs within operating expenses except for expected return on schemes' assets and interest on schemes' liabilities which have been recognised in investment income within net interest payable and similar charges.

The reconciliation of the opening and closing balance sheet position is as follows:

	2009 £m	2008 £m
At 1 April	(67.5)	16.8
Expense recognised in the profit and loss account	(19.9)	(11.2)
Contributions paid	0.9	1.6
Actuarial losses gross of taxation	(77.6)	(74.7)
<b>At 31 March</b>	<b>(164.1)</b>	<b>(67.5)</b>

## Notes to the financial statements (continued)

At 31 March 2009

### 21. Retirement benefits (continued)

Actuarial gains and losses are recognised directly in the statement of total recognised gains and losses.

The history of the schemes for the current and prior years is as follows:

	2009	2008	2007	2006	2005
Experience (loss)/gain on schemes' liabilities (£m)	(13.9)	14.3	28.7	-	(2.3)
Percentage of scheme liabilities (%)	1.4	(1.3)	(2.6)	-	0.2
Difference between the expected and actual return on schemes' assets (£m)	(270.6)	(131.4)	(7.3)	168.3	7.2
Percentage of scheme assets (%)	(34.0)	(12.7)	(0.6)	15.0	0.8
Change of assumptions (£m)	206.9	42.4	23.2	(114.8)	(6.5)
Percentage of scheme liabilities (%)	21.5	(3.9)	(2.1)	10.1	0.7
Amount recognised in statement of total recognised gains and losses (£m)	(77.6)	(74.7)	44.6	53.5	(1.6)
Percentage of scheme liabilities (%)	(8.1)	(6.8)	(4.0)	(4.7)	0.2

During the year, the company made £1.6 million (2008: £0.6 million) of contributions to defined contribution schemes, recognised within operating expenses.

### 22. Called up share capital and share premium account

	2009 £m	2008 £m
<b>Authorised share capital</b>		
1,150,000,000 ordinary shares of £1.00 each	1,150.0	1,150.0
93,437,000 zero per cent preference shares of £1.00 each	93.4	93.4
130,000,000 7 per cent cumulative redeemable preference shares of £1.00 each	130.0	130.0
	<u>1,373.4</u>	<u>1,373.4</u>
<b>Allotted and fully paid share capital</b>		
931,930,000 ordinary shares of £1.00 each	931.9	931.9
93,437,000 zero per cent preference shares of £1.00 each	93.4	93.4
130,000,000 7 per cent cumulative redeemable preference shares of £1.00 each	130.0	130.0
	<u>1,155.3</u>	<u>1,155.3</u>
Less: 130,000,000 7 per cent cumulative redeemable preference shares of £1.00 each designated as borrowings (see note 19)	(130.0)	(130.0)
	<u>1,025.3</u>	<u>1,025.3</u>
<b>Share premium account</b>	<u>647.8</u>	<u>647.8</u>

## Notes to the financial statements (continued)

At 31 March 2009

### 22. Called up share capital and share premium account (continued)

Zero per cent preference shareholders are not entitled to receive notice of, attend or vote at, any general meeting of the company. However, preference shareholders receive priority to other classes of shareholders on a winding up, liquidation or other return of capital to shareholders of the company.

In accordance with FRS 25 'Financial Instruments: Disclosures and Presentation', 130,000,000 7 per cent preference shares of £1.00 each have been recognised as financial liabilities. The 7 per cent preference shares have a redemption date of 1 October 2099. Refer to note 14b for details of rights pertaining to the 7 per cent preference shares.

The 2008 authorised ordinary share capital balance has been re-presented due to the identification of a mis-statement.

### 23. Share capital and reserves

	Called up share capital £m	Share premium account £m	Profit and loss account £m	Total £m
At 1 April 2008	1,025.3	647.8	951.8	2,624.9
Profit for the financial year	-	-	373.5	373.5
Actuarial losses on defined benefit pension schemes	-	-	(77.6)	(77.6)
Deferred tax credit arising on actuarial losses on defined benefit pension schemes	-	-	21.7	21.7
Dividends paid on equity shares	-	-	(845.5)	(845.5)
At 31 March 2009	<u>1,025.3</u>	<u>647.8</u>	<u>423.9</u>	<u>2,097.0</u>

### 24. Operating leases

The company is committed to make the following payments under non-cancellable leases during the next year:

	Land and buildings 2009 £m	Plant and machinery 2009 £m	Land and buildings 2008 £m	Plant and machinery 2008 £m
Non-cancellable operating leases which expire:				
Within one year	-	0.2	-	0.3
Between two and five years	-	0.2	-	0.6
After five years	1.4	-	1.0	-
	<u>1.4</u>	<u>0.4</u>	<u>1.0</u>	<u>0.9</u>

## Notes to the financial statements (continued)

At 31 March 2009

### 25. Reconciliation of operating profit to net cash inflow from operating activities

	2009	2008
	£m	£m
Operating profit	711.5	651.1
Depreciation	322.8	311.7
Amortisation of grants and contributions	(6.2)	(5.9)
Profit on disposal of tangible fixed assets	(1.8)	(5.5)
(Increase)/decrease in stocks	(0.3)	0.5
Increase in debtors	(20.5)	(36.5)
(Decrease)/increase in creditors	(29.2)	25.4
Movement in other provisions (including pension (liability)/asset)	22.2	22.9
	<u>998.5</u>	<u>963.7</u>

### 26. Reconciliation of net cashflow to movement in net debt

	2009	Represented 2008
	£m	£m
Increase in cash in the year	1.1	-
Decrease/(increase) in overdrafts in the year	77.2	(62.5)
Net cash (inflow)/outflow from (increase)/decrease in debt and lease financing	(1,058.8)	1,044.6
Net cash outflow/(inflow) from increase/(decrease) in liquid resources	80.0	(1,307.0)
Net cash outflow from derivatives <sup>(1)</sup>	24.0	-
	<u>(876.5)</u>	<u>(324.9)</u>
Changes in net debt resulting from cashflows		
Non-cash adjustments	(30.8)	(43.7)
	<u>(907.3)</u>	<u>(368.6)</u>
Movement in net debt in the year		
Net debt at 1 April	(3,812.7)	(3,444.1)
	<u>(4,720.0)</u>	<u>(3,812.7)</u>

Non-cash adjustments include fair value movements, capitalised interest and indexation.

The 2008 comparatives have been represented to include movements on derivatives as the directors consider this a fairer representation of the amounts.

(1) Cashflows on derivatives consist of £50.0 million financing outflow (see note 27) and £26.0 million interest inflow (2008: £nil).

## Notes to the financial statements (continued)

At 31 March 2009

### 27. Financing

	2009 £m	2008 £m
New loans	4,921.4	499.3
Loans repaid	(3,548.3)	(1,040.2)
Loans issued	(247.7)	(497.5)
Finance lease repayments	(66.6)	(6.2)
	<u>1,058.8</u>	<u>(1,044.6)</u>
Financing cashflows on derivatives	(50.0)	-
Net cash inflow/(outflow) from financing	<u><u>1,008.8</u></u>	<u><u>(1,044.6)</u></u>

### 28. Analysis of changes in net debt

	At 1 April 2008 £m	Cashflow £m	Non-cash movements £m	At 31 March 2009 £m
Cash	-	1.1	-	1.1
Overdrafts	(88.4)	77.2	-	(11.2)
Parent and fellow subsidiary undertaking loans	538.1	247.1	-	785.2
	<u>449.7</u>	<u>325.4</u>	<u>-</u>	<u>775.1</u>
Debt due after one year	(3,417.0)	(1,192.3)	(159.9)	(4,769.2)
Debt due within one year	(870.6)	(180.2)	(90.4)	(1,141.2)
Finance leases	(68.9)	66.6	2.3	-
	<u>(4,356.5)</u>	<u>(1,305.9)</u>	<u>(248.0)</u>	<u>(5,910.4)</u>
Current asset investments	-	80.0	-	80.0
Net debt excluding derivatives	<u>(3,906.8)</u>	<u>(900.5)</u>	<u>(248.0)</u>	<u>(5,055.3)</u>
Derivatives	94.1	24.0	217.2	335.3
Net debt including derivatives	<u><u>(3,812.7)</u></u>	<u><u>(876.5)</u></u>	<u><u>(30.8)</u></u>	<u><u>(4,720.0)</u></u>

## Notes to the financial statements (continued)

At 31 March 2009

### 29. Ultimate parent undertaking and controlling party

The company's immediate parent undertaking is United Utilities North West PLC, a company incorporated in England and Wales.

In the directors' opinion, the company's ultimate parent undertaking and controlling party is United Utilities Group PLC, a company incorporated in England and Wales.

The smallest group in which the results of the company are consolidated is that headed by United Utilities PLC. The consolidated accounts of this group are available to the public and may be obtained from: The Company Secretary, United Utilities PLC, Haweswater House, Lingley Mere Business Park, Lingley Green Avenue, Great Sankey, Warrington, WA5 3LP.

The largest group in which the results of the company are consolidated is that headed by United Utilities Group PLC. The consolidated accounts of this group are available to the public and may be obtained from: The Company Secretary, United Utilities Group PLC, Haweswater House, Lingley Mere Business Park, Lingley Green Avenue, Great Sankey, Warrington, WA5 3LP.