

# United Utilities Water PLC

## Report and Financial Statements

31 March 2010

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Registered No 2366678

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

### **Non-executive directors**

R Bird  
PW Jowitt  
DE Morton

### **Executive directors**

M Carmedy  
S Fraser  
PN Green  
GL Sims  
MR Wright

### **Secretary**

TS Keevil

### **Auditors**

Deloitte LLP  
2 Hardman Street  
Manchester  
M60 2AT

### **Registered office**

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## Chairman's statement

In this important year, which has seen the company make further progress against its strategic objectives and agree price limits for the next five years with the regulator, we have delivered a sound underlying financial performance. The company continues to benefit from a strong financing position and has headroom to cover its projected financing needs through to the autumn of 2011.

### STRATEGY

United Utilities Water PLC ('UÜW') has a consistent strategy of focusing on its core activities. During 2009/10 we continued to concentrate on the same three key areas that underpin our commitment to serving our customers:

- Improving operational performance,
- Delivering our regulatory contract, and
- The 2009 water price review

### IMPROVING OPERATIONAL PERFORMANCE

We have maintained our focus on operational performance and made good progress during the year. We have consistently highlighted a number of performance indicators against which our stakeholders can assess our progress. These include relative efficiency, security of water supply (leakage), serious pollution incidents, and overall customer satisfaction in response to enquiries.

In terms of relative efficiency, the company has a continuing focus on cost efficiency and is implementing a range of cost control measures, as we aim to lower the cost to serve our customers whilst maintaining and improving levels of service.

We are pleased to report that overall customer satisfaction is at its highest level for many years and that we met our regulatory leakage target for the fourth consecutive year. This was achieved despite exceptionally difficult winter weather conditions and highlights the commitment of our employees. 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 focused on delivering further improvements.

### DELIVERING OUR REGULATORY CONTRACT

We have completed the 2005-10 regulated water and wastewater contract in the North West of England. Over the five-year period we invested over £3 billion in our infrastructure, which allows us to maintain and improve the service we provide to our customers and to meet tough environmental standards. However, there is no time to sit back and we have already embarked on delivering the next five-year regulatory contract.

### THE 2009 WATER PRICE REVIEW

2009/10 was an important year for the water sector in England and Wales as the economic regulator, Ofwat, set price limits for the five years from 1 April 2010 to 31 March 2015. We considered the contents carefully before deciding that, on balance, it was in the company's and customers' best interests to accept the regulator's proposals.

There is no doubt this is a challenging price review. However, we are well prepared to meet the requirements of the review given the detailed plans that we have already started to implement.

## **Chairman's statement (continued)**

### **OUR EMPLOYEES**

Last November, we dealt with record levels of rain and the flooding in Cumbria that occurred as a result I witnessed the huge operational challenge it caused and I would again like to thank our people across the business for their superb response, often in very difficult conditions. This commitment from our staff was evident throughout the year, particularly in January, during the exceptional wintry conditions.

United Utilities has been set new efficiency targets as part of the regulator's price limit proposals and we have had to make some difficult decisions with regard to the internal structure of the company. As a result, approximately 350 people left the company during the 2009/10 year.

A committed workforce is central to delivering our objectives for the next five years and beyond and we continue to communicate regularly and openly with our workforce, affirming the core values of our business: passion, trust, team and commitment.

### **OUR ENVIRONMENT**

Embedded within the company's strategic objectives is the goal to operate in a more sustainable manner. With long life assets we believe it is essential to take a long-term view of our operations. We recently updated our strategic direction statement which considers the needs of our region out to 2035 and takes account of the recent final determination of prices by Ofwat. We have factored into our business plan ways in which we can adapt to climate change, whilst ensuring the continuity of water supplies for our customers.

In September 2009, we published our water resources management plan. This aims to identify the best strategy to balance supply reliability, whilst protecting the environment and having due regard for the affordability of bills. It focuses on how we adapt to meet the challenge of climate change, ensuring the abstraction of water in our region is sustainable given the increasing drought risk. We will continue to look at ways of reducing demand for water to help alleviate the impact of climate change.

### **OUR CUSTOMERS**

We are aware of the impact on our household customers of reduced economic activity and higher unemployment and have continued to fund our charitable trust. Our water and wastewater services currently cost households approximately £1 per day on average. Over the next five years, the average annual household bill will fall by £9 in real terms. We believe this represents excellent value for money, providing our customers with high quality drinking water to meet all their daily needs and for environmentally responsible wastewater collection and treatment.

### **OUTLOOK**

Based on Ofwat's final determination, prices to UUW's customers across the 2010-15 regulatory period will decrease in real terms by an annual average of 0.4 per cent with a 4.3 per cent real decrease in 2010/11. We are implementing a range of detailed efficiency and performance improvement initiatives. Our early capital investment planning should facilitate a smooth transition into the 2010-15 period and we expect capital expenditure to continue at high levels in 2010/11. Overall, we are well positioned for the next five years.

PN Green  
Chairman  
25 June 2010

## 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 of England. The company was incorporated in Great Britain on 1 April 1989 under the Companies Act 1985.

Uuw 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').

United Utilities Group PLC 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. The group also applies its utility skills to manage and operate other utility infrastructure.

#### Key facts

- 100 water treatment works
- Over 42,000 kilometres of water pipes
- 57,000 hectares of catchment land
- 575 wastewater treatment works
- Over 43,000 kilometres of sewers
- Serving a population of seven million people

Uuw 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 collected from catchment land and other sources 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. Uuw's water and wastewater service currently costs households approximately £1 per day on average. Over the next five years, the average annual household bill will fall by £9 in real terms. The company believes this represents excellent value for money, providing customers with high quality drinking water to meet all their daily needs and for environmentally responsible wastewater collection and treatment.

## Business review (continued)

### BUSINESS DESCRIPTION (continued)

Since privatisation in 1990

- Water quality in the North West 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 per cent to more than 90 per cent,
- Leakage from the network has halved, supported by ongoing investment in replacing ageing water pipes, and
- U UW has invested more than £4,000 for every household in the North West, some £750 above the national average

In the 2005-10 period, U UW invested 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 and the revised Drinking Water Directive).

U UW's water resources management plan published in September 2009 considers the water supply/demand balance in the North West of England, including the potential impacts of climate change out to 2035.

U UW's strategic direction statement, which was updated in April 2010, sets out the company's plans for the new price review period (2010-15) in a longer-term context. The key elements identified in the strategic direction statement are:

- Responsible stewardship of water and wastewater networks,
- Listening to customers and other stakeholders,
- 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

### REGULATORY DEVELOPMENTS

Environmental regulation is the responsibility of the Secretary of State for Environment, Food and Rural Affairs together with the Environment Agency, the Drinking Water Inspectorate and Natural England.

Economic regulation is the responsibility of an independent body, Ofwat, which sets price limits every five years for the water sector in England and Wales. Price cap regulation in the UK is performance based and companies are incentivised to be efficient in terms of their operating costs, capital programmes and financing. Regulated revenue is set by reference to inflation as measured by the retail prices index (RPI) plus an adjustment factor known as 'K'.

On 26 November 2009 Ofwat published its final determination of price limits for the period 1 April 2010 to 31 March 2015. U UW's profile of price limits for the five years is set out below:

Year	2010/11	2011/12	2012/13	2013/14	2014/15
K factor	-4.3%	-0.2%	+0.6%	+1.0%	+1.2%

## Business review (continued)

### REGULATORY DEVELOPMENTS (continued)

Ofwat's final determination of price limits for UUW was based upon

- a £3.6 billion capital investment programme (2007/08 prices),
- 12 per cent, or approximately £900 million, real growth in the regulatory capital value (RCV) over the five year period,
- an average annual underlying operating efficiency of 1.2 per cent for the water service and 2.4 per cent for the wastewater service, and
- a return on capital of 4.5 per cent (post-tax, real)

The RCV is the capital base on which water companies earn a return. It is increased by capital expenditure and inflation, and reduced by depreciation and clawback of past efficiencies.

UUW had indicated previously that there was potential for additional investment in respect of the North East Irish Sea, which was dependent upon a European court case decision involving the UK government. A ruling by the European Court of Justice on 10 December 2009 means that UUW will not be required to undertake this additional investment.

### Efficiency initiatives

UUW is well prepared for the 2010-15 price review period. Over the last year, UUW has undertaken a comprehensive review of the business, challenging working practices across the company, and is implementing detailed plans to improve performance and reduce its cost base.

### Operating efficiency

During 2009/10, UUW reduced the number of people working in the company by the equivalent of around 350 full time employees working in and supporting the regulated business, equivalent to around seven per cent of the workforce. This provides an immediate contribution to the achievement of efficiency targets set by Ofwat.

Customer service is a key area of focus and will contribute to the regulator's new service incentive mechanism assessment. UUW aims to reduce its cost to serve significantly, whilst continuing to improve the customer experience. The business has reduced its annual cost to serve from £23 per customer to £19 per customer over the last two years and is implementing plans to deliver further reductions, all while customer satisfaction has improved markedly. The company has amended staff incentive mechanisms to help get things right first time, with the aim of reducing unnecessary customer calls. Performance measurement is now based on first time resolution, rather than average call handling time. UUW's customer online self-serve system is being enhanced to make it more comprehensive and user friendly, with the aim of reducing by a third the need for customers to contact the company's call centre. UUW is focused on improving its debt collection rates and is planning to utilise more local authority collection agreements. The company is also enhancing systems to improve its customer segmentation analysis and to obtain better data on customers who have moved address, coupled with a more proactive debt follow-up strategy.

UUW is reviewing and streamlining its processes as it aims to become a leaner, more efficient company. The company is focused on operating with fewer, simpler and more consistent processes. For example, UUW is halving the number of steps from metering to cash collection. The company is rationalising its IT infrastructure, providing greater automation and visibility of workflow. Managers now have ownership of all steps in a process to help enhance performance. Individuals also have greater visibility and understanding of how their performance influences the efficiency of the entire process.



## Business review (continued)

### REGULATORY DEVELOPMENTS (continued)

#### Efficiency initiatives (continued)

##### Operating efficiency (continued)

The company will continue to focus on delivering benefits from its existing efficiency initiatives, including

- its workforce management system which is a key element in improving the efficiency of frontline staff,
- utilising remote operational site management and optimisation of chemical and power usage,
- improving efficiency of operational pumps,
- developing combined heat and power assets, which recycle energy generated from wastewater treatment processes, and
- improving supply chain management to deliver further procurement economies

A number of these schemes are also key elements of UUW's plan to mitigate its carbon emissions

#### Capital delivery

UUW has a robust commercial capital delivery framework in place for the 2010-15 period. Contractor partners have been appointed and the company has signed new supplier contracts, which will deliver significant savings and help improve efficiency. Incentive mechanisms are closely linked to the UUW business plan and pain/gain incentives are assessed on a project basis, rather than a cumulative basis, providing more clarity on performance. A partial fee retention mechanism is also in place to help drive on-time project delivery. In addition, UUW has flexibility in respect of the level of competitive tendering it may use in the award of future work during the five-year regulatory period.

UUW undertook detailed advanced planning which ensured smooth transition into the 2010-15 period and leveraged recent economic conditions to deliver procurement efficiency benefits. UUW expects capital investment, including infrastructure renewals expenditure, in 2010/11 to be substantial as the company aims for a smoother capital delivery profile across the five-year period compared with 2005-10. UUW has a strong focus on asset serviceability and also expects to bring forward the delivery of certain outputs under the regulatory contract.

#### Financial

UUW has approximately £2 billion of long dated, index-linked debt at an average cost of 1.8 per cent real. This compares with Ofwat's cost of debt assumption of 3.6 per cent real and secures financing outperformance for the next five years. In line with the group's policy, UUW has also fixed the interest rates on a significant proportion of the remainder of its existing debt portfolio, for the 2010-15 regulatory period, at an average nominal rate in the range 5.0 per cent to 5.5 per cent (inclusive of credit spread). This provides more clarity on UUW's ability to outperform the final determination. Taken together with the company's index-linked debt, this equates to approximately £300 million of financing outperformance over the five years, based on an RPI inflation rate of 2.5 per cent per annum. In addition, the company requires little refinancing during the 2010-15 period.

Changes to the United Utilities defined benefit pension schemes have significantly reduced the company's pension deficit, reduced the future service cost and reduced future funding and deficit risk, thereby placing the company's pension provision on a much more sustainable footing.

## **Business review (continued)**

### **THE ENVIRONMENT**

#### **Natural resource protection and environmental enhancement**

The company is committed to protecting and enhancing natural habitats and biodiversity as part of the way it manages operational sites and landholdings. The company is extending its flagship Sustainable Catchment Management Programme (SCaMP), building on recognised successes over the last five years. Integral to this is the ongoing partnership with the Royal Society for the Protection of Birds, reflecting the importance the company attaches to developing relationships with key organisations. The company continues to play an active role in the North West Biodiversity Forum and has signed up to the United Nations International Year of Biodiversity network in the UK.

#### **Sustainable consumption and production**

Last year, the company set a new waste target, demonstrating its commitment to help ensure a sustainable future for the North West by diverting more than 95 per cent of its waste from landfill by 2015. This target will help offset additional costs from increases in landfill tax. The company is planning a pilot project to produce a nutrient-rich compost by combining household green waste with wastewater treatment process waste that would normally go to landfill.

#### **Climate change and energy**

This year, the company updated its carbon strategy to take account of its 2010-15 five-year investment programme and to bring its targets and aspirations into line with revised carbon accounting rules. A major part of its carbon strategy is generating renewable energy from sludge and other sources. During 2009/10 the company generated 107 GWh. Current best available technology means the water quality investment programme will often be energy intensive, increasing the company's overall carbon footprint. The company has secured Ofwat's approval to invest £15 million in a mitigation programme to reverse that increase.

### **COMMUNITY**

#### **Community engagement**

Last year the company invested approximately £2.3 million in the communities in which it operates, including cash, time and in-kind contributions. It continued to support employees involved in community activity by linking volunteering activity to personal development and supporting them through community grants and matched funding. This investment includes a number of community partnerships such as United Futures, a partnership with Groundwork to deliver bespoke community projects that support core business objectives. The company has also continued its support of WaterAid by promoting the charity to its customers and organising staff-led fundraising events.

For many years, United Utilities has provided education services to schools ranging from the water cycle to climate change. In light of the outcome of the water price review, the company took the difficult decision to end classroom-based education services from April 2010. The business will continue to promote specific campaigns such as reservoir safety and education materials will be available on its website.

## **Business review (continued)**

### **COMMUNITY (continued)**

#### **Customer service**

The company is committed to improving its service to its customers and meeting their needs. The company recognises that in the current economic climate some customers may be experiencing financial difficulty and struggling to pay their water bills. The company is currently trialling a support tariff in specific areas to help those customers who are typically in debt with their water charges. Ofwat has approved a two year trial, which consists of new pricing bands based on an independent assessment of customers' ability to pay.

UW offers a wide range of payment options to help customers. One of the easiest ways to pay is by Direct Debit and last year nearly 40,000 Direct Debit mandates were set up. The company also offers a facility for customers to pay bills online, in the last year over 200,000 online payments were made.

#### **Developing talent**

The company regards its workforce as a key asset and invests in each employee by identifying future skills and knowledge requirements, matching need with opportunity. The company measures and targets the extent to which training contributes to business success and looks for opportunities to retrain and redeploy employees when skill and knowledge requirements change. In addition, the company has 90 apprentices following accredited training frameworks in the business.

### **EMPLOYEES**

United Utilities recognises that its business is only as strong as its employees and their collective commitment to achieving business goals. In light of this, the company aims to create a rewarding place to work, with a focus on health and safety, providing employees with a work-life balance and the chance to make a contribution to the communities in which they live and work.

#### **Health and safety**

In 2009/10 UW further consolidated the health and safety management framework across the business. During the year a director of health, safety, risk and security was appointed to drive further improvements and to lead the integration of these key risk areas in the business.

The reported accident incidence rate per 100,000 employees (injuries causing an absence of greater than one day) showed an improvement from 866 to 740. Whilst there was the same number of accidents in the business as in the previous year (34), this decrease in rate is due to an increase in average headcount arising from organisational changes during the year. Although the rate is below the industry sector rate published by the Health and Safety Executive, there are plans to almost halve this number during the next five years.

UW received a number of Royal Society for the Prevention of Accidents (ROSPA) awards for occupational health and safety. The annual ROSPA awards recognise the significant improvements made during the last 12 months in establishing effective safety management systems and improving accident performance. In addition, UW retained its accreditation to the OHSAS 18001 H&S Management Standard.

The health of our employees is vital. In addition to the required occupational health surveillance, UW offers a number of employee benefits related to health including an employee assistance programme, lifestyle health assessments and counselling services. The business appointed a new occupational health provider during the year to help improve these services and believes that its integrated health and wellbeing programme fully supports the current Health and Safety Executive strategy.

## Business review (continued)

### EMPLOYEES (continued)

#### Employee engagement

The company places a strong emphasis on increasing employees' engagement. This is measured annually and then acted upon to improve how employees feel about United Utilities and strengthen their understanding of its direction. Improving engagement is a key personal objective for all our leaders. We have seen a reduction in engagement since the last annual survey and there are targeted action plans being put in place to make improvements in key areas.

#### Workplace environment

Team and personal objectives are linked to the company's vision, strategy and objectives, allowing employees to recognise their contribution towards achieving business goals. Monthly performance updates, briefings and team talks enable employees to hear and discuss how the business is performing. A talent and skills development programme helps create a flexible and skilled workforce, which is critical to the company's ability to deliver improved services.

The company's policies on maternity, paternity, adoption and annual leave go beyond its legal obligations as an employer and play an important part in encouraging motivation and building loyalty to the company. The business principles make it clear that U UW seeks to act with integrity and fairness and observe legal requirements. Any employee with concerns that the company may not be adhering to these principles is encouraged to speak up via their manager or by calling a special telephone number in confidence. Key policies, which employees need to be aware of, are available on the intranet and promoted through new employee induction sessions. Managers benefit from an advice and guidance service which seeks to ensure they manage their employees in line with the correct procedures.

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

More than 95 per cent of employees are members of company pension schemes, which include defined benefit (now closed to new members) and defined contribution schemes. U UW also operates an open flexible benefits scheme, allowing employees to choose benefits which suit their personal needs through salary sacrifice.

United Utilities and its trade unions work together under an employee relations framework to ensure positive working relationships. Throughout 2009/10, that approach was used to positive effect in terms of consultation around the pay review and changes made to the defined benefit pension schemes.

In February 2009, United Utilities brought a number of outsourced activities back in-house. The full impact of this is reflected in the higher average headcount for 2009/10.

Number of employees (full-time equivalent including directors)

	Average 2009/10	Average 2008/09	31 March 2010	31 March 2009
U UW	4,257	3,925	4,211	4,212

## **Business review (continued)**

### **PRINCIPAL RISKS AND UNCERTAINTIES**

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

#### **Capital investment programmes**

##### **Risk**

The business 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 external debt. 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 (such as increased maintenance or enhancement costs) or amounts funded in regulatory 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 UUW's regulators of an amount of up to 10 per cent of appointed 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 outperformance.

#### **Service incentive mechanism and serviceability assessment**

##### **Risk**

For the 2010-15 period, Ofwat has introduced a new comparative incentive mechanism to reward or penalise water companies' service performance, replacing the overall performance assessment (OPA). The service incentive mechanism (SIM) compares companies' performance in terms of the number of 'unwanted' contacts received from customers and how well they deal with those contacts. Depending upon UUW's relative performance under the SIM it could receive a revenue penalty or reward when price limits are next reset in 2014.

The company is required to maintain the serviceability of its water and wastewater assets, ensuring they continue to deliver a level of service and performance at least as good as in the past. Where serviceability falls below required reference levels of performance Ofwat may impose a penalty in revenue at the next price-setting. Or, if performance were to decline, the company may incur additional operating or capital expenditure to restore performance.

##### **Mitigation**

In preparation for the change from OPA to SIM, systems and processes are being developed and enhanced, where necessary, to allow the company to report accurately on the volume of 'unwanted' contacts it receives. The company's focus is on ensuring right first time service delivery to its customers, thus avoiding the need for 'unwanted' contacts. Where 'unwanted' contacts do arise, then there is a clear focus on identifying the root causes. These actions are intended to ensure that the company's performance under the SIM is optimised and thereby mitigating the risk of a penalty at the next price-setting.

The various indicators of performance are closely and routinely monitored by management. The company's capital investment programme is targeted to seek to maintain stable serviceability of the company's water and wastewater assets. Similarly, operational practice is intended to ensure stable serviceability. Where adverse trends develop and there is a risk of serviceability deviating from stable, then corrective action can be taken.

## Business review (continued)

### PRINCIPAL RISKS AND UNCERTAINTIES (continued)

#### The adoption of private sewers

##### Risk

In 2008, the government announced its intention to transfer sewers and pumping stations currently owned by private individuals and businesses to sewerage undertakers. The precise date and nature of the transfer is yet to be determined but could occur as soon as 2011. No allowance has been made in price limits for the costs associated with the transfer. Therefore, any costs incurred will represent an unbudgeted increase in operating and capital expenditure.

##### Mitigation

Although there are costs associated with the transfer, as long as they are incurred efficiently they are expected to be largely recoverable when price limits are next reset, either at an interim determination or the next periodic review, but there can be no guarantee of full cost recovery at this stage.

#### Economic environment, inflation and capital marketing conditions

##### Risk

In recent years, the global banking crisis and economic downturn have impacted the bank lending environment, as well as the debt and equity capital markets. This has resulted in the cost of capital increasing and has made the arranging of finance and issuance of new equity and debt capital more expensive and difficult to secure.

A compounding challenge arises from the relationship between the regulatory capital value (RCV) of the regulated business and the retail prices 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 gearing (and other key financial ratios), credit ratings of the regulated business, and increase the cost or limit the availability of credit. 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 downturn continues to present difficult trading and financing conditions for customers, contractors and suppliers of materials and/or services to the company.

##### Mitigation

The company monitors closely 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. 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. The company's current schemes had a combined net deficit of £136.6 million as at 31 March 2010, compared with a net deficit of £118.1 million as at 31 March 2009.

## **Business review (continued)**

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

#### **Pension scheme obligations (continued)**

##### **Mitigation**

Increases to pension fund deficits may result in an increased liability for the company, the size of the liability depending upon the extent to which additional deficits are recoverable through the regulatory price determination process. In the 2009 water price review, Ofwat took account of broadly 50 per cent of the pension deficit payable over a ten year recovery period shown in UUW's final business plan when setting its overall price controls. In response to the size of its ongoing pension risks and pension costs the company has recently been consulting on a series of changes for employees in its defined benefit schemes. These changes, which came into force on 31 March 2010, will result in reduced costs and risks, including deficit, associated with defined benefit liabilities in future. In conjunction with the trustees, the company continues to monitor the investment strategy for the pension schemes, including the company's exposure to investment risks.

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

##### **Risk**

The company is subject to various laws and regulations in the UK. 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, for example, 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 appointed 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 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 water and wastewater industry**

##### **Risk**

The Cave review of competition and innovation in water markets was published in April 2009 and in September 2009 the government consulted on legislation to implement a number of the review's proposals. If its recommendations are implemented, this could eventually expand the competitive market by allowing retail competition to all non-household customers. Ofwat and the Environment Agency are considering the introduction of reforms to the regulation of water abstraction licences that would allow trading of licences. Ofwat is also examining the scope for 'upstream' competition in treated water supply.

## **Business review (continued)**

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

#### **Increased competition in water and wastewater industry (continued)**

##### **Risk (continued)**

Ofwat has 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, one of which is within U UW's region. Further inset appointments may be made in the future, resulting in increased competition.

##### **Mitigation**

The company has been fully engaged in the government and Ofwat consultations on the Cave review and other aspects of competition. A relatively small proportion of the company's profits derive from the retailing of water and wastewater services to non-household customers. However, U UW recognises that reforms to the pricing rules that govern access to the company's water network and greater upstream competition could put at risk a greater proportion of the company's profits. If competition is expanded, there would also be opportunities for the company to participate in a wider market in England and Wales.

#### **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, a significant interruption of service provision or catastrophic damage could occur resulting in significant loss of life, and/or environmental damage, and/or economic and social disruption. Such circumstances might arise, for example, from power or water shortages, the failure of an asset or an element of a network or supporting plant and equipment, human error, an individual's malicious intervention, or unavoidable resource shortfalls. 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 upon 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 the company's control.

##### **Mitigation**

The company operates long-standing, well tested and appropriately resourced incident response and escalation procedures. The processes continue to be refined, alongside related risk management and business continuity procedures. These recognise that possible events can have varying causes, 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 licence of the regulated business also contains a 'shipwreck' clause that, if applicable, may offer a degree of recourse to Ofwat in the event of a catastrophic incident.



## **Business review (continued)**

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

#### **Material litigation**

##### **Risk**

In March 2010, Manchester Ship Canal Company (MSCC), owners of the Manchester Ship Canal (the 'canal'), issued proceedings, seeking, amongst other relief, damages alleging trespass against U UW in respect of U UW's discharges of water and treated effluent into the canal. The respective legal rights of MSCC and U UW relating to the discharges are unclear. Accordingly, the relevant legal principles need to be tested through court process. U UW will be filing a defence and counterclaim in support of its believed entitlement to make discharges into the canal without charge and MSCC's claim will be vigorously defended thereafter.

##### **Mitigation**

The company faces the general risk of litigation in connection with its business. In most cases, liability for litigation is difficult to assess or quantify, recovery may be sought for very large and/or indeterminate amounts and the existence and magnitude of liability may remain unknown for substantial periods of time. The company robustly defends litigation where appropriate and seeks to minimise its exposure to such claims by early identification of risks and compliance with its legal and other obligations. Based upon the facts and matters currently known and the provisions carried in the company's balance sheet, the directors are of the opinion that the possibility of the dispute referred to in this risk section having a material adverse effect on the company's financial position is remote.

## Business review (continued)

### BUSINESS OBJECTIVES AND PERFORMANCE

#### Operational performance

Operational performance is a key area of focus and U UW is targeting an upper quartile position among UK water companies on key operational measures in the medium-term. The business continues to upgrade its infrastructure, replacing 134 kilometres of water mains during the year. U UW continues to supply high quality drinking water with a mean zonal compliance water quality performance for the year of 99.94 per cent, which compares with 99.92 per cent for the previous year. U UW is making good progress against its key performance indicators.

- **Relative efficiency** — U UW has narrowed the operational efficiency gaps to the most efficient water and wastewater companies since 2005. This is reflected in Ofwat's most recent (2008/09) assessment of U UW as band B for the water service and band C for the wastewater service and represents a one band improvement for both services over this period. U UW expects at least to sustain these bandings in Ofwat's 2009/10 assessment.
- **Security of water supply** — U UW met its economic level of leakage rolling target for the fourth consecutive year in 2009/10, despite extreme winter weather conditions, reflecting strong management focus and the commitment of the workforce.
- **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 four years. One water and seven wastewater Category 1 & 2 incidents were recorded in 2009, compared with the base position of two water and 21 wastewater incidents in 2005.
- **Sewer flooding** — U UW continues to remove properties from the sewer flooding register. In 2009/10, an independent review of U UW's sewer flooding recording and reporting process was undertaken, which was submitted to Ofwat for consideration. The independent reviewer concluded that the processes are generally fit for purpose with some scope for streamlining and further improvement. U UW agreed to implement changes required by Ofwat as a result of this review and has reassessed its sewer flooding registers. The number of properties on the register in 2009/10 is 1,028 (for properties at risk of experiencing at least one sewer flooding incident in ten years), which compares with a reassessed number for 2005/06 of 1,091 properties, a net reduction of 63 properties over the four-year period. The company has plans in place to reduce the number of incidents due to sewer flooding (other causes) and to offer mitigation measures for all properties on the register.
- **Overall customer satisfaction** — Significant progress has been achieved and overall customer satisfaction in response to enquiries is now at its highest recorded levels, with a satisfaction rating of 82 per cent for the 12 months to 31 March 2010. U UW achieved its target of 85 per cent for March 2010, the highest score attained for an individual month. These satisfaction levels are based on a comprehensive independent survey conducted on behalf of U UW each month. Customer satisfaction has improved from less than 50 per cent in 2005 to consistently over 80 per cent during the second half of 2009/10. The business remains focused on achieving further improvements.

Although U UW has delivered real progress, the business recognises that there is more to do. Sewer flooding incidents, together with environmental underperformance at Fleetwood wastewater treatment works, negatively impacted the 2008/09 overall performance assessment (OPA) score.

U UW has a capital investment programme designed to improve performance at Fleetwood works, which is scheduled to be completed later this year on time and on budget. The business has introduced an enhanced monitoring system across the company's wastewater treatment works to help improve performance in respect of meeting consent standards at its works. With regard to sewer flooding, the

## **Business review (continued)**

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

#### **Operational performance (continued)**

business has identified those areas of its sewer network which are high risk with the potential to have a major flooding impact and has commenced a programme of work to help mitigate these risks

Improving the company's response to customer contacts is another key area of focus, in particular billing enquiries. The business has introduced new working practices to help improve performance and early progress is encouraging. The process of monitoring regulatory targets has been enhanced and managers now have better information and the flexibility to reallocate resources to help meet these targets. The more technical work has also been brought back in-house, giving the business greater control to resolve issues and help meet its targets.

The business expects an improved OPA score for 2009/10, with an increase in points in the areas of wastewater treatment works compliance, company contact score and unplanned interruptions. The actions being taken will have a positive impact on UUW's performance as measured by Ofwat's new service incentive mechanism, which is replacing OPA and is due to be introduced in 2010/11.

## 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 2009/10 against these measures is set out in the table below, together with the prior year performance data

	2010	2009
<b>Financial</b>		
Turnover <sup>(1)</sup>	£1,549.2m	£1,508.2m
Operating profit	£788.0m	£711.5m
Profit before tax	£438.7m	£505.0m
RCV gearing <sup>(2)</sup>	64%	64%
Interest cover <sup>(3)</sup>	3.2	3.4
Capital expenditure (net cashflow)	£636.5m	£757.1m
<b>Environment</b>		
Pollution incidents <sup>(4)</sup>	8	11
Water quality – mean zonal compliance <sup>(5)</sup>	99.94%	99.92%
Renewable energy generated <sup>(6)</sup>	107GWh	100GWh
<b>Employees</b>		
Employee engagement – employee opinion survey <sup>(7)</sup>	68%	81%
Health and Safety – incident rate per 100,000 employees	740	866
<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>	461MI/day	462MI/day
Overall customer satisfaction – water (in response to enquiries)	82%	76%
Overall Performance Assessment (OPA) <sup>(10)</sup>	378 points	344 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 £29.7 million (2009: £14.8 million) interest on swaps and debt under fair value option

(4) Number of category 1 & 2 pollution incidents recorded during the year as defined by the Environment Agency. Figures stated are for the years ended 31 December 2009 and 2008

(5) The percentage mean zonal compliance with samples taken according to the current Drinking Water Quality Regulations during the calendar year. It is constituted from data for 40 parameters with National or European standards. Figures stated are for the years ended 31 December 2009 and 31 December 2008

(6) In 2009/10 107 GWh of renewable energy was generated, the equivalent of 57,987 tonnes of carbon dioxide

(7) 88% of employees in UUW took the opportunity to 'have their say' as part of the 2009/10 annual employee survey. The company achieved an engagement score of 68 per cent

(8) The operating expenditure relative efficiency band as assessed by Ofwat for the years ended 31 March 2009 and 31 March 2008. The 2009/10 assessment is due to be published by Ofwat later in the year

(9) Annual rolling average total leakage – figures given are in megalitres per day for the years ended 31 March 2010 and 31 March 2009. The Ofwat regulatory rolling average leakage target was 465 megalitres per day for each year

(10) The Overall Performance Assessment (OPA) has now been replaced by the Service Incentive Mechanism (SIM). Although company SIM scores will be published for 2010/11 they will only be taken into account for the 2014 Price Review from 2011/12 onwards. UUW has calculated and reported its best estimate OPA score for 2009/10 in the annual June Return submission. 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 quoted for 2008/09 is the final assessment score

## Business review (continued)

### BUSINESS OBJECTIVES AND PERFORMANCE (continued)

#### Financial highlights

Turnover has increased by 2.7 per cent to £1,549.2 million, principally as a result of an allowed price increase of 6.0 per cent (including inflation of 3.0 per cent), partially offset by reduced water demand reflecting the challenging economic climate. The regulated price increase supports significant investment in UUW's infrastructure which provides vital water and wastewater services to customers.

Operating profit for the year increased by 10.8 per cent, primarily reflecting the revenue increase coupled with the impact of tight cost control measures and the exceptional credit relating to pensions net of restructuring costs, offset by higher depreciation, bad debts and power costs. The increase in depreciation reflects the recent high levels of capital spend, in line with the planned profile of the investment programme.

Net interest payable of £349.3 million was £142.8 million higher than the prior year. This expense included £138.4 million of net fair value losses on debt and derivative instruments, compared with £15.1 million of net fair value losses in 2008/09. The impact of changes in credit spreads on debt accounted for at fair value through profit or loss can result in significant volatility and this is the principal reason for the large net fair value movement in the year. In addition, the volatility in financing expense reflects the fact that, 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 a substantial proportion 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 income statement. However, this volatility in fair values has no cashflow impact. A reduction in returns on the company's pension schemes' assets in 2009/10, compared with the prior year, has also contributed to the increase in finance expense in the year.

The current tax charge for 2009/10 was £61.1 million and the current tax effective rate was 13.9 per cent, compared with 26.0 per cent in the prior year. The current tax charge included a £15.1 million credit in relation to the amendment of prior years' tax returns. The remaining reduction in rate relates to an increase in accelerated tax allowances, the fair value movement in derivatives and pension movements following the amendment of pension obligations and for each of these items the timing differences are matched by an equal and opposite movement in deferred tax.

The deferred tax credit was £22.0 million compared to £nil in the prior year. The principal reasons are movements in the discount for deferred tax together with a credit in relation to the amendment of prior years' tax returns.

A significant level of capital investment has been made as the company completed the peak phase of the 2005-10 water and wastewater capital investment programme. The 2009/10 net capital investment spend of £636.5 million represents a 15.9 per cent decrease over 2008/09. This level of spend was in line with the planned capital investment profile for the final year of UUW's 2005-10 regulatory programme.

Net debt including derivatives increased by £230.7 million to £4,950.7 million at 31 March 2010. As expected, RCV gearing, measured as these borrowings divided by the regulatory capital value, increased to 64.4 per cent compared with 63.8 per cent at 31 March 2009.

In 2009/10 interim dividends amounting to £231.2 million were paid (2009 interim dividend of £75.5 million and 2008 final dividend of £770.0 million declared and paid during 2009). No final dividend has been recommended for 2009/10 (2009 £nil).

## Business review (continued)

### BUSINESS OBJECTIVES AND PERFORMANCE (continued)

#### Regulatory accounts measures

##### Atypical and exceptional 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'

The net atypical operating expenditure items are as below

	2010 £m	2009 £m
Pension schemes curtailment gains arising on amendment of pension obligations	(76.7)	-
Restructuring costs	15.8	10
Accrual for discharge consents to cover potential charges which may be imposed on the company	-	1.6
Credit adjustment to the wastewater business rates growth accrual covering the period from 1 April 2005	(7.8)	(6.1)
Restoration costs incurred to support the clean up of Cumbrian region after floods	1.4	-
Legal provision	2.0	-
	65.3	(3.5)
	65.3	(3.5)

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

The annual infrastructure renewals charge is based on actual infrastructure renewals spend for Asset Management Plan (AMP) 4, the Company Business Plan for AMP 5 and the Final Business Plan projections for AMP 6 covering the period 2005 to 2020. The charge for the year ended 31 March 2010 is £109.1 million (2009 £139.9 million)

The current cost depreciation charge (net of deferred credits) for the year of £339.8 million (2009 £311.0 million) compares with the Final Determination assumption of £350.4 million (2009 £346.3 million). This reduction of £10.6 million 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 2010 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 (2009 £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.

## **Business review (continued)**

### **CAPITAL STRUCTURE**

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

UUV's objective when managing capital is to maintain a capital structure that enables the company to retain a credit rating of A3 from Moody's Investors Services, which the company believes best mirrors regulatory assumptions in relation to capital structure. The strategy of targeting a credit rating of A3 has been consistently maintained since 2007.

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.

UUV's current long-term credit ratings are A3/BBB+ with stable outlooks from Moody's Investors Service and Standard and Poor's Ratings Services respectively. Shortly after the company accepted Ofwat's final determination on 21 January 2010, Moody's re-affirmed its credit rating of A3 with stable outlook. However, as expected, Standard & Poor's downgraded the company to BBB+ from A- with stable outlook, reflecting differing methodologies particularly with regard to the treatment of infrastructure renewals expenditure.

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

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, UUV is able to access further liquidity from its ultimate parent United Utilities Group PLC, which, as at 31 March 2010, maintained a healthy headroom position of £1,100 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 the spring of 2012.

UUV believes that it operates a prudent approach to managing banking counterparty risk. Counterparty risk, in relation to both cash deposits and derivatives, is controlled through the use of counterparty credit limits. The company's cash is held in the form of short-term (generally no longer than three months) money market deposits with either prime commercial banks or with triple A rated money market funds. As at 31 March 2010, no cash deposits were held in money market funds.

UUV 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.

UUV 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.

## **Business review (continued)**

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

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

Long-term borrowings are structured or hedged to match assets and earnings, 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 assets and earnings. At 31 March 2010, index-linked debt represented 26.8% of the company's regulatory capital value, with an average real interest rate of 1.8%. 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, which is in excess of 25 years.

Where nominal debt is raised in a currency other than sterling and/or with a fixed interest rate, to manage exposure to long-term interest rates, the debt is generally swapped to create a floating rate sterling liability for the term of the liability. To manage exposure to medium-term interest rates, the company fixes interest costs for a substantial proportion of the company's debt for the duration of each price control period at around the time of that price control determination. U UW does not undertake any speculative trading activity.

### **ACCOUNTING ISSUES**

The financial statements for the year ended 31 March 2010 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 2006.

### **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.



## **Business review (continued)**

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

#### **Carrying value of long-lived assets (continued)**

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.

#### **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 the sales value of an estimate of the units supplied between the date of the last meter reading and the billing date. 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.

## **Business review (continued)**

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

#### **Accounting for provisions and contingencies (continued)**

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.

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 recorded at fair value are valued using a discounted cashflow valuation model. This model calculates the zero coupon curves for the applicable 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 converted into sterling at the spot exchange rate observed at the balance sheet date.

## **Business review (continued)**

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

#### **Derivatives and borrowings (continued)**

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 represents 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.

#### **Taxation**

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 2010 is £329.2 million (2009 £363.5 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 2010 by approximately £13.0 million and the tax charge, for the year then ended, by the same amount.

Assessing the outcome of uncertain tax positions requires judgement to be made regarding the result of negotiations with, and enquiries from, HM Revenue and Customs' ('HMRC').

### **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 £0.8 million in the year ended 31 March 2010 (2009 £0.9 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 2010.

## Business review (continued)

### 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 27 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 2006.

## Directors' report

The directors present their report and the audited financial statements of the company for the year ended 31 March 2010

### Profit and dividends

The results for the year, set out in the profit and loss account on page 38, show that turnover for the year ended 31 March 2010 was £1,549.2 million, an increase of 2.7 per cent over the previous year. Profit for the year before tax was £438.7 million (2009: £505.0 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 2009 of £nil, being recognised in the current year financial statements, along with an interim ordinary dividend of £231.2 million (2009: interim dividend of £75.5 million and 2008 final dividend of £770.0 million declared and paid during 2009).

The directors have not recommended a final ordinary dividend for 2009/10 (2009: £nil). The company paid a £550.0 million special dividend in the prior 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 2010, 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 27 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 27 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 2006.

## 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, encourages 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 2010, the average credit period taken for trade purchases was 21 days (2009 27 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

PW Jowitt (appointed 3 August 2009)

DE Morton

#### *Executive directors*

M Carmedy<sup>(1)</sup> (appointed 15 July 2009)

CH Elphick (resigned 27 May 2009)

S Fraser (appointed 15 July 2009)

PN Green<sup>(2)</sup>

IJ McAulay (resigned 15 July 2009)

JM Perrie (resigned 15 July 2009)

GL Sims

TP Weller<sup>(3)</sup> (resigned 21 May 2010)

MR Wright

#### *Company secretary*

TS Keevil

(1) Director, United Utilities PLC (appointed 21 May 2010)

## Directors' report (continued)

### Directors (continued)

(2) Director, United Utilities PLC and United Utilities Group PLC

(3) Director, United Utilities PLC and United Utilities Group PLC (resigned 21 May 2010)

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' indemnities and insurance

The company has in place contractual entitlements for directors of the company to claim indemnification by the company in respect of certain liabilities which might be incurred by them in the course of their duties as directors. The company also maintains an appropriate level of directors' and officers' liability insurance

### Disclosure of information to the auditors

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

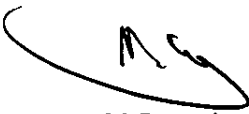
- 1 so far as he or she is aware, there is no relevant audit information of which the company's auditors are unaware, and
- 2 he or she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that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

This confirmation is given, and should be interpreted, in accordance with the provisions of s418 of the Companies Act 2006

### Auditors

A resolution to reappoint Deloitte LLP as auditors will be put to the members at the Annual General Meeting

By order of the board



M Carmedy

Director

25 June 2010

## Corporate governance report

### The Combined Code

In August 2008 United Utilities Water PLC ('Uuw', the 'company' as the context requires) 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 2008

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 Uuw 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 Uuw board also considered the Code provisions of Section B ('Remuneration'), Section C ('Accountability and Audit') and Section D ('Relations with Shareholders'). After due consideration, it was concluded that none of these sections were appropriate for Uuw.

The reasons for the non-application set out on page 35 below with Sections B, C and D have been notified to Ofwat.

This report gives details of how those principles of the code applicable to Uuw have been applied during the year.

### The board of directors

The directors who served during the year are set out on page 29. 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 (2009 ten). A number of additional meetings and telephone conferences were also held during the year. These additional meetings were associated with Ofwat's draft and final price review determinations and the company's annual June Return submission to Ofwat. The following table shows the attendance of each of the directors at scheduled meetings of the board during the year. The figures in brackets show the maximum number of meetings which the directors could have attended.

	Board	
R Bird	10	(10)
M Carmedy	7	(7)
CH Elphick	-	(2)
S Fraser	6	(7)
PN Green	10	(10)
PW Jowitt	5	(6)
IJ McAulay	-	(3)
DE Morton	10	(10)
JM Perrie	1	(3)
GL Sims	9	(10)
TP Weller	8	(10)
MR Wright	10	(10)

#### Notes:

- 1 CH Elphick resigned from the board on 27 May 2009
- 2 IJ McAulay and JM Perrie resigned from the board on 15 July 2009
- 3 M Carmedy and S Fraser were appointed to the board on 15 July 2009
- 4 PW Jowitt was appointed to the board on 3 August 2009



## Corporate governance report (continued)

### 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. 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.

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 whilst always bearing in mind the company's regulatory obligations. Consideration of the long-term interests of shareholders and bondholders, together with those of the wider interests of stakeholders represented by regulators, 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.

**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. All directors are members of the regulation committee.

**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.

### Chairman and managing director

Since 27 May 2009 when CH Elphick stepped down from the U UW board, the positions of chairman and managing director have been exercised by the same individual, PN Green. The board was comfortable with this approach given Mr Green's role in providing focussed leadership throughout the group. As the roles of chairman and managing director are exercised by the same individual for the reasons explained above, no division of responsibilities and terms of reference for each respective role have been agreed, although were the roles to be exercised by different individuals in future, a division of responsibilities and terms of reference would be accordingly drafted.

## Corporate governance report (continued)

### Board balance and independence

There are three non-executive positions on the board which complies with the company's Licence obligation and the non-executive directors are determined by the board to be independent in accordance with the code. The directors have a wide and diverse range of business and other experience and expertise. The board has determined that Mrs 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.

Professor PW Jowitt was appointed to the board as an independent non-executive director on 3 August 2009, to fill the vacancy created by Mr B Gray's decision to step down from the board in November 2008.

### Senior independent director

The board does not consider it appropriate to appoint a senior independent director, as the company is a wholly owned subsidiary of United Utilities Group 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. In October 2009, as part of the annual review process, a review of directors' conflicts was undertaken by the company secretary. The results were assessed by the chairman and the board which concluded that no director had a conflict which required authorisation. 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 Act 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 Mrs DE Morton.

## Corporate governance report (continued)

### 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.

### 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, Prof Paul Jowitt's induction was 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 Walker Report and the Financial Reporting Council consultation associated with proposed changes to the code.

### 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 various 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 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 2009/10 exercise, the board has identified a number of actions including an enhanced review of the risk management processes undertaken by each of the company's business units, at appropriate intervals.

### 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 2010/11, the company's proposed five-year business plan and investment programme, together with a review of the cash and committed borrowing facilities available to the company (discussed in further detail in the liquidity section on page 22 and the debt financing and interest rate management section on page 23). That review gives details of the company's headroom as at 31 March 2010.

## Corporate governance report (continued)

### Going concern (continued)

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' by the Financial Reporting Council

### Auditor independence

The company adheres to the United Utilities Group PLC policies on auditor independence which are described in the United Utilities Group PLC accounts (available from the address given in note 30) Non-audit services provided to the company must be pre-approved by the United Utilities Group PLC audit committee Non-audit services received during the year ended 31 March 2010 were primarily relating to regulatory work (see note 3)

### 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 United Utilities Group PLC's remuneration policy United Utilities Group 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

United Utilities Group PLC has an Audit Committee and the group has a well resourced internal audit function in place (to which the UUW board has access and which reports to the UUW board on a quarterly basis) Accordingly, the board concluded that having a separate Audit Committee for the company would be inappropriate because it could potentially make more confusing a key aspect of internal control

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

As the company is a wholly owned subsidiary of United Utilities Group PLC, this provision is not relevant to the company United Utilities Group 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 UUW's directors, including the non-executive directors, if they so wish, have access to the annual shareholder opinion survey which is produced for United Utilities Group 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). Under company law the directors must not approve the financial statements unless they are satisfied that they 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 accounting 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 adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. 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.

## Independent auditors' report

We have audited the financial statements of United Utilities Water PLC for the year ended 31 March 2010 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 30. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements.

### Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the company's affairs as at 31 March 2010 and of its profit for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

### Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit.



Jane Boardman (Senior Statutory Auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditors  
Manchester  
25 June 2010

## Profit and loss account

For the year ended 31 March 2010

	Note	2010 £m	2009 £m
<b>Turnover</b>	1, 2	1,549.2	1,508.2
Net operating expenses (including net exceptional credits of £60.9 million (2009 exceptional charges of £1.0 million))	3	(761.2)	(796.7)
<b>Operating profit</b>		<u>788.0</u>	<u>711.5</u>
Net interest payable and similar charges	7	(349.3)	(206.5)
<b>Profit on ordinary activities before taxation</b>		<u>438.7</u>	<u>505.0</u>
Tax charge on profit on ordinary activities	8	(39.1)	(131.5)
<b>Profit for the financial year</b>	23	<u><u>399.6</u></u>	<u><u>373.5</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 2010

	2010 £m	2009 £m
Profit for the financial year	399 6	373 5
Actuarial losses relating to defined benefit pension schemes (see note 21)	(69 4)	(77 6)
Deferred tax attributable to actuarial losses (see note 17)	19 4	21 7
<b>Total recognised gains and losses since last annual report and financial statements</b>	<u>349 6</u>	<u>317 6</u>

## Reconciliation of movements in shareholders' funds

For the year ended 31 March 2010

	2010 £m	2009 £m
Profit for the financial year	399 6	373 5
Dividends (see note 9)	(231 2)	(845 5)
Actuarial losses on defined benefit pension scheme net of deferred tax	(50 0)	(55 9)
<b>Net addition to/(reduction in) shareholders' funds</b>	<u>118 4</u>	<u>(527 9)</u>
Opening shareholders' funds	2,097 0	2,624 9
<b>Closing shareholders' funds</b>	<u>2,215 4</u>	<u>2,097 0</u>



## Balance sheet

At 31 March 2010

	Note	2010 £m	2009 £m
<b>Fixed assets</b>			
Tangible assets	10	7,854.9	7,589.4
Investments	11	0.2	0.2
		<u>7,855.1</u>	<u>7,589.6</u>
<b>Current assets</b>			
Stock raw materials and consumables		3.7	3.7
Debtors amounts falling due within one year	12a	317.3	1,279.8
Debtors amounts falling due after more than one year	12b	270.7	239.8
Current asset investments	13	-	80.0
Cash at bank and in hand		0.3	1.1
		<u>592.0</u>	<u>1,604.4</u>
<b>Creditors: amounts falling due within one year</b>			
Trade and other creditors	14a	(405.6)	(594.9)
Borrowings	14b	(297.3)	(1,152.4)
		<u>(702.9)</u>	<u>(1,747.3)</u>
<b>Net current liabilities</b>		<u>(110.9)</u>	<u>(142.9)</u>
<b>Total assets less current liabilities</b>		<u>7,744.2</u>	<u>7,446.7</u>
<b>Creditors, amounts falling due after more than one year</b>			
Trade and other creditors	15a	(174.9)	(88.8)
Borrowings	15b	(4,870.5)	(4,769.2)
		<u>(5,045.4)</u>	<u>(4,858.0)</u>
<b>Provisions for liabilities</b>	17	(346.8)	(373.6)
<b>Net assets excluding pension liability</b>		<u>2,352.0</u>	<u>2,215.1</u>
Pension liability	21	(136.6)	(118.1)
<b>Net assets including pension liability</b>		<u>2,215.4</u>	<u>2,097.0</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	542.3	423.9
<b>Equity shareholders' funds</b>		<u>2,215.4</u>	<u>2,097.0</u>

The financial statements of United Utilities Water PLC, registered number 2366678, were approved by the board of directors on 25 June 2010 and signed on its behalf by



M Carmedy  
Director

## Cashflow statement

At 31 March 2010

	2010 £m	2009 £m
<b>Net cash inflow from operating activities (see note 25)</b>	1,070 5	998 5
<b>Returns on investments and servicing of finance</b>		
Interest received	8 0	66 9
Interest paid	(193 9)	(190 0)
Interest element of finance lease payments	-	(7 3)
Non-equity dividends paid	(4 6)	(13 7)
<b>Net cashflow from returns on investments and servicing of finance</b>	<u>(190 5)</u>	<u>(144 1)</u>
<b>Taxation</b>	(103 0)	(102 3)
<b>Capital expenditure and financial investment</b>		
Purchase of tangible fixed assets	(657 0)	(772 7)
Grants and contributions received	16 5	13 5
Proceeds from sale of tangible fixed assets	4 0	2 1
<b>Net cash outflow for capital expenditure and financial investment</b>	<u>(636 5)</u>	<u>(757 1)</u>
<b>Equity dividend paid</b>	(231 2)	(845 5)
<b>Cash outflow before management of liquid resources and financing</b>	<u>(90 7)</u>	<u>(850 5)</u>
<b>Management of liquid resources</b>		
Decrease/(increase) in short-term deposits	80 0	(80 0)
<b>Financing (see note 27)</b>	16 0	1,008 8
<b>Increase in cash and overdraft in the year</b>	<u><u>5 3</u></u>	<u><u>78 3</u></u>

## Notes to the financial statements

At 31 March 2010

### 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 2006

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. Group accounts have not been prepared as the company has no material subsidiaries. The company is 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 and joint ventures 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 the sales value of an estimate of the units supplied between the date of the last meter reading and the billing date

#### **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 2010

### 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 10-60 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 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (the 'Accounting Regulations') 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 Accounting Regulations 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.

#### *Operating leases*

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

## Notes to the financial statements (continued)

At 31 March 2010

### 1. Accounting policies (continued)

#### 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 section 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 10 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.

In addition the United Utilities group also operates defined contribution pension schemes. Payments are charged to the profit and loss account 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.

## Notes to the financial statements (continued)

At 31 March 2010

### 1. Accounting policies (continued)

#### 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 current asset investments*

Cash and current asset investments 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.

#### *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.

## Notes to the financial statements (continued)

At 31 March 2010

### 1. Accounting policies (continued)

#### Financial instruments (continued)

##### *Financial 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 related 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. The otherwise inconsistent accounting treatment that would have resulted allows the company to satisfy the criteria for this designation.

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.

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

Interest rate swap agreements 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.

#### **Environmental remediation**

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.

## Notes to the financial statements (continued)

At 31 March 2010

### 1. Accounting policies (continued)

#### Taxation (continued)

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 £0.9 million in relation to the year ended 31 March 2010 (2009: £0.6 million).

### 2. Segmental information

The company operates in the United Kingdom in one class of business.



## Notes to the financial statements (continued)

At 31 March 2010

### 3. Net operating expenses

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

	2010 £m	2010 £m	2009 £m	Re-presented 2009 £m
<b>Employee costs (including directors)</b>				
Wages and salaries		136 1		130 1
Social security costs		10 7		10 3
Pension costs				
- pension costs excluding curtailment gains arising on amendment of pension obligations and restructuring costs	19 5		24 6	
- exceptional pension schemes curtailment gains arising on amendment of pension obligations (see below)	(76 7)		-	
		(57 2)		24 6
Exceptional restructuring costs (see below)		15 8		1 0
		105 4		166 0
Less charged to capital schemes		(67 4)		(68 4)
Charged to profit and loss account		38 0		97 6
<b>Depreciation</b>				
Owned non-infrastructure fixed assets		229 3		212 0
Non-infrastructure fixed assets held under finance leases (see note 10)		-		1 7
Non-infrastructure depreciation		229 3		213 7
Infrastructure depreciation (see note 10)		114 4		109 1
Total depreciation		343 7		322 8
<b>Other operating expenses</b>				
Hired and contracted services		120 6		128 0
Raw materials and consumables		41 0		40 6
Power		61 5		54 6
Property rates		52 1		54 8
Charge for bad and doubtful debts (see note 12c)		52 9		50 3
Other operating expenses		56 8		53 3
Auditors' remuneration - audit of the company's financial statements		0 2		0 2
Auditors' remuneration - other services (see below)		0 2		0 3
Amortisation of grants and contributions (see note 16)		(6 4)		(6 2)
Research and development		0 8		0 9
Operating leases				
- plant and machinery		0 7		0 5
- land and buildings		4 1		1 7
Other income (see note 4)		(5 0)		(2 7)
		379 5		376 3
<b>Total net operating expenses</b>		761 2		796 7

## Notes to the financial statements (continued)

At 31 March 2010

### 3. Net operating expenses (continued)

Fees payable to Deloitte LLP for non-audit services during the year were £0.2 million, primarily relating to regulatory work (2009: £0.3 million). The Deloitte LLP fee for 2009/10 audit services amounted to £0.2 million (2009: £0.2 million).

Exceptional credits of £60.9 million comprise pension schemes curtailment gains arising on amendment of pension obligations of £76.7 million (2009: £nil) offset by restructuring costs of £15.8 million (2009: £1.0 million) relating to staff severance. Employee costs including business restructuring exceptional items, net of charges to capital schemes, amount to £46.2 million (2009: £97.6 million).

The operating expenses for the year ended 31 March 2009 have been re-presented to better reflect the nature of restructuring costs.

### 4. Other income

	2010 £m	2009 £m
Profit on disposal of tangible fixed assets	4.0	1.8
Rents receivable	1.0	0.9
	<u>5.0</u>	<u>2.7</u>

### 5. Directors' emoluments

	2010 £m	2009 £m
Aggregate emoluments in respect of qualifying services	2.2	2.1
Aggregate amounts receivable under long-term incentive plans	-	-
	<u>2.2</u>	<u>2.1</u>
	2010 Number	2009 Number
Number of directors who received shares in respect of qualifying services	6	6
Number of directors who exercised share options	-	-
Number of directors accruing benefits under defined benefit schemes	2	2
	2010 £m	2009 £m
<b>In respect of the highest paid director</b>		
Aggregate emoluments	<u>0.6</u>	<u>0.6</u>

TP Weller and PN Green are remunerated by United Utilities PLC and then recharged to United Utilities Water PLC.

There were no directors who had incentive plans which vested during the year ended 31 March 2010 (2009: £nil).

## Notes to the financial statements (continued)

At 31 March 2010

### 5. Directors' emoluments (continued)

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

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 ages between 60 and 65 of between 1/45<sup>th</sup> and 1/90<sup>th</sup> 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.

### 6. Employees

	2010	2009
	Number	Number
Average number of persons employed during the year		
Regulated activities	4,257	3,925
	<u>          </u>	<u>          </u>

## Notes to the financial statements (continued)

At 31 March 2010

### 7. Interest payable and similar charges

	2010 £m	2009 £m
<b>Interest payable and similar charges</b>		
On bank loans, overdrafts and other loans	184.9	185.2
On finance leases	-	2.7
On borrowings from parent and fellow subsidiary undertakings	10.0	35.4
<b>Interest payable before preference share dividends and fair value adjustments</b>	<u>194.9</u>	<u>223.3</u>
Preference share dividends (see notes 9 and 14b)	9.1	9.1
<b>Total interest payable</b>	<u>204.0</u>	<u>232.4</u>
<b>Fair value (gains)/losses on debt and derivative instruments <sup>(1)</sup></b>		
Fair value hedge relationships		
- Borrowings	(53.3)	326.5
- Designated swaps	59.9	(225.3)
	<u>6.6</u>	<u>101.2</u>
Held for trading derivatives – economic hedge	-	(95.9)
	<u>6.6</u>	<u>5.3</u>
Financial instruments at fair value through the profit and loss		
- Borrowings designated at fair value through the profit and loss <sup>(2)</sup>	8.0	56.5
- Held for trading derivatives – economic hedge	86.0	(160.6)
	<u>94.0</u>	<u>(104.1)</u>
Held for trading derivatives – 2005-2010 regulatory hedge	(42.6)	63.0
Held for trading derivatives – 2010-2015 regulatory hedge	49.7	31.2
Net payments on swaps and debt under fair value option	29.7	17.0
Held for trading derivatives – other <sup>(3)</sup>	1.0	26.8
Other	-	(24.1)
<b>Net fair value losses <sup>(4)</sup></b>	<u>138.4</u>	<u>15.1</u>
<b>Net pension interest expense (see note 21)</b>	<u>15.6</u>	<u>-</u>
<b>Total interest payable and other similar charges</b>	<u>358.0</u>	<u>247.5</u>
<b>Investment income</b>		
Interest receivable and similar income		
- Parent and fellow subsidiary undertakings	(7.8)	(34.9)
- External	(0.9)	(3.0)
Net pension interest income	-	(3.1)
<b>Total investment income</b>	<u>(8.7)</u>	<u>(41.0)</u>
<b>Net interest payable and similar charges</b>	<u>349.3</u>	<u>206.5</u>

1 Fair value losses include foreign exchange gains of £19.0 million (2009 £211.6 million losses), excluding those on instruments measured at fair value through profit or loss. These gains/losses are largely offset by fair value losses/gains on derivatives.

2 Includes losses of £48.2 million (2009 £76.6 million gains) 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 £29.7 million (2009 £14.8 million) interest on swaps and debt under fair value option.

## Notes to the financial statements (continued)

At 31 March 2010

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

(a) Analysis of charge in the year

	2010	2009
	£m	£m
Current tax		
UK corporation tax at 28% (2009 28%)	80 0	139 1
Prior year adjustment	(15 1)	(7 3)
Tax on exceptional items	(3 8)	(0 3)
<b>Total current tax charge</b>	<b>61 1</b>	<b>131 5</b>
Deferred tax		
Origination and reversal of timing differences	28 2	1 0
Increase in discount	(51 9)	(3 8)
Adjustment in respect of prior periods	(19 2)	2 8
Tax on exceptional items	20 9	-
<b>Total deferred tax credit</b>	<b>(22 0)</b>	<b>-</b>
<b>Total tax charge on profit on ordinary activities</b>	<b>39 1</b>	<b>131 5</b>

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

	2010	2009
	£m	£m
Profit on ordinary activities before taxation	438 7	505 0
UK corporation tax rate at 28% (2009 28%)	122 8	141 4
Capital allowances in excess of depreciation	(39 4)	(29 3)
Adjustment in respect of prior periods	(15 1)	(7 3)
Other timing differences	(9 8)	28 2
Net non-deductible expenses/(non-taxable income)	2 6	(1 5)
<b>Actual current tax</b>	<b>61 1</b>	<b>131 5</b>

### 9. Dividends

Amounts recognised as distributions to equity holders in the year comprise

	2010	2009
	£m	£m
Final dividend for the year ended 31 March 2009 at nil pence per share (2008 82 6 pence per share)	-	770 0
Interim dividend for the year ended 31 March 2010 at 24 8 pence per share (2009 8 1 pence per share)	231 2	75 5
	<b>231 2</b>	<b>845 5</b>

## Notes to the financial statements (continued)

At 31 March 2010

### 9. Dividends (continued)

The directors have not recommended a final ordinary dividend for 2009/10 (2009 £nil) The company's dividend policy is stated in note 20

The company's redeemable preference shares are included in the balance sheet as a liability and, accordingly, the dividends payable on them are included in net interest payable (see notes 7 and 14(b))

### 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 2009	206 1	4,873 7	4,412 4	572 1	929 3	10,993 6
Additions	9 5	185 2	81 1	36 4	309 9	622 1
Grants and contributions	-	(12 9)	-	-	-	(12 9)
Transfers	10 3	58 5	317 8	0 2	(386 8)	-
Disposals	(0 2)	-	(15 3)	(3 4)	-	(18 9)
<b>At 31 March 2010</b>	<b>225 7</b>	<b>5,104 5</b>	<b>4,796 0</b>	<b>605 3</b>	<b>852 4</b>	<b>11,583 9</b>
<b>Depreciation</b>						
At 1 April 2009	65 6	1,699 4	1,353 7	285 5	-	3,404 2
Charge for the year	7 2	114 4	163 2	58 9	-	343 7
Transfers	-	-	11 2	(11 2)	-	-
Disposals	(0 2)	-	(15 3)	(3 4)	-	(18 9)
<b>At 31 March 2010</b>	<b>72 6</b>	<b>1,813 8</b>	<b>1,512 8</b>	<b>329 8</b>	<b>-</b>	<b>3,729 0</b>
<b>Net book value</b>						
<b>At 31 March 2010</b>	<b>153 1</b>	<b>3,290 7</b>	<b>3,283 2</b>	<b>275 5</b>	<b>852 4</b>	<b>7,854 9</b>
At 31 March 2009	140 5	3,174 3	3,058 7	286 6	929 3	7,589 4

## Notes to the financial statements (continued)

At 31 March 2010

### 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 cost of tangible fixed assets is £177.4 million (2009: £164.5 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 2009	(12.9)
Expenditure on asset replacements to maintain the network in the year	113.8
Depreciation for the year	(114.4)
Excess depreciation over expenditure at 31 March 2010	<u>(13.5)</u>

#### Operational structures held under finance leases

The company held no tangible fixed assets under finance leases at 31 March 2010 or 31 March 2009. The depreciation charge for the year for assets held under finance leases is £nil (2009: £1.7 million).

Capital commitments	2010	2009
	£m	£m
Contracted but not provided for	<u>382.6</u>	<u>312.5</u>

## Notes to the financial statements (continued)

At 31 March 2010

### 11. Fixed asset investments

	Other investments £m
Cost and net book value at 1 April 2009 and 31 March 2010	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 (non-voting) 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 which is limited by guarantee. The company is one of four equal guarantors of Rivington Heritage Trust. Its liability is limited to its guarantee of £1.

### 12. Debtors

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

	2010 £m	2009 £m
Trade debtors	110.2	97.8
Amounts owed by parent and fellow subsidiary undertakings – trading balances	6.7	11.2
Amounts owed by parent and fellow subsidiary undertakings – fixed rate loans	-	745.2
Amounts owed by parent and fellow subsidiary undertakings – floating rate loans	40.0	40.0
Other debtors	13.4	22.0
Prepayments and accrued income	128.7	139.1
Derivative financial instruments (see note 20)	18.3	224.5
	<u>317.3</u>	<u>1,279.8</u>

The fixed rate loans owed by fellow subsidiary undertakings of £nil (2009: £745.2 million) principally relate to the intercompany funding structure set up during the prior year.

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

	2010 £m	2009 £m
Derivative financial instruments (see note 20)	<u>270.7</u>	<u>239.8</u>



## Notes to the financial statements (continued)

At 31 March 2010

### 12. Debtors (continued)

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

	2010 £m	2009 £m
Allowance at start of year	(179 0)	(159 0)
Amounts charged to operating expenses (see note 3)	(52 9)	(50 3)
Trade debtors written-off	40 4	30 3
Allowance at end of year	<u>(191 5)</u>	<u>(179 0)</u>

#### (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
<i>At 31 March 2010</i>				
Gross trade debtors	115 8	58 9	127 0	301 7
Amounts owed by parent and fellow subsidiary undertakings	46 7	-	-	46 7
Other debtors	13 4	-	-	13 4
Prepayments and accrued income	128 7	-	-	128 7
	<u>304 6</u>	<u>58 9</u>	<u>127 0</u>	<u>490 5</u>
<i>At 31 March 2009</i>				
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>

The above analysis in respect of gross trade debtors reconciles to net trade debtors by deduction of the allowance for doubtful debtors of £191.5 million (2009 £179.0 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 2010

### 12. Debtors (continued)

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

	2010	2009
	£m	£m
Debtors in respect of unmetered water supplies	93 0	89 6
Debtors in respect of metered water supplies	115 0	107 8
Sundry debtors	44 3	61 5
	<u>252 3</u>	<u>258 9</u>

The directors consider that the carrying amount of trade and other debtors approximates to their fair value, at both 31 March 2010 and 31 March 2009

### 13. Current asset investments

	2010	2009
	£m	£m
Short-term deposits	-	80 0
	<u>-</u>	<u>80 0</u>

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

#### (a) Trade and other creditors

	2010	Re-presented 2009
	£m	£m
Trade creditors	27.7	45 8
Amounts owed to parent and fellow subsidiary undertakings	24 8	11 9
Amounts owed to related parties (see note 29)	-	0 1
Taxation and social security	60 1	101 9
Deferred grants and contributions (see note 16)	6 2	6 0
Accruals and deferred income	261 6	301 5
Derivative financial instruments (see note 20)	25.2	127 7
	<u>405 6</u>	<u>594 9</u>

The amounts owed to parent and fellow subsidiary undertakings and related parties for the year ended 31 March 2009 have been re-presented to better reflect the nature of amounts owed to those parties

#### (b) Borrowings

	2010	2009
	£m	£m
Bank overdraft	5 1	11 2
Bonds, bank and other term borrowings	50 2	230 9
130,000,000 7 0 per cent £1 00 redeemable preference shares	130 0	130 0
Amounts owed to parent and fellow subsidiary undertakings	112 0	780 3
	<u>297 3</u>	<u>1,152 4</u>

## Notes to the financial statements (continued)

At 31 March 2010

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

#### (b) Borrowings (continued)

The £130.0 million 7.0 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.

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

#### (a) Trade and other creditors

	2010 £m	2009 £m
Other creditors	7.2	3.8
Deferred grants and contributions (see note 16)	80.7	83.7
Derivative financial instruments (see note 20)	87.0	1.3
	174.9	88.8

#### (b) Borrowings

	2010 £m	2009 £m
Bonds, bank and other term borrowings	4,398.2	4,244.7
Amounts owed to parent and fellow subsidiary undertakings	472.3	524.5
	4,870.5	4,769.2

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

### 16. Deferred grants and contributions

	2010 £m	2009 £m
At start of year	89.7	92.2
Received in the year	3.6	3.7
Credited to the profit and loss account (see note 3)	(6.4)	(6.2)
At end of year	86.9	89.7
Represented by		
Amounts falling due within one year (see note 14a)	6.2	6.0
Amounts falling due after one year (see note 15a)	80.7	83.7
At end of year	86.9	89.7

## Notes to the financial statements (continued)

At 31 March 2010

### 17. Provisions for liabilities

	Deferred tax pension (note 21) £m	Deferred tax other (note 18) £m	Other £m	Total £m
At 1 April 2009	-	363.5	10.1	373.6
At 1 April 2009 – disclosed separately in pensions (see note 21)	(46.0)	-	-	(46.0)
Net profit and loss charge/(credit)	12.3	(34.3)	18.1	(3.9)
	<u>(33.7)</u>	<u>329.2</u>	<u>28.2</u>	<u>323.7</u>
Tax on actuarial losses on defined benefit pension schemes	(19.4)	-	-	(19.4)
Utilised in the year	-	-	(10.6)	(10.6)
At 31 March 2010 – disclosed separately in pensions (see note 21)	53.1	-	-	53.1
At 31 March 2010	<u>-</u>	<u>329.2</u>	<u>17.6</u>	<u>346.8</u>

Other provisions include legal claims of £6.4 million (2009 £9.2 million). The timing of the settlement of these legal claims is uncertain but expected to occur within twelve months of the balance sheet date. Other provisions also include obligations for restructuring costs which are expected to be incurred within the next twelve months.

### 18. Deferred tax

Deferred tax is provided as follows

	2010 £m	2009 £m
Accelerated capital allowances	1,111.4	1,107.5
Short-term timing differences	(29.3)	(43.0)
<b>Undiscounted provision for deferred tax</b>	<u>1,082.1</u>	<u>1,064.5</u>
Discount	(752.9)	(701.0)
<b>Discounted provision for deferred tax (see note 17)</b>	<u>329.2</u>	<u>363.5</u>

## Notes to the financial statements (continued)

At 31 March 2010

### 19. Borrowings

The following analysis provides information about the contractual terms of the company's borrowings

	2010 £m	2009 £m
<i>Non-current liabilities</i>		
Bank and other term borrowings	932 2	981 6
Bonds	3,466 0	3,263 1
Amounts owed to parent and fellow subsidiary undertakings	472 3	524 5
	4,870 5	4,769 2
<i>Current liabilities</i>		
Bank overdrafts	5 1	11 2
Bank and other term borrowings	50 2	40 2
130,000,000 7 per cent £1 00 redeemable preference shares	130 0	130 0
Bonds	-	153 2
Euro-commercial paper	-	37 5
Amounts owed to parent and fellow subsidiary undertakings	112 0	780 3
	297 3	1,152 4
	5,167 8	5,921 6

## Notes to the financial statements (continued)

At 31 March 2010

### 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	2010 Carrying value £m	Fair value £m	2009 Carrying value £m
<b>Borrowings in fair value hedge relationships</b>						
5 75% 375m (2009 275m) bond	GBP	2022	383.2	367.9	274.7	270.3
5 625% 300m bond	GBP	2027	308.5	326.7	286.1	338.3
5 00% 200m bond	GBP	2035	184.6	208.2	165.1	220.3
5 25% 150m bond	GBP	2010	-	-	154.1	153.2
5 375% 150m bond	GBP	2018	161.6	163.0	158.8	164.4
4 25% 500m bond	EUR	2020	444.8	467.2	425.0	479.7
5 02% JPY 10,000m dual currency loan	JPY/USD	2029	70.1	84.0	76.7	94.5
<b>Borrowings designated at fair value through profit or loss</b>						
6 875% 400m bond (owed to intermediate parent undertaking)	USD	2028	266.8	266.8	259.7	259.7
1 135% 3,000m bond	JPY	2013	20.8	20.8	20.0	20.0
<b>Borrowings measured at amortised cost</b>						
6 125% 425m (2009 375m) bond	GBP	2015	473.2	432.0	405.9	379.1
Amounts owed to parent and fellow subsidiary undertakings	GBP	Various	317.5	317.5	1,045.1	1,045.1
Long term bank borrowings - floating	GBP	2010-12	249.9	250.0	250.3	250.0
1 97% + RPI 200m IL loan	GBP	2016	203.6	217.5	183.7	220.2
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	100.4	112.6	83.2	114.2
1 7829% + RPI 100m IL bond	GBP	2040	92.3	111.4	74.4	113.0
1 5802% + RPI 100m IL bond	GBP	2042	85.9	111.0	68.3	112.6
1 847% + RPI 100m IL bond	GBP	2056	77.8	110.8	67.5	106.8
1 815% + RPI 100m IL bond	GBP	2056	76.8	110.3	66.5	106.4
1 662% + RPI 100m IL bond	GBP	2056	72.7	110.1	62.7	106.2
1 585% + RPI 100m IL bond	GBP	2057	70.5	105.9	60.5	102.2
2 40% + RPI 70m IL bond	GBP	2039	67.1	71.4	-	-
3 375% + RPI 50m IL bond	GBP	2032	74.0	59.7	60.0	60.6
1 3258% + RPI 50m IL bond	GBP	2041	40.4	55.6	32.1	56.4
1 397% + RPI 50m IL bond	GBP	2046	40.1	55.5	30.4	56.3
1 5366% + RPI 50m IL bond	GBP	2043	42.5	55.4	33.8	56.2
1 7937% + RPI 50m IL bond	GBP	2049	43.9	55.3	37.1	56.1
1 5865% + RPI 50m IL bond	GBP	2056	35.3	55.0	30.3	53.1
1 556% + RPI 50m IL bond	GBP	2056	35.1	54.7	30.2	52.8
1 435% + RPI 50m IL bond	GBP	2056	33.5	54.5	28.6	52.6
1 702% + RPI 50m IL bond	GBP	2057	36.9	53.4	31.7	51.5
1 61% + RPI 50m IL loan	GBP	2020	49.8	50.2	42.3	48.5
1 73% + RPI 50m IL loan	GBP	2020	50.4	50.2	42.9	48.4
1 84% + RPI 50m IL loan	GBP	2020	50.9	50.1	43.7	48.4
1 90% + RPI 50m IL loan	GBP	2020	51.2	50.1	43.7	48.3
1 93% + RPI 50m IL loan	GBP	2020	51.3	50.0	43.8	48.2
1 88% + RPI 50m IL loan	GBP	2020	51.0	49.9	43.5	48.2
2 10% + RPI 50m IL loan	GBP	2020	52.1	49.9	44.6	48.1
2 46% + RPI 50m IL loan	GBP	2020	53.9	49.9	46.4	48.2
1 3805% + RPI 35m IL bond	GBP	2056	22.9	38.2	19.6	36.8
1 66% + RPI 35m IL bond	GBP	2037	28.8	36.7	24.3	35.4

## Notes to the financial statements (continued)

At 31 March 2010

### 19. Borrowings (continued)

	Currency	Year of maturity	Fair value £m	2010 Carrying value £m	Fair value £m	2009 Carrying value £m
Commission for New Towns loan	GBP	2053	50.9	30.6	45.1	30.8
1.591% + RPI 25m IL bond	GBP	2056	17.6	27.4	15.1	26.5
Euro-commercial paper	GBP	2009	-	-	37.5	37.5
Committed facilities (drawn)	GBP	2009	-	-	40.0	40.0
1.30% + LIBOR 5,000m (floating) bond	JPY	2017	38.8	35.3	38.8	35.3
<b>Other borrowings</b>						
Bank overdrafts	GBP	2010	5.1	5.1	11.2	11.2
			4,814.5	5,167.8	5,215.0	5,921.6

The amount of unamortised bond discount contained within the company's borrowings amounts to £21.4 million (2009 £21.5 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 2010

### 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, market risk and capital risk. Market risk includes interest rate, foreign exchange 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 risk management policy. 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 materially 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:

	2010	2009
	£m	£m
Cash and short-term deposits	0.3	81.1
Trade and other debtors	299.0	1,055.3
Derivative financial instruments	289.0	464.3
	588.3	1,600.7
	588.3	1,600.7



## Notes to the financial statements (continued)

At 31 March 2010

### 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.

At 31 March, the company had available committed borrowing facilities as follows

	2010 £m	2009 £m
Expiring within one year	25 0	50 0
Expiring after one year but in less than two years	125 0	175 0
Expiring after more than two years	250 0	275 0
<b>Total borrowing facilities</b>	400 0	500 0
Facilities drawn	-	(40 0)
<b>Undrawn borrowing facilities</b>	400 0	460 0

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 2010

### 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 2010								
Bonds	9,048.8	-	128.9	129.7	130.6	153.9	132.4	8,373.3
Bank borrowings and other	1,449.3	-	77.2	72.9	170.9	20.2	20.5	1,087.6
Preference shares	130.0	-	130.0	-	-	-	-	-
Parent and fellow subsidiary borrowings	1,112.9	-	132.7	22.0	24.4	26.0	26.9	880.9
Adjustment to carrying value	(6,573.2)	(6,573.2)	-	-	-	-	-	-
Financial liabilities excluding derivatives	5,167.8	(6,573.2)	468.8	224.6	325.9	200.1	179.8	10,341.8
Derivatives								
Payable	902.1	-	86.3	64.7	56.3	70.3	46.6	577.9
Receivable	(1,160.1)	-	(99.6)	(79.5)	(73.3)	(90.6)	(76.0)	(741.1)
Adjustment to carrying value	81.2	81.2	-	-	-	-	-	-
Derivatives – net assets	(176.8)	81.2	(13.3)	(14.8)	(17.0)	(20.3)	(29.4)	(163.2)
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 – net assets	(335.3)	137.3	(157.6)	(9.1)	(12.6)	(35.8)	(46.4)	(211.1)

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 2010

### 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 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 its underlying assets and cashflows. The regulated business earns an economic return on its Regulatory Capital Value (RCV) asset, comprising a real return through revenues, determined by the real cost of capital fixed by the regulator for each five-year regulatory pricing period, and an inflation return as an uplift to its RCV.

The preferred form of debt, therefore, is sterling index-linked debt which occurs fixed interest, in real terms, and forms a natural hedge of regulatory assets and cashflows.

Where conventional long-term debt is raised in a fixed-rate form to manage exposure to long term interest rates, the debt is generally swapped at inception to create a floating rate liability for the term of the liability through the use of interest rate swaps.

To manage exposure to medium-term interest rates, the company fixes interest costs for a substantial proportion of the company's debt for the duration of each five-year regulatory pricing period at around the time of that price control determination.

#### 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 2010 and 31 March 2009, respectively. As a result, this analysis relates to the positions at the balance sheet dates 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 2010

### 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,
- 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

	2010	2009
	£m	£m
100bp increase in interest rate	75.8	63.3
100bp decrease in interest rate	(82.0)	(67.0)

Brackets denote a reduction in profit

#### 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.

## Notes to the financial statements (continued)

At 31 March 2010

### 20. Financial instruments (continued)

At 31 March 2010	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	1,617 0	-	-	-	-	-	1,617 0
Effect of swaps	-	1,617 0	-	-	-	-	(1,617 0)
	<b>1,617 0</b>	<b>1,617 0</b>	-	-	-	-	-
<b>Borrowings designated at fair value through profit or loss</b>							
Fixed rate instruments	287 6	-	-	-	20 8	-	266 8
Effect of swaps	-	287 6	-	-	(20 8)	-	(266 8)
	<b>287 6</b>	<b>287 6</b>	-	-	-	-	-
<b>Borrowings measured at amortised cost</b>							
Fixed rate instruments	592 6	0 2	0 3	0 3	0 3	0 3	591 2
Floating rate instruments	607 9	607 9	-	-	-	-	-
Index-linked instruments	2,062 7	2,062 7	-	-	-	-	-
	<b>3,263 2</b>	<b>2,670 8</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>591 2</b>
Effect of a fixed hedge for the term of the regulatory business plan	-	(1,831 3)	-	-	-	1,381 3	450 0
<b>Total borrowings</b>	<b>5,167 8</b>	<b>2,744 1</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>1,381 6</b>	<b>1,041.2</b>
<b>Cash and short-term deposits</b>	<b>(0 3)</b>	<b>(0 3)</b>	-	-	-	-	-
<b>Net borrowings</b>	<b>5,167 5</b>	<b>2,743 8</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>1,381 6</b>	<b>1,041 2</b>
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>
<b>Cash and short-term deposits</b>	<b>(81 1)</b>	<b>(81 1)</b>	-	-	-	-	-
<b>Net borrowings</b>	<b>5,840 5</b>	<b>3,825 3</b>	<b>348 6</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>1,665 7</b>

## Notes to the financial statements (continued)

At 31 March 2010

### 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.

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.

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

	2010 £m	2009 £m
Index-linked debt	2,062.7	1,962.2

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 2010 and 31 March 2009, 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

	2010 £m	2009 £m
1 per cent increase in RPI	(21.1)	(20.0)
1 per cent decrease in RPI	21.1	20.0

Brackets denote a reduction in profit

## Notes to the financial statements (continued)

At 31 March 2010

### 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 from Moody's Investors Services, which the company believes best mirrors regulatory assumptions in relation to capital structure. The strategy of targeting a credit rating of A3 has been consistently maintained since 2007.

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 and 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 rating agencies.

## Notes to the financial statements (continued)

At 31 March 2010

### 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

	2010 Carrying value £m	2010 Fair value £m	2009 Carrying value £m	2009 Fair value £m
<b>Financial assets</b>				
<i>Non-current assets</i>				
Derivative financial instruments				
Fair value hedge derivatives	186 0	186 0	239 8	239 8
Held for trading derivatives <sup>(2)</sup>	84 7	84 7	-	-
Total non-current assets	270 7	270 7	239 8	239 8
<i>Current assets</i>				
Cash and short-term deposits	0 3	0 3	81 1	81 1
Trade and other debtors	299 0	299 0	1,055 3	1,055 3
Derivative financial instruments				
Held for trading derivatives <sup>(2)</sup>	18 3	18 3	224 5	224 5
Total current assets	317 6	317 6	1,360 9	1,360 9
<b>Financial liabilities</b>				
<i>Non-current liabilities</i>				
Trade and other creditors	(87 9)	(87 9)	(87 5)	(87 5)
Borrowings				
Financial liabilities designated at fair value through profit or loss	(287 6)	(287 6)	(279 7)	(279 7)
Financial liabilities in a hedged relationship	(1,617 0)	(1,552 8)	(1,567 5)	(1,386 4)
Financial liabilities measured at amortised cost	(2,965 9)	(2,676 8)	(2,922 0)	(2,395 6)
	(4,870 5)	(4,517 2)	(4,769 2)	(4,061 7)
Derivative financial instruments				
Fair value hedge derivatives	(5 0)	(5 0)	(1 3)	(1 3)
Held for trading derivatives <sup>(2)</sup>	(82 0)	(82 0)	-	-
Total non-current liabilities	(5,045 4)	(4,692 1)	(4,858 0)	(4,150 5)
<i>Current liabilities</i>				
Trade and other creditors	(380 4)	(380 4)	(467 2)	(467 2)
Borrowings				
Financial liabilities in a hedge relationship	-	-	(153 2)	(154 1)
Financial liabilities measured at amortised cost	(297 3)	(297 3)	(999 2)	(999 2)
	(297 3)	(297 3)	(1,152 4)	(1,153 3)
Derivative financial instruments				
Held for trading derivatives <sup>(2)</sup>	(25 2)	(25 2)	(127 7)	(127 7)
Total current liabilities	(702 9)	(702 9)	(1,747 3)	(1,748 2)
Adjustment for accrued interest <sup>(1)</sup>	-	(34 2)	-	(34 5)
Net financial liabilities	(5,160 0)	(4,840 9)	(5,004 6)	(4,332 5)



## Notes to the financial statements (continued)

At 31 March 2010

### 20. Financial instruments (continued)

1 Fair values quoted include accrued interest of £34.2 million (2009 £34.5 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 £100.3 million (2009 £181.9 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 £7.9 million loss (2009 £56.6 million loss), a £48.2 million loss (2009 £76.6 million gain) is attributable to changes in credit risk. The cumulative impact of changes in credit spread was £59.0 million profit (2009 £107.2 million profit). The difference between the carrying amount and the amount contracted to settle on maturity was a carrying amount increase of £63.4 million (2009 a carrying amount increase of £55.5 million).

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable.

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities,
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices), and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based upon observable market data (unobservable).

	Level 1 £m	Level 2 £m	Level 3 £m	2010 Total £m
<b>Financial assets at fair value through profit or loss</b>				
Derivative financial assets	-	289.0	-	289.0
<b>Financial liabilities at fair value through profit or loss</b>				
Derivative financial liabilities	-	(112.2)	-	(112.2)
Financial liabilities designated as fair value through profit or loss	-	(287.6)	-	(287.6)
	-	(110.8)	-	(110.8)

There were no transfers between level 1 and 2 during the year.

## Notes to the financial statements (continued)

At 31 March 2010

### 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 PLC section of the Electricity Supply Pension Scheme (ESPS). Both schemes are funded defined benefit schemes which are closed to new employees. The schemes also include a defined contribution section which constitutes around two 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 UUPS was carried out as at 30 September 2008 and 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 2010 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 defined benefit members over the five years from 1 April 2005. Regular contributions resume from 1 April 2010. The company made £7.9 million of contributions to the defined benefit schemes for the year ended 31 March 2010 (2009 £0.9 million). Other payments will be made by the company in accordance with the funding agreement between the trustees and United Utilities Group PLC.

Overall, the company expects to contribute around £50.0 million to its defined benefit schemes in the year ending 31 March 2011.

The company's total defined benefit pension income for the year was £35.9 million (2009 £19.9 million expense), including pension income credited to operating profit of £51.5 million (2009 £23.0 million expense) which reflects curtailment gains arising on amendment of pension obligations of £76.7 million (2009 £nil). A pension obligation of £136.6 million, net of deferred tax of £53.1 million, is included in the balance sheet at 31 March 2010 (2009 obligation of £118.1 million, net of deferred tax of £46.0 million).

The credit of £76.7 million offsetting the pension expense for the year ended 31 March 2010 has arisen as a result of the amendment of pensions obligations. These include the introduction of a restriction on the rate of increase in pensionable pay for defined benefit members of the UUPS and the ESPS. This restriction took effect on 31 March 2010. Changes to the benefits accruing after 31 March 2010 for the defined benefit members of the UUPS have also been implemented. The impact of these changes will be reflected in the current service cost element of the pension expense for 2010/11.

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

	2010	2009	2008
	% p a	% p a	% p a
Discount rate – UUPS	5.70	7.00	6.00
Discount rate – ESPS	5.70	7.00	6.10
Expected return on assets – UUPS	6.20	6.60	6.80
Expected return on assets – ESPS	6.30	6.20	6.50
Pensionable salary growth – UUPS	3.30	4.15	4.35
Pensionable salary growth – ESPS	3.30	4.20	4.40
Pension increases	3.30	3.20	3.40
Price inflation	3.30	3.20	3.40

## Notes to the financial statements (continued)

At 31 March 2010

### 21. Retirement benefits (continued)

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

	2010 years	2009 years	2008 years
Retired member	24.9	24.9	24.9
Non-retired member	26.0	26.0	26.0

At 31 March, the fair value of the schemes' assets and liabilities recognised in the balance sheet, and their expected long-term rates of return were as follows

	Schemes' assets at 31 March 2010 %	Long-term rate of return expected at 31 March 2010 %	At 31 March 2010 £m	Schemes' assets at 31 March 2009 %	Long-term rate of return expected at 31 March 2009 %	At 31 March 2009 £m
Equities	47.4	7.4	476.7	55.9	7.0	445.9
Gilts	5.4	4.4	54.2	5.8	4.0	46.3
Bonds	47.1	5.2	473.7	37.8	6.4	301.6
Property	-	7.4	-	0.1	7.0	0.2
Cash	0.1	0.5	1.0	0.4	0.5	3.0
Total fair value of assets	100.0		1,005.6	100.0		797.0
Present value of liabilities			(1,195.3)			(961.1)
Pension liability			(189.7)			(164.1)
Related deferred tax asset (see note 17)			53.1			46.0
<b>Net pension liability</b>			<b>(136.6)</b>			<b>(118.1)</b>

## Notes to the financial statements (continued)

At 31 March 2010

### 21. Retirement benefits (continued)

Details in respect of 2008 are as follows

	Schemes' assets at 31 March 2008 %	Long-term rate of return expected at 31 March 2008 %	At 31 March 2008 £m
Equities	69.4	7.5	717.0
Gilts	16.6	4.5	171.6
Bonds	13.1	6.8	135.0
Cash	0.9	4.5	10.1
Total fair value of assets	100.0		1,033.7
Present value of liabilities			(1,101.2)
Pension asset			(67.5)
Related deferred tax liability			18.9
<b>Net pension asset</b>			<b>(48.6)</b>

To develop the expected long-term rate of return on asset assumptions, the company considered the current level of expected returns on risk free investments, the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based upon the actual asset allocation to develop the expected long-term rate of return on asset assumptions for the portfolio. The company's actual return on schemes' assets was a gain of £249.4 million (2009 £201.7 million loss).

Movements in the present value of the defined benefit obligations are as follows

	2010 £m	2009 £m
At start of year	(961.1)	(1,101.2)
Interest cost on schemes' obligations	(66.4)	(65.8)
Actuarial (losses)/gains	(268.0)	193.0
Curtailments/settlements		
arising on reorganisation	(8.3)	-
arising on amendment of pension obligations	76.7	-
Member contributions	(5.6)	(5.8)
Benefits paid	54.3	41.7
Current service cost	(14.3)	(20.9)
Past service cost	(2.6)	(2.1)
At end of year	<u>(1,195.3)</u>	<u>(961.1)</u>

## Notes to the financial statements (continued)

At 31 March 2010

### 21. Retirement benefits (continued)

Movements in the fair value of the schemes' assets were as follows

	2010 £m	2009 £m
At start of year	797 0	1,033 7
Expected return on schemes' assets	50 8	68 9
Actuarial gains/(losses)	198 6	(270 6)
Member contributions	5 6	5 9
Benefits paid	(54 3)	(41 7)
Company contributions	7 9	0 8
At end of year	<u>1,005 6</u>	<u>797 0</u>

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

	2010 £m	2009 £m
Current service cost	(14 3)	(20 9)
Curtailments/settlements		
arising on reorganisation	(8 3)	-
arising on amendment of pension obligations	76 7	-
Past service cost	(2 6)	(2 1)
<b>Pension income/(expense) credited/(charged) to operating profit</b>	<u>51 5</u>	<u>(23 0)</u>
Expected return on schemes' assets	50 8	68 9
Interest on schemes' liabilities	(66 4)	(65 8)
<b>Pension (expense)/income (charged)/credited to net interest payable and similar charges (see note 7)</b>	<u>(15 6)</u>	<u>3 1</u>
<b>Net pension income/(expense) credited/(charged) before taxation</b>	<u>35 9</u>	<u>(19 9)</u>

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

	2010 £m	2009 £m
At start of year	(164 1)	(67 5)
Income/(expense) recognised in the profit and loss account	35 9	(19 9)
Contributions paid	7 9	0 9
Actuarial losses gross of taxation	(69 4)	(77 6)
At end of year	<u>(189 7)</u>	<u>(164 1)</u>

Actuarial gains and losses are recognised directly in the statement of total recognised gains and losses. At 31 March 2010, a cumulative pre-tax loss of £123.6 million (2009 £54.2 million) had been recorded directly in the statement of total recognised gains and losses.

## Notes to the financial statements (continued)

At 31 March 2010

### 21. Retirement benefits (continued)

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

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Present value of defined benefit obligations	(1,195 3)	(961 1)	(1,101 2)	(1,109 4)	(1,138 4)
Fair value of schemes' assets	1,005 6	797 0	1,033 7	1,126 2	1,121 4
Net retirement benefit obligations	(189 7)	(164 1)	(67 5)	16 8	(17 0)
Experience adjustments on schemes' liabilities	3 2	(13 9)	14 3	28 7	-
Experience adjustments on schemes' assets	198 6	(270 6)	(131 4)	(7 3)	168 3

During the year, the company made £2 6 million (2009 £1 6 million) of contributions to defined contribution schemes

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

	2010 £m	2009 £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 2010

### 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 14(b) for details of rights pertaining to the 7 per cent preference shares.

### 23. Share capital and reserves

	Called up share capital £m	Share premium account £m	Profit and loss account £m	Total £m
At 1 April 2009	1,025.3	647.8	423.9	2,097.0
Profit for the financial year	-	-	399.6	399.6
Actuarial losses on defined benefit pension schemes	-	-	(69.4)	(69.4)
Deferred tax credit arising on actuarial losses on defined benefit pension schemes	-	-	19.4	19.4
Dividends paid on equity shares	-	-	(231.2)	(231.2)
At 31 March 2010	1,025.3	647.8	542.3	2,215.4

### 24. Operating leases

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

	Land and buildings 2010 £m	Plant and machinery 2010 £m	Land and buildings 2009 £m	Plant and machinery 2009 £m
Non-cancellable operating leases which expire				
Within one year	0.2	0.2	-	0.2
Between two and five years	0.3	0.4	-	0.2
After five years	2.6	-	1.4	-
	3.1	0.6	1.4	0.4

## Notes to the financial statements (continued)

At 31 March 2010

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

	2010 £m	2009 £m
Operating profit	788 0	711 5
Depreciation	343 7	322 8
Amortisation of grants and contributions	(6 4)	(6 2)
Profit on disposal of tangible fixed assets	(4 0)	(1 8)
Increase in stocks	-	(0 3)
Decrease/(increase) in debtors	11 0	(20 5)
Decrease in creditors	(9 8)	(29 2)
Movement in other provisions (including pension liability)	(52 0)	22 2
	<u>1,070 5</u>	<u>998 5</u>

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

	2010 £m	2009 £m
(Decrease)/increase in cash in the year	(0 8)	1 1
Decrease in overdrafts in the year	6 1	77 2
Net cash outflow/(inflow) from decrease/(increase) in debt and lease financing	2 2	(1,058 8)
Net cash (inflow)/outflow from (decrease)/increase in liquid resources	(80 0)	80 0
Net cash outflow from derivatives <sup>(1)</sup>	11 5	24 0
	<u>(61 0)</u>	<u>(876 5)</u>
Changes in net debt resulting from cashflows		
Non-cash adjustments	(169 7)	(30 8)
	<u>(230 7)</u>	<u>(907 3)</u>
Movement in net debt in the year		
Net debt at 1 April	(4,720 0)	(3,812 7)
Net debt at 31 March	<u>(4,950 7)</u>	<u>(4,720 0)</u>

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

(1) Cashflows on derivatives consist of £0 8 million financing inflow (2009 £50 0 million outflow) (see note 27) and £12 3 million interest outflow (2009 £26 0 million inflow)



## Notes to the financial statements (continued)

At 31 March 2010

### 27. Financing

	2010 £m	2009 £m
New loans	303.6	4,921.4
Loans repaid	(288.4)	(3,548.3)
Loans issued	-	(247.7)
Finance lease repayments	-	(66.6)
	<u>15.2</u>	<u>1,058.8</u>
Financing cashflows on derivatives	0.8	(50.0)
	<u>16.0</u>	<u>1,008.8</u>

### 28. Analysis of changes in net debt

	At 1 April 2009 £m	Cashflow £m	Non-cash movements £m	At 31 March 2010 £m
Cash	1.1	(0.8)	-	0.3
Overdrafts	(11.2)	6.1	-	(5.1)
Parent and fellow subsidiary undertaking loans	785.2	(745.2)	-	40.0
	<u>775.1</u>	<u>(739.9)</u>	<u>-</u>	<u>35.2</u>
Debt due after one year	(4,769.2)	(144.7)	43.4	(4,870.5)
Debt due within one year	(1,141.2)	892.1	(43.1)	(292.2)
	<u>(5,910.4)</u>	<u>747.4</u>	<u>0.3</u>	<u>(5,162.7)</u>
Current asset investments	80.0	(80.0)	-	-
Net debt excluding derivatives	<u>(5,055.3)</u>	<u>(72.5)</u>	<u>0.3</u>	<u>(5,127.5)</u>
Derivatives	335.3	11.5	(170.0)	176.8
Net debt including derivatives	<u>(4,720.0)</u>	<u>(61.0)</u>	<u>(169.7)</u>	<u>(4,950.7)</u>

## Notes to the financial statements (continued)

At 31 March 2010

### 29. Related party transactions

The aggregate disclosable transactions with the related parties of the company were with Lingley Mere Management Company Limited as follows

	2010 £m	2009 £m
Sales of services	0.2	0.2
Purchases of goods and services	0.5	0.4
Amounts owed to related parties (see note 14a)	-	0.1

Sales of services to related party were on the company's normal trading terms

The amounts outstanding are unsecured and will be settled in accordance with normal credit terms. No guarantees have been given or received. No amounts have been written-off during the year (2009 £nil)

### 30. 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