WATER SERVICES LICENCE

granted to

Scottish Water Business Stream Limited
Terms of this licence

1. This licence, granted by the Water Industry Commission for Scotland (the "Commission") under section 6(1) of the Water Services Etc. (Scotland) Act 2005 (the "2005 Act"), authorises Scottish Water Business Stream Limited, a company incorporated in Scotland (Registered Number SC294924), (the "licensee") whose registered office is 55 Buckstone Terrace, Edinburgh, EH10 6XH:
   (a) to:
      (i) make arrangements with the occupier of any eligible premises for or in relation to the supply of water to the premises through the public water supply system; and
      (ii) fix, demand and recover charges for or in relation to the supply of water to any premises in respect of which the licensee has made such arrangements; and
   (b) to make such arrangements with Scottish Water and such other persons as are necessary for the purposes of or in connection with the things mentioned in paragraph (a); during the period specified in paragraph 4 below.

2. This licence is subject to:
   (a) the standard conditions applicable to water services licences which shall have effect in the licence in accordance with the provisions of the standard conditions and subject to such modifications (if any) as are set out in Part 2 below (together the "applicable standard conditions");
   (b) the ordinary conditions, if any, set out in Part 3 below (the "ordinary conditions"); and
   (c) such schedules hereto, if any, as may be referenced in the applicable standard conditions, the ordinary conditions or the terms of the licence.

3. This licence is subject to transfer, modification or amendment in accordance with the provisions of the 2005 Act, the ordinary conditions or the applicable standard conditions.

4. This licence, unless revoked or suspended in accordance with the 2005 Act, shall continue until determined by not less than 10 years' notice in writing given by the Commission to the licensee.
5. (a) Where any notice or direction is served on or given to any licensee under this licence or the 2005 Act (including any regulations made thereunder), it shall be treated as served -

(i) by delivering it to any person or leaving it at his proper address or by sending it by post to him at that address; or

(ii) if the person is a body corporate, by serving it in accordance with sub-paragraph (i) above on the secretary of that body; or

(iii) if the person is a partnership, or a partner in a partnership, by serving it in accordance with sub-paragraph (i) above on a person having the control or management of the partnership business.

(b) For the purposes of this paragraph and section 7 of the Interpretation Act 1978 (which relates to the service of documents by post) in its application to this paragraph, the proper address of any person on whom a document is to be served shall be his last known address, except that

(i) in the case of service on a body corporate or its secretary, it shall be the address of the registered or principal office of the body; and

(ii) in the case of service on a partnership or a partner or a person having the control or management of a partnership business, it shall be the address of the principal office of the partnership;

and for the purposes of this sub-paragraph the principal office of a company registered outside the United Kingdom or of a partnership carrying on business outside the United Kingdom is its principal office within the United Kingdom.

(c) If a person to be served by virtue of this licence or under the 2005 Act with any notice or direction has specified an address within the United Kingdom other than his proper address (as determined in pursuance of sub-paragraph (b) above) as the one at which he or someone on his behalf will accept any notice or direction of the same description, that address shall also be treated as his proper address for the purposes of that sub-paragraph.

(d) This section shall not apply to any notice or direction in relation to the service of which provision is made by rules of court.
6. This licence shall be interpreted and construed in like manner as an Act of Parliament for the purposes of the Interpretation Act 1978.

7. References in this licence to a provision of any enactment where, after the date of this licence:
   (a) the enactment has been replaced or supplemented by another enactment, and
   (b) such enactment incorporates a corresponding provision in relation to the same subject matter,
   shall be construed, so far as the context permits, as including a reference to the corresponding provision of that other enactment.

PART 2 (AMENDMENT OF STANDARD LICENCE CONDITIONS)

8. There are no amendments to the standard licence conditions.
**PART 3 (ORDINARY CONDITIONS)**

**Ordinary condition 1, Definitions and interpretation**

1. In these ordinary conditions, unless the context otherwise requires:

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<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
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<tbody>
<tr>
<td>affiliate</td>
<td>means, in relation to the licensee, its ultimate controller(s) and any person or undertaking (other than a subsidiary of the licensee) under the control of such ultimate controller(s);</td>
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<tr>
<td>subsidiary</td>
<td>has the meaning given to the phrase &quot;subsidiary undertaking&quot; by section 258 of the Companies Act 1985; and</td>
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<tr>
<td>ultimate controller</td>
<td>means (a) for so long as it, acting alone or jointly, has control of the licensee, Scottish Water and (b) any other person or undertaking who, having acquired control of the licensee after the grant of this licence and acting alone or jointly, has control of the licensee and is not itself controlled by another person or undertaking.</td>
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Ordinary condition 2, Charges

1. The licensee shall, in fixing, demanding or recovering charges for licensed services in any particular case, ensure (in so far as permitted by this licence) that such charges reasonably reflect the costs incurred by the licensee in providing such services in that case.

2. The licensee shall, within forty business days of entering into or revising arrangements with an eligible customer for the provision of relevant services (or, if later, within forty business days of the coming into effect of this condition in this licence), take appropriate steps to publicise details (to the extent not already published) of (a) the charges (and other terms and conditions) applicable to those services and (b) the class or classes of eligible customers with whom it would be prepared to enter into similar such arrangements.

3. The Commission may (following such consultation as the Commission considers appropriate) issue directions as to the steps by which details of arrangements are publicised for the purposes of paragraph 2 above.

4. For the purposes of this condition:

| relevant services | means licensed services other than services provided by the licensee in connection with a section 29E departure. |
Ordinary condition 3, Prohibition on intra-group contracting

1. The licensee shall not enter into or implement, or agree to enter into or implement, any intra-group contract except on terms approved by the Commission.

2. The licensee shall not, except with the Commission's consent, make any amendment to (or enter into any agreement that amends) an intra-group contract that has been approved by the Commission.

3. Nothing which the licensee is expressly required to do or not to do by the 2005 Act, this licence or any other relevant statutory requirement, shall be regarded as an intra-group contract for the purposes of this condition.

4. For the purposes of this condition:

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<tr>
<th>intra-group contract</th>
<th>means any agreement between the licensee or any subsidiary of the licensee and any affiliate of the licensee; and</th>
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<tbody>
<tr>
<td>the licensee</td>
<td>shall be taken to include any business carried on by the licensee or by any subsidiary of the licensee.</td>
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</tbody>
</table>
Ordinary condition 4, Prohibition on cross-subsidies

1. The licensee shall not give any cross-subsidy to, or receive any cross-subsidy from, any affiliate of the licensee without the Commission's consent.

2. Nothing which the licensee is expressly required to do or not to do by the 2005 Act, this licence or any other relevant statutory requirement, shall be regarded as a cross-subsidy for the purposes of this condition.

3. For the purposes of this condition, references to the licensee shall be taken to include references to any business carried on by the licensee and to any subsidiary of the licensee.
Ordinary condition 5, Production of regulatory accounts

1. The following paragraphs of this condition apply for the purpose of ensuring that the licensee maintains accounting and reporting arrangements which enable regulatory accounts to be prepared for the licensee's business.

2. Except with the Commission's consent, the licensee shall:

(a) keep or cause to be kept for the period referred to in section 222(5)(b) of the Companies Act 1985 and in the manner referred to in that section such accounting records in respect of the licensee's business so that the revenues, costs, assets, liabilities, reserves and provisions of, or reasonably attributable to, the licensee's business are separately identifiable in the accounting records of the licensee from those of Scottish Water and any affiliate of the licensee;

(b) prepare on a consistent basis from such accounting records in respect of:

(i) each financial year, accounting statements (comprising a profit and loss account, a statement of total recognised gains and losses, a balance sheet and a cash flow statement, together with notes thereto) and an analysis of and information on operating costs, revenues and assets in accordance with regulatory accounting rule 5; and

(ii) the first six months of each financial year, an interim profit and loss account;

(c) procure, in respect of the accounting statements prepared in accordance with this condition in respect of each financial year, a report by the auditors and addressed to the Commission stating whether in their opinion those statements have been properly prepared in accordance with this condition and give a true and fair view of the revenues, costs, assets, liabilities, reserves and provisions of, or reasonably attributable to, the licensee's business to which the statements relate; and

(d) deliver to the Commission a copy of the accounting statements referred to in sub-paragraph (b)(i), a copy of the account referred to in sub-paragraph (b)(ii) and a principal signed version of the auditors' report referred to in sub-paragraph (c), as soon as reasonably practicable, and in any event not later than three months after the end of the period to which it relates in the case of the account referred to in sub-paragraph (b)(ii) and six months after the end of the financial year to which they relate in the case of the accounting statements and auditors' report referred to in sub-paragraphs (b)(i) and (c).
3. Unless the Commission so specifies in directions issued for the purposes of this condition, or with
the Commission's consent, the licensee shall not in relation to the accounting statements referred
to in sub-paragraph 2(b)(i) in respect of a financial year change the bases of charge or
apportionment or allocation from those applied in respect of the previous financial year.

4. Where, in relation to the accounting statements in respect of a financial year, the licensee has
changed such bases of charge or apportionment or allocation from those adopted for the
immediately preceding financial year, the licensee shall, if so directed in directions issued by the
Commission, in addition to preparing accounting statements on those bases which it has adopted,
prepare such accounting statements on the bases which applied in respect of the immediately
preceding financial year.

5. Accounting statements in respect of a financial year prepared under sub-paragraph 2(b)(i) shall,
so far as reasonably practicable and unless the Commission's consent has directed otherwise
having regard to the purposes of this condition:
(a) have the same content and format as the statutory accounts of the licensee prepared under
section 226 and, where appropriate, section 227 of the Companies Act 1985 and conform to
the best commercial accounting practices including all relevant accounting standards issued
or adopted by the Accounting Standards Board currently in force;
(b) state the accounting policies adopted; and
(c) with the exception of the part of such statements and information which shows separately the
amounts charged, apportioned or allocated and describes the bases of charge or
apportionment or allocation respectively, be published with the statutory accounts of the
licensee.

6. The licensee shall prepare accounting statements for the licensee's business which shall
comprise and show separately:
(a) a profit and loss account, a statement of total recognised gains and losses, a balance sheet,
and a cash flow statement, together with notes thereto, which shall show or disclose the
information and other matters required by the alternative accounting rules to be shown or
disclosed in accounts where the amounts included in respect of assets covered by any items
shown in those accounts have been determined on any basis mentioned in paragraph 31 of section C of Part II of Schedule 4 to the Companies Act 1985; and
(b) in respect of the licensee's business the adjusted amount of any such provision for depreciation as is referred to in paragraph 32(2) of section C of Part II of Schedule 4 to the Companies Act 1985;
and shall deliver the same, to the Commission within the time limit referred to in sub-paragraph 2(d), and shall (with the exception of the part of such statements and information which shows separately the amounts charged, apportioned or allocated and describes the bases of charge or apportionment or allocation respectively) publish the same with the statutory accounts of the licensee.

7. References in this licence to costs or liabilities of, or reasonably attributable to, the licensee's business shall be construed as excluding taxation and capital liabilities which do not relate principally to the licensee's business, and interest thereon; and references to any profit and loss account shall be construed accordingly.

8. For the purposes of this condition, the following terms shall have the following meanings:

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<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
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<tbody>
<tr>
<td>alternative accounting rules</td>
<td>means the rules set out in section C of part II of schedule 4 to the Companies Act 1985;</td>
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<tr>
<td>financial year</td>
<td>means each 12 month period from 1 April to the following 31 March;</td>
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<tr>
<td>licensee's business</td>
<td>means the licensee's provision of licensed services;</td>
</tr>
<tr>
<td>regulatory accounts</td>
<td>means the accounts required to be prepared by the licensee pursuant to this ordinary condition;</td>
</tr>
<tr>
<td>regulatory accounting rules</td>
<td>means the regulatory accounting rules originally published by the Water Industry Commissioner for Scotland and adopted by the Commission (as amended and in force from time to time); and</td>
</tr>
</tbody>
</table>
regulatory accounting rule 5

means the regulatory accounting rule
(presently entitled RAR 5) which relates to
transfer pricing.

9. References in this condition to a regulatory accounting rule where, after the date of this licence:
   (a) such rule has been replaced or supplemented by another rule, and
   (b) such other rule incorporates a corresponding provision in relation to the same subject
       matter,

shall be construed, so far as the context permits, as including a reference to the corresponding
 provision of that other rule.
Ordinary condition 6, Restricted transactions

1. The licensee shall not enter into or implement, or agree to enter into or implement, any restricted transaction, except with the Commission's consent.

2. The licensee shall promptly report to the Commission any circumstances in which it has been invited by Scottish Water to enter into a restricted transaction.

3. For the purposes of this condition:

<table>
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<tr>
<th>intra-group directions</th>
<th>means the Water Services (Intra-Group Regulation) Directions 2006 (or any other direction which amends, replaces or supplements, or is made in respect of substantially the same subject matter as those directions); and</th>
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<tbody>
<tr>
<td>restricted transaction</td>
<td>means any transaction or arrangement the entering into or implementation of which by Scottish Water would constitute a breach of the intra-group directions.</td>
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</tbody>
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4. For the purposes of this condition, references to the licensee shall be taken to include references to any business carried on by the licensee and to any subsidiary of the licensee.
Ordinary condition 7, Constraints on unlicensed activities

1. The licensee shall not conduct any business or carry on any activity other than licensed services.

2. The licensee shall not hold or acquire shares, investments or interests of any kind in any business conducted by any other person.

3. The licensee shall not create or permit to enter or remain in effect any mortgage, charge, pledge, lien or other form of security or encumbrance whatsoever, undertake any indebtedness to any other person or enter into any guarantee or any obligation, in each case otherwise than on an arm’s length basis, on normal commercial terms and for the relevant purpose.

4. The licensee shall not transfer, lease, license or lend any sum or sums, asset, right or benefit to any affiliate of the licensee other than:
   (a) a dividend or other distribution out of distributable reserves, or a repayment of capital;

   (b) payment properly due for any goods or services provided to the licensee on an arm’s length basis, on normal commercial terms and for the relevant purpose;

   (c) repayment of, or payment of interest on, a loan not prohibited by paragraph 3;

   (d) payments for group corporation tax relief or for the surrender of advance corporation tax calculated on a basis not exceeding the value of the benefit received; or

   (e) repayment of value added tax paid to Her Majesty’s Revenue and Customs on behalf of the licensee by another member of its VAT group.

5. The licensee shall not enter into an agreement or incur a commitment incorporating a cross-default obligation.
6. The Commission's consent may be granted to the licensee to derogate from any or all of the foregoing provisions of this condition.

7. Nothing in paragraphs 3 or 4 above shall authorise the licensee to take any step or to undertake any transaction which would otherwise contravene another condition of this licence including, without prejudice to the generality, ordinary condition 3 (Prohibition on intra-group contracting), 4 (Prohibition on cross-subsidies) or 6 (Restricted transactions).

8. For the purposes of this condition:

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
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<tbody>
<tr>
<td>cross-default obligation</td>
<td>means a term of any agreement or arrangement whereby the licensee's liability to pay or repay any debt or other sum arises or is increased or accelerated or is capable of arising, of increasing or of being accelerated by reason of a default (however such default may be described or defined) by any person other than the licensee;</td>
</tr>
<tr>
<td>indebtedness</td>
<td>means all liabilities now or hereafter due, owing or incurred, whether actual or contingent, whether solely or jointly with any other person and whether as principal or surety, together with any interest accruing thereon and all costs, charges, penalties and expenses incurred in connection therewith; and</td>
</tr>
<tr>
<td>relevant purpose</td>
<td>means, in relation to the carrying out of any transaction by the licensee, the purpose of carrying on any business or activity permitted by paragraph 1 of this ordinary condition, but only if such purpose represents the sole or principal purpose for the transaction and is not additional or ancillary to or consequential upon the pursuit of some larger purpose including but not limited to the financial health or welfare of the licensee's ultimate controller and/or any of the licensee's affiliates.</td>
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Ordinary condition 8, Compliance with governance code

1. The licensee shall comply with the governance code.

2. The Commission may (following such consultation as the Commission may consider appropriate) issue directions relieving the licensee of its obligations under paragraph 1 above in respect of such parts of the governance code and to such extent as may be specified in those directions and/or providing that the governance code in force for the time being shall have effect with or subject to such modifications as are specified in those directions.

3. For the purposes of this condition:

| governance code | means the code which Scottish Water and the licensee have agreed to comply with and which has been approved by the Commission for the purposes of ensuring the independence of the licensee from Scottish Water and for related purposes. |

Done at Stirling on 11 January 2008

For and on behalf of the Water Industry Commission for Scotland

[Signature]

Alan Sutherland, Chief Executive