

**UNITED UTILITIES ELECTRICITY PLC**

**Annual Report and Consolidated Financial  
Statements**

**31 March 2007**

**ANNUAL REPORT AND FINANCIAL STATEMENTS 2007**

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## MANAGING DIRECTOR'S STATEMENT

### Performance

The board is pleased to report another good set of financial results. Revenue increased by 11.8 per cent to £315.6 million, reflecting allowed price increases of 2.6 per cent and adjustments to tariffs resulting from underrecoveries of allowed revenue in previous years. Operating profit before the impact of restructuring credit of £0.6 million increased to £175.5 million, up 18.9 per cent on last year, primarily reflecting the increase in revenue.

United Utilities Electricity PLC 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 293 kilometres of overhead lines and replaced 91 kilometres of underground cables. It also replaced or refurbished 579 switchgear units and replaced 280 transformers.

Electricity supplies were available for 99.99 per cent of the time during the financial year ended 31 March 2007, sustaining the business's high level of performance in managing the network to maintain constant supplies for consumers. Under the regulatory interruptions incentive scheme, United Utilities Electricity PLC ('UUE') 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 53.89\*, out-performing the regulatory target for the year of 57.1. The average number of minutes for which consumers were without supply was 56.68\*, beating the regulatory target for the year of 58.1 minutes. (Figures denoted by \* have not yet been audited 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 would like to thank them for their continuing commitment and hard work.

The board places great importance on the quality, accuracy and reliability of information on both financial and non-financial matters that we provide to our regulators. Such information is subject to rigorous internal checks, review and sign off before it is submitted.

### Strategy

United Utilities Electricity PLC maintains its strategic focus on enhancing the value of the business by increasing investment, improving 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.

### The future

We have updated our operating model to formally separate asset ownership from asset operations and maintenance. This has been done through the creation of a new operating subsidiary, United Utilities Electricity Services Ltd, which has operated since 1 April 2007 with clearly defined cost targets and performance incentives. The aim is to increase our focus on performance management and support the sharing of best practice and knowledge across the business.

The formal legal split between asset ownership and asset operations will enhance the performance and value of UUE in a number of ways. The creation of an ownership team, distinct from the service provider, enables a specific, senior management focus on the commercial, regulatory and financial strategy of UUE and connects this with the strategy for the long-term development of the asset base. The operational management team of the service provider is able to focus on cost control, performance, customer service, and delivery. Furthermore, the contractual discipline and reporting regimes that have been put in place to separate the two businesses have increased the awareness of, and incentives to improve, performance, customer service, and cost efficiency. United Utilities PLC announced on 5 June 2007 its decision to initiate a sale process for United Utilities Electricity PLC's distribution assets.

Eóin Cooke  
Managing Director

**OPERATING AND FINANCIAL REVIEW**

**NATURE OF THE BUSINESS**

**Business overview**

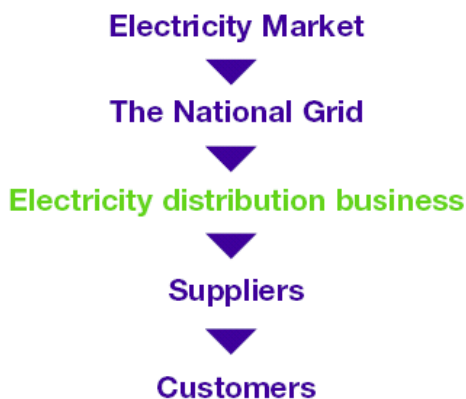
United Utilities Electricity PLC (‘the Company’) is a public limited company registered in England and Wales. The principal activity of the Company and of United Utilities Electricity PLC Group (‘the Group’) is the operation of electricity distribution assets.

United Utilities Electricity PLC is a subsidiary of United Utilities PLC. The activities of United Utilities Electricity PLC are controlled 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 (‘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.

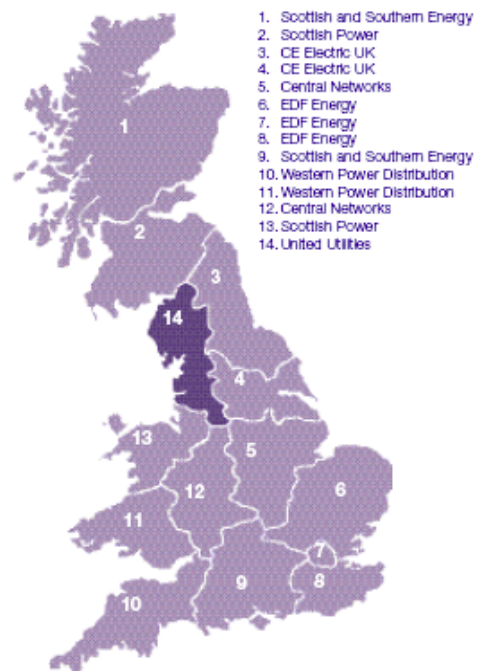
**Business description**

The electricity industry in the UK consists of four distinct components: generation, transmission, distribution and supply (see figure 1 – UK electricity market components). The majority of electricity distribution services are provided by regional distribution companies, each with its own service area. These are broadly based on the former electricity board areas (see figure 2 – UK electricity distribution companies in England, Scotland and Wales). The electricity market is regulated by the Gas and Electricity Markets Authority (the Authority), which governs and acts through the Office of Gas and Electricity Markets (‘Ofgem’). In the electricity market, suppliers contract with generators (for wholesale power) and with transmission and distribution network businesses (for delivery services), in order that they can provide energy to final consumers.

**Figure 1 UK electricity market components**



**Figure 2 UK electricity distribution companies**



## OPERATING AND FINANCIAL REVIEW

### *Electricity distribution*

The Group 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 PLC's main customers. Annual revenue is driven, in part, by the volume of electricity distributed. The income derived from the distribution business therefore depends in part on changes in the demand for electricity by consumers in north west England, and also from generators who have been connected to United Utilities Electricity PLC's network under contracts agreed since 1 April 2005. 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 and energy efficiency measures. The electricity distribution business is a regulated business in which the average revenue from charges, which a company may collect in any year, is capped by the electricity regulator (as described in more detail below). Accordingly, profit derived from the distribution business of United Utilities Electricity PLC also depends upon efficiency, achieved by reducing and controlling costs, and providing high standards of service.

Key non- financial 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 31 March 2007, sustaining the business's high level of performance in managing the network to maintain constant supplies for consumers. Under the regulatory Interruptions Incentive Scheme, United Utilities Electricity PLC has been set network performance targets for the number and duration of customer supply interruptions. Although we have still outperformed regulatory targets, performance in the past year has been adversely affected by a few high impact events on the grid and primary distribution systems, including third party damage to 33,000 volt cables. The average number of interruptions per 100 consumers per annum was 53.89\*, out-performing the regulatory target for the year of 57.1. The average number of minutes for which consumers were without supply was 56.68\*, just out-performing the regulatory target for the year of 58.1 minutes. (Figures in this paragraph denoted by \* are still to be audited by Ofgem at the date of this report).

### **Economic regulation**

The electricity industry in Great Britain 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'). 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 Ofgem. Ofgem also exercises powers under UK competition legislation, most significantly the Competition Act 1998 and the Enterprise Act 2002.

The UK 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 PLC holds an electricity distribution licence that authorises it to distribute electricity anywhere in Great Britain. Under that licence, United Utilities distributes electricity across its distribution system covering an area in north west England comprising 2.4 million consumer premises. Restrictions included within the electricity distribution licence include:

- a non-discrimination obligation;
- restrictions on the payment of dividends. The board of directors must provide a certificate of compliance before declaring dividends, affirming they are satisfied that the business is complying with relevant licence obligations including that it has sufficient resources and that the making of the distribution will not cause it to be in material breach of any of the obligations in the future;
- restrictions on dealing with associated companies. The consent of Ofgem is required before lending any funds to an associated company and all transactions with associated companies must be on an arm's length basis, without cross subsidy;
- ring-fencing of financial and management resources of the licensed business; and
- restriction on the disposal of any asset forming part of the distribution system.

Licence conditions can be modified by Ofgem either with the agreement of the licensee (or, in the case of standard conditions, with the agreement of the requisite proportion of 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.

**OPERATING AND FINANCIAL REVIEW**

Ofgem regulates electricity distribution charges by capping the average charges that a company can impose in any year. Ofgem 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. The size of a company's X factor (which can be positive, negative or zero) and the change at the start of a price control period to the opening revenue value (defined as P<sub>0</sub> change) reflect 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 PLC was allowed a real (excluding inflation) P<sub>0</sub> price increase of 8.2 per cent in 2005/06 followed by constant real prices thereafter (i.e. the X factor = zero). Ofgem published its first scoping letter and timetable for the 2010 price review on 17 May 2007.

Price cap regulation as operated in the UK 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 Ofgem 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. Ofgem consulted on its approach to the incentive scheme as part of the price control review and again in 2006; including the form of the scheme, targets and associated costs. It has been agreed that the distribution network operators' performance in those areas will continue to be incentivised until the end of the next price control period (31 March 2015). Under the scheme, United Utilities Electricity PLC 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.

Under the terms of their licences, electricity distribution network operators ('DNOs') must produce and implement charging methodologies for both connection to and use of their distribution systems. The methodologies are required to set out the principles and methods by which charges will be calculated. The methodologies must be approved by Ofgem.

**Use of system agreements**

Following a review by Ofgem, in 2006 the former bilateral agreements governing the commercial contractual arrangements relating to the connection to and use of distribution networks were replaced by a single multilateral contract, the Distribution Connection and Use of System Agreement ('DCUSA'), as Ofgem felt that it would improve transparency.

**Electricity metering services**

In 2006/07 Ofgem consulted on licence modifications that are intended to clarify the obligations on DNOs with respect to electricity metering services after the price controls on the provision of new and replacement meters and meter operation services expire on 31 March 2007. The effect of the modifications is to make clear that from 1 April 2007, the regulatory price cap will be retained only for the rental of electricity meters installed prior to 31 March 2007. Other metering services will no longer form part of the definition of a distribution business and DNOs that wish to provide new or replacement meters or meter operation services must do so through a separate subsidiary. As a result of this change, United Utilities Electricity PLC will cease to provide meter operation services from 30 June 2007 and the provision of new or replacement meters will be carried out by a fellow subsidiary of United Utilities PLC.

**Environmental regulation*****Underground cabling***

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 PLC 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 PLC's operating area, and with the backing of Ofgem, the company has embarked on a programme of converting from overhead cables to underground cables in designated areas on aesthetic grounds.

## OPERATING AND FINANCIAL REVIEW

There is an allowance of £5 million provided by Ofgem for such work over the period 2005-10. The first of these schemes was completed recently and five more are now in progress.

### *High voltage cables*

United Utilities Electricity PLC, in common with all other UK electricity companies, owns and operates pressure-assisted high voltage cables. These operate at voltages of 33,000 and 132,000 volts. These cables are either filled with nitrogen gas or a light 'oil' type fluid. United Utilities operate both types, having 620 kilometres of the latter type of cable. 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') and is an issue concerning waste disposal and pollution law. In order to mitigate the effects of any losses, United Utilities Electricity PLC is party to a national code of practice agreement with the EA. Over the last six years, the company has worked to minimise losses into the environment and has reduced annual loss to around 25m<sup>3</sup> in 2005/06 from a high of 74m<sup>3</sup> in 2001/02. However 2006/07 has been a particularly disappointing year, with losses of 49m<sup>3</sup>. A significant contribution to this figure is damage caused to United Utilities Electricity PLC's 33,000 volts cables by third parties, although there is a contribution from some particularly poorly performing cables that have been replaced during 2006/07.

### *Sulphur hexafluoride (SF6) management*

SF6 is a gas with excellent electrical insulation and other properties, which has led to its widespread use in electrical switchgear. However, there is concern over the SF6 that escapes into the atmosphere since it is a potent greenhouse gas, with a greenhouse warming potential of 22,200 times that of carbon dioxide. The Kyoto Protocol to the Climate Change Convention has recognised the need to curb emissions of all greenhouse gases, including SF6.

United Utilities Electricity PLC's strategy is accurately to record levels of leaks, to replace high leak rate sites and to review and develop future targets. The company is working with the electricity industry and manufacturers to continue developing vacuum and solid insulation for switchgear, and so work towards eliminating the use of SF6 switchgear.

The annual leakage of SF6, as recorded at 1 April 2006 and reported to the Environment Agency, equates to 254kg, or 2% of the total mass of SF6 controlled by UUNW of 12,984kg. Management are not currently aware of any requirements or proposals that will result in the company being required to reduce leakage or otherwise increase costs, although we are monitoring the situation closely through the Energy Networks Association.

### *Microgeneration*

The Climate Change and Sustainable Energy Act was adopted in June 2006 with the primary aim of encouraging the production of energy through microgeneration and community energy schemes, improving energy efficiency and alleviating fuel poverty. The act seeks to cut the emission of carbon dioxide in the UK and introduces new powers to modify the conditions of electricity distribution and supply licences to ensure that energy companies pay a fair price for electricity produced from microgeneration. These are uncertain dependent on technology, market and regulatory issues. A possible significant effect could be a reduction of units distributed in the long-term. We are working to influence Ofgem through the price control mechanism so that this does not have a negative effect on the Company's revenue.

### *Electric and magnetic fields*

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 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 ('WHO') and the International Agency for Research on Cancer and, in the UK, the Health Protection Agency ('HPA') (which has subsumed the former National Radiological Protection Board) continue to investigate this issue and have concluded that there is no established causal link between EMFs and ill health.

In March 2001, the HPA 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

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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 HPA 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 for Non-Ionising Radiation Protection ('ICNIRP'). In March 2004, the HPA recommended that the ICNIRP guidelines should be adopted. A report published by the Childhood Cancer Research Group ('CCRG') in 2005 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 HPA, has issued several reports relating to EMFs, considering their possible link with an increased risk of cancer. The most recent AGNIR report on EMFs published in February 2006 concluded that the evidence does not support the hypothesis that exposure to EMFs is associated with an increased risk of breast cancer and that, although it is inconclusive, it does not appear that EMFs affect the hormone melatonin (a reduction in which can lead to breast cancer). The report gave recommendations for further research to be carried out.

In spite of the official view of bodies like the HPA and the WHO, there continues to be significant lobbying by pressure groups concerned about the alleged effects of public electricity infrastructure on health. In 2005, a cross industry all stakeholder group on the issue was set up in the UK. It is known as the Stakeholder Advisory Group on Extra Low Frequency EMFs ('SAGE'). Although SAGE was initiated by National Grid plc, it has now been taken up by the Department of Health, and essentially will undertake a report to the Department of Health and the government on EMF issues in relation to health. The industry is represented on SAGE by the National Grid and by the Energy Networks Association of which United Utilities Electricity PLC is a member. The work of SAGE is not complete, although it is expected that a report will be delivered to the Department of Health during 2007/08. Currently the balance of advice in SAGE seems to support the status quo, although given the breadth of views necessarily aired in the process, other options which could drive significant costs for the industry (such as the maintenance of building-free corridors around power lines) have had their merits reviewed. However it will be for government to decide on the appropriate response to stakeholder concerns, and United Utilities Electricity PLC does not currently expect any real shift from the status quo to emerge.

United Utilities Electricity PLC, in line with other Energy Networks Association ('ENA') member companies, carries out its activities in accordance with HPA 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.

## RESOURCES

### People

#### *Industrial relations*

Good industrial relations remain a priority for United Utilities Electricity PLC. The Group continues to recognise and work in partnership with trade unions. A statement of principles governs the approach to labour relations across the Group. Around 99 per cent of employees within the Company are now represented by trade unions for collective bargaining purposes, a process which is underpinned by principles contained within a voluntary collective agreement entitled 'Together in Partnership'. Following an independent and comprehensive review and re-evaluation of the agreement, a series of joint initiatives have been put in place to develop this collaborative approach to employee relations further.

#### *Health and safety*

United Utilities Electricity PLC remains committed to maintaining high standards of health and safety in every area of its business and is in full alignment with the HSE 'Revitalising Health and Safety' strategy. Key performance indicators are in place and progress is monitored regularly at all levels throughout the business. As a utility business, the risk profile remains broad with both major construction projects and contractor management playing a key part. There were 11 accidents in 2006/07 (representing a rate of 10.3 per 1,000 employees) which were reportable under the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations, showing a reduction of over 5.7% to the previous year's rate of 10.9 per 1,000 employees. In addition there were 10,361 working days

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lost, due to accidents and ill health, a rate of 9,746 per 1,000 employees, showing a reduction of 1.2% on the previous rate of 9,868 days per 1,000 employees.

### *Training and development*

The Group encourages employees to work to their full potential and is committed to improving its employees' skills through training and development and nurturing a culture in which employees feel valued.

### *Dignity and equality*

The Group respects the dignity and rights of every employee and supports them in performing various roles in society. The Group also challenges prejudice and stereotyping. October 2006 saw the introduction of the new Employment Equality (Age) Regulations. Employees across the Company were briefed, making them aware of their rights under this new legislation.

An equal pay audit was conducted during the year and no major disparities in pay between male and female employees were found when comparing like for like roles.

### *Employees with disabilities*

The Group is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995 and best practice. As an equal opportunities employer, the Group 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 Group 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 2007, the Group's facilities included 13,128 kilometres of overhead lines, 43,149 kilometres of underground cables (operating at 132 kilovolts, 33 kilovolts, 25 kilovolts, 11 kilovolts, 6.6 kilovolts and 400/230 volts), 18,248 ground mounted substations and 17,021 pole mounted transformers. United Utilities Electricity PLC 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, United Utilities Electricity PLC has statutory rights to seek the compulsory retention of a wayleave if termination is sought by the landowner/occupier. United Utilities Electricity PLC does not anticipate that any significant relocation of these facilities will be required, although any relocation of a major portion of these facilities would have a material adverse effect on its business and financial position. Ground mounted substations are situated on properties either owned by United Utilities Electricity PLC or held under lease. Pole mounted transformers are generally held under wayleave agreements. United Utilities Electricity PLC anticipates that it will be able to negotiate lease renewals on satisfactory terms or relocate equipment so that the non-renewal of any such leases would not have a material adverse effect upon United Utilities Electricity PLC.

In addition to the assets described above, the Group 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 Group will be able to negotiate renewals of any expiring leases, or relocate the relevant facilities, without having a material adverse impact on the Group.

## PRINCIPAL RISKS AND UNCERTAINTIES

The board considers the following risks to be the principal ones that might affect the Group's performance and results but cautions that the risks listed in this section do not address all the factors that could cause results to differ materially. There may be additional risks that the Group does not currently know of, or that are deemed immaterial based on either information currently available or the Group's current assessment of the risk. The Group's business, financial condition or results of operations could be materially affected by any of these risks, resulting in a decline

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in the trading price of United Utilities PLC's ordinary shares. The Group operates an internal control system to evaluate and manage risks as described immediately below.

### *Internal control*

The board is responsible for the company's system of internal controls and for reviewing its effectiveness. Each year management 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.

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 which provides independent scrutiny of internal control systems and risk management procedures;
- 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 an 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.

### **Principle risks and uncertainties**

#### **The Group's revenue is substantially influenced by the regulator, which could adversely affect profitability**

The revenue and profitability of the Group is substantially influenced by price controls established every five years by the regulator. The price control review for the Group covering the five-year period commencing on 1 April 2005 was determined by the regulator in November 2004. The Group 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.

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### **Failure to deliver the capital investment programmes could adversely affect profitability**

The Group requires significant capital expenditure for additions to, or replacement of, plant and equipment for its facilities and networks. The price controls 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 Group has financed the expenditure from cashflows from operations and from debt financing. There can be no assurance that cashflows 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 could adversely affect profitability**

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 Group's profitability would suffer. Similarly, if operational performance were to deteriorate, this may be reflected in less favourable outcomes from future price control reviews and the Group's profitability would suffer.

### **Environmental regulations could increase the Group's costs and adversely affect profitability**

Various 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 Group's operations. In addition, the Group is required to obtain various environmental permissions from regulatory agencies for its operations. The Group endeavours to comply with all regulatory standards. Should the Group fail to comply, it would face fines imposed by the courts or otherwise face sanctions by the regulator.

### **Service interruptions could adversely affect profitability**

In addition to the capital investment programmes, the Group 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.

During 2006/07, there were an unusually high number of interruptions in total, which led to a few long duration interruptions and a number of interruptions affecting a large number of customers. However there were no instances of interruptions combining long duration and high numbers affected. Nevertheless, 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 Group's operating results or financial position.

### **Pension scheme obligations may require the Group to make additional contributions to the schemes which would reduce profitability**

The Group participates in a number of pension schemes. The principal schemes are funded defined benefit schemes and the assets of the schemes are held in trust funds independent of Group finances.

A one-off lump sum contribution of £8.6 million was made to UUPS and £71.0 million was made to ESPS on 31 March 2005. These contributions were calculated to equal the capitalised value of the Group's funding obligations to the schemes for the next five years (based on the actuarial valuation as at 31 March 2004) and paid in lieu of certain employer contributions which would have been made to the schemes during that period.

The Group's proportion of the schemes was estimated to have a combined pre-tax surplus of £24.5 million as at 31 March 2007, compared to a pre-tax obligation of £1.8 million at 31 March 2006, as disclosed under IAS 19.

It should be noted that the funding requirements of the schemes are set on the basis of a number of actuarial assumptions about the future and, to the extent that actual experience is less favourable than the assumptions made, additional contributions over and above those paid already/expected to be paid in the future may be required. The profitability of the Group may therefore be affected.

Currently expected further pension contributions and a proportion of the existing scheme deficits are recoverable through the price controls established by Ofgem.

## OPERATING AND FINANCIAL REVIEW

### 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 PLC 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.

#### Developing a high performance company

Our strategy is built upon the key enabler of a high performance culture and the achievement of a long-term sustainable operating model. This requires significant transformational change of the business in the way it will enhance expenditure planning and manage its assets and workforce.

#### Sale of electricity distribution assets

Since the end of the financial year, the Group has realigned its structure to encourage improved performance and to lead to more commercial behaviour. As one of the first stages of realigning the existing businesses into the new structure, a new operating entity, United Utilities Electricity Services Limited, has been established. This company will focus on the operation and maintenance of the group's electricity assets, currently owned by United Utilities Electricity PLC.

The board of United Utilities PLC has taken a decision to initiate a sale process for United Utilities Electricity PLC, which owns the electricity distribution assets, but intends to retain the asset operator function (within United Utilities Electricity Services Limited), consistent with its core skills strategy.

The Company has identified a number of measurements against which it assesses its performance:

- **Customer minutes lost ('CMLs')** – to meet or out-perform regulatory targets during the regulatory period 2005-10.

United Utilities Electricity PLC met the 2006/07 regulatory targets for CMLs set by Ofgem.

- **Customer interruptions ('CIs')** – to meet or out-perform regulatory targets during the regulatory period 2005-10.

United Utilities Electricity PLC met the 2006/07 regulatory targets for CIs set by Ofgem.

- **Overall customer satisfaction** – 85% in the medium-term.

Good progress has already been made in meeting the efficiency challenges set by Ofgem and 69 per cent of United Utilities Electricity PLC's customers, who had made an enquiry, were satisfied with the overall service they received. 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. 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 2006/07 against these measures is set out in the table below, together with the prior year performance data.

## OPERATING AND FINANCIAL REVIEW

### Key performance indicators

|   | 2007      | 2006      |
|---|-----------|-----------|
| <b>Financial</b>  |           |           |
| Revenue   | £315.6m   | £282.4m   |
| Operating profit before restructuring credit of £0.6m<br>(2006: £0.6m)    | £175.5m   | £147.6m   |
| Profit before tax   | £144.9m   | £103.0m   |
| RAV Gearing <sup>(1)</sup>  | 44%       | 47%       |
| Interest cover <sup>(2)</sup>   | 4.5 times | 3.2 times |
| Capital expenditure on property, plant and equipment<br>(cashflow)        | £175.4m   | £142.0m   |
| <b>Non-financial</b>  |           |           |
| Average minutes for which customers were without supply<br><sup>(3)</sup> | 56.68     | 51.52     |
| Customer interruptions per 100 customers <sup>(4)</sup>                   | 53.89     | 47.50     |
| Overall customer satisfaction <sup>(5)</sup>                              | 69%       | 70%       |
| Electricity supply availability   | 99.99%    | 99.99%    |

<sup>(1)</sup> RAV Gearing is measured as borrowings net of cash and short-term deposits and loans from other United Utilities PLC group companies divided by the provisional Regulatory Asset Value (RAV) of £1,090.3 million (2006: £1,057.1 million). The RAV Gearing is on a Company basis which is consistent with Ofgem's reporting requirements.

<sup>(2)</sup> Interest cover is the number of times the net underlying finance expense is covered by operating profit from continuing operations before restructuring costs. Net underlying interest expense is calculated as the underlying cost of borrowings excluding any pension adjustment and movements in the fair value of debt and derivatives but including the £24.4 million (2006: £22.0 million) interest on swaps and debt under fair value option.

<sup>(3)</sup> 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 2007 figure is still to be audited by Ofgem.

<sup>(4)</sup> Customer interruptions per 100 customers is a standard measure of network reliability used by Ofgem and is calculated as: (total customers affected/total customers connected to the network) x 100. The 2007 figure is unaudited by Ofgem at the date of this report.

<sup>(5)</sup> Overall customer satisfaction in relation to the response received from an enquiry is measured by an internal overall customer experience assessment mechanism. It involves a series of interviews with customers. Sample interviews are conducted monthly.

### Financial review

Revenue increased by 11.8 per cent to £315.6 million in 2006/07, largely due to an allowed real price increase of 2.6 per cent in the year and adjustments to tariffs resulting from underrecoveries of allowed revenue in previous years. Operating profit increased by 18.8 per cent to £176.1 million in 2006/07, primarily reflecting the increase in revenue. Capital investment in property, plant and equipment for the year was £175.4 million (2005/06: £142.0 million). This is within the regulatory allowance for the year and reflects the re-phasing of expenditure across the 2005-10 regulatory review period.

## OPERATING AND FINANCIAL REVIEW

The net finance expense for the year was £31.2 million compared with £45.2 million in 2005/06. This reduction reflects the full year effect of the equity injection in March 2006, fair value movements on debt and derivative financial instruments, and returns on pension scheme assets.

### Dividends and dividend policy

In 2006/07, United Utilities Electricity PLC dividends recognised in the period were £36.0 million. This figure represents a dividend payment relating to the financial year 2005/06 of £24.0 million, and an interim payment in 2006/07 of £12.0 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.

### Business performance

United Utilities Electricity PLC places a strong focus on maintaining the integrity, security and safety of its electricity distribution network and ensuring outputs are in line with its five-year delivery plan. During the year, the business replaced or refurbished 293 kilometres of overhead lines and replaced 91 kilometres of underground cables. It also replaced or refurbished 579 switchgear units and replaced 280 transformers.

### Business impacts

- **Business restructuring**

Since the end of the financial year, the board of United Utilities PLC has realigned the structure of United Utilities Electricity PLC to encourage improved performance and to lead to more commercial behaviour. From 1 April 2007, Utility Solutions will manage the operation of all wastewater and water, electricity and gas networks, whether that is on behalf of United Utilities' own businesses or for external clients. The Asset Management and Regulation function will develop and deliver regulatory price review strategy and will engage with key opinion-formers, ministers, regulators and civil servants. Finally, the Business Development function will develop a business growth strategy for the Group and deliver its international business' financial targets.

- **Sale of electricity distribution assets**

As one of the first stages of realigning the existing businesses into the new structure, a new operating entity, United Utilities Electricity Services Limited, has been established. This company will focus on the operation and maintenance of the group's electricity assets, which remain owned by United Utilities Electricity PLC. The board has taken a decision to initiate a sale process for the electricity distribution assets but expects to retain the United Utilities Electricity asset operator function.

## LIQUIDITY AND CAPITAL RESOURCES

The Group's primary source of liquidity is cash generated from its ongoing business operations. As reflected in the cashflow statement on page 26, in the financial year ended 31 March 2007, net cash generated from the Group's operating activities was £164.6 million, compared with £64.4 million in 2005/06. The electricity regulator has established price controls to 2010 which will provide certainty for a large majority of the Group'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, where necessary, are eliminated at the start of each financial year using short-term hedges. The credit quality of counterparties and individual aggregate exposures are reviewed annually.

## OPERATING AND FINANCIAL REVIEW

### *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. Standard and Poor upgraded its rating on the 2 April 2007 to A long-term with a stable outlook and A1 short-term. The Group's borrowings net of cash and short-term deposits of £481.9 million at 31 March 2007 comprised £642.6 million of bonds, £90.0 million of loans from the European Investment Bank (EIB – the Group's largest debt investor), £7.3 million of bank overdrafts and £0.4 million owed to parent undertaking, offset by £258.4 million of cash and short-term deposits.

### *Shorter-term liquidity*

Short-term liquidity requirements are met from the Group's normal operating cashflow. Further liquidity is provided by cash and short-term deposit balances, the 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 £258.4 million at 31 March 2007, compared with £137.0 million at 31 March 2006.

Bank overdrafts and temporary borrowings, which are repayable in less than one year, were £7.7 million at 31 March 2007, compared with £14.7 million at 31 March 2006. The Group had available unutilised committed bank facilities of £50.0 million (2006: £75.0 million), of which £20.0 million expires within one year (2006: £30 million), £nil million expires after one year but in less than two years (2006: £20.0 million), and the remaining £30.0 million expires in more than two years (2006: £25.0 million). Although unutilised during the financial year ended 31 March 2007, the US\$1.5 billion euro-commercial paper programme still provides for the periodic issuance of notes by United Utilities Electricity PLC. United Utilities Electricity PLC has entered into £50.0 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 Group has effective access to the international debt capital markets through its €7 billion medium-term note programme which provides for the periodic issuance by United Utilities Electricity PLC of debt instruments on terms and conditions determined at the time that the instruments are issued. The 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.

The Group's term loans were £732.6 million at 31 March 2007, compared with £643.9 million at 31 March 2006. Amounts repayable after more than five years comprise bank and other loans repayable between 2012 and 2046. Fixed interest rates, for amounts after more than five years, are at 8.875 per cent on £539.6 million (2005/06: £553.8 million) and are at floating rates on £90.0 million (2005/06: £90.1 million) of these loans. £103.0m of index linked debt was held at 31 March 2007 (2006: nil) at an interest rate of 1.4746% plus retail price index.

### *Interest rate management*

The Group manages interest rate exposure by seeking to match financing costs as closely as possible with the revenues generated by its assets. The Group's exposure to interest rate fluctuations is periodically managed in the medium-term through the use of interest rate swaps and the use of financial futures contracts traded on the London International Financial Futures and Options Exchange. The average interest rate for 2006/07 was 6.55 per cent, compared with 6.84 per cent in 2005/06 excluding fair value adjustments.

The Group uses a combination of interest rate swaps, futures and funding instruments to hedge exposure to interest rate volatility. The Group'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 Group 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 Group 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 Group 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 'Financial Instruments: Recognition and Measurement' limits the use of hedge accounting, thereby increasing the potential volatility of the income statement. However, this has no cashflow impact and the effect of IAS 39 should broadly balance out over the 2005-10 period.

## OPERATING AND FINANCIAL REVIEW

### *Summary*

The board has reviewed the business plan and considers that the Group has sufficient liquidity to meet the anticipated financial commitments for the next 12 months. In total, at 31 March 2007, unutilised committed facilities of £30.0 million expiring in more than one year, together with cash and short-term deposits of £258.4 million provide substantial pre-funding for the Group.

### CRITICAL ACCOUNTING POLICIES

The Group prepares its consolidated financial statements in accordance with accounting principles consistent with International Financial Reporting Standards ('IFRS') as adopted for use in the European Union including International Accounting Standards ('IAS') and interpretations issued by the International Financial Reporting Interpretation Committee ('IFRIC'). As such, the Group 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 Group 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 Group's accounting policies are detailed in the consolidated financial statements. The following paragraphs detail the policies the Group believes to have the most significant impact on the annual results under IFRS.

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

The Group'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 2007 was £1,831.6 million. Additions to PPE totalled £176.7 million and the depreciation charge was £59.4 million in the year ended 31 March 2007. 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 Group, 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 Group 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 Group 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 Group 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 PLC's distribution network to distribute electricity from generators to the end consumer. The amount 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 Group 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 Group 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

**OPERATING AND FINANCIAL REVIEW**

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.

**Retirement benefits**

United Utilities Electricity PLC participates in two defined benefit schemes, one of which has a defined contribution section, which are independent of the Group's finances. Actuarial valuations of the schemes for funding purposes are carried out at intervals of not more than three years. The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a firm of actuaries. The assumptions are disclosed in note 20 of the financial statements. Results are affected by the actuarial assumptions used. These assumptions include those made for investment returns on the schemes' assets, discount rates, pay growth and increases to pensions in payment and deferred pensions. Actual experience may differ from the assumptions made, for example, due to changing market and economic conditions and longer or shorter lives of participants.

**Derivatives and borrowings**

The Group'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 Group 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 Group'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 Group'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 Group is a member of a number of collaborative research programmes including EA Technology Limited which addresses common issues that face the electricity industry. The Group also undertakes specific projects with these and other research and development providers, manufacturers and with universities. Research and development expenditure by the Group was £1.3 million in the year ended 31 March 2007 (2005/06: £0.7 million).

**EVENTS AFTER THE BALANCE SHEET DATE**

On 4 June 2007, the United Utilities PLC board took the decision to initiate a sale process for UUE's distribution assets. United Utilities PLC intends to retain a contract for the operation of its electricity distribution assets.

## **OPERATING AND FINANCIAL REVIEW**

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

Certain statements included or incorporated by reference within the annual report may constitute ‘forward looking statements’. Forward looking statements are based on expectations, forecasts and assumptions by our management and involve a number of risks, uncertainties and other factors that could cause actual results to differ materially from those stated.

This report contains certain statements with respect to the financial condition, results of operations and business of the Group. Some of these statements are not facts, including those about the board’s beliefs and expectations. Words such as ‘expects’, ‘anticipates’, ‘intends’, ‘plans’, ‘believes’, ‘seeks’, ‘estimates’, ‘potential’, ‘reasonably possible’, ‘targets’ and variations of these words and similar expressions reflect inherent risks and uncertainty. Such statements are based on current plans, estimates and projections, and therefore investors should not rely on them. Further, the company undertakes no obligation to update publicly any of them in light of new information or future events and they are relevant only as at the date made. The company cautions investors that a number of important factors could cause actual results to differ materially from those anticipated or implied in any forward looking statements. These factors include: (i) the effect of, and changes in, regulation and government policy; (ii) the effects of competition and price pressures; (iii) the ability of the company to achieve cost savings and operational synergies; (iv) the ability of the company to service its future operations and capital requirements; (v) the timely development and acceptance of new products and services by the company; (vi) the effect of technological changes; and (vii) the company’s success in managing the risks of the foregoing. There may be additional risks that the Group does not currently know of, or that are deemed immaterial based on either information currently available or the group’s current assessment of the risk. The Group’s business, financial condition or results of operations could be materially affected by any of these risks.

The directors of United Utilities Electricity PLC advise that all the information supplied in the managing director’s statement on page 3 and the operating and financial review on pages 4 to 18 form part of the directors’ report as incorporated by reference. Any liability for the information is restricted to the extent prescribed in the Companies Act 2006.

## DIRECTORS' REPORT

The directors present their report and the audited financial statements of the United Utilities Electricity PLC Group (the 'Group') for the year ended 31 March 2007.

### Profit and dividends

The results for the year, set out in the income statement on page 23, show that revenue for the year ended 31 March 2007 increased to £315.6 million (2006: £282.4 million), an increase of 11.8 per cent over the previous year. Profit for the year after tax was £112.3 million (2006: £77.3 million).

An interim dividend of £12.0 million was paid in March 2007 for the year ended 31 March 2007 (2006: £11.7million), and a final dividend for the year ended 31 March 2006 of £24.0 million was paid in the year (2006: £39.1 million). The directors have recommended a final ordinary dividend for 2006/07 of £100.0 million.

### 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 apart from the sale of the distribution assets as mentioned below.

On 30 March 2007 the Company disposed of its interest in its non-trading subsidiary NB Generation Limited as detailed in note 29.

On 4 June 2007, the United Utilities PLC board took the decision to initiate a sale process for United Utilities Electricity PLC's distribution assets. United Utilities PLC intends to retain a contract for the operation of its electricity distribution assets.

The managing director's statement and the operating and financial review on pages 3 to 18 report on the Company's activities during the year and on likely future developments. A summary of key performance indicators can be found in the operating and financial review. The directors, in preparing the operating and financial review, have not sought to comply with the ASB's 2006 Reporting Statement on operating and financial reviews. All the information supplied in the managing director's statement on page 3 and the operating and financial review on pages 4 to 18 form part of the directors' report as incorporated by reference. Any liability is restricted to the extent prescribed in the Companies Act 2006.

### Principal risks and uncertainties

Principal risks and uncertainties are discussed as part of the operating and financial review.

### Research and development

The Group 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 Group.

### Employees

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

The Group is committed to improving its employees' skills through training and development and nurturing a culture in which employees feel valued. The Group 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 Group also challenges prejudice and stereotyping.

The Group is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995 and best practice. As an equal opportunities employer, the Group 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 Group 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.

## DIRECTORS' REPORT

The Group 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. A sharebuy scheme offers employees an opportunity to build up a shareholding in the ultimate parent company United Utilities PLC.

### Policy on the payment of creditors

The policy is to pay suppliers according to agreed terms of business. These terms are agreed upon entering into binding contracts and the Group seeks to adhere to the payment terms, provided the relevant goods and services have been supplied in accordance with the contracts. The Group and Company had 43 days of purchases outstanding at the end of the financial year (2006: 49 days).

### Directors

The directors of the Company during the year ended 31 March 2007 are set out below. All were directors for the whole year except where otherwise indicated.

S G Batey (resigned 26 July 2006)\*

S Beaumont (resigned 5 July 2006)

M Beesley

M J Boxall

E Cooke

C Cornish\*

A Cowan (appointed 1 February 2007)

G Dixon (resigned 30 November 2006)

T Weller (appointed 1 August 2006)\*

\*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 Group's business.

### Directors' and officers' insurance

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

### Directors' responsibilities in respect of the preparation of the financial statements

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with IFRSs as adopted by the European Union. The financial statements are required by law to be properly prepared in accordance with IFRS as adopted by the European Union and the Companies Act 1985.

IAS 1 'Presentation of Financial Statements' requires that the financial statements present fairly for each financial year the company's financial position, financial performance and cashflows. 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.

## DIRECTORS' REPORT

In preparing the financial statements, 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;
- 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; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors confirm that the financial statements comply with the above requirements. 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. 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 given 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.

### Independent auditor

A resolution to reappoint Deloitte & Touche LLP as the auditor of the Company will be proposed at the forthcoming annual general meeting.

### Registered address

United Utilities Electricity PLC  
Haweswater House  
Lingley Mere Business Park  
Lingley Green Avenue  
Great Sankey  
Warrington  
WA5 3LP

Registered number: 2366949

By order of the board

**Mike Boxall**  
**Director**

**25 July 2007**

## **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF UNITED UTILITIES ELECTRICITY PLC**

We have audited the group and company financial statements of United Utilities Electricity PLC for the year ended 31 March 2007 which comprise the consolidated income statement, the consolidated and company balance sheets, the consolidated and company statements of recognised income and expense, the consolidated and company cashflow statements and the related notes 1 to 32. These financial statements have been prepared under the accounting policies set out therein.

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

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

The directors' responsibilities for the preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards ('IFRSs') as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the directors' report is consistent with the financial statements. The information given in the directors' report includes that specific information presented in the managing director's statement and the operating and financial review that is cross-referenced from the "Business review and principal activities" section of the directors' report.

In addition, we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited financial statements. The other information comprises only the managing director's statement, the operating and financial review and the directors' report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

### **Basis of audit opinion**

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

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

### **Opinion**

In our opinion:

- the group and individual company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's and company's affairs as at 31 March 2007 and of the profit of the group for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.

### **Deloitte & Touche LLP**

Chartered Accountants and Registered Auditors  
Manchester, England  
27 July 2007

**CONSOLIDATED INCOME STATEMENT**

**For the year ended 31 March 2007**

|                                       | Note | Group<br>2007<br>£m | Group<br>2006<br>£m |
|---------------------------------------|------|---------------------|---------------------|
| <b>Revenue</b>                        | 2    | 315.6               | 282.4               |
| Employee benefits expense             | 4    | (18.3)              | (21.2)              |
| Depreciation and amortisation expense |      | (55.5)              | (48.9)              |
| Other operating costs                 |      | (66.3)              | (64.7)              |
| Restructuring credit                  |      | 0.6                 | 0.6                 |
| <b>Total operating expenses</b>       |      | (139.5)             | (134.2)             |
| <b>Operating profit</b>               | 3    | 176.1               | 148.2               |
| Investment income                     | 5    | 19.7                | 8.8                 |
| Finance expense                       | 6    | (50.9)              | (54.0)              |
| Investment income and finance expense |      | (31.2)              | (45.2)              |
| <b>Profit before taxation</b>         |      | 144.9               | 103.0               |
| Taxation                              | 7    | (32.6)              | (25.7)              |
| <b>Profit for the year</b>            |      | 112.3               | 77.3                |

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

Operating profit and investment income for 2006 have been re-presented as the Group has changed its presentation of interest income and expenditure associated with its defined benefit pension schemes (see note 5).

**BALANCE SHEETS**  
**At 31 March 2007**

|                                  | Note | Group<br>2007<br>£m     | Company<br>2007<br>£m   | Group<br>2006<br>£m     | Company<br>2006<br>£m   |
|----------------------------------|------|-------------------------|-------------------------|-------------------------|-------------------------|
| <b>ASSETS</b>                    |      |                         |                         |                         |                         |
| <b>Non-current assets</b>        |      |                         |                         |                         |                         |
| Intangible assets                | 10   | 24.2                    | 24.2                    | 28.1                    | 28.1                    |
| Property, plant and equipment    | 11   | 1,831.6                 | 1,831.6                 | 1,714.3                 | 1,714.3                 |
| Investment property              | 12   | -                       | -                       | 5.4                     | 5.4                     |
| Other investments                | 13   | -                       | -                       | 1.0                     | 35.7                    |
| Derivative financial instruments | 18   | 2.1                     | 2.1                     | -                       | -                       |
| Retirement benefit surplus       | 20   | 24.5                    | 24.5                    | -                       | -                       |
|                                  |      | <u>1,882.4</u>          | <u>1,882.4</u>          | <u>1,748.8</u>          | <u>1,783.5</u>          |
| <b>Current assets</b>            |      |                         |                         |                         |                         |
| Inventories                      | 14   | 3.3                     | 3.3                     | 3.4                     | 3.4                     |
| Trade and other receivables      | 15   | 106.8                   | 106.5                   | 54.4                    | 50.8                    |
| Cash and cash equivalents        | 16   | 258.4                   | 258.4                   | 137.0                   | 137.0                   |
| Derivative financial instruments | 18   | 4.4                     | 4.4                     | 13.0                    | 13.0                    |
|                                  |      | <u>372.9</u>            | <u>372.6</u>            | <u>207.8</u>            | <u>204.2</u>            |
| <b>Total assets</b>              |      | <u><u>2,255.3</u></u>   | <u><u>2,255.0</u></u>   | <u><u>1,956.6</u></u>   | <u><u>1,987.7</u></u>   |
| <b>LIABILITIES</b>               |      |                         |                         |                         |                         |
| <b>Non-current liabilities</b>   |      |                         |                         |                         |                         |
| Borrowings                       | 17   | (732.6)                 | (732.6)                 | (643.9)                 | (643.9)                 |
| Retirement benefit obligations   | 20   | -                       | -                       | (1.8)                   | (1.8)                   |
| Deferred tax                     | 21   | (325.0)                 | (325.0)                 | (305.4)                 | (305.4)                 |
| Provisions                       | 22   | -                       | -                       | (1.3)                   | (1.3)                   |
| Consumer contributions           | 23   | (300.5)                 | (300.5)                 | (245.9)                 | (245.9)                 |
| Refundable customer deposits     | 24   | (10.6)                  | (10.6)                  | (6.1)                   | (6.1)                   |
|                                  |      | <u>(1,368.7)</u>        | <u>(1,368.7)</u>        | <u>(1,204.4)</u>        | <u>(1,204.4)</u>        |
| <b>Current liabilities</b>       |      |                         |                         |                         |                         |
| Borrowings                       | 17   | (7.7)                   | (7.7)                   | (14.7)                  | (14.7)                  |
| Trade and other payables         | 19   | (152.3)                 | (151.4)                 | (112.7)                 | (160.5)                 |
| Derivative financial instruments | 18   | (6.7)                   | (6.7)                   | (1.9)                   | (1.9)                   |
| Current income tax liabilities   |      | (38.2)                  | (38.2)                  | (36.3)                  | (33.3)                  |
|                                  |      | <u>(204.9)</u>          | <u>(204.0)</u>          | <u>(165.6)</u>          | <u>(210.4)</u>          |
| <b>Total liabilities</b>         |      | <u><u>(1,573.6)</u></u> | <u><u>(1,572.7)</u></u> | <u><u>(1,370.0)</u></u> | <u><u>(1,414.8)</u></u> |
| <b>Total net assets</b>          |      | <u><u>681.7</u></u>     | <u><u>682.3</u></u>     | <u><u>586.6</u></u>     | <u><u>572.9</u></u>     |
| <b>EQUITY</b>                    |      |                         |                         |                         |                         |
| Called up share capital          | 25   | 238.4                   | 238.4                   | 238.4                   | 238.4                   |
| Share premium account            | 26   | 4.4                     | 4.4                     | 4.4                     | 4.4                     |
| Revaluation reserve              | 26   | 122.4                   | 122.4                   | 127.0                   | 127.0                   |
| Capital redemption reserve       | 26   | 8.6                     | 8.6                     | 8.6                     | 8.6                     |
| Retained earnings                | 26   | 307.9                   | 308.5                   | 208.2                   | 194.5                   |
|                                  |      | <u>681.7</u>            | <u>682.3</u>            | <u>586.6</u>            | <u>572.9</u>            |

Approved by the board of directors on 25 July 2007 and signed on its behalf by:

Eóin Cooke  
Director

**UNITED UTILITIES ELECTRICITY PLC**

**STATEMENTS OF RECOGNISED INCOME AND EXPENSE**

**For the year ended 31 March 2007**

|  | Note | Group<br>2007<br>£m | Company<br>2007<br>£m | Group<br>2006<br>£m | Company<br>2006<br>£m |
|--|------|---------------------|-----------------------|---------------------|-----------------------|
| Losses on write back of trade and other payables on adoption of IAS 39 |      | -                   | -                     | (1.0)               | (1.0)                 |
| Gains on debt and derivative instruments on adoption of IAS 39         |      | -                   | -                     | 11.2                | 11.2                  |
| Fair value gain/(loss) on cashflow hedges                              | 18   | 2.1                 | 2.1                   | (0.7)               | (0.7)                 |
| Actuarial gains on defined benefit pension schemes                     | 20   | 24.8                | 24.8                  | 35.6                | 35.6                  |
| Deferred tax on items taken directly to equity                         | 21   | (8.2)               | (8.2)                 | (13.7)              | (13.7)                |
| <b>Net income recognised directly in equity</b>                        |      | <u>18.7</u>         | <u>18.7</u>           | <u>31.4</u>         | <u>31.4</u>           |
| Profit for the year  |      | <u>112.3</u>        | <u>126.6</u>          | <u>77.3</u>         | <u>78.3</u>           |
| <b>Total recognised income and expense for the year</b>                |      | <u><u>131.0</u></u> | <u><u>145.3</u></u>   | <u><u>108.7</u></u> | <u><u>109.7</u></u>   |

**CASHFLOW STATEMENTS**  
**For the year ended 31 March 2007**

|   | Note | Group<br>2007<br>£m | Company<br>2007<br>£m | Group<br>2006<br>£m | Company<br>2006<br>£m |
|---|------|---------------------|-----------------------|---------------------|-----------------------|
| <b>Operating activities</b>                               |      |                     |                       |                     |                       |
| Cash generated from operations                            | 31   | 212.7               | 212.7                 | 125.2               | 159.4                 |
| Interest paid   |      | (43.6)              | (43.6)                | (50.0)              | (50.0)                |
| Interest received and similar income                      |      | 11.8                | 11.8                  | 2.8                 | 2.8                   |
| Tax paid  |      | (16.3)              | (16.3)                | (13.6)              | (13.6)                |
|   |      | <hr/>               | <hr/>                 | <hr/>               | <hr/>                 |
| <b>Net cash generated from operating activities</b>       |      | 164.6               | 164.6                 | 64.4                | 98.6                  |
|   |      | <hr/>               | <hr/>                 | <hr/>               | <hr/>                 |
| <b>Investing activities</b>                               |      |                     |                       |                     |                       |
| Disposal of subsidiaries                                  | 29   | -                   | -                     | 29.6                | 29.4                  |
| Purchase of investment property                           |      | (0.3)               | (0.3)                 | -                   | -                     |
| Purchase of property, plant and equipment                 |      | (175.4)             | (175.4)               | (142.0)             | (142.0)               |
| Purchase of other intangible assets                       |      | (0.9)               | (0.9)                 | (6.3)               | (6.3)                 |
| Consumer contributions received                           |      | 67.3                | 67.3                  | 37.1                | 37.1                  |
| Proceeds from sale of investment property                 |      | 6.0                 | 6.0                   | 5.8                 | 5.8                   |
| Proceeds from sale of property, plant and equipment       |      | 1.3                 | 1.3                   | 3.3                 | 3.3                   |
|   |      | <hr/>               | <hr/>                 | <hr/>               | <hr/>                 |
| <b>Net cash used in investing activities</b>              |      | (102.0)             | (102.0)               | (72.5)              | (72.7)                |
|   |      | <hr/>               | <hr/>                 | <hr/>               | <hr/>                 |
| <b>Financing activities</b>                               |      |                     |                       |                     |                       |
| Proceeds on issue of ordinary shares                      |      | -                   | -                     | 160.0               | 160.0                 |
| Proceeds from borrowings                                  |      | 100.0               | 100.0                 | 34.1                | 0.1                   |
| Repayment of borrowings                                   |      | (4.4)               | (4.4)                 | (4.4)               | (4.4)                 |
| Dividends paid to equity shareholders of the Company      |      | (36.0)              | (36.0)                | (50.8)              | (50.8)                |
|   |      | <hr/>               | <hr/>                 | <hr/>               | <hr/>                 |
| <b>Net cash generated from financing activities</b>       |      | 59.6                | 59.6                  | 138.9               | 104.9                 |
|   |      | <hr/>               | <hr/>                 | <hr/>               | <hr/>                 |
| <b>Net increase in cash and cash equivalents</b>          |      | 122.2               | 122.2                 | 130.8               | 130.8                 |
|   |      | <hr/>               | <hr/>                 | <hr/>               | <hr/>                 |
| <b>Cash and cash equivalents at beginning of the year</b> |      | 128.9               | 128.9                 | (1.9)               | (1.9)                 |
|   |      | <hr/>               | <hr/>                 | <hr/>               | <hr/>                 |
| <b>Cash and cash equivalents at end of the year</b>       | 16   | 251.1               | 251.1                 | 128.9               | 128.9                 |
|   |      | <hr/> <hr/>         | <hr/> <hr/>           | <hr/> <hr/>         | <hr/> <hr/>           |

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**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 in accordance with International Financial Reporting Standards ('IFRS') as adopted for use in the European Union, including International Accounting Standards (IAS) and interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC').

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 ('GAAP') 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.

**b) Basis of consolidation**

The Group financial statements consolidate the financial statements of the Company and entities controlled by the Company (its subsidiaries), made up to 31 March each year.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used under the relevant local GAAP into line with those used by the Group.

**Subsidiaries**

Control is achieved where the Company has the power to govern the financial and operating policies, generally accompanied by a shareholding of more than one half of the voting rights, of an invested entity so as to obtain benefits from its activities. On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired is credited to the income statement in the period of acquisition. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

**Associates**

An associate is an entity over which the Group, either directly or indirectly, is in a position to exercise significant influence by participating in, but not controlling, the financial and operating policies of the entity. Associates are accounted for using the equity method. Losses of an associate in excess of the Group's interest in the associate are not recognised, except to the extent that the Group has incurred obligations in respect of the associate. Unrealised profits and losses recognised by the Group on transactions with an associate are eliminated to the extent of the Group's interest in the associate concerned.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**1. ACCOUNTING POLICIES (continued)**

**c) 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

**d) Property, plant and equipment**

Property, plant and equipment comprises operational structures and other assets (including properties, overground 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 5 to 80 years. Employee costs incurred in implementing the capital schemes of the Group 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 Group 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.

Freehold land and assets in the course of construction are not depreciated. Other assets are depreciated by writing off their cost 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

Depreciation methods 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.

**e) 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 Group 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.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**1. ACCOUNTING POLICIES (continued)**

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, the reversal 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.

**f) Inventories**

Inventories are stated at cost less any provision necessary to recognise damage or obsolescence.

**g) Financial instruments**

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group 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 interests in subsidiaries and fixed deposits) are recognised and derecognised on a trade date basis and are initially measured at fair value, including transaction costs. Investments are classified as available-for-sale and are measured at subsequent reporting dates at fair value. Gains and losses arising from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the net profit or loss for the period.

**Trade 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 Group after deducting all of its liabilities.

**Equity instruments**

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

## NOTES TO THE ACCOUNTS

### For the year ended 31 March 2007

#### 1. ACCOUNTING POLICIES (continued)

##### 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 Group 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.

Where hedge accounting has not been applied, the Group may elect to designate a financial liability at inception as fair value through the income statement 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 the income statement. Gains or losses from remeasuring the derivative are recognised in profit or loss.

Where changes in the fair value of a derivative differ from changes in the fair value of the hedged item attributable to the risks being hedged, the hedge ineffectiveness is recorded in the 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.

For those of the Group's derivative instruments stated at fair value, the fair value will be determined by the Group applying discounted cashflow analysis using quoted market rates as an input into the valuation model.

##### 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 Group 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 Group to

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**1. ACCOUNTING POLICIES (continued)**

satisfy the criteria for this designation. The treatment of financial assets and liabilities designated at fair value through the income statement is consistent with the Group's documented risk management strategy.

**h) 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.

**i) Construction contracts**

Where the outcome of a construction contract can be estimated reliably, revenue and 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 revenue is recognised to the extent of contract costs incurred that it is probable will be recovered. Contract costs are recognised as expenses in the period in which they are incurred. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

**j) Operating profit**

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

**k) Taxation**

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

**Current taxation**

Current tax, representing UK corporation 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 Group 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

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**1. ACCOUNTING POLICIES (continued)**

recovered. Deferred tax is charged or credited to 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.

**l) Employee benefits**

**Retirement benefit obligations**

The Group participates in two defined benefit pension schemes, operated by United Utilities PLC, which are independent of the Group's finances, for the substantial majority of its employees. Actuarial valuations of the schemes for funding purposes are carried out 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.

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. The difference between the expected return on scheme assets and interest on scheme liabilities are included within the income statement within finance expense.

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

**Share-based compensation arrangements**

United Utilities PLC 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.

United Utilities PLC 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, United Utilities PLC revises its estimate of the number of options that are expected to become exercisable with the impact of any revision being recognised in the income statement, and a corresponding adjustment to equity over the remaining vesting period. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

United Utilities Electricity PLC is recharged the amount expensed under IFRS 2 that relates to United Utilities Electricity PLC employees.

**m) Provisions**

Provisions are recognised when the Group 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.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**1. ACCOUNTING POLICIES (continued)**

**n) 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 Group 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.

**o) 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.

**p) Leases**

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

**q) Critical accounting judgements and key sources of estimation uncertainty**

In the process of applying the Group's accounting policies, the Group 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 Group 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 Group believes to have the most significant impact on the annual results under IFRS.

**Carrying value of property, plant and equipment**

The carrying value of property, plant and equipment (PPE) as at 31 March 2007 was £1,831.6 million. Additions to PPE totalled £176.7 million and the depreciation charge was £59.4 million in the year ended 31 March 2007. 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 Group, 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 Group 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 Group 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 PLC's distribution network to distribute electricity from generators to the end consumer.

## NOTES TO THE ACCOUNTS

### For the year ended 31 March 2007

#### 1. ACCOUNTING POLICIES (continued)

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 historical 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 2007, the Group's gross trade receivables were £13.1 million and the provision for doubtful receivables was £0.8 million.

##### Accounting for provisions and contingencies

The Group 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 Group 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 Group participates in two defined benefit schemes operated by United Utilities PLC, one of which has a defined contribution section, which are independent of the Group's finances. Actuarial valuations of the schemes for funding purposes are carried out at intervals of not more than three years. The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a firm of actuaries. The assumptions are disclosed in note 20. Results are affected by the actuarial assumptions used. These assumptions include those made for future investment returns on the schemes' assets, discount rates, pay growth and increases to pensions in payment and deferred pensions. Actual experience may differ from the assumptions made for example due to changing market and economic conditions and longer or shorter lives of participants.

##### Derivatives and borrowings

The Group'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 Group 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 Group's level of borrowings.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**1. ACCOUNTING POLICIES (continued)**

**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 Group's financial statements. The directors anticipate that the Group 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 23 'Amendment – Borrowing Costs'. On 29 March 2007, the International Accounting Standards Board (IASB) issued a revised IAS 23 'Borrowing costs'. The main change from the previous version is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for sale. The revised standard is effective for periods commencing on or after 1 January 2009. The Group is, therefore, required to capitalise borrowing costs as part of the qualifying assets from 1 April 2009.

IFRS 7 'Financial Instruments: Disclosures'. On 18 August 2005, the IASB issued IFRS 7 'Financial Instruments: Disclosures'. This standard is effective for periods commencing after 1 January 2007. As a result of the adoption of this standard, the Group's disclosures regarding financial instruments will change from those currently disclosed in the financial statements.

IFRS 8 'Operating Segments', issued in November 2006, is effective for periods commencing on or after 1 January 2009.

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.

IFRIC 10 'Interim Financial Reporting and Impairment', issued in July 2006, is effective for periods commencing on or after 1 November 2006.

IFRIC 11 'Group and Treasury Share Transactions', issued in November 2006, is effective for periods commencing on or after 1 March 2007.

IFRIC 12 'Service Concession Arrangements', issued in November 2006, is effective for periods commencing on or after 1 January 2008.

Interpretations in issue but not considered relevant to the activities of the group are as follows:

IFRIC 1 'Changes in Existing Decommissioning, Restoration and Similar Liabilities'.

IFRIC 2 'Members' Shares in Cooperative Entities and Similar Instruments'.

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 7 'Applying the Re-statement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies'.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**2. REVENUE**

|         | <b>2007</b> | <b>2006</b> |
|---------|-------------|-------------|
|         | <b>£m</b>   | <b>£m</b>   |
| Revenue | 315.6       | 282.4       |

All revenue predominantly arises from the principal activity of electricity distribution and associated activities.

The geographical origin and destination of revenue is all within the United Kingdom.

**3. OPERATING PROFIT**

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

|   | <b>2007</b> | <b>2006</b> |
|---|-------------|-------------|
|   | <b>£m</b>   | <b>£m</b>   |
| <b>Employee benefits expense</b>                    |             |             |
| Employee costs (see note 4)                         | 18.3        | 21.2        |
| <b>Depreciation and amortisation expense</b>        |             |             |
| Depreciation of property, plant and equipment       |             |             |
| Owned assets (see note 11)                          | 59.4        | 52.5        |
| Investment property (see note 12)                   | 0.8         | 0.3         |
| Amortisation of intangible assets and contributions |             |             |
| Software (see note 10)                              | 3.5         | 2.7         |
| Consumer contributions (see note 23)                | (8.2)       | (6.6)       |
| <b>Other income</b>                                 |             |             |
| Profit on disposal of property, plant and equipment | 1.3         | 1.5         |
| Profit on disposal of investment property           | 1.1         | 0.5         |
| <b>Other operating costs include:</b>               |             |             |
| Research and development                            | 1.3         | 0.7         |
| Operating leases:                                   |             |             |
| - land and buildings                                | 0.6         | 0.4         |
| - hire of plant and machinery                       | 1.8         | 2.2         |
| Restructuring credit                                | (0.6)       | (0.6)       |

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

|                                    | <b>2007</b> | <b>2006</b> |
|------------------------------------|-------------|-------------|
|                                    | <b>£m</b>   | <b>£m</b>   |
| Audit services                     |             |             |
| Statutory audit                    | 0.2         | 0.1         |
| Audit related regulatory reporting | 0.1         | -           |

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**4. DIRECTORS AND EMPLOYEES**

**Directors' remuneration**

|                      | <b>2007</b> | <b>2006</b> |
|----------------------|-------------|-------------|
|                      | <b>£m</b>   | <b>£m</b>   |
| Salaries             | 0.3         | 0.3         |
| Benefits             | -           | 0.1         |
| Bonus                | 0.1         | 0.1         |
| Share-based payments | 0.1         | 0.1         |
|                      | <u>0.5</u>  | <u>0.6</u>  |

**Employee costs**

|  | <b>2007</b> | <b>2006</b> |
|--|-------------|-------------|
|  | <b>£m</b>   | <b>£m</b>   |
| Wages and salaries                             | 48.2        | 46.8        |
| Social security costs                          | 4.2         | 4.1         |
| Pension costs (see note 20)                    | 5.5         | 7.8         |
|  | <u>57.9</u> | <u>58.7</u> |
| Capital schemes and charges against provisions | (39.6)      | (37.5)      |
| Charged to the income statement                | <u>18.3</u> | <u>21.2</u> |

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

|                          | <b>2007</b>   | <b>2006</b>   |
|--------------------------|---------------|---------------|
|                          | <b>Number</b> | <b>Number</b> |
| Electricity distribution | <u>1,306</u>  | <u>1,305</u>  |

The total expense included within operating profit in respect of share-based payments was £0.4 million (2006: £0.1million).

**5. INVESTMENT INCOME**

|  | <b>2007</b> | <b>2007</b> | <b>2006</b> | <b>2006</b> |
|--|-------------|-------------|-------------|-------------|
|  | <b>£m</b>   | <b>£m</b>   | <b>£m</b>   | <b>£m</b>   |
| Interest receivable                            |             | 12.8        |             | 3.6         |
| Profit on disposal of subsidiary (see note 29) |             | -           |             | 0.3         |
| Expected return on pension scheme assets       | 42.5        |             | 36.2        |             |
| Interest cost on pension scheme obligations    | (35.6)      |             | (31.3)      |             |
|  | <u>6.9</u>  |             | <u>4.9</u>  |             |
| Net pension interest credit                    |             | <u>19.7</u> |             | <u>8.8</u>  |

The Group has changed its presentation of interest income and expenditure associated with its defined benefit pension schemes (see note 20). The amounts were previously disclosed within operating profit, but have been reclassified to investment income in the income statement as the directors believe this provides a fairer presentation of the nature of the income and costs. Corresponding amounts for 2006 have been re-presented accordingly.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**6. FINANCE EXPENSE**

|  | <b>2007</b> | <b>2006</b> |
|--|-------------|-------------|
|  | <b>£m</b>   | <b>£m</b>   |
| Fair value loss on debt and derivative instruments | 23.2        | 25.5        |
| Interest payable on bank borrowings                | 27.1        | 26.7        |
| Interest payable to Group undertakings             | 0.6         | 1.8         |
|  | <u>50.9</u> | <u>54.0</u> |

The Group has changed its presentation of interest on swaps and interest on debt under the fair value option. The amounts were previously disclosed within interest payable on bank borrowings but have been reclassified to the fair value movement on debt and derivative instruments line as the directors believe this provides a fairer presentation of the nature of the interest. Corresponding amounts for 2006 have been re-presented accordingly. The reclassification for 2006 has reduced interest payable on bank borrowings by £22.0 million and increased the fair value loss on debt and derivative instruments by the same amount.

**7. TAXATION**

|                                | <b>2007</b> | <b>2006</b> |
|--------------------------------|-------------|-------------|
|                                | <b>£m</b>   | <b>£m</b>   |
| <b>Current tax:</b>            |             |             |
| UK corporation tax             | 38.0        | 23.8        |
| Prior year                     | (16.8)      | 0.4         |
| <b>Deferred tax (note 21):</b> |             |             |
| Current year                   | 8.9         | 6.0         |
| Prior year                     | 2.5         | (4.5)       |
|                                | <u>32.6</u> | <u>25.7</u> |

Corporation tax is calculated at 30 per cent (2006: 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:

|   | <b>2007</b> | <b>2007</b> | <b>2006</b> | <b>2006</b> |
|---|-------------|-------------|-------------|-------------|
|   | <b>£m</b>   | <b>%</b>    | <b>£m</b>   | <b>%</b>    |
| Profit before tax                         | 144.9       |             | 103.0       |             |
| Tax at the UK corporation tax rate of 30% | 43.5        | 30.0        | 30.9        | 30.0        |
| Prior years' tax adjustments              | (14.3)      | (9.9)       | (4.1)       | (4.0)       |
| Non-taxable (income)/expense              | 3.4         | 2.4         | (1.1)       | (1.1)       |
|   | <u>32.6</u> | <u>22.5</u> | <u>25.7</u> | <u>24.9</u> |

In addition to the amount charged to the income statement, deferred tax relating to actuarial gains on defined benefits schemes of £7.6 million charge (2006: £10.7 million) and adjustments under IAS 32 and 39 of £0.6 million (2006: £3.0 million) was also charged to the statement of recognised income and expense.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**8. DIVIDENDS**

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

|  | <b>2007</b> | <b>2006</b> |
|--|-------------|-------------|
|  | <b>£m</b>   | <b>£m</b>   |
| Final dividend for the year ended 31 March 2006<br>(31 March 2005)   | 24.0        | 39.1        |
| Interim dividend for the year ended 31 March 2007<br>(31 March 2006) | 12.0        | 11.7        |
|  | <u>36.0</u> | <u>50.8</u> |

The proposed final dividends for the year ended 31 March 2007 (£100.0 million) and 31 March 2006 are 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 2007 and 31 March 2006 respectively.

The directors have recommended a final ordinary dividend for 2006/07 of £100.0 million which is not recognised as a liability at the balance sheet date.

**9. DIRECTORS AND THEIR INTERESTS**

The aggregate emoluments of the directors in 2007 amounted to £534,401 (2006: £525,290). Emoluments comprise salaries, fees, taxable benefits and the value of short-term incentive awards. The emoluments of T Weller 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 2007 in respect of services to the Company amounted to £171,561 (2006: E Cooke £188,899).

Seven long-term incentive awards vested in the year ended 31 March 2007 (2006: four). 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. Only the defined contribution section is open to eligible employees. The defined benefit section provides an entitlement on normal retirement of age 60 (or age 65 for some people) equal to between 1/30<sup>th</sup> and 1/60<sup>th</sup> of pensionable earnings for each completed year of service. Early retirement is possible from the age of 50 if the Company agrees.

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

The earnings cap previously applying to directors under the Finance Act 1989 was removed as part of the "A-day" changes introduced by the Company as at 6 April 2006.

The pension contributions for the highest paid director for 31 March 2007 (E Cooke) were £3,938 (2006: E Cooke £15,502). The accrued pension at 31 March 2007 for the highest paid director (E Cooke) was £33,065 (2006: E Cooke £25,474).

At 31 March 2007 and 2006, or date of appointment, the directors and their families had the following interests, all of which were beneficial interests, in the ordinary shares and options to subscribe for ordinary shares in United Utilities PLC. The interests of S G Batey, C Cornish and T Weller in United Utilities PLC are disclosed in that company's accounts.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**9. DIRECTORS AND THEIR INTERESTS (continued)**

|              | At 31 March 2007 |                                 |                            | At 31 March 2006 |                                 |                            |
|--------------|------------------|---------------------------------|----------------------------|------------------|---------------------------------|----------------------------|
|              | Ordinary shares  | Executive option scheme options | Employee sharesave options | Ordinary shares  | Executive option scheme options | Employee sharesave options |
| S Beaumont   | -                | -                               | -                          | 10,758           | 27,258                          | 2,909                      |
| M Beesley    | 7,534            | 578                             | -                          | 6,769            | 578                             | 465                        |
| M J Boxall   | 4,293            | -                               | -                          | 3,006            | -                               | 950                        |
| K M Budinger | -                | -                               | -                          | 1,213            | -                               | -                          |
| E Cooke      | 4,553            | 3,758                           | -                          | 2,465            | 3,758                           | 1,751                      |
| A Cowan      | 2,963            | 13,906                          | -                          | -                | -                               | -                          |
| G Dixon      | -                | -                               | -                          | 8,637            | 5,585                           | 2,609                      |

During the year three directors exercised share options (2006: four).

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

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**10. INTANGIBLE ASSETS**

| <b>Group and Company</b>               | <b>Software<br/>£m</b> | <b>Assets in<br/>course of<br/>construction<br/>£m</b> | <b>Total<br/>£m</b> |
|--|------------------------|--|---------------------|
| Cost at 1 April 2005                   | 14.6                   | 15.9   | 30.5                |
| Additions                              | 6.3                    | -  | 6.3                 |
| Transfer                               | 15.9                   | (15.9)   | -                   |
| Disposals                              | (2.0)                  | -  | (2.0)               |
| <b>At 31 March 2006</b>                | <b>34.8</b>            | <b>-</b>   | <b>34.8</b>         |
| Amortisation at 1 April 2005           | 6.0                    | -  | 6.0                 |
| Charge for the year                    | 2.7                    | -  | 2.7                 |
| Disposals                              | (2.0)                  | -  | (2.0)               |
| <b>At 31 March 2006</b>                | <b>6.7</b>             | <b>-</b>   | <b>6.7</b>          |
| Cost at 1 April 2006                   | 34.8                   | -  | 34.8                |
| Additions                              | (1.3)                  | 0.9  | (0.4)               |
| Transfers                              | -                      | -  | -                   |
| <b>At 31 March 2007</b>                | <b>33.5</b>            | <b>0.9</b>   | <b>34.4</b>         |
| Amortisation at 1 April 2006           | 6.7                    | -  | 6.7                 |
| Charge for the year                    | 3.5                    | -  | 3.5                 |
| <b>At 31 March 2007</b>                | <b>10.2</b>            | <b>-</b>   | <b>10.2</b>         |
| <b>Net book value at 31 March 2007</b> | <b>23.3</b>            | <b>0.9</b>   | <b>24.2</b>         |
| Net book value at 31 March 2006        | 28.1                   | -  | 28.1                |

At 31 March 2007, the Group had entered into contractual commitments for the acquisition of intangible assets amounting to £0.4 million (2006: £2.9 million).

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**
**11. PROPERTY, PLANT AND EQUIPMENT**

| <b>Group and Company</b>               | <b>Operational structures<br/>£m</b> | <b>Non operational land and buildings<br/>£m</b> | <b>Fixtures and equipment, vehicles and other<br/>£m</b> | <b>Assets in course of construction<br/>£m</b> | <b>Total<br/>£m</b> |
|--|--------------------------------------|--|--|--|---------------------|
| 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                                 | -  | 4.1  | (61.1)   | -                   |
| Disposals                              | (4.3)                                | (2.0)  | (20.2)   | -  | (26.5)              |
| <b>At 31 March 2006</b>                | <b>2,258.5</b>                       | <b>23.1</b>                                      | <b>55.7</b>  | <b>142.6</b>                                   | <b>2,479.9</b>      |
| 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)              |
| <b>At 31 March 2006</b>                | <b>721.2</b>                         | <b>4.3</b>                                       | <b>40.1</b>  | <b>-</b>                                       | <b>765.6</b>        |
| Cost or valuation at 1 April 2006      | 2,258.5                              | 23.1   | 55.7   | 142.6  | 2,479.9             |
| Additions                              | 97.5                                 | 0.4  | 1.5  | 77.3   | 176.7               |
| Transfers                              | 79.5                                 | -  | -  | (79.5)   | -                   |
| Disposals                              | (3.2)                                | (0.1)  | (3.9)  | -  | (7.2)               |
| <b>At 31 March 2007</b>                | <b>2,432.3</b>                       | <b>23.4</b>                                      | <b>53.3</b>  | <b>140.4</b>                                   | <b>2,649.4</b>      |
| Depreciation at 1 April 2006           | 721.2                                | 4.3  | 40.1   | -  | 765.6               |
| Charge for the year                    | 54.5                                 | (0.2)  | 5.1  | -  | 59.4                |
| Disposals                              | (3.2)                                | (0.1)  | (3.9)  | -  | (7.2)               |
| <b>At 31 March 2007</b>                | <b>772.5</b>                         | <b>4.0</b>                                       | <b>41.3</b>  | <b>-</b>                                       | <b>817.8</b>        |
| <b>Net book value at 31 March 2007</b> | <b>1,659.8</b>                       | <b>19.4</b>                                      | <b>12.0</b>  | <b>140.4</b>                                   | <b>1,831.6</b>      |
| Net book value at 31 March 2006        | 1,537.3                              | 18.8   | 15.6   | 142.6  | 1,714.3             |

At 31 March 2007, had the property, plant and equipment other than investment property of the Group been carried at historical cost less accumulated depreciation and accumulated impairment losses, the carrying amount would have been approximately £1,657.8 million (2006: £1,533.9 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 2007, the Group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £96.9 million (2006: £29.1 million).

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**12. INVESTMENT PROPERTY**

| <b>Group and Company</b> | <b>Fair Value</b> | <b>Depreciation</b> | <b>Net Book Value</b> |
|--------------------------|-------------------|---------------------|-----------------------|
|                          | <b>£m</b>         | <b>£m</b>           | <b>£m</b>             |
| At 1 April 2005          | 11.0              | -                   | 11.0                  |
| Disposal                 | (5.3)             | -                   | (5.3)                 |
| Depreciation             | -                 | (0.3)               | (0.3)                 |
|                          | <hr/>             | <hr/>               | <hr/>                 |
| At 31 March 2006         | 5.7               | (0.3)               | 5.4                   |
| Additions                | 0.3               | -                   | 0.3                   |
| Depreciation             | -                 | (0.8)               | (0.8)                 |
| Disposal                 | (6.0)             | 1.1                 | (4.9)                 |
|                          | <hr/>             | <hr/>               | <hr/>                 |
| At 31 March 2007         | <hr/> <hr/>       | <hr/> <hr/>         | <hr/> <hr/>           |

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

The property rental income earned by the Group from its investment property, all of which is leased out under operating leases, amounted to £0.2 million (2006: £0.9 million). Direct operating expenses arising on the investment property in the period amounted to nil (2006: nil).

**13. OTHER INVESTMENTS**

|                     | <b>Group<br/>£m</b> | <b>Company<br/>£m</b> |
|---------------------|---------------------|-----------------------|
| Cost                |                     |                       |
| At 1 April 2005     | 2.0                 | 65.0                  |
| Disposals           | (1.0)               | (29.3)                |
|                     | <hr/>               | <hr/>                 |
| At 31 March 2006    | 1.0                 | 35.7                  |
| Disposals (note 29) | (1.0)               | (35.7)                |
|                     | <hr/>               | <hr/>                 |
| At 31 March 2007    | <hr/> <hr/>         | <hr/> <hr/>           |

The Group disposal is shown in note 29.

Details of the other investments at 31 March 2007 are as follows:

**Company**

| <b>Subsidiary undertaking</b>  | <b>Description of holding</b> | <b>Proportion held</b> | <b>Nature of business</b> |
|--|-------------------------------|------------------------|---------------------------|
| NB Property and Estate Services No. 1 Limited (formerly NB Property and Estate Services Limited) | Ordinary shares of £1 each    | 100%                   | Non-trading               |
| NB Leasing Limited   | Ordinary shares of £1 each    | 100%                   | Non-trading               |
| NB (Miles Platting Community Project) Limited (formerly NB Miles Platting Limited)               | Ordinary shares of £1 each    | 100%                   | Dormant                   |

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**13. OTHER INVESTMENTS (continued)**

**Group and Company**

| <b>Other investments</b> | <b>Description of holding</b>  | <b>Proportion held</b> | <b>Nature of business</b> |
|--------------------------|--------------------------------|------------------------|---------------------------|
| ESN Holdings Limited     | Ordinary shares of £1 each     | 6.20%                  | Investment company        |
| National Grid plc        | Ordinary shares of 11.76p each | Negligible             | Energy distribution       |

**Group and Company**

| <b>Associated undertaking</b> | <b>Description of holding</b> | <b>Proportion held</b> | <b>Nature of business</b> |
|-------------------------------|-------------------------------|------------------------|---------------------------|
| Nor.Web Limited               | Ordinary shares of £1 each    | 50%                    | Dormant                   |

**14. INVENTORIES**

| <b>Group and Company</b>      | <b>2007<br/>£m</b> | <b>2006<br/>£m</b> |
|-------------------------------|--------------------|--------------------|
| Raw materials and consumables | 3.3                | 3.4                |

**15. TRADE AND OTHER RECEIVABLES**

|                                    | <b>Group<br/>2007<br/>£m</b> | <b>Company<br/>2007<br/>£m</b> | <b>Group<br/>2006<br/>£m</b> | <b>Company<br/>2006<br/>£m</b> |
|------------------------------------|------------------------------|--------------------------------|------------------------------|--------------------------------|
| Trade receivables                  | 12.3                         | 12.0                           | 14.5                         | 14.5                           |
| Amounts owed by group undertakings | 61.7                         | 61.7                           | 12.5                         | 9.1                            |
| Prepayments and accrued income     | 32.8                         | 32.8                           | 27.4                         | 27.2                           |
|                                    | <u>106.8</u>                 | <u>106.5</u>                   | <u>54.4</u>                  | <u>50.8</u>                    |

Trade receivables do not carry interest and are stated net of allowances for doubtful receivables of £0.8 million (2006: £0.6 million) estimated by management based on known specific circumstances, past default experience and their assessment of the current economic environment.

The Group has no significant concentration of credit risk with exposure spread over a large number of customers. The average credit period taken on sales is 13.8 days (2006: 18.7 days).

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

**16. CASH AND CASH EQUIVALENTS**

| <b>Group and company</b>  | <b>2007<br/>£m</b> | <b>2006<br/>£m</b> |
|---------------------------|--------------------|--------------------|
| Short-term bank deposits  | 258.4              | 137.0              |
| Bank overdrafts (note 17) | (7.3)              | (8.1)              |
|                           | <u>251.1</u>       | <u>128.9</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 4.89 per cent (2006: 4.50 per cent) and these deposits had an average maturity of 42 days (2006: 22 days).

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**17. BORROWINGS**

This note provides information about the contractual terms of the Group's loans and borrowings. For more information about the Group's exposure to interest rate risk see note 18.

|                                    | <b>2007</b>  | 2006  |
|------------------------------------|--------------|-------|
| <b>Group and company</b>           | <b>£m</b>    | £m    |
| <b>Non-current liabilities</b>     |              |       |
| Bank and other term borrowings     | <b>90.0</b>  | 90.1  |
| Bonds                              | <b>642.6</b> | 553.8 |
|                                    | <b>732.6</b> | 643.9 |
| <b>Current liabilities</b>         |              |       |
| Bank overdrafts                    | <b>7.3</b>   | 8.1   |
| Amounts owed to parent undertaking | <b>0.4</b>   | 6.6   |
|                                    | <b>7.7</b>   | 14.7  |
|                                    | <b>740.3</b> | 658.6 |

Borrowings for 2006 have been re-presented to include 'Amounts owed to parent undertakings' of £6.6 million which was previously included within the 'Trade and Other Payables' category on the balance sheet.

**Terms and debt repayment schedule**

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

| <b>Group and company</b>   | Currency         | Year of maturity | <b>2007</b><br><b>Carrying value</b><br><b>£m</b> | 2006<br>Carrying value<br>£m |
|--|------------------|------------------|---|------------------------------|
| <b>Borrowings designated at fair value through profit and loss</b> |                  |                  |   |                              |
| 8.875% 250m bond   | GBP <sup>2</sup> | 2026             | <b>344.7</b>                                      | 358.9                        |
| <b>Borrowings in cash flow hedge relationship</b>                  |                  |                  |   |                              |
| EIB 90m (floating) loan – 5.6%                                     | GBP <sup>2</sup> | 2013             | <b>90.0</b>                                       | 90.1                         |
| <b>Borrowings measured at amortised cost</b>                       |                  |                  |   |                              |
| 8.875% 200m bond   | GBP <sup>2</sup> | 2026             | <b>194.9</b>                                      | 194.9                        |
| 1.4746%+RPI <sup>1</sup> 100m index-linked bond                    | GBP <sup>2</sup> | 2046             | <b>103.0</b>                                      | -                            |
| Bank overdrafts  | GBP <sup>2</sup> | 2007             | <b>7.3</b>  | 8.1                          |
| Amounts owed to parent undertaking                                 | GBP <sup>2</sup> | 2007             | <b>0.4</b>  | 6.6                          |
|  |                  |                  | <b>740.3</b>                                      | 658.6                        |

<sup>1</sup> RPI - Retail Price Index – the UK general index of retail prices (for all items) as published by the Office of National Statistics (Jan 1987 = 0) as published by HM Government.

<sup>2</sup> GBP - Pound Sterling

All loans and borrowings are unsecured. Bank overdrafts are repayable on demand.

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

## NOTES TO THE ACCOUNTS

### For the year ended 31 March 2007

#### 17. BORROWINGS (continued)

##### **Borrowing facilities**

The Group and Company had available unutilised committed bank facilities of £50.0 million at 31 March 2007 (2006: £75.0 million). Of the amounts unutilised, £20.0 million expires within one year (2006: £30.0 million), £nil expires after one year but in less than two years (2006: £20.0 million), and £30.0 million expires in more than two years (2006: £25.0 million).

#### 18. FINANCIAL INSTRUMENTS

Exposure to credit and interest rate risks arise in the normal course of the Group's business. Derivatives are used to hedge exposure to fluctuations in interest rates.

##### **Risk management**

The primary financial risk faced by the Group 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 group. The United Utilities PLC's treasury function, which is authorised to conduct the day-to-day treasury activities of the Group, reports at least annually to the board. The use of financial derivatives is governed by the Group's policies approved by the board, which provide written principles on the use of financial derivatives.

All of the Group'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 Group'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 Group modifies and enhances its risk management policies and systems to reflect changes in markets and products. The United Utilities PLC Audit Committee, under authority delegated by the board, formulates high level Group risk management policy, monitors risk and receives reports that allow it to review the effectiveness of the Group's risk management policies.

##### **Credit risk**

Credit risk is the risk that financial loss arises from the failure of a customer or counterparty to meet its obligations under a contract. It arises principally from lending, trade finance, treasury and leasing activities. The Group has dedicated standards, policies and procedures to control and monitor all such risks.

The counterparties under these activities consist of financial institutions and other bodies with good credit ratings. Although the Group 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. Management does not anticipate any counterparty will fail to meet its obligations.

The directors do not believe that the Group is exposed to any material concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivatives, in the balance sheet.

##### **Liquidity risk**

Liquidity risk is the risk that the Group will not have sufficient funds to meet the obligations or commitments associated with its financial instruments. The Group 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.

The cashflow hedge relates to the management of cashflow on a particular floating rate loan over the regulatory period to 2010. The group largely manages all of its financing cashflows over the observed five-year regulatory period; however, the majority of these economic hedges do not qualify for hedge accounting as they would be overlaid onto transactions which are already within fair value hedge relationships.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007****18. FINANCIAL INSTRUMENTS (continued)****Market risk**

Market risk is the risk that movements in market rates, including foreign exchange rates, interest rates, equity and commodity prices will reduce the Group'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 Group 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.

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

*Interest rate risk*

The Group's fixed rate borrowings are exposed to a risk of change in their fair value due to changes in interest rates. The Group's floating rate borrowings are exposed to a risk of change in cashflows due to changes in interest rates. Investments in equity securities and short-term receivables and payables are not exposed to interest rate risk.

The Group uses interest rate swap contracts and financial futures to hedge these exposures.

Under an interest rate swap, the Group 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 Group's involvement in the instruments, but does not represent its exposure to credit risk, which is assessed by reference to the fair value.

Non-current asset investments, trade and other receivables, and trade and other payables are not directly exposed to interest rate risk.

*Currency risk*

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

**Hedging**

The Group does not use derivative financial instruments for speculative purposes, and has not pledged collateral in relation to any of its derivative instruments. The derivative financial instruments do not contain any early settlement or termination options.

Those derivative instruments that are not part of a designated and effective hedging relationship are classified as held for trading and are therefore measured at fair value through profit and loss. Where fair value hedges occur these hedges are managing interest rate risk in relation to financing.

The derivative financial instruments utilised by the Group to achieve the hedging of these exposures can be summarised as follows.

*Interest rate swaps*

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

Interest rate swaps mature between 2010 and 2026. Swaps are executed in conjunction with bond issues to ensure that the combined cashflows approximate to floating sterling. In these cases, interest on the swap is received to coincide with bond interest payments which are generally annual on fixed rate bonds. Interest received on these swaps will match the nominal interest paid on the bonds; these rates are detailed in the borrowings note 17 'Terms and debt repayment schedule'. The floating sterling side payable on these swaps will generally occur semi-annually. Taking into account the latest fixings prior to year end, rates range from 5.73 to 7.30 per cent on these floating legs. Additionally, swaps are executed to fix floating rate cashflows over the regulatory period. Cashflows on these regulatory swaps will coincide with the floating cashflow they

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**18. FINANCIAL INSTRUMENTS (continued)**

are intended to fix. Interest received on these regulatory swaps is floating sterling and the fixed payable side ranges from 4.81 to 5.37 per cent.

*Financial futures*

Financial futures are used to manage the Group's exposure to possible future changes in short-term interest rates. The financial future contracts are traded on the London International Financial Futures and Options Exchange.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**
**18. FINANCIAL INSTRUMENTS (continued)**
**Effective interest rates and repricing analysis**

In respect of interest bearing financial liabilities, the following tables indicate their average effective interest rates at the reporting date and the periods in which they mature or, if earlier, reprice:

| Group and Company<br>– 31 March 2007  | Average<br>effective<br>interest<br>rate | Total | 1 year<br>or less | 1-2<br>years | 2-3<br>years | 3-4<br>years | 4-5<br>years | More<br>than 5<br>years |
|---|--|-------|-------------------|--------------|--------------|--------------|--------------|-------------------------|
|   | %  | £m    | £m                | £m           | £m           | £m           | £m           | £m                      |
| <b>Borrowings designated at fair value through profit and loss</b>              |  |       |                   |              |              |              |              |                         |
| <i>Fixed rate instruments:</i>  |  |       |                   |              |              |              |              |                         |
| 8.875% GBP 250m bond due 2026   | 5.87                                     | 344.7 | -                 | -            | -            | -            | -            | 344.7                   |
| Effect of swaps   | 0.79                                     | -     | 344.7             | -            | -            | -            | -            | (344.7)                 |
| Total after effect of swaps <sup>1</sup>  | 6.66                                     | 344.7 | 344.7             | -            | -            | -            | -            | -                       |
| <b>Borrowings in cashflow hedge relationship</b>                                |  |       |                   |              |              |              |              |                         |
| <i>Floating rate instruments:</i>   |  |       |                   |              |              |              |              |                         |
| EIB GBP 90m loan due 2013   | 5.60                                     | 90.0  | 90.0              | -            | -            | -            | -            | -                       |
| Effect of swaps   | (0.78)                                   | -     | (90.0)            | -            | 90.0         | -            | -            | -                       |
| Total after effect of swaps <sup>1</sup>  | 4.82                                     | 90.0  | -                 | -            | 90.0         | -            | -            | -                       |
| <b>Borrowings measured at amortised cost</b>                                    |  |       |                   |              |              |              |              |                         |
| <i>Fixed rate instruments:</i>  |  |       |                   |              |              |              |              |                         |
| 8.875% GBP 200m bond due 2026   | 9.16                                     | 194.9 | -                 | -            | -            | -            | -            | 194.9                   |
| <i>Floating rate instruments:</i>   |  |       |                   |              |              |              |              |                         |
| Bank overdraft <sup>2</sup>   | Various                                  | 7.3   | 7.3               | -            | -            | -            | -            | -                       |
| Amounts owed to parent undertaking  | LIBOR <sup>3</sup> +0.5%                 | 0.4   | 0.4               | -            | -            | -            | -            | -                       |
|   |  | 7.7   | 7.7               | -            | -            | -            | -            | -                       |
| <b>Index-linked instruments</b>   |  |       |                   |              |              |              |              |                         |
| 1.4746% GBP 100m index-linked bond due 2046                                     | 1.4746%+RPI                              | 103.0 | 103.0             | -            | -            | -            | -            | -                       |
| Effect of fixed hedge for the term of the regulatory business plan <sup>1</sup> | 4.98                                     | -     | (340.0)           | -            | 265.0        | 75.0         | -            | -                       |
|   |  | 740.3 | 115.4             | -            | 355.0        | 75.0         | -            | 194.9                   |

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**
**18. FINANCIAL INSTRUMENTS (continued)**
**Effective interest rates and repricing analysis**

The debt balance on the 1.4746% GBP 100m index-linked bond, and thus the balance upon which interest is paid at the quoted coupon, is adjusted for movements in the Retail Price Index established at the trade date. The corresponding annualised inflation rate for the year to 31 March 2007 was 4.8 per cent (31 March 2006: 2.4 per cent).

| Group and Company<br>- 31 March 2006  | Average<br>effective<br>interest<br>rate | Total | 1 year<br>or less | 1-2<br>years | 2-3<br>years | 3-4<br>years | 4-5<br>years | More<br>than 5<br>years |
|---|--|-------|-------------------|--------------|--------------|--------------|--------------|-------------------------|
|   | %  | £m    | £m                | £m           | £m           | £m           | £m           | £m                      |
| <b>Borrowings designated at fair value through profit and loss</b>              |  |       |                   |              |              |              |              |                         |
| <i>Fixed rate instruments:</i>  |  |       |                   |              |              |              |              |                         |
| 8.875% GBP 250m bond due 2026   | 5.87                                     | 358.9 | -                 | -            | -            | -            | -            | 358.9                   |
| Effect of swaps   | (0.17)                                   | -     | 358.9             | -            | -            | -            | -            | (358.9)                 |
| Total after effect of swaps <sup>1</sup>  | 5.70                                     | 358.9 | 358.9             | -            | -            | -            | -            | -                       |
| <b>Borrowings in cashflow hedge relationship</b>                                |  |       |                   |              |              |              |              |                         |
| <i>Floating rate instruments:</i>   |  |       |                   |              |              |              |              |                         |
| EIB GBP 90m loan due 2013   | 4.65                                     | 90.1  | 90.1              | -            | -            | -            | -            | -                       |
| Effect of swaps   | 0.17                                     | -     | (90.1)            | -            | -            | 90.1         | -            | -                       |
| Total after effect of swaps <sup>1</sup>  | 4.82                                     | 90.1  | -                 | -            | -            | 90.1         | -            | -                       |
| <b>Borrowings measured at amortised cost</b>                                    |  |       |                   |              |              |              |              |                         |
| <i>Fixed rate instruments:</i>  |  |       |                   |              |              |              |              |                         |
| 8.875% GBP 200m bond due 2026   | 9.16                                     | 194.9 | -                 | -            | -            | -            | -            | 194.9                   |
| <i>Floating rate instruments:</i>   |  |       |                   |              |              |              |              |                         |
| Bank overdraft <sup>2</sup>   | Various                                  | 8.1   | 8.1               | -            | -            | -            | -            | -                       |
| Amounts owed to parent undertaking  | LIBOR <sup>3</sup> + 0.5%                | 6.6   | 6.6               | -            | -            | -            | -            | -                       |
|   |  | 14.7  | 14.7              | -            | -            | -            | -            | -                       |
| Effect of fixed hedge for the term of the regulatory business plan <sup>1</sup> | 4.98                                     | -     | (340.0)           | -            | -            | 265.0        | 75.0         | -                       |
|   |  | 658.6 | 33.6              | -            | -            | 355.1        | 75.0         | 194.9                   |

<sup>1</sup> The rate quoted is the last GBP LIBOR fixing plus any margin which is payable under the relevant swap. The interest receivable on these swaps will be on the coupon due on the corresponding debt item.

<sup>2</sup> This represents a number of bank balances with various floating rates.

<sup>3</sup> LIBOR – London Inter-Bank Offered Rate.

Where a floating rate is quoted, the latest fixing is quoted including any appropriate margins.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**18. FINANCIAL INSTRUMENTS (continued)**

**Sensitivity analysis**

In managing interest rate risk the Group aims to reduce the impact of short-term fluctuations on its earnings. Over the longer term, permanent changes in interest rates will have an impact on profit.

The analysis in the table below illustrates the sensitivity of the market value (fair value) of the Group's financial instruments to changes in interest rates. The analysis assumes a general increase or decrease of one percentage point in interest rates for all maturities and currencies from their levels at 31 March with all other variances held constant:

|                               | <b>Fair value 31<br/>March 2007</b> | <b>+1% movement in<br/>interest rate</b> | <b>-1% movement<br/>in interest rate</b> |
|-------------------------------|-------------------------------------|--|--|
| <b>Group and Company</b>      |                                     |  |  |
| <b>Interest rate movement</b> | <b>£m</b>                           | <b>£m</b>                                | <b>£m</b>                                |
| Non-current borrowings        | (801.0)                             | 83.5                                     | (102.4)                                  |
| Derivatives                   | (0.2)                               | (25.9)                                   | 31.3                                     |
| Cash and cash equivalents     | 259.5                               | (0.3)                                    | 0.3                                      |
|                               | <b>Fair value 31<br/>March 2006</b> | <b>+1% movement in<br/>interest rate</b> | <b>-1% movement<br/>in interest rate</b> |
| <b>Interest rate movement</b> | <b>£m</b>                           | <b>£m</b>                                | <b>£m</b>                                |
| Non-current borrowings        | (760.0)                             | 78.0                                     | (91.4)                                   |
| Derivatives                   | 11.1                                | (27.9)                                   | 34.6                                     |
| Cash and cash equivalents     | 137.0                               | -  | -  |

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**18. FINANCIAL INSTRUMENTS (continued)**

**Fair values**

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

| <b>Group and company</b>  | <b>2007<br/>Carrying<br/>value<br/><br/>£m</b> | <b>2007<br/>Fair value<br/><br/>£m</b> | <b>2006<br/>Carrying<br/>value<br/><br/>£m</b> | <b>2006<br/>Fair value<br/><br/>£m</b> |
|---|--|--|--|--|
| <b>Financial assets:</b>  |  |  |  |  |
| <i>Non-current assets:</i>  |  |  |  |  |
| Derivative financial instruments - cashflow<br>hedge swaps <sup>1</sup> | 2.1  | 2.1                                    | -  | -                                      |
| <i>Current assets:</i>  |  |  |  |  |
| Cash and cash equivalents <sup>2</sup>                                  | 258.4  | 259.5                                  | 137.0  | 137.0                                  |
| Derivative financial instruments - held for<br>trading swaps            | 4.4  | 4.4                                    | 13.0   | 13.0                                   |

<sup>1</sup> During the year a gain on the fair value movement of the cashflow hedge derivative of £2.1 million (2006: loss £0.7 million) was recognised and taken to reserves, gross of tax.

<sup>2</sup> The fair value of cash and cash equivalents includes £1.1 million of interest receivable. The interest receivable is included within trade and other receivables.

The carrying value of trade and other receivables approximates to their fair value for both the Group and Company.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**18. FINANCIAL INSTRUMENTS (continued)**

**Fair values (continued)**

| Group and Company  | 2007           | 2007           | 2006           | 2006           |
|--|----------------|----------------|----------------|----------------|
|  | Carrying value | Fair value     | Carrying value | Fair value     |
|  | £m             | £m             | £m             | £m             |
| <b>Financial liabilities:</b>  |                |                |                |                |
| <i>Non-current liabilities:</i>  |                |                |                |                |
| Borrowings designated at fair value through profit and loss <sup>1</sup> | (344.7)        | (344.7)        | (358.9)        | (358.9)        |
| Borrowings in cash flow hedge relationship <sup>1</sup>                  | (90.0)         | (90.4)         | (90.1)         | (90.0)         |
| Borrowings measured at amortised cost <sup>1</sup>                       | (297.9)        | (365.9)        | (194.9)        | (311.1)        |
|  | <u>(732.6)</u> | <u>(801.0)</u> | <u>(643.9)</u> | <u>(760.0)</u> |
| <i>Current liabilities:</i>  |                |                |                |                |
| Borrowings - bank overdrafts   | (7.3)          | (7.3)          | (8.1)          | (8.1)          |
| Borrowings - amounts owed to parent undertaking                          | (0.4)          | (0.4)          | (6.6)          | (6.6)          |
|  | <u>(7.7)</u>   | <u>(7.7)</u>   | <u>(14.7)</u>  | <u>(14.7)</u>  |
| Derivative financial instruments - held for trading swaps                | (6.7)          | (6.7)          | (1.9)          | (1.9)          |

<sup>1</sup> The total fair value of non-current borrowings includes £1.3 million of interest payable. The interest payable is included within trade and other payables.

Of the £14.2 million gain (2006: £17.8 million loss) in fair value of financial liabilities designated at fair value through profit and loss, a loss of £8.4 million (2006: £4.3 million gain) is attributable to changes in credit risk.

The carrying value of trade and other payables approximates to their fair value for both the Group and Company.

**19. TRADE AND OTHER PAYABLES**

|   | Group        | Company      | Group        | Company      |
|---|--------------|--------------|--------------|--------------|
|   | 2007         | 2007         | 2006         | 2006         |
|   | £m           | £m           | £m           | £m           |
| Trade creditors                         | 8.0          | 8.0          | 8.0          | 7.9          |
| Amounts owed to group undertakings      | 57.6         | 56.7         | 24.2         | 24.3         |
| Amounts owed to subsidiary undertakings | -            | -            | -            | 47.7         |
| Other taxation and social security      | 5.5          | 5.5          | 4.4          | 4.4          |
| Other creditors                         | -            | -            | 6.4          | 6.4          |
| Consumers' contributions                | 14.2         | 14.2         | 6.8          | 6.8          |
| Refundable customer deposits            | 8.7          | 8.7          | 19.1         | 19.1         |
| Accruals and deferred income            | 58.3         | 58.3         | 43.8         | 43.9         |
|   | <u>152.3</u> | <u>151.4</u> | <u>112.7</u> | <u>160.5</u> |

Trade creditors principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 41 days (2006: 43 days). The prior year amounts owed to group undertakings has been restated by £6.6m to reflect the treatment of intercompany debt. This has been reflected in note 18.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**19. TRADE AND OTHER PAYABLES (continued)**

Trade and Other Payables for 2006 have been re-presented to exclude 'Amounts owed to parent undertakings' of £6.6 million which is now included within the Borrowings category on the balance sheet.

**20. RETIREMENT BENEFIT SCHEMES**

**Group and Company**

The Group 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 Group of Electricity Supply Pension Scheme (ESPS) (the 'Schemes'). Both defined benefit Schemes are 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 Group finances.

The last actuarial valuations of the Schemes were carried out as at 31 March 2006. 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 2007 by projecting forward from 31 March 2006, and have been performed by an independent actuary, Mercer Human Resource Consulting.

On 31 March 2005, the Group 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 are expected to resume from 1 April 2010. In the meantime, the Group will continue to pay contributions in respect of the defined contribution members and insurance premiums. Other payments will be made by the Group in accordance with the funding agreement between the Trustee and the Group.

The total defined benefit pension income for the year was £1.4 million (2006: pension cost £2.9 million). A pension surplus of £24.5 million is included in the balance sheet at 31 March 2007 (2006: obligation of £1.8 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:

|                                  | <b>At 31<br/>March<br/>2007</b> | <b>At 31<br/>March<br/>2006</b> |
|----------------------------------|---------------------------------|---------------------------------|
| Discount rate – UUPS             | 5.20%                           | 4.90%                           |
| Discount rate - ESPS             | 5.30%                           | 4.90%                           |
| Expected return on assets –UUPS  | 6.50%                           | 6.20%                           |
| Expected return on assets – ESPS | 6.30%                           | 5.90%                           |
| Pensionable salary growth - UUPS | 3.95%                           | 3.75%                           |
| Pensionable salary growth - ESPS | 4.00%                           | 3.80%                           |
| Pension increases                | 3.00%                           | 2.80%                           |
| Price inflation                  | 3.00%                           | 2.80%                           |

The current life expectancies (in years) underlying the value of the accrued liabilities for the Schemes are:

|                                 | <b>At 31 March<br/>2007</b> | <b>At 31 March<br/>2006</b> |
|---------------------------------|-----------------------------|-----------------------------|
| Male life expectancy at age 60: |                             |                             |
| Retired member                  | 23.8                        | 22.5                        |
| Non-retired member              | 25.9                        | 24.8                        |

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**20. RETIREMENT BENEFIT SCHEMES (continued)**

Recent studies have shown faster rates of life expectancy improvement than had previously been expected. An allowance has been made for these faster rates of improvements. Studies have also illustrated that mortality rates vary significantly with the location of employees and the nature of their work. These factors have been taken into account in the calculation of the defined benefit obligations of the company.

As at 31 March 2007, the Group's share of the fair value of Schemes assets, together with the liabilities in the Schemes recognised in the balance sheet were as follows:

|  | <b>Scheme<br/>assets at<br/>31 March<br/>2007<br/>%</b> | <b>Value at<br/>31 March<br/>2007<br/>£m</b> | <b>Scheme<br/>assets at<br/>31 March<br/>2006<br/>%</b> | <b>Value at<br/>31 March<br/>2006<br/>£m</b> |
|--|---|--|---|--|
| Equities                                       | 58.4  | 496.6  | 66.6  | 493.9  |
| Gilts  | 26.1  | 222.4  | 22.3  | 165.2  |
| Bonds  | 14.5  | 123.1  | 11.0  | 81.5   |
| Property                                       | -   | -  | 0.1   | 0.7  |
| Cash   | 1.0   | 8.5  | -   | -  |
|  | <hr/>   | <hr/>  | <hr/>   | <hr/>  |
| Total fair value of assets                     | 100.0   | 850.6  | 100.0   | 741.3  |
|  |   | <hr/>  |   | <hr/>  |
| Present value of liabilities                   |   | (826.1)                                      |   | (743.1)                                      |
|  |   | <hr/>  |   | <hr/>  |
| Net retirement benefit surplus / (obligations) |   | 24.5   |   | (1.8)  |
|  |   | <hr/>  |   | <hr/>  |

To develop the expected long-term rate of return on assets assumption, the Group considered the level of expected returns on risk-free investments, the historical 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 Scheme assets for the Schemes was £17.4 million (2006: £147.8 million).

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

|                                     | <b>2007<br/>£m</b> | <b>2006<br/>£m</b> |
|-------------------------------------|--------------------|--------------------|
| At 1 April                          | (743.1)            | (666.3)            |
| Current service cost                | (7.6)              | (7.5)              |
| Interest cost on scheme obligations | (35.6)             | (31.3)             |
| Member contributions                | (1.9)              | (2.0)              |
| Past service credit/(cost)          | 2.1                | (0.3)              |
| Actuarial losses                    | (86.1)             | (76.0)             |
| Benefits paid                       | 46.1               | 40.3               |
|                                     | <hr/>              | <hr/>              |
| At 31 March                         | (826.1)            | (743.1)            |
|                                     | <hr/>              | <hr/>              |

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**20. RETIREMENT BENEFIT SCHEMES (continued)**

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

|                                  | <b>2007</b>  | <b>2006</b>  |
|----------------------------------|--------------|--------------|
|                                  | <b>£m</b>    | <b>£m</b>    |
| At 1 April                       | 741.3        | 631.3        |
| Expected return on scheme assets | 42.5         | 36.2         |
| Actuarial gains                  | 110.9        | 111.6        |
| Company contributions            | 0.1          | 0.5          |
| Member contributions             | 1.9          | 2.0          |
| Benefits paid                    | (46.1)       | (40.3)       |
|                                  | <u>850.6</u> | <u>741.3</u> |
| At 31 March                      | <u>850.6</u> | <u>741.3</u> |

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

|  | <b>2007</b> | <b>2006</b>  |
|--|-------------|--------------|
|  | <b>£m</b>   | <b>£m</b>    |
| Current service cost                         | (7.6)       | (7.5)        |
| Past service credit/(cost)                   | 2.1         | (0.3)        |
| Expected return on scheme assets             | 42.5        | 36.2         |
| Interest on scheme obligations               | (35.6)      | (31.3)       |
|  | <u>1.4</u>  | <u>(2.9)</u> |
| Net pension income/(expense) before taxation | <u>1.4</u>  | <u>(2.9)</u> |

The above amounts are recognised in arriving at operating profit except for expected return on scheme assets and interest on scheme obligations which have been recognised within investment income.

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

|  | <b>2007</b> | <b>2006</b>  |
|--|-------------|--------------|
|  | <b>£m</b>   | <b>£m</b>    |
| At 1 April   | (1.8)       | (35.0)       |
| Income/(expenses) recognised in the income statement | 1.4         | (2.9)        |
| Contributions paid                                   | 0.1         | 0.5          |
| Net actuarial gains gross of taxation                | 24.8        | 35.6         |
|  | <u>24.5</u> | <u>(1.8)</u> |

Actuarial gains and losses are recognised directly in the statement of recognised income and expense. At 31 March 2007, a cumulative gain of £54.7 million (2006: £29.9 million) had been recorded directly in the statement of recognised income and expense.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**20. RETIREMENT BENEFIT SCHEMES (continued)**

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

|  | <b>2007</b> | <b>2006</b> | <b>2005</b> |
|--|-------------|-------------|-------------|
|  | <b>£m</b>   | <b>£m</b>   | <b>£m</b>   |
| Present value of defined benefit obligation  | (826.1)     | (743.1)     | (666.3)     |
| Fair value of scheme assets                  | 850.6       | 741.3       | 631.3       |
|  | <hr/>       | <hr/>       | <hr/>       |
| Net retirement benefit surplus/(obligation)  | 24.5        | (1.8)       | (35.0)      |
|  | <hr/>       | <hr/>       | <hr/>       |
| Experience adjustments on scheme liabilities | 38.6        | -           | (8.1)       |
| Experience adjustments on scheme assets      | (25.1)      | 111.6       | 25.6        |

**21. DEFERRED TAX**

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

| <b>Group and Company</b>        | <b>Accelerated<br/>tax<br/>depreciation<br/>£m</b> | <b>Retirement<br/>benefit<br/>obligations<br/>£m</b> | <b>Other<br/>£m</b> | <b>Total<br/>£m</b> |
|---------------------------------|--|--|---------------------|---------------------|
| At 1 April 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                |
|                                 | <hr/>  | <hr/>  | <hr/>               | <hr/>               |
| At 31 March 2006                | 334.5  | (0.7)  | (28.4)              | 305.4               |
| Charged to the income statement | (2.6)  | 0.3  | 13.7                | 11.4                |
| Charged to equity for the year  | -  | 7.6  | 0.6                 | 8.2                 |
|                                 | <hr/>  | <hr/>  | <hr/>               | <hr/>               |
| At 31 March 2007                | <u>331.9</u>                                       | <u>7.2</u>   | <u>(14.1)</u>       | <u>325.0</u>        |

The 2007 Chancellor's Budget proposed various changes to the rules for claiming tax allowances on capital expenditure together with a reduction in the main corporate tax rate. The impact of these changes on the Group and Company's future deferred tax position is currently under review.

**22. PROVISIONS**

| <b>Group and Company</b>         | <b>Restructuring<br/>Provision<br/>£m</b> | <b>Other<br/>£m</b> | <b>Total<br/>£m</b> |
|----------------------------------|---|---------------------|---------------------|
| At 1 April 2006                  | 0.8                                       | 0.5                 | 1.3                 |
| Released to the income statement | (0.6)                                     | (0.3)               | (0.9)               |
| Utilisation of provision         | (0.2)                                     | (0.2)               | (0.4)               |
|                                  | <hr/>                                     | <hr/>               | <hr/>               |
| At 31 March 2007                 | <u>-</u>                                  | <u>-</u>            | <u>-</u>            |

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**23. CONSUMER CONTRIBUTIONS**

Consumer contributions are 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.

**Group and Company**

|   | <b>£m</b>   |
|---|-------------|
| At 1 April 2005                                 | 228.0       |
| Additions during the year                       | 31.3        |
| Amortisation                                    | (6.6)       |
|   | <hr/>       |
| At 31 March 2006                                | 252.7       |
| Additions during the year                       | 70.2        |
| Amortisation                                    | (8.2)       |
|   | <hr/>       |
| At 31 March 2007                                | 314.7       |
|   | <hr/> <hr/> |
| Amounts due in less than one year (see note 19) | 14.2        |
| Amounts due after more than one year            | 300.5       |
|   | <hr/> <hr/> |
|   | 314.7       |
|   | <hr/> <hr/> |

**24. REFUNDABLE CUSTOMER DEPOSITS**

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

**Group and Company**

|   | <b>2007</b> | <b>2006</b> |
|---|-------------|-------------|
|   | <b>£m</b>   | <b>£m</b>   |
| Amounts due in less than one year (see note 19) | 8.7         | 19.1        |
| Amounts due after more than one year            | 10.6        | 6.1         |
|   | <hr/> <hr/> | <hr/> <hr/> |

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**25. SHARE CAPITAL**

|  | <b>2007</b>        | <b>2006</b>        |
|--|--------------------|--------------------|
|  | <b>£</b>           | <b>£</b>           |
| <b>Authorised:</b>   |                    |                    |
| 569,999,996 (2006: 569,999,996) ordinary shares of 50 pence each | 284,999,998        | 284,999,998        |
| 4 'A' ordinary shares of 50 pence each                           | 2                  | 2                  |
| Special rights redeemable preference share of £1                 | 1                  | 1                  |
|  | <u>285,000,001</u> | <u>285,000,001</u> |
|  | <b>2007</b>        | <b>2006</b>        |
|  | <b>£</b>           | <b>£</b>           |
| <b>Allotted, called up and fully paid:</b>                       |                    |                    |
| 476,821,341 (2006: 476,821,341) ordinary shares of 50 pence each | 238,410,671        | 238,410,671        |
| 4 'A' ordinary shares of 50 pence each                           | 2                  | 2                  |
|  | <u>238,410,673</u> | <u>238,410,673</u> |

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 2007**

**26. SHAREHOLDERS' EQUITY**

**Group**

|  | Called<br>up share<br>capital<br>£m | Share<br>premiu<br>m<br>account<br>£m | Revaluation<br>reserve<br>£m | Capital<br>redemption<br>reserve<br>£m | Retained<br>earnings<br>£m | Total<br>£m |
|--|-------------------------------------|---------------------------------------|------------------------------|--|----------------------------|-------------|
| At 1 April 2005  | 78.4                                | 4.4                                   | 129.0                        | 8.6                                    | 155.4                      | 375.8       |
| Profit for the year  | -                                   | -                                     | -                            | -                                      | 77.3                       | 77.3        |
| Dividends  | -                                   | -                                     | -                            | -                                      | (50.8)                     | (50.8)      |
| Fair value loss on cashflow<br>hedges  | -                                   | -                                     | -                            | -                                      | (0.7)                      | (0.7)       |
| Transfer from revaluation<br>reserve   | -                                   | -                                     | (2.0)                        | -                                      | 2.0                        | -           |
| Post employment benefits:<br>actuarial gains on defined<br>benefit schemes             | -                                   | -                                     | -                            | -                                      | 25.0                       | 25.0        |
| New share capital issued   | 160.0                               | -                                     | -                            | -                                      | -                          | 160.0       |
| At 31 March 2006   | 238.4                               | 4.4                                   | 127.0                        | 8.6                                    | 208.2                      | 586.6       |
| Profit for the year  | -                                   | -                                     | -                            | -                                      | 112.3                      | 112.3       |
| Dividends  | -                                   | -                                     | -                            | -                                      | (36.0)                     | (36.0)      |
| Post tax fair value gain on<br>cashflow hedges   | -                                   | -                                     | -                            | -                                      | 1.5                        | 1.5         |
| Transfer from revaluation<br>Reserve   | -                                   | -                                     | (4.6)                        | -                                      | 4.6                        | -           |
| Post employment benefits:<br>Post tax actuarial gains on<br>defined<br>benefit schemes | -                                   | -                                     | -                            | -                                      | 17.3                       | 17.3        |
| At 31 March 2007   | 238.4                               | 4.4                                   | 122.4                        | 8.6                                    | 307.9                      | 681.7       |

As allowed by section 230(4) of the Companies Act 1985, the Company has not presented its own income statement. The amount of Group profit after tax for the financial year dealt with in the Company's income statement is £126.6 million (2006: £78.3 million).

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**26. SHAREHOLDERS' EQUITY (continued)**

**Company**

|  | <b>Called up<br/>share<br/>capital<br/>£m</b> | <b>Share<br/>premium<br/>account<br/>£m</b> | <b>Revaluation<br/>reserve<br/>£m</b> | <b>Capital<br/>redemption<br/>reserve<br/>£m</b> | <b>Retained<br/>earnings<br/>£m</b> | <b>Total<br/>£m</b> |
|--|---|---|---------------------------------------|--|-------------------------------------|---------------------|
| 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<br>cashflow hedges  | -   | -   | -                                     | -  | (0.7)                               | (0.7)               |
| Transfer from revaluation<br>reserve   | -   | -   | (2.0)                                 | -  | 2.0                                 | -                   |
| Post employment benefits:<br>actuarial gains on<br>defined benefit schemes             | -   | -   | -                                     | -  | 25.0                                | 25.0                |
| New share capital issued   | 160.0   | -   | -                                     | -  | -                                   | 160.0               |
| At 31 March 2006   | 238.4   | 4.4   | 127.0                                 | 8.6  | 194.5                               | 572.9               |
| Profit for the year  | -   | -   | -                                     | -  | 126.6                               | 126.6               |
| Dividends  | -   | -   | -                                     | -  | (36.0)                              | (36.0)              |
| Post tax fair value gain on<br>cashflow hedges   | -   | -   | -                                     | -  | 1.5                                 | 1.5                 |
| Transfer from revaluation<br>Reserve   | -   | -   | (4.6)                                 | -  | 4.6                                 | -                   |
| Post employment benefits:<br>post tax actuarial gains<br>on defined benefit<br>schemes | -   | -   | -                                     | -  | 17.3                                | 17.3                |
| At 31 March 2007   | 238.4   | 4.4   | 122.4                                 | 8.6  | 308.5                               | 682.3               |

**27. OPERATING LEASES**

The Group and Company are committed to making the following payments over the lifetime of the lease in respect of non-cancellable operating leases which expire in:

|  | <b>Land and<br/>buildings<br/>2007<br/>£m</b> | <b>Plant and<br/>machinery<br/>2007<br/>£m</b> | <b>Land and<br/>buildings<br/>2006<br/>£m</b> | <b>Plant and<br/>machinery<br/>2006<br/>£m</b> |
|--|---|--|---|--|
| Within one year                        | 1.1   | 0.2  | 0.6   | 0.5  |
| In the second to fifth years inclusive | 4.2   | 0.6  | 2.1   | 0.6  |
| After five years                       | 6.3   | 2.3  | 3.1   | 0.1  |
|  | 11.6  | 3.1  | 5.8   | 1.2  |

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**28. RELATED PARTY TRANSACTIONS**

**Group and Company**

The Group receives and pays interest and recharges to other businesses in United Utilities PLC, which are related parties, in the normal course of business. Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the United Utilities Electricity PLC Group and other parts of United Utilities PLC were as follows:

|                                | <b>2007</b>       | <b>2006</b>       |
|--------------------------------|-------------------|-------------------|
|                                | <b>£m</b>         | <b>£m</b>         |
| Interest paid                  | 0.6               | 1.5               |
| Recharges to group companies   | 13.3              | 13.9              |
| Recharges from group companies | 59.3              | 91.6              |
|                                | <u>          </u> | <u>          </u> |

Amounts outstanding at 31 March 2007 and 2006 between the United Utilities Electricity PLC Group and other companies within United Utilities PLC are provided in notes 15 and 19.

The following transactions were carried out with other related parties:

|                              | <b>Sale of goods</b> | <b>Purchase of goods</b> | <b>Amounts owed by</b> | <b>Amounts owed to</b> |
|------------------------------|----------------------|--------------------------|------------------------|------------------------|
|                              | <b>£m</b>            | <b>£m</b>                | <b>related parties</b> | <b>related parties</b> |
|                              | <b>£m</b>            | <b>£m</b>                | <b>£m</b>              | <b>£m</b>              |
| Associates of parent company | 1.2                  | 1.2                      | 0.8                    | -                      |
|                              | <u>          </u>    | <u>          </u>        | <u>          </u>      | <u>          </u>      |

Sale of goods to related parties were on the Group's normal trading terms.

**29. DISPOSAL OF SUBSIDIARY**

As referred to in note 13, on 30 March 2007 the Group disposed of its interest in NB Generation Limited.

The unaudited net assets of NB Generation Limited at the date of disposal and Group gain on disposal were as follows:

|   |                   |
|---|-------------------|
|   | <b>2007</b>       |
|   | <b>£m</b>         |
| Investments                                   | 1.0               |
| Trade receivables                             | 4.4               |
| Current tax liability                         | (3.0)             |
| Amounts owed from parent                      | 47.6              |
|   | <u>          </u> |
|   | 50.0              |
| Gain on disposal                              | -                 |
|   | <u>          </u> |
| Total consideration                           | 50.0              |
|   | <u>          </u> |
| Satisfied by:                                 |                   |
| Increase in amount owed by group undertakings | (50.0)            |
|   | <u>          </u> |
|   | (50.0)            |
|   | <u>          </u> |

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**29. DISPOSAL OF SUBSIDIARY (continued)**

On 13 September 2005 the Group disposed of its interest in UU Investments (No.2) Limited.

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

|                                      | <b>2006</b><br><b>£m</b> |
|--------------------------------------|--------------------------|
| Investments                          | 1.0                      |
| Trade receivables                    | 49.2                     |
| Current tax liability                | (11.8)                   |
| Amounts owed to parent               | (9.1)                    |
|                                      | <hr/>                    |
|                                      | 29.3                     |
| Gain on disposal                     | 0.3                      |
|                                      | <hr/>                    |
| Total consideration                  | 29.6                     |
|                                      | <hr/> <hr/>              |
| Satisfied by:                        |                          |
| Cash                                 | 29.6                     |
|                                      | <hr/>                    |
|                                      | 29.6                     |
|                                      | <hr/> <hr/>              |
| Net cash inflow arising on disposal: |                          |
| Cash consideration                   | 29.6                     |
|                                      | <hr/>                    |
|                                      | 29.6                     |
|                                      | <hr/> <hr/>              |

**30. ULTIMATE PARENT UNDERTAKING AND CONTROLLING PARTY**

The accounts of the Company and the Group 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, Haweswater House, Lingley Mere Business Park, Lingley Green Avenue, Great Sankey, Warrington, WA5 3LP. The immediate parent of the Company is United Utilities North West PLC.

**NOTES TO THE ACCOUNTS**  
**For the year ended 31 March 2007**

**31. CASH GENERATED FROM OPERATIONS**

|   | <b>Group<br/>2007<br/>£m</b> | <b>Company<br/>2007<br/>£m</b> | <b>Group<br/>2006<br/>£m</b> | <b>Company<br/>2006<br/>£m</b> |
|---|------------------------------|--------------------------------|------------------------------|--------------------------------|
| <b>Cash generated from operations</b>                   |                              |                                |                              |                                |
| Profit before taxation                                  | 144.9                        | 159.2                          | 103.0                        | 104.0                          |
| Adjustment for investment income and<br>finance expense | 31.2                         | 16.9                           | 45.2                         | 44.2                           |
| Operating profit  | <u>176.1</u>                 | <u>176.1</u>                   | <u>148.2</u>                 | <u>148.2</u>                   |
| Adjustments for:  |                              |                                |                              |                                |
| Depreciation of property, plant and<br>equipment        | 59.4                         | 59.4                           | 52.5                         | 52.5                           |
| Depreciation of investment properties                   | 0.8                          | 0.8                            | 0.3                          | 0.3                            |
| Amortisation of intangible assets                       | 3.5                          | 3.5                            | 2.7                          | 2.7                            |
| Amortisation of customer contributions                  | (8.2)                        | (8.2)                          | (6.6)                        | (6.6)                          |
| Profit on disposal of subsidiary                        | -                            | -                              | (0.3)                        | (0.1)                          |
| Profit on disposal of investment property               | (1.1)                        | (1.1)                          | (0.5)                        | (0.5)                          |
| Profit on disposal of property, plant and<br>equipment  | (1.3)                        | (1.3)                          | (1.5)                        | (1.5)                          |
| Restructuring credit                                    | (0.6)                        | (0.6)                          | (0.6)                        | (0.6)                          |
| Changes in working capital                              |                              |                                |                              |                                |
| Decrease in inventories                                 | 0.1                          | 0.1                            | 0.2                          | 0.2                            |
| Increase in trade and other<br>receivables              | (4.5)                        | (4.5)                          | (13.8)                       | (14.9)                         |
| Decrease in provisions and payables                     | (11.5)                       | (11.5)                         | (55.4)                       | (20.3)                         |
| Cash generated from continuing operations               | <u><u>212.7</u></u>          | <u><u>212.7</u></u>            | <u><u>125.2</u></u>          | <u><u>159.4</u></u>            |

**32. EVENTS AFTER THE BALANCE SHEET DATE**

On 4 June 2007, the United Utilities PLC board took the decision to initiate a sale process for United Utilities Electricity PLC's distribution assets. United Utilities PLC intends to retain a contract for the operation of those electricity distribution assets.