

| OVERALL STRATEGY FOR 2010-2015 PERIOD AND BEYOND   |  |
|--|--|
| <p>Our vision is to provide a highly reliable supply of water of excellent quality, delivered in a sustainable and affordable way.</p> <p>Our strategy has been set in the context of our 25-year Strategic Direction Statement and has been specifically tested in a recent market survey. In summary, our plan has the support of customers.</p> <p>The major issues we must address in the period up to 2015, and beyond, are to:</p> <ul style="list-style-type: none"> <li>- maintain or improve where possible service to customers despite an ageing asset base by investing in sustainable levels of maintenance of our extensive assets</li> <li>- ensure water quality is at the highest possible standards</li> <li>- improve the resilience of our supply system so we can continue to supply water in the event of a loss, for whatever reason, of a critical part of our system</li> <li>- manage increasing numbers of metered customers</li> <li>- provide sufficient water to meet the demand from population growth.</li> </ul> <p>Previously we have invested at a significantly lower rate than the industry average to keep customer prices as low as possible. There is now evidence that we need to invest more to achieve a sustainable level of maintenance so as to ensure customer service does not deteriorate. Additionally, extra investment is required on water quality schemes, to improve resilience and to ensure an adequate balance between supply and demand in the future. In total, we need to invest £319m by 2015, double the current rate of investment despite having deferred £100m of identified projects.</p> <p>Our average household bill needs to increase by less than £1 per week to £4 per week to fund part of this investment.</p> <p>The factors driving real price increases by 2015 are :</p> <ul style="list-style-type: none"> <li>- Taking account of all changes up to 2010 +11%</li> <li>- Moving to sustainable levels of maintenance +7%</li> <li>- Water quality assurance +5%</li> <li>- Greater resilience +3%</li> <li>- Increased metering and supply demand balancing +6%</li> </ul> <p>We have considered an "austerity" alternative but consider it not to be in the overall interests of customers. Accordingly, we will provide additional support for those having genuine difficulties paying bills.</p> <p>The plan provides what customers tell us they want and are generally willing to pay for. We believe our proposals deliver the best possible value for customers, both in the short and long term.</p> |  |

| QUALITY AND SERVICE IMPROVEMENTS IN 2010-2015 PERIOD AND IN THE LONGER TERM   |  |
|---|--|
| <p>Our plan has been designed to address customer priorities and their willingness to pay for improvements. Key deliverables are:</p> <ul style="list-style-type: none"> <li>- a 10% reduction in leakage</li> <li>- improved resilience of supply for 236,000 customers by 2015 and further schemes started to protect a further 407,000 by 2020</li> <li>- maintaining high standards of water quality compliance including improving taste and appearance aesthetic aspects</li> <li>- maintaining stable serviceability of our assets</li> <li>- reducing the number of interruptions to supply</li> <li>- ensuring an adequate supply/demand balance, including preparing for the construction of a new reservoir when it is needed</li> <li>- a lower carbon footprint.</li> </ul> <p>These are challenging targets. We intend maintaining service to customers at high standards whilst providing further resilience in the longer term.</p> |  |

| WHAT IS DRIVING THE CHANGES IN BILLS? (2007-08 PRICES)                  |    | Water |
|---|----|-------|
| Average household bill in 2009-10                                       |    | £146  |
| (1) maintaining base services   |    | £21   |
| of which -  |    |       |
| a) changes in revenue   | £2 |       |
| b) changes in operating costs to maintain current services to consumers | £6 |       |
| c) changes in costs of maintaining assets                               | £9 |       |
| d) changes in impact of taxation  | £3 |       |
| e) change in the cost of capital  | £1 |       |
| (2) maintaining the security of supplies for all customers              |    | £9    |
| (3) the impact of improvements in services                              |    | £12   |
| of which -  |    |       |
| a) drinking water quality   | £8 |       |
| b) environmental improvements   | £0 |       |
| c) Improvements in service levels (resilience)                          | £4 |       |
| Average household bill in 2014-15                                       |    | £188  |

| PRICE LIMITS AND EFFECT ON AVERAGE BILLS (2007-08 PRICES) |         |         |         |         |         |         |
|---|---------|---------|---------|---------|---------|---------|
| Proposed price limit                                      | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
| W Indicative price limit (water service)                  |         | 17.7%*  | 5.3%    | 3.7%    | 1.8%    | 0.7%    |
| * includes 0.2% incentive to reflect high OPA performance |         |         |         |         |         |         |
| 1 Average measured household bill                         | 129     | 148     | 153     | 158     | 160     | 161     |
| 2 Average unmeasured household bill                       | 154     | 185     | 199     | 209     | 217     | 221     |
| 3 Average household bill                                  | 146     | 170     | 179     | 184     | 187     | 188     |

| ESTIMATE OF EXPENDITURE NEEDS (2007-08 PRICES) |  |   |
|--|--|---|
|  |  | Annual average for the 2010-2015 period (£/property/annum)              |
|  |  | <b>Water</b>  |
| 1  | Operating costs to maintain current services to consumers  | 99  |
| 2  | Operating costs to improve services to consumers (water quality, resilience and supply demand balancing)     | 7   |
| 3  | Cost of maintaining assets to deliver current services to consumers  | 52  |
| 4  | Cost of assets to deliver improvements for consumers (water quality, resilience and supply demand balancing) | 75  |
|  |  | <b>Pre tax cost of debt and post tax cost of equity basis (Vanilla)</b> |
|  |  | <b>Fully post-tax basis</b>   |
| 5  | Assumed cost of capital (%)  | 7.00%   |
|  |  | 5.90%   |