

UNITED UTILITIES ELECTRICITY PLC

Regulatory Financial Statements

31 March 2006

REPORT AND FINANCIAL STATEMENTS 2006

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MANAGING DIRECTOR'S STATEMENT

Performance

The board is pleased to report another good set of financial results. Revenue increased by 9.3 per cent to £282.4 million, reflecting allowed price increases of 8.2 per cent above inflation. Operating profit increased to £153.2 million before the impact of restructuring costs, up 28.1 per cent on last year, primarily reflecting the increase in revenue and overall decreases in operating costs.

United Utilities Electricity continued to focus on maintaining the integrity, security and safety of its electricity distribution network and outputs are in line with its five year delivery plan. During the year the business replaced or refurbished 221 kilometres of overhead lines and replaced 95 kilometres of underground cables. It also replaced or refurbished 428 switchgear units and replaced 223 transformers in the twelve month period.

Electricity supplies were available for 99.99 per cent of the time during the financial year ended 2006, sustaining the business's high level of performance in managing the network to maintain constant supplies for consumers. All the overall standards of performance set by the Gas and Electricity Markets Authority were achieved. Under the regulatory interruptions incentive scheme, United Utilities Electricity has been set network performance targets for the number and duration of customer supply interruptions. The average number of interruptions per 100 consumers per annum was 49.8*, out-performing the regulatory target for the year of 57.2. The average number of minutes for which consumers were without supply was 47.5*, beating the regulatory target for the year of 59.8 minutes. (Figures in this paragraph denoted by * are unaudited by Ofgem at the date of this report).

Stakeholders

We are committed to listening and responding to the needs of our different stakeholders: employees, customers, investors, regulators and our commercial partners. Understanding their requirements and then managing and reporting our performance is central to how we run our business. The cornerstone of this approach is our employees and I should like to thank all our employees for their continuing commitment and hard work.

The future

United Utilities Electricity maintains its strategic focus to improve efficiency and quality of service and we are well placed to build on our current successes. We are on track to deliver better performance for all our stakeholders during the period to 2010.

Charlie Cornish
Managing Director

OPERATING AND FINANCIAL REVIEW

NATURE OF THE BUSINESS

Business Overview

United Utilities Electricity PLC (“the company”) is a public limited company registered in England and Wales. The principal activity of the company is the operation of electricity distribution assets.

United Utilities Electricity PLC is a subsidiary of United Utilities PLC. The activities of United Utilities Electricity PLC are controlled within the UU group through the United Utilities North West division. This division also controls the water and wastewater assets owned by United Utilities Water PLC in north west England. Besides the operation of electricity distribution assets, United Utilities PLC group (“the UU group”) is one of the largest operators of water and wastewater systems in the UK. The UU group also operates a gas network and provides multi-utility metering and connections services. It is also a leading provider of outsourced business services and technology solutions.

The company owns the distribution network which carries electricity from the National Grid along power lines to consumers’ premises on behalf of the electricity supply companies who are United Utilities Electricity’s customers. The income derived from the distribution business depends in part on changes in the demand for electricity by consumers in north west England. Demand for electricity is affected by such factors as growth and movements in population, social trends, economic and business growth or decline, changes in the mix of energy sources used by consumers, weather conditions, energy efficiency measures and other factors. The electricity distribution business is a regulated business in which the average increase in charges, which a company may impose in any year, is capped by the electricity regulator (as described in more detail below). Accordingly, profit derived from the distribution business also depends upon efficiency, achieved by reducing and controlling costs, and providing high standards of service. Key performance measures for the business relate to quality of supply.

Electricity supplies were available for 99.99 per cent of the time during the financial year ended 2006, sustaining the business’s high level of performance in managing the network to maintain constant supplies for consumers. All the overall standards of performance set by the Gas and Electricity Markets Authority (the ‘electricity regulator’) were achieved. Under the regulatory interruptions incentive scheme, United Utilities Electricity has been set network performance targets for the number and duration of customer supply interruptions. The average number of interruptions per 100 consumers per annum was 49.8*, out-performing the regulatory target for the year of 57.2. The average number of minutes for which consumers were without supply was 47.5*, beating the regulatory target for the year of 59.8 minutes. (Figures in this paragraph denoted by * are unaudited by Ofgem at the date of this report).

Economic Regulation

The electricity industry is regulated under the Electricity Act 1989 (the ‘Electricity Act’), the Utilities Act 2000 (the ‘Utilities Act’) and the Energy Act 2004 (the ‘Energy Act’) by the Gas and Electricity Markets Authority (GEMA). GEMA governs and acts through the Office of Gas and Electricity Markets (‘Ofgem’). The Electricity Act, as amended by the Utilities Act, requires all companies distributing electricity to be licensed unless they are covered by an exemption. Economic regulation pursuant to these licences is the responsibility of GEMA. GEMA also exercises powers under UK competition legislation, most significantly the Competition Act 1998 and the Enterprise Act 2002.

The government awarded electricity distribution licences in 2001. The licences continue in force for an indefinite period, subject to potential termination rights as set out below. United Utilities Electricity holds an electricity distribution licence that authorises it to distribute electricity anywhere in the country. Under that licence, United Utilities Electricity distributes electricity across its distribution system covering an area in north west England comprising 2.3 million consumer premises. Licence conditions can be modified by GEMA either with the agreement of the licensee (or, in the case of standard conditions, with the agreement of the requisite proportion of

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licensees) or following reference to the Competition Commission for a decision on public interest grounds. The licence can be terminated on 25 years' notice given by the Secretary of State.

GEMA regulates electricity distribution charges by capping the average charges that a company can impose in any year. GEMA conducts a periodic review and sets price caps every five years. This price cap is set by reference to inflation as measured by the retail price index in the UK plus an adjustment factor known as 'X' which is specific to each company and which can vary for each year of the review period. The size of a company's X factor (which can be positive, negative or zero) reflects the scale of its capital investment programme, its cost of capital and its operational and environmental obligations, together with scope for it to improve its efficiency. The last periodic review was completed at the end of 2004 and covers the period from 1 April 2005 to 31 March 2010. For the 2005-10 review period, United Utilities Electricity was allowed a real (excluding inflation) price increase of 8.2 per cent in 2005/06 followed by constant real prices thereafter.

'Price cap' regulation in the industry is performance-based. Companies are incentivised to be efficient, both in terms of their operating costs and in the implementation of their capital expenditure programme. The benefit of any efficiency savings achieved through effective management is retained by the companies for a period of up to five years, after which time the benefit is passed to customers via the price setting process. The cost of any under-performance due to poor management is borne by the companies. An incentive scheme was introduced by GEMA in April 2002 which provided greater focus on three specific service areas: number of interruptions to customers' supplies; length of those interruptions; and quality of the telephone response to customers. GEMA consulted on its approach to the incentive scheme as part of the price control review; including the form of the scheme, targets and associated costs. It was agreed that the distribution network operators' performance in those areas would continue to be incentivised. Under the scheme, United Utilities Electricity is subject to annual rewards and penalties depending upon its performance against pre-specified targets. Both rewards and penalties under the incentive scheme are capped at 3.0 per cent of annual revenues.

Environmental regulation

All electricity companies have a general duty under the Electricity Act to have regard to the desirability of environmental preservation and conservation and the protection of Sites of Special Scientific Interest when they formulate proposals for development. United Utilities Electricity may be required to carry out an environmental assessment when it intends to lay cables, construct overhead lines or carry out any other development in connection with its licensed activities. In response to discussions with environmental organisations in United Utilities Electricity's operating area, and with the backing of Ofgem, the company has undertaken work to assess the cost of converting from overhead cables to underground cables in designated areas on aesthetic grounds. There is a small allowance of £5 million allowed by Ofgem for such work over the period 2005-10.

United Utilities Electricity, in common with all other UK electricity companies, owns and operates pressure-assisted high voltage cables. These cables are either filled with nitrogen gas or an insulating liquid. United Utilities operate both types, having 620km of the latter type of cable. Cables of the latter type are pressurised with a light 'oil' type fluid. In the main the fluid is biodegradable, although some older cables are pressured with a variety of fluid that is not. The potential for loss into the environment of the fluid, due to leaks or third party damage, is recognised nationally by all electricity companies and the Environment Agency (EA). In order to mitigate the effects of any losses, United Utilities Electricity is party to a national code of practice agreement with the EA. In the last five years, the company has worked to minimise losses into the environment and has reduced annual loss to around 25kl from a high of 48kl in 2000 – 2001. As part of the monitoring system, United Utilities Electricity has developed and implemented a new software-based management system to identify and categorise leakage allowing rapid deployment of resources to protect the environment.

The possibility that electric and magnetic fields (EMFs) may cause adverse health effects has been a topic of debate and research for many years. Over the last 20 years, major research programmes throughout the world have explored whether EMFs have an adverse impact on health. A large epidemiological study – the UK Childhood Cancer Study – reported in December 1999 that there was "no evidence that exposure to magnetic fields associated

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with the electricity supply in the UK increases risk for childhood leukaemia, cancers of the nervous system, or any childhood cancer". International bodies such as the World Health Organisation and the International Agency for Research on Cancer and, in the UK, the National Radiological Protection Board (NRPB) have investigated this issue and have concluded that there is no established causal link between EMFs and ill health. The NRPB was the body with statutory responsibility for advising on EMFs until April 2005 when it was subsumed into the Health Protection Agency (HPA), which has taken on its radiation protection functions.

In March 2001, the NRPB published a review of the state of the science and concluded "for the vast majority of children in the UK there is now considerable evidence that the EMF levels to which they are exposed do not increase the risk of leukaemia or other malignant disease". However, it also noted that the possibility remains that intense and prolonged exposure to magnetic fields can increase the risk of leukaemia in children but the epidemiological evidence is currently not strong enough to justify a firm conclusion that such fields cause leukaemia in children. In the spirit of the precautionary approach, the NRPB published in May 2003 a consultation document on how to limit exposure to EMFs and, in particular, on whether the UK should adopt the more stringent exposure guidelines of the International Commission on Non-Ionizing Radiation Protection (ICNIRP). In March 2004, the NRPB recommended that the ICNIRP guidelines should be adopted. Most recently, a report published by the Childhood Cancer Research Group (CCRG) strengthened the evidence that childhood leukaemia rates are slightly higher near power lines, but leaves the question of what causes this more confused than before, stating that: "There is no accepted biological mechanism to explain the epidemiological results; indeed, the relation may be due to chance."

The independent Advisory Group on Non-ionising Radiation (AGNIR), which reports to the Board of the HPA, has issued several reports relating to EMFs, considering their possible link with an increased risk of cancer, including childhood leukaemia. AGNIR consider there to be insufficient newly published research that would, at present, justify the development of any update to the 2001 NRPB report.

United Utilities Electricity, in line with other Energy Networks Association (ENA) member companies, carries out its activities in accordance with Health Protection Agency guidance. The ENA is the trade association for electricity companies in the UK. The ENA and its member companies are committed to responsible behaviour in the light of the scientific evidence, including considering any appropriate precautionary actions. United Utilities Electricity believes that present evidence does not justify any change in the electricity industry's operating practices, or the everyday utilisation of electricity by its customers, but United Utilities Electricity keeps this under review and looks to the Health Protection Agency and UK government for advice on the issue.

RESOURCES

People

Good industrial relations remain a priority for United Utilities Electricity. The company continues to recognise and work in partnership with trade unions. A statement of principles governs the approach to labour relations across the company. 99 per cent of employees within the company are represented by trade unions for collective bargaining purposes under the terms of a voluntary collective agreement, underpinned by the 'Together in Partnership' agreement. This Partnership is continuing to develop and is now being supported by joint training programmes, which have been very well received. The relationships with key union players are maturing and the company has received positive feedback from the unions on the partnership approach.

United Utilities Electricity remains committed to maintaining high standards of health and safety in every area of its business. The company's health and safety aims and objectives are integrated into the business planning processes. Progress is monitored regularly at all levels throughout the business.

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The company is committed to improving its employees' skills through training and development and nurturing a culture in which employees feel valued. The company encourages employees to work to their full potential and respects the dignity and rights of every employee and supports them in performing various roles in society. The company is equally committed to involving employees through open and regular communications about business developments and issues of general interest, both formally and informally.

The company is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995 and best practice. The company gives equal consideration to applicants with disabilities in its employment criteria and will modify equipment and working practices wherever it is safe and practical to do so, both for new employees and for those employees that are disabled during the course of their employment. Additionally, the company is committed to providing full support and appropriate training for employees who become disabled during the course of their employment so that they can continue to work in a position appropriate to their experience and abilities.

Operating facilities

As at 31 March 2006, the company's facilities included 13,525 kilometres of overhead lines, 42,930 kilometres of underground cables (operating at 132 kilovolts, 33 kilovolts, 25 kilovolts, 11 kilovolts, 6.6 kilovolts and 400/230 volts), 18,100 ground mounted substations and 16,730 pole mounted transformers. The company holds wayleaves which entitle it to run lines and cables through and across private land and in some circumstances these can be terminated by the landowner or occupier upon notice pursuant to the Electricity Act. However, the company has statutory rights to seek the compulsory retention of a wayleave if termination is sought by the landowner/occupier.

In addition to the properties described above, the company occupies various non-operational properties consisting primarily of offices, depots, warehouses and workshops. These are either owned by the company or leased. It is anticipated that the company will be able to negotiate renewals of any expiring leases, or relocate the relevant facilities, without having a material adverse impact on the company.

PRINCIPAL RISKS AND UNCERTAINTIES

The board is responsible for the company's system of internal controls and for reviewing its effectiveness. Each year management review all controls, including financial, operational and compliance controls and risk management procedures. The internal control system is designed to manage, rather than to eliminate, the risk of failure to achieve the company's business objectives and can only provide reasonable, and not absolute, assurance against material misstatement or loss.

The key features of the internal control system are:

- a control environment with clearly defined organisation structures operating within a framework of policies and procedures covering every aspect of the business;
- comprehensive business planning, risk assessment and financial reporting procedures; including the annual preparation of detailed operational budgets for the year ahead and projections for subsequent years;
- a bi-monthly board review of financial and non-financial performance to assess progress towards objectives;
- regular monitoring of risks and control systems throughout the year, supported by the use of risks and issues databases;
- a self-certification process, whereby management are required to confirm that the system of internal control is operating effectively;
- a UU group internal audit function provides independent scrutiny of internal control systems and risk management procedures;
- a bi-monthly risk management forum attended by senior management at which key risks are scrutinised;

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- an annual risk assessment exercise involving self-assessment by management of all business risks in terms of impact, likelihood and control strength and an objective challenge of that assessment by the internal audit team;
- health and safety performance reviews carried out by our in-house safety professionals in addition to the normal health and safety risk assessment and management processes carried out within each of the operating businesses;
- centralised treasury operations operating within defined limits and subject to regular reporting requirements and internal audit reviews; and
- established procedures, set out in a UU group internal control manual, for planning, approving and monitoring major capital expenditure, major projects which includes short and long-term project budgets, risk evaluation, detailed appraisal and review procedures, defined authority levels and post-investment performance reviews.

There are a number of potential risks and uncertainties that could have a material impact on the company's long term performance.

Revenue of the company's regulated business is substantially influenced by the regulator, which could adversely affect profitability

The revenue and profitability of the company is substantially influenced by price limits established every five years by the regulator. The price review for the company covering the five-year period commencing on 1 April 2005 was determined by the regulator in November 2004. The company has accepted this determination and has not exercised its right to appeal adverse price determinations to the Competition Commission.

An adverse price determination may occur as a result of a number of factors, including an inadequate allowed cost of capital or unrealistic regulatory assumptions concerning operating expenses, required capital expenditure and revenue forecasts. Scope to re-open these price controls within the charging period is limited. Specific re-opening provisions have been made, with effect from 1 April 2005, in relation to uncertain costs associated with specified provisions of the Electricity Safety, Quality and Continuity Regulations 2002 (or amending/ replacement regulations), the New Roads and Street Works Act 1991 and the Traffic Management Act 2004.

Failure to deliver the capital investment programmes

The company requires significant capital expenditure for additions to, or replacement of, plant and equipment for its facilities and networks. The price limits set by Ofgem take into account the level of capital expenditure expected to be incurred during the relevant five-year price review period and the associated funding costs. Historically, the company has financed the expenditures from cash flows from operations and from debt financing. There can be no assurance that cash flows from operations will not decline, or that additional debt financing or other sources of capital will be available to meet these requirements.

Failure to deliver operational performance or cost savings implicit in the regulatory review

Operating cost savings to be achieved during the current five-year regulatory period are implicit in the regulatory review. To assist the achievement of these operating cost savings a business change programme is underway. If the operating cost savings are not achieved, or the business change programme is not delivered, then the company's profitability would suffer. Similarly, if operational performance were to deteriorate, this may be reflected by less favourable outcomes from future price reviews and the company's profitability would suffer.

Environmental regulations could increase the company's costs

Various government environmental protection and health and safety laws and regulations govern the electricity distribution business. These laws and regulations establish, amongst other things, standards for quality of electricity supply, which affect the company's operations. In addition, the company is required to obtain various environmental permissions from regulatory agencies for its operations. The company endeavours to comply with all regulatory standards. Should the company fail to comply, it would face fines imposed by the courts or otherwise face sanction by the regulators.

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Service interruptions

In addition to the capital investment programmes, the company controls and operates the electricity distribution network and undertakes maintenance of the associated assets with the objective of providing a continuous service. Historically, there have been interruptions to the supply of services, such as the incident in January 2005 affecting Cumbria and Lancashire, when a storm severely damaged the electricity network supply to 250,000 customers, but the majority of interruptions relate to minor issues that are rectified promptly. However, the failure of a key asset could cause a more significant interruption to the supply of services (in terms of duration or number of customers affected), which may have an adverse effect on the company's operating results or financial position.

Pension scheme obligations may require the company to make additional contributions to the schemes

The company participates in a number of pension schemes. The schemes are funded defined benefit schemes and the assets of the schemes are held in trust funds independent of company finances. These schemes are controlled on a United Utilities PLC group level. The company increased pension contribution rates to the United Utilities Pension Scheme and the United Utilities group of the Electricity Supply Pension Scheme in 2003/04 and the results of the full actuarial valuation resulted in further increases being required to the United Utilities Pension Scheme and the United Utilities Group of the Electricity Supply Pension Scheme from 1 April 2005. A one-off lump sum contribution of £79.6 million was made by the company on 31 March 2005. This contribution was calculated to equal the value of the company's funding obligations to the schemes for the next five years (based on the actuarial valuation as at 31 March 2004) and represents advance payment of certain employer contributions which would have been made to the schemes during that period. As a consequence the company's proportion of the schemes were estimated to have a combined post-tax obligation of £2.2 million as at 31 March 2006, compared to a post-tax obligation of £35.0 million at 31 March 2005. However, the UU group continues to monitor the funding of the schemes and cannot guarantee that during the next five years further contributions will not be required to eliminate continuing shortfalls in the schemes. This may adversely affect the financial position of the company. Should long-term investment returns remain lower than the rate assumed by the actuaries in their pension scheme valuations, or interest rates reduce further leading to an increased deficit, the profitability of the company may be further adversely affected and the company required to increase its contributions to eliminate this under-funding. Currently, anticipated future pensions contributions and a proportion of existing pension scheme deficits are recoverable through the price limits established by Ofgem.

Operating risk

Managing the company's businesses is dependent upon the ability to process a large number of transactions efficiently and accurately. Operational risk and losses can result from fraud, employee errors, failure to properly document transactions or to obtain proper internal authorisation, failure to comply with regulatory requirements and business principles, resource shortages, equipment failures, natural disasters or the failure of external systems. Although the company has implemented risk controls and loss mitigation actions, and substantial resources are devoted to developing efficient procedures and to staff training, it is only possible to be reasonably, but not absolutely, certain that such procedures will be effective in controlling each of the operational risks faced by the company.

LONG TERM STRATEGY, BUSINESS OBJECTIVES AND PERFORMANCE

United Utilities Electricity PLC's strategy is to outperform its regulatory contract (effective April 2005) pursuant to which the company operates the electricity distribution network.

The key objectives of United Utilities Electricity are to:

- deliver improved customer service through more efficient processes, systems and higher first time resolution;
- deliver sustainable operating and capital expenditure efficiencies; and
- enable its people to achieve their full potential.

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Good progress has already been made in meeting the efficiency challenges set by Ofgem. Successful delivery of the capital investment programme is vital and the partnership framework approach that has been developed will help to optimise the company's performance. The current strategy is to target customer service and operational performance improvement. With further real price increases ahead, the company should continue to deliver strong profit growth. Overall the company's progress means that it has a strong platform from which to develop.

Our progress on our strategic objectives is monitored by the Board of Directors by reference to key performance indicators. Performance in 2005/06 against these measures is set out in the table below, together with the prior year performance data.

Key performance indicators

	2006	2005
Financial		
Revenue	£282.4m	£258.4m
Operating profit before restructuring credit of £ 0.6m (2005: cost £8.7m)	£152.5m	£128.3m
Profit before tax	£104.0	£81.4m
Gearing ⁽¹⁾	47%	63%
Interest cover ⁽²⁾	3.3 times	3.4 times
Capital expenditure	£142.0m	£150.8m
Non-financial		
Average minutes for which customers were without supply ⁽³⁾	47.5	51.5
Customer interruptions per 100 customers ⁽⁴⁾	49.8	47.0
Electricity supply availability	99.99%	99.99%

⁽¹⁾ Gearing is measured as borrowings net of cash and short-term deposits divided by total capital employed. Total capital employed is shareholders' equity plus borrowings net of cash and short-term deposits.

⁽²⁾ Interest cover is the number of times the net finance expense before the impact of IAS 39 is covered by operating profit from continuing operations before restructuring costs and the impact of IAS 39.

⁽³⁾ The minutes of supply lost per customer is an Ofgem measure calculated by taking the sum of the customer minutes lost for all restoration stages for all incidents and dividing by the number of connected customers as at 30 September each year. The 2006 figure is still to be audited by Ofgem. The 2005 figure excludes an exceptional storm experienced in January 2005.

⁽⁴⁾ 2006 figure is unaudited by Ofgem at the date of this report.

Financial Review

Revenue increased by 9.3 per cent to £282.4 million in 2005/06, largely due to an allowed real price increase of 8.2 per cent in the year. Operating profit (excluding the impact of exceptional restructuring costs in 2004/05) increased by 18.8 per cent to £152.5 million in 2005/06, primarily reflecting the increase in revenue and reductions in operating cost. Capital investment for the year was £142.0 million (2004/05: £150.8 million). This is within the regulatory allowance for the year and reflects the re-phasing of expenditure from the first year of the capital

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programmes to future years. Capital expenditure is likely to peak at around £150.0 million in the fourth year of the five-year programme.

The most significant transaction undertaken by the company with its shareholder was an equity injection of £160.0 million on 22 March 2006 (generated via the second stage of a rights issue by United Utilities PLC that raised a total of £508 million in the period).

Dividend and dividend policy

Following the introduction of 'IAS10 – Events after the Balance Sheet Date', the company no longer recognises a proposed final dividend in its current year figures (see note 1(a)). In 2005/06, United Utilities Electricity dividends recognised in the period were £50.8 million. This figure represents a dividend payment relating to the financial year 2004/05 of £39.1 million, and an interim payment in 2005/06 of £11.7 million.

The company's dividend policy is to distribute the theoretical maximum consistent with the 5 year regulatory contract. The earnings available for distribution comprise the return on equity assumed by the regulatory contract plus or minus any out-performance or under-performance over the period of the contract. Annual distributions are based on this policy.

Business Performance

United Utilities Electricity continued to focus on maintaining the integrity, security and safety of its electricity distribution network and outputs are in line with its five-year delivery plan. During the year, the business replaced or refurbished 221 km of overhead lines and replaced 95 km of underground cables. It also replaced or refurbished 428 switchgear units and replaced 223 transformers in the 12 month period.

Business Impacts

To ensure that higher levels of performance continue to be achieved following the acceptance of Ofgem final price determinations in December 2004, initiatives have been put in place to improve efficiency and reduce cost:

- there has been increased focus on work planning, scheduling and field force productivity, and a new mobile communications system has been implemented; and
- a number of transformation initiatives have been developed, which are primarily focused around implementing a range of business process changes to improve the way the business operates; and
- the company is continuing to increase its focus on service and performance levels, and new programmes and initiatives are being introduced to link remuneration and performance for all staff; and
- additionally, UU group has a number of initiatives in place to leverage its increasing size and achieve additional efficiencies, particularly in the area of procurement.

The capital investment partnership framework approach is now embedded into the business. A range of integrated work teams have been set up to help reduce project management costs. A new project and investment management system to support delivery of the capital programmes is now up and running and benefits have also been realised through relocation of activities, shared systems and greater collaboration through the supply chain.

CAPITAL STRUCTURE

Liquidity and resources

The company's primary source of liquidity is cash generated from its ongoing business operations. As reflected in the cashflow statement on page 29, in the financial year ended 31 March 2006, net cash generated from the company's operating activities was £98.5 million, compared with £89.0 million in 2004/05. The electricity

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regulator has established price increase limits to 2010 which will provide certainty for a large majority of the company's revenues from ongoing operations, providing both a stable and a predictable source of funds.

Treasury policy

United Utilities PLC's treasury function operates with the delegated authority of, and under policies approved by, the United Utilities Electricity PLC board. The treasury function does not act as a profit centre and does not undertake any speculative trading activity. It seeks to ensure that sufficient funding is available to meet foreseeable needs and maintains reasonable headroom for contingencies. Long term borrowings are structured or hedged to match earnings, which are largely in sterling, indexed to inflation and subject to regulatory price reviews every five years. Exposure to interest rate movements for the following 12 months is largely eliminated at the start of each financial year using short-term hedges. The credit quality of counterparties and individual aggregate exposures are reviewed annually.

Debt financing

Moody's Investor Service rates the credit of United Utilities Electricity PLC as A2 on a long-term basis with a stable outlook and P-1 on a short-term basis. Equivalent ratings published by Standard and Poor's Rating Services are A- long-term with a stable outlook and A-2 short-term. The company's borrowings net of cash and short-term deposits of £521.6 million at 31 March 2006 comprised £553.8 million of bonds, £90.1 million of loans from the European Investment Bank (EIB – the company's largest debt investor), £6.6 million of bank loans and other borrowings and £8.1 million of bank overdrafts offset by £137.0 million of cash and short-term deposits.

Shorter-term liquidity

Short-term liquidity requirements are met from the company's normal operating cashflow. Further liquidity is provided by cash and short-term deposit balances, the UU group's US\$1.5 billion euro commercial paper programme, supported by committed bank facilities and committed but undrawn long-term credit facilities. Cash and short-term deposit balances were £137.0 million at 31 March 2006, compared with £nil at 31 March 2005.

Bank overdrafts and temporary borrowings, which are repayable in less than one year, were £67.7 million at 31 March 2006, compared with £66.7 million at 31 March 2005. The weighted average rate of interest on bank overdrafts was 5.50 per cent (2004/05: 5.75 per cent). The company had available unutilised committed bank facilities of £75.0 million (2004/05: £75.0 million), of which £30 million expires within one year (2004/05: £25.0 million), £20.0 million expires after one year but in less than two years (2004/05: £30.0 million), and the remaining £25.0 million expires in more than two years (2004/05: £20.0 million). Although unutilised during the financial year ended 31 March 2006, the US\$1.5 billion euro commercial paper programme still provides for the periodic issuance of notes by United Utilities Electricity. United Utilities Electricity has entered into £75 million of credit facilities, as noted above, used primarily as support for the US\$1.5 billion euro commercial paper programme.

Longer-term liquidity

The company has effective access to the international debt capital markets through its €5 billion medium-term note programme which provides for the periodic issuance by United Utilities Electricity of debt instruments on terms and conditions determined at the time that the instruments are issued. This programme does not represent a funding commitment, with funding only becoming committed when debt securities have been successfully issued. The currencies in which borrowings are held are disclosed in note 17 to the financial statements.

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The company arranged £25.0 million of new five-year medium-term committed bank facilities. The company's term loans were £643.9 million at 31 March 2006, compared with £629.1 million at 31 March 2005. Amounts repayable after more than five years comprise bank and other loans repayable between 2011 and 2053. Fixed interest rates, for amounts after more than five years, are at 8.875 per cent on £553.8 million (2004/05: £539.1 million) and are at floating rates on £90.1 million (2004/05: £90.0 million) of these loans.

Interest rate and foreign currency management

The company manages interest rate exposure by seeking to match financing costs as closely as possible with the revenues generated by its assets. The company uses a combination of interest rate swaps, futures and funding instruments to hedge exposure to interest rate volatility. The company's use of derivative instruments relates directly to underlying indebtedness; no speculative or trading transactions are undertaken. The proportion of borrowings at effective fixed rates of interest for a period greater than one year is set in conjunction with the level of floating rate borrowings and projected regulatory revenues that are exposed to inflationary adjustments (index linked). In addition, the company aims to manage its short-term budgetary commitments by ensuring that the majority of floating rate interest is fixed for periods of less than one year through the use of exchange traded financial futures. The company has limited exposure to foreign currency exchange rate movements. Interest rate management and funding policies are set by the board.

In order to hedge the interest cost implicit in the regulatory contract, the company fixes interest rates for the duration of each five-year review period by typically swapping fixed rate debt to floating at the time of issue and then swapping back to fixed rate at the outset of each five-year regulatory contract period. IAS 39 limits the use of hedge accounting, thereby increasing the potential volatility of the income statement. However, this has no cash flow impact and the effect of IAS 39 should broadly balance out over the 2005-10 period.

Summary

The board has reviewed the business plan and considers that the company has sufficient liquidity to meet the anticipated financial commitments for the next 12 months. In total, at 31 March 2006, unutilised committed facilities of £45.0 million expiring in more than one year, together with cash and short-term deposits of £137.0 million provide substantial pre-funding for the company.

ACCOUNTING ISSUES

International Financial Reporting Standards

The financial statements for the year ended 31 March 2006 have been prepared in accordance with International Financial Reporting Standards (IFRS). These results, and prior period comparisons, are consistent with IFRS, with the exception of IAS 39 which has been applied prospectively from 1 April 2005. Reconciliation between IFRS and UK accounting standards is provided in note 28 of the financial statements.

CRITICAL ACCOUNTING POLICIES

The company prepares its consolidated financial statements in accordance with accounting principles consistent with IFRS as adopted for use in the European Union (EU) including International Accounting Standards (IAS) and interpretations issued by the International Financial Reporting Interpretation Committee (IFRIC). 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

OPERATING AND FINANCIAL REVIEW

liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the 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 the consolidated financial statements. The following paragraphs detail the policies the company believes to have the most significant impact on the annual results under IFRS.

Carrying value of long-lived assets

The company's accounting policy for property, plant and equipment (PPE) is detailed in the accounting policies section of the consolidated financial statements. The carrying value of PPE under IFRS as at 31 March 2006 was £1,713.7 million. Additions to PPE totalled £141.2 million and the depreciation charge was £52.5 million in the year ended 31 March 2006. The estimated useful economic lives of PPE 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 PPE 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.

In accordance with IFRS, the company is required to evaluate the carrying values of PPE 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.

Revenue recognition

Under IFRS, the company recognises revenue generally at the time of delivery and when collection of the resulting receivable 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. Payments received in advance of revenue recognition are recorded as deferred revenue. The company raises bills and recognises revenue in accordance with its entitlement to receive revenue in line with the limits established by the periodic regulatory price review processes. The customers of the business are the electricity supply companies that utilise United Utilities Electricity's distribution network to distribute electricity from generators to the end consumer. The receivable billed is dependent upon the volume of electricity distributed, including estimates of the units distributed to customers. The estimated usage is based on historic data, judgement and assumptions. Operating revenues are gradually adjusted to reflect actual usage in the period over which the meters are read.

Accounting for provisions and contingencies

The company is subject to a number of claims incidental to the normal conduct of its business, relating to and including commercial, contractual and employment matters, which are handled and defended in the ordinary course of business. The company routinely assesses the likelihood of any adverse judgements or outcomes to these matters as well as ranges of probable and reasonably estimated losses. Reasonable estimates involve judgements made by management after considering information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute and prior experience. In accordance with IFRS, 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.

OPERATING AND FINANCIAL REVIEW**Retirement benefits**

United Utilities Company PLC operates 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 IFRS, the pension cost under IAS 19 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 20 of the financial statements. The operating results 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 income statement. This has the potential to introduce considerable volatility to both the income statement and balance sheet. Therefore, for fair value hedges, changes in the recognised value of hedged debt that are attributable to the hedged risk are adjusted through the income statement. In the case of cashflow hedges, movements in the fair value of derivatives are deferred within reserves until they can be recycled through the income statement to offset the future income statement effect of changes in the hedged risk. In order to apply this treatment, 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. Changes in the fair value of all derivatives are recognised in the income statement, except for derivatives that are designated and effective in terms of cashflow hedging relationships, in which case the gains and losses are deferred in equity. The company applies the fair value option through profit or loss where the complexity of the swaps means that they are disallowed from being allocated in a hedge relationship despite there being significant fair value offset between the hedged item and the derivative itself. This area is considered to be of significance due to the magnitude of the company's level of borrowings.

RESEARCH AND DEVELOPMENT

The company undertakes research primarily to provide improved standards of service to customers, together with continuing improvements in business efficiency. Research and development within the company's electricity network aims to deliver financial, supply quality, environmental and safety improvements to customers and is supported under the Innovation Funding Incentive introduced by Ofgem. The company is a member of a number of collaborative research programmes including EA Technology Limited which addresses common issues that face the electricity industry. The company also undertakes specific projects with these and other research and development providers, manufacturers and with universities. Research and development expenditure by the company was £0.7 million in the year ended 31 March 2006 (2004/05: £0.1 million).

POST BALANCE SHEET EVENTS

OPERATING AND FINANCIAL REVIEW

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 2006.

FORWARD LOOKING STATEMENTS

This report contains certain forward-looking statements with respect to the financial condition, results of operations and business of the company. Statements that are not historical facts, including statements about the board's beliefs and expectations, are forward-looking statements. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential', 'reasonably possible', 'targets' and variations of these words and similar expressions are intended to identify forward-looking statements which are based on current plans, estimates and projections, and therefore investors should not rely on them. Forward-looking statements speak only as of the date they are made, and the company undertakes no obligation to update publicly any of them in light of new information or future events. The company may also make written and/or oral forward-looking statements, in the annual report to shareholders, in proxy statements, in offering circulars and prospectuses, in press releases and other written materials and in oral statements made by officers, directors or employees to third parties, including financial analysts. Forward-looking statements involve inherent risks and uncertainties. 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.

CORPORATE GOVERNANCE

The Combined Code

The company's ultimate parent company, United Utilities PLC, is subject to the Combined Code on Corporate Governance as updated in 2003 (the 'Combined Code'). The Combined Code does not apply to United Utilities Electricity PLC directly. Throughout the year, the board of United Utilities PLC has complied fully with the Combined Code, and a report on governance is contained in the United Utilities PLC group annual report and accounts. This report gives details of how the principles of the Combined Code have been applied by United Utilities Electricity PLC.

The Board of Directors

The United Utilities Electricity PLC board ("the board") is scheduled to meet six times each year with additional meetings called if required. The board takes all major strategy, policy and investment decisions affecting the business. In addition, it is responsible for business planning and risk management and for the development of company policies including such areas as health and safety and for social, environmental and ethical issues. The business plan is reviewed at United Utilities PLC group level and consolidated within the overarching United Utilities PLC group business plan.

Attendance by individual directors at scheduled meetings of the board during the year ended 31 March 2006 is shown in the table below.

Board attendance		
	Possible	Actual
John Roberts	6	3
Simon Batey	6	3
Steven Beaumont	6	2
Martin Beesley	6	5
Keith Budinger	3	0
Michael Boxall	6	6
Eóin Cooke	6	5
Charles Cornish	6	5
Gary Dixon	6	5

Directors have a right to ensure that any concerns they have, which cannot be resolved about the running of the company or a proposed action, are recorded in the board minutes.

The United Utilities PLC group ("the UU PLC group") governance structure ensures that all decisions are made by the most appropriate people in such a way that the decision-making process itself does not unnecessarily delay progress. Investment decisions taken by the board above certain limits must be referred to the UU PLC group board through its own approvals committee. This is necessary to ensure that major UU PLC group cash inflows and outflows are co-ordinated and are in-line with the company strategic plan.

The board has formally delegated specific responsibilities to a treasury committee which is provided with sufficient resources to undertake its duties. The treasury committee comprises any two directors and its main duties are to appoint and terminate bankers, to open and close bank accounts, to enter into borrowing, leasing, bonding, hedging and any other banking facilities and guarantees in connection with them and to make inter-company loans. All decisions must be referred to the treasury committee to ensure that such facilities are in accordance with company policy and to ensure that they are co-ordinated with facilities negotiated across the UU PLC group and do not in any way impinge on or breach the terms of those company facilities.

The UU PLC group maintains an appropriate level of directors' and officers' insurance in respect of legal action against the directors.

CORPORATE GOVERNANCE

The board of United Utilities PLC aims to maintain a balance of executive and non-executive directors and, at the date of adoption of this statement, comprises the chairman, five executive directors and seven non-executive directors determined by the UU PLC group board to be independent. The directors have a wide and diverse range of business and other experience and expertise. The board of United Utilities Electricity PLC comprises six executive directors who are all company employees.

Statement of directors, responsibilities

The directors are responsible for preparing the statutory report and the financial statements. The directors are required to prepare financial statements for the company in accordance with International Financial Reporting Standards (IFRS). Company Law requires the directors to prepare such financial statements in accordance with IFRS, the Companies Act 1985, and article 4 of the International Accounting Standard (IAS) Regulation.

The director's are also required to prepare Regulatory Accounts for each financial year, prepared in accordance with Standard Licence Condition 42, which present fairly the assets, liabilities, reserves and provisions of, or reasonably attributable to the distribution business, and the revenues, costs and cash flows of, or reasonably related to, the business for that year. The Regulatory Accounts presented represent the legal entity that contains the distribution business and the corporate function. The directors are required to prepare the Regulatory Accounts on a going concern basis unless it is inappropriate to presume that the Company will continue in business.

IAS 1 requires that the financial statements present fairly for each financial year the company's financial position, financial performance and financial cash flows. This requires the faithful representation of the effects of the transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by the compliance with all applicable IFRS.

In preparing the Statutory Financial Statements and the Regulatory Accounts, the directors are required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial performance.

The directors confirm that the financial statements comply with the above requirements and that Regulatory Accounts on pages 26 to 63 have been prepared in accordance with Standard Licence Condition 42 of the Company's Distribution Licence. The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy the financial position of the company and to enable them to ensure that the statutory financial statements comply with the Companies Act 1985 and to enable them to ensure that the Regulatory Accounts are published in accordance with Standard Licence Condition 42. They have a general responsibility for the system of internal control and for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

Information to auditors

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

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

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

Information and professional development

The quality of the contribution that directors can make is directly dependent on the quality of the information they receive. Accordingly, all directors receive comprehensive information on a regular basis. Board papers are normally distributed five days in advance of the relevant meeting to allow sufficient time for directors to be fully briefed. The papers are sufficiently detailed to enable the directors to obtain a thorough grasp of the management and financial

CORPORATE GOVERNANCE

performance of the company and the operating businesses. Minutes of committee meetings are circulated to all board members.

Performance evaluation

During the year, the UU PLC group board conducted an evaluation of its own performance and that of its committees and individual directors.

The process involved the completion by each director of a confidential questionnaire in a form consistent with the previous year's and which was modelled on the Chairmen's Guide to the Board Performance Review published by the Chairmen's Forum and was consistent with guidance published by the Chartered Institute of Secretaries and Administrators.

No similar evaluation was carried out by the board of United Utilities Electricity PLC.

Re-appointment of directors

United Utilities PLC's articles of association include provisions requiring one-third of all directors to retire and seek re-election at each annual general meeting, and ensuring that no director serves for more than three years without retiring and being proposed for re-election at an annual general meeting. There is no similar requirement for United Utilities Electricity PLC directors although directorships would cease with the cessation of the directors' employment contract with the company or upon a change in job function of the individual director.

Directors' remuneration

The UU Group board's policy for executive directors' and senior executives' remuneration is to:

- pay a basic salary which compares with other companies of about the same size and complexity;
- use short and long-term incentives to encourage executives to out-perform key targets, thereby linking their rewards to the interests of shareholders and other stakeholders and giving them the opportunity to increase their earnings;
- encourage executives to hold shares in the ultimate parent company, United Utilities PLC; and
- overall, reward executives fairly and responsibly for their contribution to the company's short and long-term performance and avoid paying more than is necessary for achieving this objective.

In deciding the executive directors' total remuneration package and individual elements of it, the UU group remuneration committee ("the committee") assesses where the UU group should be positioned relative to other companies. It makes appropriate comparisons but treats them with caution. The UU group aims to pay about the market median but may pay more for an outstanding performer or to attract executives of the right calibre. Earnings may be increased through the operation of annual and long-term incentive plans.

The committee aims to achieve an appropriate balance between fixed and variable rewards consistent with and reflecting the company's profile.

Fixed rewards include basic salary, a car allowance or company car and fuel for private mileage, life, medical and permanent health insurance and pension benefits. Variable rewards take the form of an annual bonus and a long-term incentive (the performance share plan). The plans are designed to establish a clear link between pay and performance by encouraging and rewarding out-performance in both the short and long term. They are based on business and individual performance, linking executives' rewards directly to the interests of shareholders and other stakeholders. Annual and long-term awards are non-pension able.

Fixing directors' remuneration

The committee makes recommendations to the UU group board on the UU group's framework of executive remuneration and its cost. It approves, on the UU group board's behalf, the general recruitment terms, remuneration benefits, employment conditions and severance terms for directors of United Utilities Electricity PLC who are also directors of United Utilities PLC. The managing director of United Utilities North West decides the specific recruitment terms, remuneration benefits, employment conditions, pension rights, compensation payments and severance terms for the remaining directors of the company.

CORPORATE GOVERNANCE**Financial reporting**

In presenting the company's annual financial statements and similar significant publications, the directors of United Utilities Electricity PLC aim to present a balanced and understandable assessment of the company's position and prospects.

The directors have adopted the going concern basis in preparing these financial statements. This is based upon a review of the company's budget for 2006/07, the five-year business plan and investment programme, together with the cash and committed borrowing facilities available to the company. The board also took into account potential contingent liabilities and other risk factors as interpreted by the 'Guidance on Going Concern and Financial Reporting for Directors of Listed Companies registered in the United Kingdom', published in November 1994.

Internal control

The UU PLC group board is responsible for the UU PLC group's system of internal controls and for reviewing its effectiveness. Throughout the year under review and up to the date of this report, procedures have operated throughout the UU group meeting the requirements of the Combined Code relating to internal control as set out in the September 1999 guidance "Internal Control Guidance for Directors on the Combined Code" published by the Institute of Chartered Accountants in England and Wales. Each year the UU group board reviews all controls, including financial, operational and compliance controls and risk management procedures. The internal control system is designed to manage, rather than to eliminate, the risk of failure to achieve the company's business objectives and can only provide reasonable, and not absolute, assurance against material misstatement or loss.

In addition, the UU PLC group board is making preparations for compliance with section 404 of the US Sarbanes-Oxley Act of 2002. This includes ensuring that key financial controls are adequately documented and that they have been specifically tested.

The key features of the internal control system are:

- a control environment with clearly defined organisation structures operating within a framework of policies and procedures covering every aspect of the business;
- comprehensive business planning, risk assessment and financial reporting procedures; including the annual preparation of detailed operational budgets for the year ahead and projections for subsequent years;
- a review at each board meeting of financial and non-financial performance to assess progress towards objectives;
- regular monitoring of risks and control systems throughout the year supported by the use of a risks and issues database;
- a self-certification process, subject to internal audit, whereby managers are required to confirm that the system of internal control is operating effectively;
- an company wide internal audit function to provide independent scrutiny of internal control systems and risk management procedures;
- a bi-monthly risk management forum chaired by the UU PLC group finance director, and comprising the company secretary, the UU PLC group internal audit manager, the UU PLC group health and safety manager and senior management, to scrutinise key risks;
- an annual risk assessment exercise involving self-assessment by management of all business risks in terms of impact, likelihood and control strength and an objective challenge of that assessment by the internal audit team;
- health and safety risk assessment and management processes carried out by our in-house safety professionals;
- centralised treasury operations operating within defined limits and subject to regular reporting requirements and internal audit reviews; and
- established procedures, set out in an internal control manual, for planning, approving and monitoring major capital expenditure, major projects and the development of new business which includes short and long-term budgets, risk evaluation, detailed appraisal and review procedures, defined authority levels and post-investment performance reviews.

The audit committee and the auditor

The UU PLC group's audit committee has primary responsibility for making a recommendation to the UU PLC group board, for it to put to UU PLC group shareholders for their approval in general meeting, on the appointment, reappointment and removal of the external auditors and it keeps under review the scope and results of the external

CORPORATE GOVERNANCE

audit and its effectiveness and the independence and objectivity of the auditors. The audit committee has established policies and procedures to pre-approve the engagement of the auditors to provide any audit or non-audit services and keeps the nature and extent of non-audit services under review seeking to balance the maintenance of objectivity and value for money. It reviews the half year and annual financial statements and any formal announcements relating to financial performance before submission to the UU PLC group board, reviews periodically the scope, remit and effectiveness of the internal audit function and the effectiveness of the company's internal control system. It also reviews arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.

The terms of reference of the audit committee are available to shareholders on request and are also available on the company's website at www.unitedutilities.com.

Audit and audit-related services are pre-approved annually by the UU group audit committee. Audit-related services generally are highly correlated with the role of independent auditors. Such services include assurance on non-statutory information, assurance work carried out in connection with reporting to a statutory regulator, analysis and interpretation of accounting principles and their application, support for debt issues and similar transactions, and other services that have a bearing on the company's financial statements on which the external auditors provide their opinion. Audit and audit related fee disclosures are included in note 3 to the annual report and accounts.

Dialogue with institutional shareholders

There is a programme of United Utilities PLC investor meetings and presentations which take place throughout the year, both in the UK and overseas. During the year, members of the UU PLC group board met or offered to meet with 89 different funds, representing 42 per cent of the company's issued share capital. This, together with regular announcements of significant events affecting the company and frequent updates on current trading, emphasises the UU PLC group board's commitment to keeping the company's equity and debt investors informed of developments affecting the company. The UU PLC group board regards this programme as important to improve investors' awareness of the business and for them to gain an understanding of investors' priorities. As a wholly owned subsidiary of United Utilities PLC, United Utilities Electricity PLC has no direct equity investors in its own right.

DIRECTORS' REPORT

The directors present their report and the audited financial statements of the United Utilities Electricity PLC company for the year ended 31 March 2006.

Profit and dividends

The results for the year, set out in the income statement on page 26, show that revenue for the year ended 31 March 2006 increased to £282.4 million (2005: £258.4 million), an increase of 9.3 per cent over the previous year. Profit for the year after tax was £78.3 million (2005: £78.2 million).

An interim dividend of £11.7 million was paid in March 2006 for the year ended 31 March 2006 (2005 £19.9 million), and a final dividend for the year ended 31 March 2005 of £39.1 million was paid in the year.

Business Review and Principal Activities

The company is a wholly owned subsidiary of United Utilities PLC. The company's principal activity is the operation of electricity distribution assets. The distribution of electricity is regulated by the terms of the Company's Electricity Distribution Licence granted under the Electricity Act 1989 and monitored by the Gas and Electricity Markets Authority. There have not been any significant changes in the company's principal activities in the year under review. The directors are not aware, at the date of this report, of any likely major changes in the company's activities in the next year.

During the year, share capital to the value of £160.0 million was issued.

There are no significant events since the balance sheet date that are required to be disclosed.

The directors have not sought to comply with the Asp's 2006 Reporting Statement on operating and financial reviews.

Principal risks and uncertainties

Principal risks and uncertainties are discussed as part of the Operating and Financial Review previously contained in this document.

UU Group risks are discussed in the UU group Annual Report which does not form part of this report.

Research and development

The Company is committed to developing innovative, cost-effective and practical solutions for providing high quality services and standards to our customers, and for the benefit of the wider community and the development of the business. It seeks to take as part of this process maximum advantage of wide-ranging expertise, abilities and facilities within the Company.

Employees

Employees are key to achieving the business strategy and enhancing shareholder value and as such the Company remains committed to maintaining high standards of health and safety in every area of its business.

The Company is committed to improving its employees' skills through training and development and nurturing a culture in which employees feel valued. The Company encourages employees to work to their full potential and respects the dignity and rights of every employee and supports them in performing various roles in society. The Company also challenges prejudice and stereotyping.

The Company is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995 and best practice. As an equal opportunities employer, the Company gives equal consideration to applicants with disabilities in its employment criteria and will modify equipment and working practices wherever it is safe and practical to do so, both for new employees, and for those employees that are disabled during the course of their employment. Additionally, the Company is committed to providing full support and appropriate training for employees who become disabled during the course of their employment so they can continue to work in a position appropriate to their experience and abilities.

The Company believes that share ownership is an effective way of strengthening employees' involvement in the development of the business and bringing together their interests and those of the shareholders. It offers employees an opportunity to build up a shareholding in the ultimate parent company United Utilities PLC.

DIRECTORS' REPORT (continued)

Policy on the payment of creditors

The policy is normally to pay suppliers according to agreed terms of business. These terms are agreed upon entering into binding contracts and the Company seeks to adhere to the payment terms provided the relevant goods and services have been supplied in accordance with the contracts. The Company had 43 days of purchases outstanding at the end of the financial year (2005: 49 days).

Directors

The directors of the Company during the year ended 31 March 2006 are set out below. All were directors for the whole year except where otherwise indicated.

J E Roberts* Chairman (and Chief Executive, United Utilities PLC) (resigned 31 March 2006)

S G Batey*

S Beaumont (resigned 5 July 2006)

M Beesley

M J Boxall

K M Budinger (resigned 31 October 2005)

E Cooke

C Cornish*

G Dixon

*Director, United Utilities PLC

Details of directors' interests in the share capital of United Utilities PLC are set out in note 9 to the accounts or in the accounts of United Utilities PLC where appropriate.

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

Independent Auditor

A resolution to reappoint Deloitte & Touché LLP as the auditor of the company will be proposed at the forthcoming Annual General Meeting.

Registered address

United Utilities Electricity PLC,

Dawson House,

Great Sankey

Warrington

WA5 3LW

Registered number: 2366949

By order of the board

Martin Beesley
Finance Director

28 July 2006

INDEPENDENT AUDITORS' REPORT TO THE GAS AND ELECTRICITY MARKETS AUTHORITY ("THE REGULATOR") AND UNITED UTILITIES ELECTRICITY PLC ("THE COMPANY")

We have audited the Regulatory Accounts of the Company for the year ended 31 March 2006 on pages 26 to 63 which comprise the income statement, the balance sheet, the statement of recognised income and expense, the cash flow statement and the related notes numbered 1 to 32. These Regulatory Accounts have been prepared under the accounting policies set out therein.

This report is made, on terms that have been agreed, solely to the Company and the Regulator in order to meet the requirements of Standard Condition 42 of the Electricity Distribution Licence, (the "Regulatory Licence"). Our audit work has been undertaken so that we might state to the Company and the Regulator those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under the Regulatory Licence to procure such a report and (b) to facilitate the carrying out by the Regulator of its regulatory functions, 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 Regulator, for our audit work, for this report, or for the opinions we have formed.

Basis of preparation

The Regulatory Accounts have been prepared under the historical cost convention and in accordance with the Regulatory Licence and the accounting policies set out in the notes to the Regulatory Accounts.

The Regulatory Accounts are separate from the statutory financial statements of the Company and have not necessarily been prepared under the basis of International Financial Reporting Standards adopted for use in the European Union ("IFRS"). Financial information other than that prepared on the basis of IFRS does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

Respective responsibilities of the Regulator, the Directors and auditors

The nature, form and content of Regulatory Accounts are determined by the Regulator. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purposes. Accordingly we make no such assessment.

The Directors' responsibilities for preparing the Regulatory Accounts in accordance with Condition 42 of the Regulatory Licence are set out in the statement of directors' responsibilities on page 18.

Our responsibility is to audit the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board, except as stated in the 'Basis of audit opinion', below and having regard to the guidance contained in Audit 05/03 *'Reporting to Regulators of Regulated Entities'*.

We report to you our opinion as to whether the Regulatory Accounts present fairly, in accordance with Standard Condition 42 of the Regulatory Licence and the accounting policies set out on pages 30 to 38, the results and financial position of the Company. We also report to you if, in our opinion, the Company has not kept proper accounting records or if we have not received all the information and explanations that we require for our audit.

We read the other information presented with the Regulatory Accounts, being the managing director's statement, operating and financial review, the directors' report and the corporate governance statement on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts.

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board, except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts, and of whether the accounting policies are consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature,

INDEPENDENT AUDITORS' REPORT TO THE GAS AND ELECTRICITY MARKETS AUTHORITY ("THE REGULATOR") AND UNITED UTILITIES ELECTRICITY PLC ("THE COMPANY") (continued)

Basis of opinion (continued)

form and content of Regulatory Accounts are determined by the Regulator, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK and Ireland).

Our opinion on the Regulatory Accounts is separate from our opinion on the Statutory Accounts of the Company on which we reported on 28 July 2006, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our "statutory audit") was made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a Statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

Audit opinion

In our opinion, the Regulatory Accounts present fairly in accordance with Standard Condition 42 of the Regulatory Licence and the accounting policies set out on pages 30 to 38 the financial position of the Company as at 31 March 2006 and of its financial performance and cashflows for the year then ended, and have been properly prepared in accordance with Standard Condition 42 and the Company's accounting policies.

Deloitte & Touche LLP

Chartered Accountants and Registered Auditors
Manchester

28 July 2006

INCOME STATEMENT
For the year ended 31 March

	Note	2006 £m	2005 £m
Revenue	2	282.4	258.4
Employee benefits expense	4	(21.2)	(30.8)
Depreciation and amortisation expense		(48.9)	(54.3)
Other operating costs		(59.8)	(45.0)
Restructuring costs		0.6	(8.7)
Total operating expenses		(129.3)	(138.8)
Operating profit	3	153.1	119.6
Investment income	5	4.9	6.7
Finance expense:			
Other finance expense	6	(54.0)	(44.8)
Investment income and finance expense		(49.1)	(38.1)
Profit before taxation		104.0	81.4
Taxation	7	(25.7)	(3.2)
Profit for the year		78.3	78.2

All the results shown in the income statement derive from continuing operations.

BALANCE SHEET
At 31 March

	Note	2006 £m	2005 £m
ASSETS			
Non-current assets			
Intangible assets	10	28.1	24.5
Property, plant and equipment	11	1,714.3	1,626.7
Investment property	12	5.4	11.0
Other investments	13	35.7	65.0
		<u>1,783.5</u>	<u>1,727.2</u>
Current assets			
Inventories	14	3.4	3.6
Cash and cash equivalents	15	137.0	-
Trade and other receivables	16	50.8	43.1
Derivative financial instruments	18	13.0	-
		<u>204.2</u>	<u>46.7</u>
Total assets		<u><u>1,987.7</u></u>	<u><u>1,773.9</u></u>
LIABILITIES			
Non-current liabilities			
Borrowings	17	(643.9)	(624.7)
Retirement benefit obligations	20	(1.8)	(35.0)
Deferred tax	21	(305.4)	(290.2)
Provisions	22	(1.3)	(4.2)
Consumer contributions	23	(245.9)	(221.6)
Refundable customer deposits	24	(6.1)	(13.1)
		<u>(1,204.4)</u>	<u>(1,188.8)</u>
Current liabilities			
Borrowings	17	(8.1)	(6.3)
Trade and other payables	19	(167.1)	(195.0)
Derivative financial instruments	18	(1.9)	-
Current income tax liabilities		(33.3)	(29.9)
		<u>(210.4)</u>	<u>(231.2)</u>
Total liabilities		<u>(1,414.8)</u>	<u>(1,420.0)</u>
Total net assets		<u><u>572.9</u></u>	<u><u>353.9</u></u>
EQUITY			
Called up share capital	25	238.4	78.4
Share premium account	26	4.4	4.4
Revaluation reserve	26	127.0	129.0
Capital redemption reserve	26	8.6	8.6
Retained earnings	26	194.5	133.5
Total equity		<u><u>572.9</u></u>	<u><u>353.9</u></u>

Approved by the board of directors on 28 July 2006 and signed on its behalf by:

Martin Beesley
Finance Director

STATEMENT OF RECOGNISED INCOME AND EXPENSE

For the year ended 31 March

	Note	2006 £m	2005 £m
Losses on write back of Trade and other payables on adoption of IAS 39		(1.0)	-
Gains on debt and derivative instruments on adoption of IAS 39		11.2	-
Fair value loss on cash flow hedges	18	(0.7)	-
Actuarial gains/(losses) on defined benefit pension schemes	20	35.6	(5.7)
Tax on items taken directly to equity	21	(13.7)	1.7
		<hr/>	<hr/>
Net income / (expenditure) recognised directly in equity		31.4	(4.0)
Profit for the year		78.3	78.2
		<hr/>	<hr/>
Total recognised income and expense for the year		109.7	74.2
		<hr/> <hr/>	<hr/> <hr/>

CASHFLOW STATEMENT

For the year ended 31 March

	Note	2006 £m	2005 £m
Operating activities			
Cash generated from operations	32	159.4	129.7
Interest paid		(50.0)	(45.7)
Interest received and similar income		2.8	5.3
Tax paid		(13.6)	(0.3)
		<hr/>	<hr/>
Net cash generated from operating activities		98.6	89.0
		<hr/>	<hr/>
Investing activities			
Disposal of investments		-	100.0
Disposal of subsidiaries	30	29.4	-
Purchase of investments		-	-
Purchase of property, plant and equipment		(142.0)	(150.8)
Purchase of other intangible assets		(6.3)	-
Consumer contributions received		37.1	15.8
Proceeds from sale of investment property		5.8	-
Proceeds from sale of property, plant and equipment		3.3	5.6
		<hr/>	<hr/>
Net cash used in investing activities		(72.7)	(29.4)
		<hr/>	<hr/>
Financing activities			
Proceeds on issue of ordinary shares		160.0	-
Proceeds from borrowings		0.1	4.1
Repayment of borrowings		(4.4)	(4.4)
Dividends paid to equity holders of the company		(50.8)	(58.0)
		<hr/>	<hr/>
Net cash generated from/(used in) financing activities		104.9	(58.3)
		<hr/>	<hr/>
Net increase in cash and cash equivalents		130.8	1.3
		<hr/>	<hr/>
Cash and cash equivalents at beginning of the year		(1.9)	(3.2)
		<hr/>	<hr/>
Cash and cash equivalents at end of the year	15	<u>128.9</u>	<u>(1.9)</u>

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

1. ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below:

a) Basis of preparation

The financial statements have been prepared for the first time in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the European Union (EU), including International Accounting Standards (IAS) and Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC). Results for the comparative periods have been restated under IFRS as adopted for use in the EU.

IFRS, as adopted by the EU, differs in certain respects from IFRS as issued by the International Accounting Standards Board (IASB). However, the considered financial statements for the periods presented would be no different had the company applied IFRS as issued by the IASB. References to IFRS hereafter should be construed as references to IFRS as adopted by the EU.

The financial statements have been prepared on the historical cost basis, except for the revaluation of financial instruments, investment properties and certain property, plant and equipment.

The preparation of financial statements, in conformity with generally accepted accounting principles under IFRS, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from these estimates.

The disclosures required by IFRS 1 'First-time Adoption of International Financial Reporting Standards' concerning the transition from UK GAAP (United Kingdom generally accepted accounting practice) to IFRS are given in note 28.

b) Intangible assets

Intangible assets are measured initially at cost and are amortised on a straight-line basis over their estimated useful lives. Carrying amount is reduced by any provision for impairment where necessary.

Amortisation periods for categories of intangible assets are:

Computer software 3-10 years

c) Property, plant and equipment

Property, plant and equipment comprises operational structures and other assets (including properties, over ground plant and equipment and electricity operational assets).

Operational structures

Infrastructure assets are depreciated by writing off their deemed cost less the estimated residual value, evenly over their useful lives, which range from 15 to 80 years. Employee costs incurred in implementing the capital schemes of the company are capitalised within operational structure assets.

Other assets

All other property, plant and equipment is stated at historical cost less accumulated depreciation.

Historical cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the company and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

1. ACCOUNTING POLICIES (continued)

Freehold land and assets in the course of construction are not depreciated. Other assets are depreciated by writing off their cost less their estimated residual value evenly over their estimated useful lives, based on management's judgement and experience, which are principally as follows:

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

Depreciation methods, residual values and useful lives are re-assessed annually and, if necessary, changes are accounted for prospectively.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in income.

d) Impairment of tangible and intangible assets

Intangible assets with definite useful lives and property, plant and equipment are reviewed for impairment at each reporting date to determine whether there is any indication that those assets may have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Where the asset does not generate cashflows that are independent from other assets, the company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell, and value in use. Value in use represents the net present value of expected future cashflows discounted on a pre-tax basis using a rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cashflows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. Impairment of non-current assets is recognised in the income statement within operating costs.

Where an impairment loss subsequently reverses, it is recognised in the income statement and the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but not so as to exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

e) Financial instruments

To 31 March 2005

Debt instruments

New borrowings were stated at net proceeds received after deduction of issue costs. The issue costs of debt instruments were amortised at a constant rate over the life of the instrument.

Interest rate swaps and financial futures

Interest rate swap agreements and financial futures were used to manage interest rate exposure. Instruments designated as a hedge of a debt instrument were accounted for on an accruals basis, with amounts payable or receivable in respect of those instruments recognised as adjustments to interest expense of the designated liability.

Realised gains and losses that occurred from the early termination of such instruments designated as a hedge were deferred and amortised to interest expense over the period of the hedged position, to the extent that the originally designated liability remained outstanding. In order to have qualified for hedge accounting, the notional amount of the company's interest rate swaps and financial futures must not have exceeded the amount of its existing variable rate debt and must have changed the interest rate characteristics of the underlying debt, while the contractual maturities cannot have exceeded the maturities of the debt.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006**1. ACCOUNTING POLICIES (continued)****From 1 April 2005 (upon adoption of IAS 39 'Financial Instruments: Recognition and Measurement')**

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

Cash and cash equivalents

In the consolidated cashflow statement and related notes, cash and cash equivalents includes cash at bank and in hand, deposits, other short-term highly liquid investments which are readily convertible on initial investment into known amounts of cash within three months and which are subject to an insignificant risk of change in value.

Financial investments

Investments (other than fixed deposits) are recognised and derecognised on a trade date and are initially measured at fair value, including transaction costs. Investments are classified as either held-to-maturity, held-for-trading, loans and receivables or available-for-sale. Held-to-maturity investments and loans and receivables are measured at amortised cost. Held-for-trading and available-for-sale investments are measured at subsequent reporting dates at fair value. Where securities are held for trading purposes, gains and losses arising from changes in fair value are included in net profit or loss for the period. For available-for-sale investments, 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 receivables

Trade receivables are stated at nominal value less allowances for estimated irrecoverable amounts.

Trade payables

Trade payables are stated at their nominal value.

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.

Bank borrowings

Interest-bearing bank loans and overdrafts are 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 income statement 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.

Derivative financial instruments and hedge accounting

Interest rate swap agreements and financial futures are used to manage interest rate exposure. 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 income statement within finance expense as they arise, except for derivatives that are designated and effective in terms of cashflow hedging relationships, in which case the gains and losses are deferred in equity.

NOTES TO THE ACCOUNTS

For the year ended 31 March 2006

1. ACCOUNTING POLICIES (continued)

Where hedge accounting has not been applied, the company may elect to designate a financial liability at inception as fair value through profit or loss provided the financial liability meets the conditions specified in IAS 39 'Financial Instruments: Recognition and measurement'. Where possible, hedge accounting is applied.

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 to changes in the fair value of the hedged item attributable to the risks being hedged, the hedge ineffectiveness is recorded in the income statement within finance costs. 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 IFRS, or where the hedge designation is revoked. Any adjustment that has been recognised to the hedged item, for which the effective interest rate is used, is amortised to the income statement and is based on the recalculated effective interest rate at the time at which amortisation commences.

Cashflow hedges

Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cashflows are recognised directly in equity and the ineffective portion is recognised immediately in the income statement. For hedges that do not result in the recognition of a non-financial asset or liability, amounts deferred in equity are recognised in the income statement in the same period in which the hedged item affects net profit or loss. Hedge ineffectiveness is recognised directly in the income statement within finance costs. Hedge accounting is discontinued when the hedge designation is revoked, the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to net profit or loss for the period.

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

The company applies this designation where the complexity of the swaps means that they are disallowed from being allocated in a hedge relationship despite there being significant fair value offset between the hedged item and the derivative itself. The otherwise inconsistent accounting treatment that would have resulted allows the company to satisfy the criteria for this designation. The treatment of financial assets and liabilities designated at fair value through profit and loss is consistent with the company's documented risk management strategy.

f) Borrowing costs and finance income

All borrowing costs and finance income are recognised in the income statement in the period in which they are accrued.

g) Construction contracts

Where the outcome of a construction contract can be estimated reliably, costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date, as measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer.

Where the outcome of a construction contract cannot be estimated reliably contract costs are recognised as expenses in the period in which they are incurred.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

1. ACCOUNTING POLICIES (continued)

h) Operating profit

Operating profit is stated after charging operating expenses but before investment income and finance expense.

i) Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

Current taxation

Current tax, including UK corporation tax and foreign tax, is based on the taxable profit for the period and is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted at the balance sheet date. Taxable profit differs from the net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

Deferred taxation

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are provided, using the liability method, on all taxable temporary differences at the balance sheet date. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

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

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer more likely than not that sufficient taxable profits will be available to allow all or part of the asset to be recovered. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited to equity, in which case the deferred tax is also dealt with in equity.

j) Employee benefits

Pension obligations

The company participates in two defined benefit pension schemes, operated by United Utilities PLC, which are independent of the company's finances, for the substantial majority of its employees. Actuarial valuations of the schemes are carried out as determined by the pension scheme trustees using the projected unit credit method at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates.

Defined benefit assets are measured at fair value while liabilities are measured at present value. The difference between the two amounts is recognised as a surplus or obligation in the balance sheet.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

1. ACCOUNTING POLICIES (continued)

The cost of providing pension benefits to employees relating to the current year's service and the difference between the expected return on scheme assets and interest on scheme liabilities are included within the income statement within employee costs.

All actuarial gains and losses as at 1 April 2004, the date of transition to IFRS, were recognised in full. All future actuarial gains and losses are recognised outside the income statement in retained earnings and presented in the statement of recognised income and expense.

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

Share-based compensation arrangements

The United Utilities PLC Group operates equity-settled, share-based compensation plans in the shares of United Utilities PLC. In accordance with the transitional provisions, IFRS 2 'Share-based Payments' has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 April 2004.

The United Utilities PLC Group issues equity-settled share-based payments to certain employees. 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, the United Utilities PLC Group 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 Electricity PLC is recharged the amount expensed under IFRS 2 that relates to United Utilities Electricity PLC employees.

k) Provisions

Provisions are recognised when the company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated.

Expenditure that relates to an existing condition caused by past operations that does not contribute to current or future earnings is expensed.

l) Revenue recognition

Revenue represents the fair value of the income receivable in the ordinary course of business for the distribution of electricity during the year, exclusive of value-added tax.

The company recognises revenue generally at the time of delivery and when collection of the resulting receivable is reasonably assured. Payments received in advance of revenue recognition are recorded as deferred revenue.

m) Contributions

Contributions receivable in respect of property, plant and equipment are treated as deferred income, which is credited to the income statement over the estimated economic lives of the related assets.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

1. ACCOUNTING POLICIES (continued)

n) Leases

Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

o) Critical accounting policies and key sources of estimation uncertainty

In the process of applying the company's accounting policies, 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 reported amounts of revenue and expenses during the 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 following paragraphs detail the policies the company believes to have the most significant impact on the annual results under IFRS.

Carrying value of long-lived assets

The carrying value of property, plant and equipment (PPE) as at 31 March 2006 was £1,713.7 million. Additions to PPE totalled £141.2 million and the depreciation charge was £52.5 million in the year ended 31 March 2006. The estimated useful economic lives of PPE 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 PPE investment to the company, variations between actual and estimated useful lives could impact operating results both positively and negatively, although historically, few changes to estimated useful lives have been required.

The company is required to evaluate the carrying values of PPE 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.

Revenue recognition

The company recognises revenue generally at the time of delivery and when collection of the resulting receivable 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. Payments received in advance of revenue recognition are recorded as deferred revenue.

The customers of the electricity distribution business are the electricity supply companies that utilise United Utilities Electricity's distribution network to distribute electricity from generators to the end consumer. The receivable billed is dependent upon the volume of electricity distributed, including estimates of the units distributed to customers. The estimated usage is based on historic data, judgement and assumptions. Operating revenues are gradually adjusted to reflect actual usage in the period over which the meters are read.

Provision for doubtful receivables

At each balance sheet date, the company and each of its subsidiaries evaluate the collectability of trade receivables and record provisions for doubtful receivables based on experience. These provisions are based on, amongst other things, comparisons of the relative age of accounts and consideration of actual write-off history. The actual level of receivables collected may differ from the estimated levels of recovery, which could impact operating results positively or negatively. As at 31 March 2006, the company's gross trade receivables were £15.1 million and the provision for doubtful receivables was £0.6 million.

NOTES TO THE ACCOUNTS

For the year ended 31 March 2006

1. ACCOUNTING POLICIES (continued)

Accounting for provisions and contingencies

The company is subject to a number of claims incidental to the normal conduct of its business, relating to and including commercial, contractual and employment matters, which are handled and defended in the ordinary course of business. The company routinely assesses the likelihood of any adverse judgements or outcomes to these matters as well as ranges of probable and reasonably estimated losses. Reasonable estimates involve judgements made by management after considering information including notifications, settlements, estimates performed by independent

parties and legal counsel, available facts, identification of other potentially responsible parties and their ability to contribute, and prior experience. 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.

Retirement benefits

The company operates 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. The pension cost under IAS 19 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 20. Operating results 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 income statement. This has the potential to introduce considerable volatility to both the income statement and balance sheet. Therefore, for fair value hedges, changes in the recognised value of hedged debt that are attributable to the hedged risk are adjusted through the income statement. In the case of cashflow hedges, movements in the fair value of derivatives are deferred within reserves until they can be recycled through the income statement to offset the future income statement effect of changes in the hedged risk. In order to apply this treatment, 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. Changes in the fair value of all derivatives are recognised in the income statement, except for derivatives that are designated and effective in terms of cashflow hedging relationships, in which case the gains and losses are deferred in equity.

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

Recently issued accounting pronouncements

International Financial Reporting Standards

At the date of authorisation of these financial statements, the following relevant standards and interpretations were in issue but not yet effective. The directors anticipate that the adoption of these standards and interpretations will have no material impact on the company's financial statements. The directors anticipate that the company will adopt these standards and interpretations on their effective dates.

IAS 1 Amendment – Capital disclosures, is effective for periods commencing on or after 1 January 2007

IAS 39 Amendment – Cashflow hedge accounting of forecast intra company transactions, issued in April 2005, is effective for periods commencing on or after 1 January 2006

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

1. ACCOUNTING POLICIES (continued)

IAS 39 Amendment – The fair value option, issued in June 2005, is effective for periods commencing on or after 1 January 2006
 IAS 39 Amendment – Financial guarantee contracts, issued in August 2005 is effective for periods commencing on or after 1 January 2006

IFRS 7 Financial instruments: Disclosures, issued in August 2005, is effective for periods commencing on or after 1 January 2007

IFRIC 1 Changes in existing decommissioning, restoration and similar liabilities

IFRIC 2 Members' shares in cooperative entities and similar instruments

IFRIC 4 Determining whether an arrangement contains a lease, issued in December 2004, is effective for periods commencing on or after 1 January 2006

IFRIC 5 Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds

IFRIC 6 Liabilities arising from participating in a specific market-waste electrical and electronic equipment

IFRIC 8 Scope of IFRS 2, issued in January 2006, is effective for periods commencing on or after 1 May 2006

IFRIC 9 Reassessment of embedded derivatives, issued in March 2006, is effective for periods commencing on or after 1 June 2006

2. REVENUE

	2006	2005
	£m	£m
Revenue	282.4	258.4
	<u>282.4</u>	<u>258.4</u>

All revenue is generated from the distribution of electricity.

3. OPERATING PROFIT

The following items have been included in arriving at the company's operating profit:

	2006	2005
	£m	£m
Employee benefits expense		
Employee costs (see note 4)	21.2	30.8
Depreciation and amortisation expense		
Depreciation of property, plant and equipment		
Owned assets (see note 11)	52.5	56.5
Investment property (see note 12)	0.3	0.3
Amortisation of intangible assets and contributions		
Software (see note 10)	2.7	3.7
Consumer contributions (see note 23)	(6.6)	(6.2)
Other income		
Profit on disposal of property, plant and equipment	1.5	2.5
Profit on disposal of investment property	0.5	-
Other operating costs		
Restructuring (credit)/cost	(0.6)	8.7

Included within restructuring costs for 2005 is an additional amount of pension costs to the value of £5.1 million.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

During the year, the company obtained the following services from the company's auditors, at costs detailed below:

3. OPERATING PROFIT (continued)

	2006	2005
	£m	£m
Audit services		
Statutory audit	0.1	0.1
Audit related regulatory reporting	-	-
	<u> </u>	<u> </u>

4. DIRECTORS AND EMPLOYEES

Directors' remuneration

	2006	2005
	£m	£m
Salaries	0.3	0.3
Benefits	0.1	0.1
Bonus	0.1	0.1
Share-based payments	0.1	0.1
	<u> </u>	<u> </u>
	<u>0.6</u>	<u>0.6</u>

Employee costs

	2006	2005
	£m	£m
Wages and salaries	46.8	50.9
Social security costs	4.1	4.4
Pension costs (see note 20)	7.8	8.1
	<u> </u>	<u> </u>
	58.7	63.4
Capital schemes and charges against provisions	(37.5)	(32.6)
	<u> </u>	<u> </u>
Charged to the income statement	<u>21.2</u>	<u>30.8</u>

Included within restructuring costs for 2005 is an additional amount of pension costs to the value of £5.1 million .

Average number of employees during the year (full-time equivalent)

	2006	2005
	Number	Number
Licensed multi-utility operations	<u>1,305</u>	<u>1,459</u>

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

5. INVESTMENT INCOME

	2006	2005
	£m	£m
Interest receivable	4.8	5.2
Income from fixed assets	-	1.5
Income from disposal of investment (see note 30)	0.1	-
	<u>4.9</u>	<u>6.7</u>

6. FINANCE EXPENSE

	2006	2005
	£m	£m
Fair value loss on debt and derivative instruments	3.5	-
Interest payable on bank borrowings	48.7	41.5
Interest payable to company undertakings	1.8	3.3
	<u>54.0</u>	<u>44.8</u>

7. TAXATION

	2006	2005
	£m	£m
Current tax:		
UK corporation tax	23.8	(6.0)
Prior year	0.4	(24.6)
Deferred tax (note 21)		
Current year	6.0	33.8
Prior year	(4.5)	-
	<u>25.7</u>	<u>3.2</u>

Corporation tax is calculated at 30 per cent (2005: 30 per cent) of the estimated assessable profit for the year

The table below reconciles the notional tax charge at the UK corporation tax rate to the effective tax rate for the year:

	2006	2006	2005	2005
	£m	%	£m	%
Profit before tax	104.0	-	81.4	-
Tax at the UK corporation tax rate of 30%	31.2	29.8	24.4	30.0
Prior years' tax adjustments	(4.1)	(3.9)	(25.7)	(31.6)
Non-taxable (income)/expense	(1.4)	(1.3)	4.5	5.5
	<u>25.7</u>	<u>24.6</u>	<u>3.2</u>	<u>3.9</u>

In addition to the amount charged to the income statement, deferred tax relating to actuarial gains/(losses) on defined benefits scheme £10.7 million charge (2005: £1.7 million credit) and adjustments due to the adoption of IAS32 and 39 of £3.0 million (2005: nil) was also charged to the statement of recognised income and expense.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

8. DIVIDENDS

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

	2006	2005
	£m	£m
Final dividend for the year ended 31 March 2005 at 8.2 pence per share (2004: 24.3 pence)	39.1	38.1
Interim dividend for the year ended 31 March 2006 at 7.4 pence per share (2005: 12.7 pence)	11.7	19.9
	<u>50.8</u>	<u>58.0</u>

The proposed final dividends for the year ended 31 March 2006 and 31 March 2005 were subject to approval by equity holders of the company and, hence, have not been included as a liability in the financial statements at 31 March 2006 and 31 March 2005 respectively.

9. DIRECTORS AND THEIR INTERESTS

The aggregate emoluments of the directors in 2006 amounted to £525,290 (2005: £367,920). Emoluments comprise salaries, fees, taxable benefits and the value of short-term incentive awards. The emoluments of J E Roberts and S G Batey are not included in the aggregate emoluments figures. The emoluments of these two directors are disclosed in the accounts of United Utilities PLC. The emoluments of the highest paid director (E Cooke) in 2006 in respect of services to the company amounted to £188,899 (2005: M J Boxall £104,591).

Four long-term incentive awards vested in the year ended 31 March 2006 (year ended 31 March 2005 was £nil). Information relating to long-term incentive awards is contained in the accounts of United Utilities PLC.

With the exception of M J Boxall and G Dixon, all 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. The defined benefit scheme provides an entitlement on normal retirement of age 60 equal to between 1/30th and 1/45th 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. All other directors are members of defined benefit pension schemes.

M J Boxall and G Dixon are members of, and contributes to, the Electricity Supply Pension Scheme, a defined benefit scheme which provides on normal retirement at the age of 60 a pension equal to 1/80th of pensionable earnings for each completed year of service (plus 3/80th cash). Early retirement is possible from the age of 50 if the company agrees.

The Finance Act 1989 restricts the pension's benefits that can be paid by these schemes to directors who joined the company after 1 June 1989 because the earnings cap limits pensionable earnings for calculating benefits. The company has put in place separate arrangements for some of the executive directors affected, the effect of which is to provide for them the same total pension benefits as for those executives who are not limited by the cap. These arrangements are unfunded.

The pension contributions for the highest paid director for 31 March 2006 (E Cooke) was £15,502 (2005: M J Boxall £30,420). The accrued pension at 31 March 2006 for the highest paid director (E Cooke) was £273,529 (2005: M J Boxall £599,358).

At 31 March 2006 and 2005, or date of appointment, the directors and their families had the following interests, all of which were beneficial interests, in the ordinary and A shares and options to subscribe for ordinary and A shares and options to subscribe for ordinary shares in United Utilities PLC. The interests of J E Roberts, S G Batey and C Comish in United Utilities PLC are disclosed in that company's accounts.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

9. DIRECTORS AND THEIR INTERESTS (continued)

2005/2006	At 31 March 2006			At 31 March 2005			
	Ordinary shares	Executive option scheme options	Employee sharesave options	Ordinary shares	A shares	Executive options	Employee sharesave options
S Beaumont	10,758	27,258	2,909	10,185	-	27,547	2,909
M Beesley	6,769	578	465	5,299	456	14,494	1,178
M J Boxall	3,006	-	950	2,224	-	-	1,351
K M Budinger	1,213	-	-	-	-	-	1,213
E Cooke	2,465	3,758	1,751	836	-	21,130	1,751
G Dixon	8,637	5,585	2,609	4,584	1,802	12,961	3,169

During the year four directors exercised share options (2005: three).

Details of the employee sharesave scheme and the executive share option scheme operated by United Utilities PLC are given in that company's accounts.

10. INTANGIBLE ASSETS

	Software £m	Assets in course of construction £m	Total £m
Cost at 1 April 2004	10.6	12.7	23.3
Additions	4.0	3.2	7.2
At 31 March 2005	14.6	15.9	30.5
Amortisation at 1 April 2004	2.3	-	2.3
Charge for the year	3.7	-	3.7
At 31 March 2005	6.0	-	6.0
Cost at 1 April 2005	14.6	15.9	30.5
Additions	6.3	-	6.3
Disposals	15.9	(15.9)	-
Disposals	(2.0)	-	(2.0)
At 31 March 2006	34.8	-	34.8
Amortisation at 1 April 2005	6.0	-	6.0
Charge for the year	2.7	-	2.7
Disposals	(2.0)	-	(2.0)
At 31 March 2006	6.7	-	6.7
Net book value at 31 March 2006	28.1	-	28.1
Net book value at 31 March 2005	8.6	15.9	24.5

At 31 March 2006, the company had entered into contractual commitments for the acquisition of other intangibles amounting to £2.9 million (2005: £11.9 million).

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

11. PROPERTY, PLANT AND EQUIPMENT

	Operational structures £m	Non operational land and buildings £m	Fixtures and equipment, vehicles and other £m	Assets in course of construction £m	Total £m
Cost or valuation at 1 April 2004	2,007.3	24.4	80.3	127.7	2,239.7
Additions	74.8	-	2.5	68.7	146.0
Transfers	50.4	-	2.9	(53.3)	-
Disposals	(2.9)	(3.2)	(15.1)	-	(21.2)
At 31 March 2005	2,129.6	21.2	70.6	143.1	2,364.5
Depreciation at 1 April 2004	638.3	4.1	57.0	-	699.4
Charge for the year	44.9	0.4	11.2	-	56.5
Disposals	(2.9)	(0.4)	(14.8)	-	(18.1)
At 31 March 2005	680.3	4.1	53.4	-	737.8
Cost or valuation at 1 April 2005	2,129.6	21.2	70.6	143.1	2,364.5
IFRS opening restatement	0.7	-	-	-	0.7
Additions	75.5	3.9	1.2	60.6	141.2
Transfers	57.0	0.0	4.1	(61.1)	0.0
Disposals	(4.3)	(2.0)	(20.2)	0.0	(26.5)
At 31 March 2006	2,258.5	23.1	55.7	142.6	2,479.9
Depreciation at 1 April 2005	680.3	4.1	53.4	-	737.8
Charge for the year	45.3	0.7	6.5	-	52.5
Disposals	(4.4)	(0.5)	(19.8)	-	(24.7)
At 31 March 2006	721.2	4.3	40.1	-	765.6
Net book value at 31 March 2006	1,537.3	18.8	15.6	142.6	1,714.3
Net book value at 31 March 2005	1,449.3	17.1	17.2	143.1	1,626.7

At 31 March 2006, had the property, plant and equipment other than investment property of the Company been carried at historical cost less accumulated depreciation and accumulated impairment losses, their carrying amount would have been approximately £1,533.9 million (2005: £1,477.8 million).

The revaluation surplus is disclosed in note 26. The revaluation surplus arose following a directors' revaluation of operational assets and non operational land and buildings in 1997.

At 31 March 2006, the company had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £29.1 million (2005: £91.5 million).

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

12. INVESTMENT PROPERTY

	£m
Fair value and deemed cost at 1 April 2004	11.3
Depreciation	(0.3)
	<hr/>
Cost at 31 March 2005	11.0
Disposal	(5.3)
Depreciation	(0.3)
	<hr/>
Cost at 31 March 2006	<u>5.4</u>

The fair value of the company's investment property at 1 April 2004 has been arrived at following a valuation performed by property advisers Matthew and Goodman following International Valuation Standards.

The property rental income earned by the Company from its investment property, all of which is leased out under operating leases, amounted to £0.9 million (2005: £1.5 million). Direct operating expenses arising on the investment property in the period amounted to £nil million (2005: £nil million).

13. OTHER INVESTMENTS

	£m
Cost	
At 1 April 2004	65.0
	<hr/>
At 31 March 2005	65.0
Additions	-
Disposals (see note 30)	(29.3)
	<hr/>
At 31 March 2006	<u>35.7</u>

Details of the other investments at 31 March 2006 are as follows:

Subsidiary undertaking	Description of holding	Proportion held	Nature of business
NB Generation Limited	Ordinary shares of £1 each	100%	Dormant
NB Property & Estate Services Limited	Ordinary shares of £1 each	100%	Pursuance of investment opportunities on behalf of United Utilities Electricity PLC
NB Leasing Limited	Ordinary shares of £1 each	100%	Lessor of assets to other companies within the United Utilities Electricity PLC Company
NB Miles Platting Limited	Ordinary shares of £1 each	100%	Dormant
Other investments	Description of holding	Proportion held	Nature of business
ESN Holdings Limited	Ordinary shares of £1 each	6.20%	Investment company

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

National Grid PLC	Ordinary shares of 11.76p each	Negligible	Energy distribution
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13. OTHER INVESTMENTS (continued)

Associated undertaking	Description of holding	Proportion held	Nature of business
Nor.Web Limited	Ordinary shares of £1 each	50%	Dormant

14. INVENTORIES

	2006 £m	2005 £m
Raw materials and consumables	3.4	3.6

15. CASH AND CASH EQUIVALENTS

	2006 £m	2005 £m
Cash at bank and in hand	137.0	-
Short term bank deposits	-	-
Bank overdrafts	(8.1)	(1.9)
	<u>128.9</u>	<u>(1.9)</u>

Cash and cash equivalents comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less, net of bank overdrafts which are payable on demand.

The effective interest rate on short term deposits was 4.50 per cent (2005: 4.49 per cent) and these deposits have an average maturity of 22 days.

The bank overdrafts and temporary borrowings are repayable in less than one year. The weighted average rate of interest on bank overdrafts and temporary borrowings was 5.50 per cent (2005: 5.75 per cent).

16. TRADE AND OTHER RECEIVABLES

	2006 £m	2005 £m
Trade receivables	14.5	4.4
Amounts owed by Company undertakings	9.1	7.1
Amounts owed by subsidiary undertakings	-	8.1
Prepayments and accrued income	27.2	23.5
	<u>50.8</u>	<u>43.1</u>

Trade receivables do not carry interest and are stated net of allowances for doubtful receivables of £0.6 million (2005: £2.6 million) estimated by management based on known specific circumstances, past default experience and their assessment of the current economic environment.

The company has no significant concentration of credit risk with exposure spread over a large number of customers.

The directors consider that the carrying amount of trade and other receivables approximates their fair value.

The average credit period taken on sales is 18.7 days (2005: 6.2).

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

17. BORROWINGS

	2006	2005
	£m	£m
Bank overdrafts	8.1	1.9
Bank loans and other loans	698.2	689.5
	<u>706.3</u>	<u>691.4</u>

The borrowings are repayable as follows:

Within one year	62.4	66.7
From one to two years	-	4.4
From two years to three years	-	4.4
From three years to four years	-	4.4
From four years to five years	-	4.5
After five years	643.9	607.0
	<u>706.3</u>	<u>691.4</u>

Included within this analysis by the company are amounts included as owed to group undertakings of £6.6 million (2005: £12.8 million) and amounts owed to subsidiaries of £47.7 million (2005: £47.6 million) all of which are included as Trade and other payables.

The company considers the following financial instruments to be significant:

	Maturity	Carrying value
		£m
Financial instruments		
£450m 8.875% notes	25-Mar-26	553.8
		<u>553.8</u>

On total borrowings, before the impact of derivative instruments, interest rates are at 8.875 per cent on £553.8 million (2005: £539.1 million) and are at floating rates on £153.5 million (2005: £152.3 million).

Bank overdrafts

Bank overdrafts are repayable on demand. The weighted average rate of interest on bank overdrafts was 5.50 per cent (2005: 5.75 per cent).

Term loans

Amounts repayable on term loans after more than five years, before the impact of derivative instruments, comprise loans repayable between 2011 and 2026. Interest rates are at 8.875 per cent on £553.8 million (2005: £517.0 million) and are at floating rates on £90.1 million (2005: £90.0 million).

The weighted average rate of interest on term loans, before the impact of derivative instruments, was 8.20 per cent (2005: 8.20 per cent).

The company had available unutilised committed bank facilities of £75.0 million (2005: £75.0 million). Of the amounts unutilised, £30.0 million expires within one year (2005: £25.0 million), £20.0 million expires after one year but in less than two years (2005: £30.0 million), and the remaining £25.0 million expires in more than two years (2005: £20.0 million).

The fair values of the company's financial instruments are shown in note 18.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

17. BORROWINGS (continued)

Taking into account all derivative instruments, including those not designated as a hedge relationship, borrowings can be analysed as follows:

	Fixed rate borrowings			Floating rate borrowings		Total £m
	Weighted average interest rates %	Weighted average period for which rate is fixed years	At fixed interest rates £m	Weighted average interest rate %	At floating interest rates £m	
2006						
Sterling	7.05	9.8	535.0	4.67	123.6	658.6

	Fixed rate borrowings			Floating rate borrowings		Total £m
	Weighted average interest rates %	Weighted average period for which rate is fixed years	At fixed interest rates £m	Weighted average interest rate %	At floating interest rates £m	
2005						
Sterling	7.20	9.7	626.0	5.32	17.8	643.8

Debt items held at fair value through profit or loss:

	Carrying value £m	Interest rates/ exchange rates £m	Credit risk £m	Total impact recognised in the income statement £m	Payable at maturity £m
£250m 8.875% due March 2026	358.9	(13.5)	(4.3)	(17.8)	250.0

The company has borrowings totalling £706.3 million (2005: £691.4 million), of which £62.4 million falls due within one year (2005: £66.7 million), is repayable on demand and is based on floating rates. The remaining loans totalling £643.9 million fall due after five years and have maturities and interest rates as follows:

£90.1 million matures in 2013 with interest charged at floating rates and £553.8 million with interest charged at 8.875 per cent matures in 2026.

As at 31 March 2005 the company had borrowings, totalling £691.4 million of which £66.7 million fell due within one year, £62.3m was repayable on demand with interest charged at floating rates, £2.2m was repayable in September 2005 and a further £2.2m was repayable in March 2006, both with interest charged at 8.875 per cent. The remaining loans totalling £624.7 million had maturities and interest rates as follows:

£90.0 million maturing in 2013 had interest charged at floating rates and the remaining £534.7 million relates to loans maturing in 2026 with interest charged at 8.875 per cent.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

18. FINANCIAL INSTRUMENTS

	Carrying value 2006 £m	Fair value 2006 £m	Carrying value 2005 £m	Fair value 2005 £m
Financial assets				
Current assets				
Derivative financial instruments	13.0	13.0	-	-
Financial liabilities				
Non-current liabilities				
Borrowings	(643.9)	(760.0)	(624.7)	(709.1)
Current liabilities				
Bank overdrafts	(8.1)	(8.1)	(1.9)	(1.9)
Borrowings	(55.2)	(55.2)	(64.8)	(64.8)
Derivative financial instruments	(1.9)	(1.9)	-	(6.8)

Financial instruments and risk management

The primary financial risk faced by the company is interest rate risk.

The Board has reviewed and agreed policies for managing this risk, as summarised below. The Board has also 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 at least annually to the Board, which provide written principles on the use of financial derivatives.

All of the company's activities involve analysis, acceptance and management of some degree of risk or combination of risks. The most important types of financial risk are credit risk, liquidity risk and market risk. Market risk includes foreign exchange, interest rate and equity price 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 United Utilities Company Audit Committee, under authority delegated by the United Utilities Group Board, formulates high level company risk management policy, monitors risk and receives reports that allow it to review the effectiveness of the company's risk management policies.

Credit risk management

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 lending, trade finance, treasury and leasing activities. The company has dedicated standards, policies and procedures to control and monitor all such risks.

Liquidity management

The company maintains a strong liquidity position and manages the liquidity profile of its assets, liabilities and commitments so that cashflows are appropriately balanced and all funding obligations are met when due.

Market risk management

Market risk is the risk that movements in market rates, including foreign exchange rates, interest rates, equity and commodity prices will reduce the company's income on the value of its portfolios. The management of market risk is undertaken using risk limits approved by the finance director under delegated authority.

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

NOTES TO THE ACCOUNTS

For the year ended 31 March 2006

18. FINANCIAL INSTRUMENTS (continued)

The company's activities expose it to the financial risks of changes in interest rates. The company uses interest rate swap contracts and financial futures to hedge this exposure. The company does not use derivative financial instruments for speculative purposes.

The counterparties to derivative instruments consist of financial institutions and other bodies with good credit ratings. Although the company is potentially exposed to credit loss in the event of non-performance by counterparties, such credit risk is controlled through credit rating reviews of the counterparties and by limiting the total amount of exposure to any one party. The company does not believe it is exposed to any material concentrations of credit risk.

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

Under an interest rate swap, the company agrees with another party to exchange at specific intervals the difference between fixed rate and floating rate interest amounts calculated by reference to an agreed notional principal amount. The notional principal of these instruments reflects the extent of the company's involvement in the instruments, but does not represent its exposure to credit risk, which is assessed by reference to fair value.

The company makes no significant sales or purchases in currencies other than its functional currency. Accordingly, the company has no material unhedged foreign currency exposures.

Financial instruments utilised by the company can be summarised as follows:

Interest rate swaps

Interest rate swaps are used solely to manage floating rate borrowings in order to reduce the financial risk to the company from potential future changes in medium-term interest rates.

Financial futures

Financial futures are used to manage the company's exposure to possible future changes in short-term rates.

Fair values of financial instruments

The fair value of derivative instruments has been calculated by discounting the future cashflows of the individual contracts using the appropriate market interest rate and currency rates. Where interpolation occurs at points along the curve this can significantly affect the value given to these instruments. As such, changes in the frequency of points taken along the curve can affect the value of these instruments. In addition, any changes in the assumed rates input to these models could give rise to significant changes in value. The fair values of interest rate swaps exclude the related accrued interest receivables and payables which are shown in the balance sheet separately within trade and other payables and receivables.

Fair values have been estimated using the following methods and assumptions:

Non-current investments

The fair value of investments, for which there are no quoted market prices, approximates to their carrying value. The company's long-term investments are detailed in note 13. The company's unlisted investments are held at cost as their fair value cannot be reliably measured as they are not actively traded and the range of estimates is too wide. The carrying value of the company's unlisted investments is £1.2 million (2005: £2.0 million).

Current assets and liabilities

Financial instruments included within current assets and liabilities (excluding cash and borrowings) are generally short-term in nature and accordingly their fair values approximate to their book values.

Borrowings and non-equity interests (excluding foreign exchange contracts)

The carrying values of cash and short-term borrowings and current asset investments approximate to their fair values because of the short-term maturity of these instruments. The fair value of long-term borrowings is estimated by discounting the future cashflows to net present values using appropriate market interest rates prevailing at the year end.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

18. FINANCIAL INSTRUMENTS (continued)

Interest rate swaps

The company enters into interest rate swaps in order to manage its interest rate exposures.

The analysis in the table below illustrates the sensitivity of the market value of the company's financial instruments to changes in interest rates. The analysis assumes an instantaneous 1.0 per cent (100 basis points) move in interest rates for all maturities and currencies from their levels at 31 March 2006 with all other variables held constant.

	Market value 31 March 2006 £m	+1% movement in interest rate £m	-1% movement in interest rate £m
Interest rate movement			
Long-term debt	(760.0)	78.0	(91.4)
Derivatives	11.1	(27.9)	34.6

Hedges

Achieving hedge accounting under IAS 39 'Financial Instruments: Recognition and Measurement' is based on measuring the effectiveness of the derivative as a hedge instrument as well as fulfilling hedge documentation rules. The effectiveness test compares the change in fair value of the designated derivative and the change in fair value of the hedged item to determine if this ratio falls within the permitted range of 80 per cent to 125 per cent. Any derivative that falls outside the permitted range is classified as held for trading. Gains or losses on the derivative are recognised immediately in the income statement except where the derivative is designated within an effective cashflow hedge relationship, in which case the gains and losses are deferred in equity and are recycled through the income statement at the time the hedged item is recognised in the income statement. Where a derivative does fall within the permitted range but is not 100 per cent effective, the ineffective element is recognised in the income statement immediately. Those derivative instruments that are not designated in a hedging relationship are classified as held for trading.

The company has no regular way transactions, and has not pledged collateral in relation to any of its derivative instruments.

The fair value of the derivative financial instruments as at 31 March 2006 was as follows:

	Assets fair value £m	Liabilities fair value £m
Current		
Held for trading derivatives	13.0	(1.9)

Included in the above table is a liability relating to a cashflow hedge, the notional and fair value of which is inconsequential. Within the year ended 31 March 2006, a movement in the fair value of the derivative of £0.7 million was recognised and taken to reserves.

The notional value of the financial instruments as at 31 March 2006 was as follows:

	Cash instrument s assets £m	Cash instrument s liabilities £m	Derivative asset legs £m	Derivative liabilities legs £m	Total £m
Sterling	137.0	(540.0)	590.0	(679.0)	(492.0)

For the year ended 31 March 2005 the following are relevant as required by FRS 13 'Derivatives and other financial instruments: Disclosure':

Unrecognised gains and losses on financial assets and liabilities for which hedge accounting has been used at the balance sheet date are £1.9 million and £8.7 million respectively.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

18. FINANCIAL INSTRUMENTS (continued)

As at 31 March 2005 the company anticipated that £0.5 million of these gains and £5.6 million of these losses would have been realised in the year ended 31 March 2006. Of the unrecognised gains and losses on hedges as at 1 April 2004 the net gain recognised in the income statement for the year ended 31 March 2005 was £4.1 million.

19. TRADE AND OTHER PAYABLES

	2006	2005
	£m	£m
Trade creditors	7.9	7.5
Amounts owed to company undertakings	30.9	36.6
Amounts owed to subsidiary undertakings	47.7	47.6
Other taxation and social security	4.4	8.1
Other creditors	6.4	12.0
Consumers' contributions	6.8	6.4
Refundable customer deposits	19.1	8.8
Accruals and deferred income	43.9	68.0
	<u>167.1</u>	<u>195.0</u>

Trade creditors principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 43 days (2005: 49 days).

Included within amounts owed by the Company to company undertakings is £6.6 million (2005: £12.8 million) included in the borrowing analysis within note 17.

Included within amounts owed by the Company to subsidiary undertakings is £47.7 million (2005: £47.6 million) included in the borrowing analysis within note 17.

20. RETIREMENT BENEFIT SCHEMES

The company participates in a number of pension schemes principally in the UK. The major schemes are funded defined benefit schemes – the United Utilities Pension Scheme (UUPS) and the United Utilities Company of Electricity Supply Pension Scheme (ESPS) (the 'Schemes'), of which the ESPS is closed to new employees. UUPS also includes a defined contribution section which constitutes less than 0.5 per cent of the total asset value. The assets of these Schemes are held in trust funds independent of company finances.

The last actuarial valuation of the Schemes were carried out as at 31 March 2004. These valuations have been updated to take account of the requirements of IAS 19 'Employee Benefits' in order to assess the position at 31 March 2006 by projecting forward from 31 March 2004, and have been performed by an independent actuary, Mercer Human Resource Consulting.

The company adopts an accounting policy of recognising actuarial gains and losses as they occur in the Statement of Recognised Income and Expense.

On 31 March 2005, the company made lump sum payments of £8.6 million and £71.0 million to UUPS and ESPS respectively. The payments were in lieu of the estimated company contributions that would have been payable for defined benefit members over the five years from 1 April 2005. Subject to the results of the actuarial valuations at 31 March 2007, company contributions will resume from 1 April 2010. In the meantime, the company will continue to pay contributions in respect of the defined contribution members and insurance premiums. Other payments will be made by the company in accordance with the funding agreement between the Trustee and the company.

The company also operates a series of unfunded, unapproved retirement benefit schemes. The cost of the unfunded, unapproved retirement benefit schemes is included in the total pension cost, on a basis consistent with IAS 19 and the assumptions set out below.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

20. RETIREMENT BENEFIT SCHEMES (continued)

The total defined benefit pension cost for the year was £2.9 million (2005: £10.8 million), of which £Nil million is included within restructuring costs, (2005: £5.1 million) in respect of pension severance benefits. A pension obligation of £1.8 million is included in the balance sheet at 31 March 2006 (2005: obligation of £35.0 million). Information about the pension arrangements for executive directors is contained in note 9.

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

	At 31 March 2006	At 31 March 2005
Discount rate	4.90%	5.40%
Expected return on assets	6.10%	6.60%
Pensionable salary growth - UUPS	3.75%	4.10%
Pensionable salary growth - ESPS	3.80%	4.30%
Pension increases	2.80%	2.80%
Price inflation	2.80%	2.80%

As at 31 March 2006, the company's share of the fair value of plan assets, together with the liabilities in the plans recognised in the balance sheet were as follows:

	Plan assets at 31 March 2006 %	Value at 31 March 2006 £m	Plan assets at 31 March 2005 %	Value at 31 March 2005 £m
Equities	66.6	493.9	63.7	402.2
Gilts	22.3	165.2	18.6	117.4
Bonds	11.0	81.5	14.9	94.1
Property	0.1	0.7	0.1	0.6
Cash	-	-	2.7	17.0
	<hr/>	<hr/>	<hr/>	<hr/>
Total fair value of assets	100.0	741.3	100.0	631.3
Present value of liabilities		(743.1)		(666.3)
		<hr/>		<hr/>
Net retirement benefit obligation		(1.8)		(35.0)
		<hr/> <hr/>		<hr/> <hr/>

To develop the expected long-term rate of return on assets assumption, the company considered the level of expected returns on risk-free investments, the historic level of the risk premium associated with the other asset class 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 on the actual asset allocation to develop the expected long-term return on assets assumption for the portfolio. The actual return on plan assets for the schemes was £147.8 million (2005: £69.1 million).

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

20. RETIREMENT BENEFIT SCHEMES (continued)

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

	2006	2005
	£m	£m
At 1 April	(666.3)	(611.5)
Current service cost	(7.5)	(8.1)
Interest cost on plan obligations	(31.3)	(41.1)
Member contributions	(2.0)	(2.0)
Past service cost	(0.3)	(5.1)
Actuarial losses	(76.0)	(31.3)
Benefits paid	40.3	32.8
	<u>(743.1)</u>	<u>(666.3)</u>

Movements in the fair value of the plan assets were as follows:

	2006	2005
	£m	£m
At 1 April	631.3	506.8
Expected return on plan assets	36.2	43.5
Actuarial gains	111.6	25.6
Company contributions	0.5	86.2
Member contributions	2.0	2.0
Benefits paid	(40.3)	(32.8)
	<u>741.3</u>	<u>631.3</u>

The net pension expense before taxation recognised in the income statement in respect of the defined benefit schemes is summarised as follows:

	2006	2005
	£m	£m
Current service cost	(7.5)	(8.1)
Past service cost	(0.3)	-
Past service cost - restructuring costs	-	(5.1)
Expected return on plan assets	36.2	43.5
Interest on plan obligations	(31.3)	(41.1)
	<u>(2.9)</u>	<u>(10.8)</u>

The above amounts are all recognised in arriving at operating profit.

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

	2006	2005
	£m	£m
At 1 April	(35.0)	(104.7)
Expenses recognised in the income statement	(2.9)	(10.8)
Contributions paid	0.5	86.2
Actuarial gains/(losses) gross of taxation	35.6	(5.7)
	<u>(1.8)</u>	<u>(35.0)</u>

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

20. RETIREMENT BENEFIT SCHEMES (continued)

Actuarial gains and losses are recognised directly in the statement of recognised income and expense. At 31 March 2006, a cumulative gain of £29.9 million (2005: loss £5.7 million) had been recorded directly in the statement of recognised income and expense.

The history of the plan for the current and prior period is as follows:

	2006	2005
	£m	£m
Experience adjustments on plan obligations	-	(8.1)
Experience adjustments on plan assets	111.6	25.6
Changes in assumptions	(76.0)	(23.2)
	<u>35.6</u>	<u>(5.7)</u>

21. DEFERRED TAX

The following are the major deferred tax liabilities and assets recognised by the company, and the movements thereon, during the current and prior reporting periods.

	Accelerated tax depreciation £m	Retirement benefit obligations £m	Other £m	Total £m
At 1 April 2004	310.7	(31.4)	(21.2)	258.1
Charged to the income statement	30.7	22.6	(19.5)	33.8
Charged to equity for the year	-	(1.7)	-	(1.7)
	<u>341.4</u>	<u>(10.5)</u>	<u>(40.7)</u>	<u>290.2</u>
At 31 March 2005	341.4	(10.5)	(40.7)	290.2
Charged to the income statement	(6.9)	(0.9)	9.3	1.5
Charged to equity for the year	-	10.7	3.0	13.7
	<u>334.5</u>	<u>(0.7)</u>	<u>(28.4)</u>	<u>305.4</u>

22. PROVISIONS

	Restructuring Provision £m	Other £m	Total £m
At 1 April 2005	3.6	0.6	4.2
Utilisation of provision	(2.8)	(0.1)	(2.9)
	<u>0.8</u>	<u>0.5</u>	<u>1.3</u>

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

23. CONSUMER CONTRIBUTIONS

Consumer contributions are those amounts received from a customer in respect of the provision of a new connection to the network.

Consumer contributions are amortised through the income statement over the lifetime of the relevant asset.

	£m
At 1 April 2004	218.4
Additions during the year	15.8
Amortisation	(6.2)
	<hr/>
At 31 March 2005	228.0
Additions during the year	31.3
Amortisation	(6.6)
	<hr/>
At 31 March 2006	252.7
	<hr/> <hr/>
Amounts due in less than one year (see note 19)	6.8
Amounts due after more than one year	245.9
	<hr/>
	252.7
	<hr/> <hr/>

24. REFUNDABLE CUSTOMER DEPOSITS

Refundable customer deposits are those consumer contributions which have may be in part refundable dependable on contracted targets.

	2006	2005
	£m	£m
Amounts due in less than one year (see note 19)	19.1	8.8
Amounts due after more than one year	6.1	13.1
	<hr/>	<hr/>

25. SHARE CAPITAL

	2006	2005
	£	£
Authorised:		
569,999,996 (2005: 249,999,996) ordinary shares of 50 pence each	284,999,998	124,999,998
4 'A' ordinary shares of 50 pence each	2	2
Special rights redeemable preference share of £1	1	1
	<hr/>	<hr/>
	285,000,001	125,000,001
	<hr/> <hr/>	<hr/> <hr/>
	2006	2005
	£	£
Allotted, called up and fully paid:		
476,821,341 (2005: 156,821,341) ordinary shares of 50 pence each	238,410,671	78,410,671
4 'A' ordinary shares of 50 pence each	2	2
	<hr/>	<hr/>
	238,410,673	78,410,673
	<hr/> <hr/>	<hr/> <hr/>

During the year 320 million ordinary shares of 50 pence each were issued at par to United Utilities North West PLC, the company's immediate holding company.

The 'A' ordinary shares and the ordinary shares rank pari passu in all respects, save that dividends may be declared on one class of shares without being declared on the other.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

26. SHAREHOLDER'S EQUITY

	Called up share capital £m	Share premium account £m	Revaluation reserve £m	Capital redemption reserve £m	Retained earnings £m	Total £m
At 1 April 2004	78.4	4.4	132.3	8.6	114.0	337.7
Profit for the year	-	-	-	-	78.2	78.2
Dividends	-	-	-	-	(58.0)	(58.0)
Transfer from revaluation reserve	-	-	(3.3)	-	3.3	-
Post employment benefits actuarial gains on defined benefit schemes	-	-	-	-	(4.0)	(4.0)
At 31 March 2005	78.4	4.4	129.0	8.6	133.5	353.9
Adoption of IAS 32 and IAS 39	-	-	-	-	7.2	7.2
At 1 April 2005	78.4	4.4	129.0	8.6	140.7	361.1
Profit for the year	-	-	-	-	78.3	78.3
Dividends	-	-	-	-	(50.8)	(50.8)
Fair value loss on cash flow hedges	-	-	-	-	(0.7)	(0.7)
New share capital issued	160.0	-	-	-	-	160.0
Transfer from revaluation reserve	-	-	(2.0)	-	2.0	-
Post employment benefits actuarial gains on defined benefit schemes	-	-	-	-	25.0	25.0
At 31 March 2006	238.4	4.4	127.0	8.6	194.5	572.9

27. OPERATING LEASES

The company is committed to making the following payments over the lifetime of the lease in respect of non-cancellable operating leases which expire in:

	Land and buildings 2006 £m	Plant and machinery 2006 £m	Land and buildings 2005 £m	Plant and machinery 2005 £m
Within one year	0.6	0.5	0.6	0.9
In the second to fifth years inclusive	2.1	0.6	2.2	0.7
After five years	3.1	0.1	3.8	0.1
	5.8	1.2	6.6	1.7

NOTES TO THE ACCOUNTS

For the year ended 31 March 2006

28. ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

From 1 January 2005, all European Union listed companies are required to prepare consolidated financial statements under International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB) and endorsed by the European Union. Accordingly, the results for the year ended 31 March 2006 have been prepared in accordance with IFRS accounting policies. The company's previously reported results for the year ended 31 March 2005 have been restated, the date of transition to IFRS being 1 April 2004.

In accordance with International Financial Reporting Standard 1 'First-time Adoption of International Financial Reporting Standards' (IFRS 1), the company's accounting policies under IFRS have been applied retrospectively at the date of transition, with the exception of a number of permitted exemptions. These are summarised below:

- The application of IAS 32 'Financial Instruments: Disclosure and Presentation' and IAS 39 'Financial Instruments: Recognition and Measurement' with effect from 1 April 2005;
- The application of IFRS 2 'Share-based Payment' to those share options granted after 7 November 2002 but which had not vested by 1 April 2004;
- The recognition, in full, of all actuarial gains and losses relating to pension schemes at 1 April 2004 and, prospectively, through the statement of recognised income and expense.

The major areas of impact of IFRS are summarised below:

Defined benefit pension schemes

IAS 19 'Employee Benefits'

The company prepared its 2005 UK GAAP results in accordance with SSAP 24 'Accounting for Pension Costs', with FRS 17 'Retirement Benefits' transitional disclosures provided in the notes to the accounts. FRS 17 became fully effective for accounting periods beginning on or after 1 January 2005. The company has not adopted FRS 17 and has moved directly to IAS 19.

Under SSAP 24, any pension scheme surplus or deficit identified at the most recent actuarial valuation is recognised gradually through the profit and loss statement over the average expected future working lifetime of current employees. The net pension cost under SSAP 24 therefore includes both the cost of providing an additional year of pension benefits to employees (regular cost) and an element of the surplus/deficit relating to previous years (variation). The difference between employer's contributions paid and the SSAP 24 net pension cost is recognised as a prepayment/accrual, resulting in a balance sheet position that does not necessarily reflect the actuarial position. Interest is calculated on this balance sheet entry and is also included within the net pension cost. In accordance with IAS 19, any legal and constructive obligation for post employment benefit plans must be immediately recognised as an asset or liability on the balance sheet. Where actual experience differs from the assumptions made at the start of a financial year, actuarial gains and losses will be recognised through the statement of recognised income and expense.

The adoption of IAS 19 increases the 2005 profit before tax by £5.9 million compared with UK GAAP.

The de-recognition of the UK GAAP SSAP 24 prepayment reduces net assets by £69.8 million (net of deferred tax). The SSAP 24 prepayment reflected the lump sum payment of £79.6 million (pre-tax) made at 31 March 2005. Net assets are then further reduced by the recognition of the IAS 19 deficit of £24.5 million (net of deferred tax).

Deferred tax

IAS 12 'Income Taxes'

The major impact of IAS 12 relates to discounting of deferred tax not being permitted. FRS 19 'Deferred Tax' permits, but does not require, a deferred tax asset or liability to be discounted and as a result the company has been able to apply a policy of discounting its deferred tax liability. However, IAS 12 does not permit discounting in any circumstances. This is of particular significance to a utility business where any reversal of timing differences is likely to be deferred long into the future due to the long asset lives of network assets.

NOTES TO THE ACCOUNTS

For the year ended 31 March 2006

28. ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

The inability to discount results in an increase in the balance sheet deferred tax liability of £196.6 million at 31 March 2005 and consequently a reduction in net assets.

The deferred tax impacts arising from any other IFRS adjustments are included in the relevant sections.

Dividends

IAS 10 'Events After the Balance Sheet Date'

IAS 10 and SSAP 17 'Accounting for Post Balance Sheet Events' both distinguish 'adjusting events' from 'non-adjusting events' with similar definitions and applications. However, under IAS 10 dividends may not be recognised until they have been appropriately authorised and are no longer at the discretion of the entity. Therefore, if this occurs after the balance sheet date, the dividends are not recognised as a liability at the balance sheet date. However, they are disclosed in the notes to the accounts in accordance with IAS 1 'Presentation of Financial Statements'.

Dividends are no longer recognised within the income statement and are recorded directly within reserves. The final dividend of £39.1 million included with the UK GAAP financial statements for 2004/05 has been reversed at 31 March 2005, thereby increasing net assets.

Accounting for derivatives

IAS 39 'Financial Instruments: Recognition and Measurement'

The company is taking the exemption offered by IFRS 1 to apply IAS 39 with effect from 1 April 2005 rather than 1 April 2004 (the date of transition). The comparative information for 2004/05 within the 31 March 2006 IFRS financial statements therefore reflects derivatives accounted for under UK GAAP applicable on 31 March 2005.

Under UK GAAP, debt is carried at its hedged amount and the fair values of derivatives are not recognised in the balance sheet. Under IAS 39, the default treatment is for debt 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 income statement. This has the potential to introduce considerable volatility to both the income statement and balance sheet. Therefore, for fair value hedges, IAS 39 allows changes in the recognised value of hedged debt that are attributable to the hedged risk to be adjusted through the income statement. In the case of cashflow hedges, movements in the fair value of derivatives are deferred within reserves until they can be recycled through the income statement to offset the future income statement effect of changes in the hedged risk. In order to apply this treatment, 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. Changes in the fair value of all derivatives are recognised in the income statement, except for derivatives that are designated and effective in terms of cashflow hedging relationships, in which case the gains and losses are deferred in equity.

As a result of IAS 39 being applied, the fair value of debt, derivatives and deferred income reduced by £11.2 million, deferred tax increased by £3.3 million and reserves increased by £7.2 million, at 1 April 2005.

Investment properties

IAS 40 'Investment Property'

Under IAS 40, a property that is held to earn rentals or for capital appreciation or both should be classified as investment property. The key change from UK GAAP (SSAP19) is that under IAS 40, properties owned by one group entity, but let and occupied by another should be treated as investment properties.

Where a property is classified as an investment property it may be held at fair value or depreciated cost. The Company policy is to use the depreciated cost model, using fair values as deemed cost on initial adoption. The revaluation undertaken to determine the fair value of those assets now deemed investment properties has resulted in a decrease to net assets of £4.4 million compared with UK GAAP.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

28. ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

Company balance sheet

Comparative balance 31 March 2005

	UK GAAP	Other	Defined Benefit Schemes	Divi- dends	Deferred tax	Investment Properties	IFRS
	£m	£m	£m	£m	£m	£m	£m
ASSETS							
Non-current assets							
Intangible assets	-	24.5	-	-	-	-	24.5
Property, plant and equipment	1,666.6	(35.8)	-	-	-	(4.4)	1,626.4
Investment property	-	11.3	-	-	-	-	11.3
Other investments	65.0	-	-	-	-	-	65.0
	<u>1,731.6</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(4.4)</u>	<u>1,727.2</u>
Current assets							
Inventories	3.6	-	-	-	-	-	3.6
Trade and other receivables	142.7	-	(99.6)	-	-	-	43.1
	<u>146.3</u>	<u>-</u>	<u>(99.6)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>46.7</u>
Total assets	<u>1,877.9</u>	<u>-</u>	<u>(99.6)</u>	<u>-</u>	<u>-</u>	<u>(4.4)</u>	<u>1,773.9</u>
LIABILITIES							
Non-current liabilities							
Amounts falling due after one year	(859.4)	859.4	-	-	-	-	-
Borrowings	-	(624.7)	-	-	-	-	(624.7)
Retirement benefit obligation	-	-	(35.0)	-	-	-	(35.0)
Deferred tax liabilities	-	-	40.3	-	(330.5)	-	(290.2)
Provisions	(138.1)	-	-	-	133.9	-	(4.2)
Consumer contributions	-	(221.6)	-	-	-	-	(221.6)
Refundable customer deposits	-	(13.1)	-	-	-	-	(13.1)
	<u>(997.5)</u>	<u>-</u>	<u>5.3</u>	<u>-</u>	<u>(196.6)</u>	<u>-</u>	<u>(1,188.8)</u>
Current liabilities							
Borrowings	-	(6.3)	-	-	-	-	(6.3)
Trade and other payables	(270.3)	36.2	-	39.1	-	-	(195.0)
Tax liabilities	-	(29.9)	-	-	-	-	(29.9)
	<u>(270.3)</u>	<u>-</u>	<u>-</u>	<u>39.1</u>	<u>-</u>	<u>-</u>	<u>(231.2)</u>
Total liabilities	<u>(1,267.8)</u>	<u>-</u>	<u>5.3</u>	<u>39.1</u>	<u>(196.6)</u>	<u>-</u>	<u>(1,420.0)</u>
Total net assets	<u>610.1</u>	<u>-</u>	<u>(94.3)</u>	<u>39.1</u>	<u>(196.6)</u>	<u>(4.4)</u>	<u>353.9</u>
EQUITY							
Called up share capital	78.4	-	-	-	-	-	78.4
Share premium account	4.4	-	-	-	-	-	4.4
Revaluation reserve	184.3	-	-	-	(55.3)	-	129.0
Capital redemption reserve	8.6	-	-	-	-	-	8.6
Retained earnings	334.4	-	(94.3)	39.1	(141.3)	(4.4)	133.5
Total equity	<u>610.1</u>	<u>-</u>	<u>(94.3)</u>	<u>39.1</u>	<u>(196.6)</u>	<u>(4.4)</u>	<u>353.9</u>

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006
28. ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)
Company balance sheet

Opening balance sheet as at 1 April 2004

	UK GAAP	Other	Defined Benefit Schemes	Divi- dends	Deferred tax	Investment Properties	IFRS
	£m	£m	£m	£m	£m	£m	£m
ASSETS							
Non-current assets							
Intangible assets	-	20.9	-	-	-	-	20.9
Property, plant and equipment	1,577.3	(32.2)	-	-	-	(4.7)	1,540.4
Investment property	-	11.3	-	-	-	-	11.3
Other investments	65.0	-	-	-	-	-	65.0
	<u>1,642.3</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(4.7)</u>	<u>1,637.6</u>
Current assets							
Inventories	3.6	-	-	-	-	-	3.6
Trade and other receivables	97.4	-	(30.1)	-	-	-	67.3
Investments	100.0	-	-	-	-	-	100.0
	<u>201.0</u>	<u>-</u>	<u>(30.1)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>170.9</u>
Total assets	<u>1,843.3</u>	<u>-</u>	<u>(30.1)</u>	<u>-</u>	<u>-</u>	<u>(4.7)</u>	<u>1,808.5</u>
LIABILITIES							
Non-current liabilities							
Amounts falling due after one year	(856.4)	856.4	-	-	-	-	-
Borrowings	-	(628.9)	-	-	-	-	(628.9)
Retirement benefit obligation	-	-	(104.6)	-	-	-	(104.6)
Deferred tax liabilities	-	-	40.4	-	(298.4)	-	(258.0)
Provisions	(114.3)	-	-	-	113.5	-	(0.8)
Consumer contributions	-	(212.3)	-	-	-	-	(212.3)
Refundable customer deposits	-	(15.2)	-	-	-	-	(15.2)
	<u>(970.7)</u>	<u>-</u>	<u>(64.2)</u>	<u>-</u>	<u>(184.9)</u>	<u>-</u>	<u>(1,219.8)</u>
Current liabilities							
Borrowings	-	(7.6)	-	-	-	-	(7.6)
Trade and other payables	(289.1)	67.0	-	38.1	-	-	(184.0)
Tax liabilities	-	(59.4)	-	-	-	-	(59.4)
	<u>(289.1)</u>	<u>-</u>	<u>-</u>	<u>38.1</u>	<u>-</u>	<u>-</u>	<u>(251.0)</u>
Total liabilities	<u>(1,259.8)</u>	<u>-</u>	<u>(64.2)</u>	<u>38.1</u>	<u>(184.9)</u>	<u>-</u>	<u>(1,470.8)</u>
Total net assets	<u>583.5</u>	<u>-</u>	<u>(94.3)</u>	<u>38.1</u>	<u>(184.9)</u>	<u>(4.7)</u>	<u>337.7</u>
EQUITY							
Called up share capital	78.4	-	-	-	-	-	78.4
Share premium account	4.4	-	-	-	-	-	4.4
Revaluation reserve	187.6	-	-	-	(55.3)	-	132.3
Capital redemption reserve	8.6	-	-	-	-	-	8.6
Retained earnings	304.5	-	(94.3)	38.1	(129.6)	(4.7)	114.0
Total equity	<u>583.5</u>	<u>-</u>	<u>(94.3)</u>	<u>38.1</u>	<u>(184.9)</u>	<u>(4.7)</u>	<u>337.7</u>

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

28. ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

Reconciliation of profit for the year ended 31 March 2005

Income statement

	UK GAAP	Other	Deferred tax	Defined Benefit Schemes	IFRS
	£m	£m	£m	£m	£m
Revenue	258.4	-	-	-	258.4
Cost of sales	(17.2)	17.2	-	-	-
Other income	-	-	-	-	-
Distribution costs	(112.3)	112.3	-	-	-
Administration costs	(15.2)	15.2	-	-	-
Employee benefits expense	-	(36.7)	-	5.9	(30.8)
Depreciation and amortisation expense	-	(54.3)	-	-	(54.3)
Other operating costs	-	(45.0)	-	-	(45.0)
Restructuring costs	-	(8.7)	-	-	(8.7)
Total operating expenses	<u>(144.7)</u>	<u>-</u>	<u>-</u>	<u>5.9</u>	<u>(138.8)</u>
Operating profit	113.7	-	-	5.9	119.6
Investment income	6.7	-	-	-	6.7
Finance expense	(44.8)	-	-	-	(44.8)
Investment income and finance expense	<u>(38.1)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(38.1)</u>
Profit before tax	75.5	-	-	5.9	81.4
Tax	10.1	-	(11.6)	(1.7)	(3.2)
Profit for the year	<u><u>85.6</u></u>	<u><u>-</u></u>	<u><u>(11.6)</u></u>	<u><u>4.2</u></u>	<u><u>78.2</u></u>

Statement of Cash Flows

There were no material adjustments to the Statement of Cash Flows on adoption of IFRS. Small movements attributed to the implementation of IAS 19 in relation to the Defined Benefit Schemes have affected the position of items within operating cash flows but the net overall effect is £ nil.

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

29. RELATED PARTY TRANSACTIONS

The company receives and pays interest and recharges to other businesses in the United Utilities PLC group, which are related parties, in the normal course of business. Transactions between the company and other parts of the United Utilities PLC group were as follows:

	£m
Interest received	Nil
Interest paid	1.5
Recharges to	13.9
Recharges from	91.6
	<u> </u>

Amounts outstanding at 31 March 2006 and 2005 between the United Utilities Electricity PLC and other companies within the United Utilities Plc group are provided in notes 16 and 19.

The following transactions were carried out with other related parties:

	Sale of goods	Purchase of goods	Amounts owed by related parties	Amounts owed to related parties
	£m	£m	£m	£m
Associates	<u>0.2</u>	<u>0.1</u>	<u>0.1</u>	<u>0.2</u>

Related party receivables and payables are not secured and no guarantees were issued in respect thereof and will be settled in accordance with normal credit terms. The directors and key management are considered to be the same as for the UU group. Information on the remuneration of directors can be found in note 4 of these financial statements.

30. DISPOSAL OF INVESTMENT

As referred to in note 13, on 13 September 2005 the company disposed of its interest in UU Investments (No.2) Limited (formerly NB Gas Limited).

The unaudited net assets of UU Investments (No.2) Limited at the date of disposal and company gain on disposal were as follows:

	13/09/05
	£m
Investments	1.0
Trade receivables	49.2
Current tax liability	(11.8)
Amounts owed to parent	(9.1)
	<u> </u>
Net assets	29.3
	<u> </u>
Total consideration	29.4
	<u> </u>
Gain on disposal	0.1
	<u> </u>

NOTES TO THE ACCOUNTS
For the year ended 31 March 2006

31. ULTIMATE PARENT UNDERTAKING AND CONTROLLING PARTY

The accounts of the Company are consolidated in the group accounts of the ultimate parent undertaking and ultimate controlling entity United Utilities PLC, a company registered in England and Wales. Copies of the accounts of United Utilities PLC may be obtained from the Company Secretary, United Utilities PLC, Dawson House, Great Sankey, Warrington WA5 3LW. The immediate parent of the Company is United Utilities North West PLC.

32. CASH GENERATED FROM OPERATIONS

	2006	2005
	£m	£m
Cash generated from operations		
Profit before taxation	104.0	81.4
Adjustment for investment income and finance expense	49.1	38.1
	<hr/>	<hr/>
Operating profit	153.1	119.5
Adjustments for:		
Depreciation of property, plant and equipment	52.8	56.8
Amortisation of intangible assets	2.7	3.7
Amortisation of customer contributions	(6.6)	(6.2)
Profit on disposal of investment	(0.1)	-
Profit on disposal of investment property	(0.5)	-
Profit on disposal of property, plant and equipment	(1.5)	(2.5)
Changes in working capital		
Decrease in inventories	0.2	-
Increase in trade and other receivables	(14.9)	(42.1)
Increase / (decrease) in provisions and payables	(25.8)	0.5
	<hr/>	<hr/>
Cash generated from continuing operations	<u>159.4</u>	<u>129.7</u>