

3085928

OFFERING CIRCULAR

FIRST HYDRO FINANCE PLC

(Incorporated in England and Wales with limited liability and registered number 3085928)



£400,000,000

9 per cent. Guaranteed Secured Bonds due 2021

Guaranteed by

FIRST HYDRO COMPANY

(Incorporated in England and Wales with unlimited liability and registered number 2444277)

and

FIRST HYDRO HOLDINGS COMPANY

(Incorporated in England and Wales with unlimited liability and registered number 3140052)

Issue Price 100 per cent.

Payable in full on acceptance

Barclays de Zoete Wedd Limited

10th January, 1996



Application has been made to the London Stock Exchange Limited (the "London Stock Exchange") for the £400,000,000 9 per cent. Guaranteed Secured Bonds due 2021 (the "Bonds") of First Hydro Finance PLC (the "Issuer") to be admitted to the Official List. Copies of this Offering Circular, including Appendix A, which comprises listing particulars prepared in compliance with the listing rules made under Section 142 of the Financial Services Act 1986 for the purpose of giving information with regard to the Issuer, First Hydro Company ("First Hydro"), First Hydro Holdings Company ("First Hydro Holdings") and the Bonds, have been delivered to the Registrar of Companies in England and Wales as required by Section 149 of the Financial Services Act 1986. Except where the context otherwise requires, references in this Offering Circular to Guarantors shall be to each of First Hydro and First Hydro Holdings.

The Bonds will comprise Bonds in bearer form ("Bearer Bonds") and in registered form ("Registered Bonds").

The Bearer Bonds will initially be represented by a Temporary Global Bond, without interest coupons, which will be deposited with a common depositary on behalf of the Cedel and Euroclear systems on or about 17th January, 1996. The Temporary Global Bond will be exchangeable for definitive Bearer Bonds in denominations of £10,000 and £100,000, on or after a date which is expected to be 27th February, 1996 upon certification as to non-U.S. beneficial ownership. The Registered Bonds will be represented initially by Renounceable Letters of Allotment, which are expected to be despatched on or about 17th January, 1996. Definitive certificates in denominations of £1 and integral multiples thereof in respect of the Registered Bonds are expected to be despatched on or about 19th February, 1996 to the subscribers thereof upon certification that the proposed holder of the relevant Registered Bonds (a) is not Euroclear, Cedel, First Chicago Clearing Center or any other person whose business is or includes the provision of clearance services within Section 96 of the Finance Act 1986 nor is it a nominee for any of them and (b) is not a person whose business is or includes issuing depositary receipts within Section 93 of the Finance Act 1986 nor is it a nominee or agent for any such person.

First Hydro Holdings accepts responsibility for the information contained in this Offering Circular, including Appendix A, with the exception of the information contained in Sections 10.2 and 10.3 on pages 28 to 39. First Hydro accepts responsibility for the information contained in this Offering Circular, including Appendix A, with the exception of Section 10.1 on pages 26 to 27. The Issuer accepts responsibility for all the information contained in this Offering Circular, including Appendix A. To the best of the knowledge and belief of each of the Issuer and the Guarantors (each of which has taken all reasonable care to ensure that such is the case), the information contained in this Offering Circular, including Appendix A, for which it takes responsibility is in accordance with the facts and does not omit anything likely to affect the import of such information.

This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Issuer, the Guarantors or Barclays de Zoete Wedd Limited ("BZW") to subscribe or purchase, any of the Bonds. The distribution of this Offering Circular and the offering of the Bonds in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Issuer, the Guarantors and BZW to inform themselves about and to observe any such restrictions. For a description of certain restrictions on offers and sales of Bonds and distribution of this Offering Circular see Section 19 — "Subscription and Sale" on page 80 of this Offering Circular.

No person is authorised to give any information or to make any representation not contained in this Offering Circular and any information or representation not so contained must not be relied upon as having been authorised by or on behalf of the Issuer, the Guarantors or BZW. The delivery of this Offering Circular at any time does not imply that the information contained in it is correct as at any time subsequent to its date.

The Bonds have not been and will not be registered under the U.S. Securities Act of 1933 (the "Securities Act") and the Bearer Bonds are subject to U.S. tax law requirements. Subject to certain exceptions, Bonds may not be offered, sold or delivered within the United States or to U.S. persons.

In connection with this issue, BZW may over-allot or effect transactions which stabilise or maintain the market price of the Bonds at a level which might not otherwise prevail. Such stabilising, if commenced, may be discontinued at any time.

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1. SUMMARY

The following summary is qualified in its entirety by, and should be read in conjunction with, the more detailed information, including the notes thereto, appearing elsewhere in this Offering Circular.

The Acquisition

The Issuer acquired First Hydro on 21st December, 1995 by trade sale from PSB Holding Limited. This sale followed the acquisition by First Hydro on 17th November, 1995 of the pumped storage business division ("PSB") of The National Grid Company plc ("NGC") which was part of the arrangements for the transfer of that business to the shareholders of The National Grid Holding plc. On 4th January, 1996, the Issuer transferred 21 per cent. of the share capital of First Hydro to its parent, First Hydro Holdings pursuant to the Further Sale Agreement, and transferred a further 78 per cent. on 8th January, 1996. Further details of the acquisition arrangements are set out in Section 15 — "Acquisition Arrangements" on page 69 of this Offering Circular.

The Issuer

The Issuer is a public limited company, incorporated on 31st July, 1995 under the Companies Act with registration number 3085928 and with its registered office at Lansdowne House, Berkeley Square, London W1X 5DH. It was established as a finance company for the principal purpose of issuing the Bonds and borrowing under the Facility Agreement referred to in Section 16 — "Finance Arrangements" on page 71 of this Offering Circular. The Issuer is wholly owned by First Hydro Holdings. The Issuer owns 1 per cent. of First Hydro, as further described in Section 15 — "Acquisition Arrangements" on page 69 of this Offering Circular.

The Guarantors

First Hydro

First Hydro was incorporated under the Companies Act with limited liability in 1989 as a special purpose company and has not carried on trading apart from acquiring the PSB. First Hydro was re-registered as a company with unlimited liability on 8th January, 1996. The principal assets of First Hydro are two pumped storage stations in North Wales with a combined registered capacity of 2,088 MW which are designed to provide fast response capability to support the electricity generating system in England and Wales and its activities are set out in Section 5 — "Description of First Hydro" on page 15 of this Offering Circular.

The generating capacity and output of First Hydro is sold to the Pool under the Pooling and Settlement Agreement described in Section 4 — "The Electricity Market in England and Wales" on page 12 of this Offering Circular.

First Hydro has three main sources of revenue, described in more detail in Section 4 — "The Electricity Market in England and Wales" on page 12 of this Offering Circular: (i) Pool trading; (ii) System support services contracted to the ASB; and (iii) contracts for differences largely with Suppliers.

First Hydro Holdings

First Hydro Holdings was incorporated under the Companies Act with unlimited liability on 15th December, 1995 and owns the entire share capital of the Issuer and 99 per cent. of the share capital of First Hydro. The principal activity of First Hydro Holdings is the ownership of shares in the Issuer and First Hydro.

The entire share capital in First Hydro Holdings is indirectly owned by Mission Energy Company, a company incorporated in the State of California, U.S.A. ("Mission") as further described below and, as regards its group structure, in Section 7 — "Description of Group Structure" on page 22 of this Offering Circular.

Issuer Affiliation

The Issuer and the Guarantors are indirect subsidiaries of Mission. Mission is engaged in the business of developing, acquiring, owning and operating independent electric power generation facilities. Currently, Mission owns interests in 58 operating projects with an aggregate generating capacity of 6,791 MW. Mission is a wholly-owned subsidiary of The Mission Group which is a wholly-owned, non-utility subsidiary of SCEcorp. SCEcorp is also the parent holding company of Southern California Edison Company, the second largest investor-owned electric utility in the United States, based on revenues from sales of electricity. Mission has issued 6,000,000 shares of preferred securities through an associated financing vehicle, Mission Capital, L.P., and these securities are listed on the New York Stock Exchange.

None of the shareholders of Mission nor any other affiliate of Mission, other than the Issuer, First Hydro and First Hydro Holdings has any obligation under the Bonds. The obligations of First Hydro Holdings and First Hydro under the Guarantees are non-recourse as against Mission and any other affiliate of Mission. No regard should be had to the assets of the shareholders of First Hydro Holdings when making any credit or other valuation of First Hydro Holdings. Further details of the group structure are set out in Section 7 — “Description of Group Structure” on page 22 of this Offering Circular.

Principal Terms of the Bonds

Terms used in the following summary have the same meaning as set out in Section 11 — “Terms and Conditions of the Bonds” on page 40 of this Offering Circular.

Issue:	£400,000,000 9 per cent. Guaranteed Secured Bonds due 2021.
Final Maturity:	31st July, 2021.
Interest Payments:	Semi-annual on 31st January and 31st July, except that the first interest payment on the Bonds will be made on 31st July, 1996 for the period from the Closing Date to 31st July, 1996.
Security:	<p>The benefit of the security granted by the Issuer and the Guarantors will be held by the Security Trustee on behalf of the Bondholders and other Secured Creditors and the respective rights and liabilities of the Bondholders and other Secured Creditors in respect of such security are regulated by the terms of the Intercreditor Deed.</p> <ul style="list-style-type: none"> – The Bonds have the benefit of first fixed charges granted by (a) the Issuer in respect of, <i>inter alia</i>, all the shares it holds in First Hydro, (b) First Hydro Holdings in respect of all the shares it holds in the Issuer and First Hydro, and (c) the Issuer in respect of Authorised Investments which it holds; – The Bonds also benefit from first floating charges granted by each of the Issuer and First Hydro over the whole of its respective undertaking, property and assets and by First Hydro Holdings over all of the shares it holds in the Issuer and First Hydro, its book debts, bank accounts, investments, uncalled capital and goodwill; – The Bonds have the further benefit of assignments by way of security of (a) the Accounts held by the Issuer, the Revenue Support LC and any other letters of credit in favour of the Issuer, (b) the Issuer’s rights under the Sale and Purchase Agreement, the Further Sale Agreement and the Inter-Company Credit Agreement and First Hydro’s rights under the Asset Acquisition Agreement and (c) First Hydro Holding’s rights under the Further Sale Agreement; – The Bonds also have the benefit of an irrevocable letter of credit having a maturity of five years from its date of issue issued by an authorised institution under the Banking Act 1987 having a short-term credit rating of A-1 or better issued by Standard & Poor’s Rating Services, and P-1 or better by Moody’s Investors Service, Inc. (in an amount of £12,000,000) in favour of the Issuer callable in specified circumstances and charged to the benefit of the Security Trustee.
Guarantees:	All obligations of the Issuer are unconditionally and irrevocably guaranteed by First Hydro to an unlimited extent and by First Hydro Holdings, limited as to recourse against assets over which First Hydro has created security in favour of the Security Trustee.
Bond Redemption Reserve Account:	A Bond Redemption Reserve Account will be established by the Issuer and funded with an amount equal to 20 per cent. of the outstanding principal amount of the Bonds on each of the anniversaries of the date of issue of the Bonds commencing on the 21st anniversary.
Bond Interest Reserve Account:	A Bond Interest Reserve Account will be established by the Issuer on the date of issue of the Bonds and funded by credit to or by the issue of Relevant LCs in amounts equal to the interest payable on the Bonds for the following six months. If the Issuer withdraws amounts from the Bond

	Interest Reserve Account then the Issuer is under no obligation to replenish that account. However, the Issuer may not make any Distribution and may not repay or prepay any principal amount of any Secured Liability for so long as the Bond Interest Reserve Account does not contain, or Relevant LCs have not been issued in, an amount equal to six months interest payable on the Bonds. The Issuer shall make such payment into the Bond Interest Reserve Account or procure that Relevant LCs are issued in such an amount as will result in it being funded equal to the interest payable on the Bonds for the following six months prior to making such repayment or prepayment of any Security Liability.
Put Option:	Upon the occurrence of a Restructuring Event in the circumstances set out in Condition 7.6.
Mandatory Early Redemption:	Upon an Event of Default as provided further in the Terms and Conditions.
Optional Early Redemption:	Upon not less than 45 days' notice by the Issuer in integral amounts of £100,000 at the higher of the principal amount and the Redemption Price.
Purchase:	Subject to the rules of the London Stock Exchange then current, the Issuer may at any time purchase all or any of the Bonds.
Intercreditor Issues:	The benefit of the security granted by the Issuer and the Guarantors will be held by the Security Trustee on behalf of the Bondholders and other Secured Creditors and the respective rights and liabilities of the Bondholders and other Secured Creditors in respect of such security are regulated by the terms of the Intercreditor Deed: see Section 16 —“Finance Arrangements” on page 71 of this Offering Circular. The Intercreditor Deed provides, <i>inter alia</i> , that if Secured Creditors recover more on an insolvency of First Hydro than they would have done if First Hydro had been a limited liability company, then such excess which is attributable to First Hydro Holdings will be paid to First Hydro Holdings.
Bond Trustee and Security Trustee:	Prudential Trustee Company Limited.

2. GLOSSARY OF TERMS

The following terms apply throughout this Offering Circular unless the context otherwise requires:

“Ancillary Services” means the services which are required for the security and integrity of the transmission system;

“ASB” means the Ancillary Services Business of NGC;

“Asset Acquisition Agreement” means the agreement under which First Hydro purchased the PSB from NGC on 17th November, 1995;

“Availability” means the percentage of time the relevant plant is made available to operate;

“Availability Payments” means the payments made to Generators in respect of plant made available but not called upon to generate;

“Bond Interest Reserve Account” has the meaning set out in Section 11 — “Terms and Conditions of the Bonds” on page 40 of this Offering Circular;

“Bond Trust Deed” means the trust deed to be dated 17th January, 1996 and entered into between the Issuer, the Guarantors and the Bond Trustee;

“Bond Trustee” means Prudential Trustee Company Limited, its successors and assigns pursuant to the Bond Trust Deed;

“Bonds” means the Bonds constituted by the Bond Trust Deed;

“Brown & Root” means Brown & Root Environmental, a division of Brown & Root Limited;

“Capacity Payments” means the incentives made available to Generators to make capacity available to the market;

“CEGB” means the former Central Electricity Generating Board;

“Central Scenario” has the meaning set out in Section 6 — “Summary of ILEX Report” on page 19 of this Offering Circular;

“Closing Date” means 17th January, 1996;

“Companies Act” means the Companies Act 1985 (as amended);

“Conditions” means the terms and conditions of the Bonds set out in Section 11 — “Terms and Conditions of the Bonds” on page 40 of this Offering Circular;

“despatch” means the process by which the operator of the Grid issues direct instructions to generators to operate their generating plant;

“Distribution” has the meaning set out in Section 11 — “Terms and Conditions of the Bonds” on page 40 of this Offering Circular;

“Electricity Act” means the Electricity Act 1989;

“Facility Agent” has the meaning set out in the Facility Agreement;

“Facility Agreement” means the £400,000,000 Credit Facility Agreement dated 18th December, 1995 entered into by, *inter alia*, the Issuer, First Hydro Holdings and the banks named therein;

“Further Sale Agreement” means the share sale agreement dated 4th January, 1996 under which the Issuer sold 99 per cent. of the issued share capital in First Hydro to First Hydro Holdings;

“Generation Licence” means the licence granted to First Hydro on 14th November, 1995 under the Electricity Act to generate electricity for the purpose of giving a supply or enabling a supply to be given to any premises;

“Generator” means a person authorised by licence or exemption under the Electricity Act to generate electricity for the purpose of giving a supply or enabling a supply to be given to any premises;

“Grid” means the high voltage transmission system operating primarily at voltages of 400KV and 275KV in England and Wales which offers connection to and use of the system to Generators and Suppliers of electricity on a transparent and non-discriminatory basis;

“Guarantees” means the guarantees of First Hydro and First Hydro Holdings in favour of the Security Trustee on behalf of all Secured Creditors (including Bondholders in respect of the obligations of the Issuer under the Bonds);

"Guarantors" means each of First Hydro and First Hydro Holdings;

"ILEX" means ILEX Consultants;

"Initial Settlement Agreement" means the Agreement of that title dated 30th March, 1990 (as amended) which, for an initial period, modifies or suspends certain provisions of the Pooling and Settlement Agreement;

"Insurance Report" means the independent insurance report dated 15th December, 1995 prepared by Sedgwicks;

"Inter-Company Credit Agreement" means the agreement dated 8th January, 1996 between First Hydro Holdings and the Issuer evidencing a debt of £400,000,000 owed by First Hydro Holdings to the Issuer;

"Intercreditor Deed" means the Security Trust and Intercreditor Deed dated 21st December, 1995 between, *inter alia*, the Issuer, the Security Trustee, First Hydro and First Hydro Holdings;

"Issuer" means First Hydro Finance PLC;

"Loan Discharge Date" means the date on which all the indebtedness of the Issuer or any Guarantor owed to the Facility Agent or the Banks under the Facility Agreement has been fully and irrevocably paid or discharged and no further such indebtedness is capable of becoming outstanding (which the Issuer expects to occur on or about the Closing Date);

"Loss of Load Probability" means the probability of supply being lost by reason of generation being insufficient to meet demand;

"Merz and McLellan" means Merz and McLellan Limited;

"MMC" means the Monopolies and Mergers Commission;

"NGC" means The National Grid Company plc;

"Pool" means the electricity trading market in England and Wales, the rules and procedures of which are contained in the Pooling and Settlement Agreement, as modified and suspended by the Initial Settlement Agreement;

"Pool Price Cap" means the price caps for electricity sales to the Pool agreed by the Regulator with the major Generators (which in October 1993 were 2.40p kWh time weighted and 2.55p kWh demand weighted);

"Pool Purchase Price" means the price paid to Generators for each unit of electricity generated and supplied to the Pool;

"Pool Selling Price" means the price which forms the basis of payments for electricity by Suppliers;

"Pooling and Settlement Agreement" means the Agreement of that title dated 30th March, 1990 (as amended) and made between the RECs and certain other parties and which sets out, *inter alia*, the rules and procedures for the operation of the Pool and for the operation of a settlement system;

"Property Clawback Debenture" means the debenture dated 30th October, 1990 between NGC and the Secretary of State for Energy restricting the use of the properties at Dinorwig and Ffestiniog;

"Reactive Output" means a form of power which arises when alternating current does not remain exactly in phase with the voltage in a system for the transmission or distribution of electricity;

"RECs" means the twelve regional electricity companies which came into existence in 1990 as a result of the restructuring and subsequent privatisation of the electricity supply industry in England and Wales;

"Regulator" means the Director General of Electricity Supply (DGES);

"Reliability" means the percentage of successful responses by the relevant plant to requests to operate;

"Revenue Support LC" has the meaning set out in Section 11—"Terms and Conditions of the Bonds" on page 40 of this Offering Circular;

"RPI" or "Retail Prices Index" means the general index of retail prices published by the Central Statistical Office each month or, where the context requires, the percentage change in such index over any period for which a calculation falls to be made;

"Sale and Purchase Agreement" means the sale and purchase agreement dated 21st December, 1995 between the Issuer and PSB Holding Limited under which the Issuer acquired all of the share capital of First Hydro;

"Secured Creditor" means the Bond Trustee and the Bondholders, until the Loan Discharge Date the financial institutions defined as Banks in the Facility Agreement, Barclays Bank as provider of the ancillary services

referred to in Section 16—“Finance Arrangements” on page 71 of this Offering Circular and any other creditor of the Issuer or any Guarantor which has executed a valid Deed of Accession (in the form set out in the Intercreditor Deed) as a result of which such creditor becomes entitled to share the security referred to in Section 16—“Finance Arrangements” on page 71 of this Offering Circular;

“Secured Finance Document” has the meaning set out in the Intercreditor Deed;

“Security Trustee” means Prudential Trustee Company Limited, its successors and assigns;

“Sedgwicks” means Sedgwicks Bankrisk Limited;

“SSSIs” means sites of special scientific interest;

“Supplier” means a person which is licensed under the Electricity Act to supply electricity to any premises;

“Synchronisation” means the synchronisation of the spin rate of the relevant generating unit with the frequency of the alternating current in the Grid as a whole;

“System Marginal Price” or “SMP” means the payment made to all Generators scheduled, whatever level of bid submitted;

“UK” means the United Kingdom of Great Britain and Northern Ireland;

“Uplift” means the difference between the Pool Selling Price and the Pool Purchase Price;

“Value of Lost Load” has the meaning set out in Section 4 — “The Electricity Market in England and Wales” on page 12 of this Offering Circular;

“Willis Corroon” means Willis Corroon London Limited;

References to “pounds”, “p”, “sterling” and “£” denote the lawful currency of the United Kingdom.

3. RISK FACTORS

The following section is qualified in its entirety by, and should be read in conjunction with, the more detailed information, including the notes thereto, appearing elsewhere in this Offering Circular.

The Market for Electricity

The ILEX Report summarised in Section 6 — “Summary of ILEX Report” on page 19 of this Offering Circular considers the factors which influence the level and shape of future Pool prices. These factors include competition amongst Generators, regulatory issues and the demand for electricity. ILEX have developed three Scenarios: the High Scenario; the Central Scenario and the Low Scenario, and these are set out on pages 19 and 20 of the Offering Circular. Although the Issuer believes that the Central Scenario referred to on page 19 of the Offering Circular is the likely future scenario no assurance can be given about the level and shape of future Pool prices.

Future Revenues

If for any reason there is an insufficiency of revenues to cover interest payments, the Issuer may have to make drawings on the Revenue Support LC (up to a maximum of £12 million and maturing five years from its date of issue) referred to in Section 11 — “Terms and Conditions of the Bonds” on page 40 of this Offering Circular in order to provide for timely payment of interest when due and to ensure that interest cover remains above 1.05: 1.00. In these circumstances, amounts drawn under the Revenue Support LC (which will be shared with other Secured Creditors) will operate to reduce the amount available to be drawn in the future. When no further drawing may be made under the Revenue Support LC or after it has expired, the Issuer may withdraw amounts from the Bond Interest Reserve Account or draw under the Relevant LCs. If the Issuer withdraws amounts from the Bond Interest Reserve Account or draws under Relevant LCs the Issuer is under no obligation to replenish that account or procure that Relevant LCs are issued to replace those drawn. However, it may not make any Distribution and may not repay or prepay any principal of any Secured Liabilities as provided in Conditions 15 and 8, respectively, of the “Terms and Conditions of the Bonds” on page 40 of the Offering Circular for so long as the Bond Interest Reserve Account is not credited with, or the amounts payable under Relevant LCs do not equal, six months interest payable on the Bonds.

Recourse and Change of Control

None of the shareholders of Mission Energy Company nor any other affiliate of Mission, other than the Issuer, First Hydro and First Hydro Holdings has any obligation under the Bonds. Recourse against First Hydro Holdings under its Guarantee is limited to those assets over which it has granted security in favour of the Security Trustee. See further Section 16 — “Finance Arrangements” on page 71 of this Offering Circular. No regard should be had to the assets of the shareholders of First Hydro Holdings when making any credit or other valuation of First Hydro Holdings. The Intercreditor Deed provides, *inter alia*, that if Secured Creditors recover more on an insolvency of First Hydro than they would have done if First Hydro had been a limited liability company, then such excess which is attributable to First Hydro Holdings will be paid to First Hydro Holdings. The “Terms and Conditions” on page 40 of this Offering Circular contain no provisions restricting the change of ownership of First Hydro Holdings.

Sale and Purchase Agreement and Asset Acquisition Agreement

The Sale and Purchase Agreement referred to under Section 15 — “Acquisition Arrangements” on page 69 of this Offering Circular contains very limited representations and warranties. There are significant restrictions on rights to claim thereunder including provisions that any claim for breach of the representations and warranties will be limited to £60 million in aggregate and that any such claim must be made within six months of the date of acquisition of the shares of First Hydro. The Asset Acquisition Agreement also contains limited representations and warranties and significant restrictions on rights to claim thereunder. Further information is set out in Section 15 — “Acquisition Arrangements” on page 69 of this Offering Circular.

Intercreditor Arrangements

Under the intercreditor arrangements described in Section 16 — “Finance Arrangements” on page 71 of this Offering Circular both the Facility Agent and the Bond Trustee will be able to exercise a veto over the enforcement of the security. However, before the Loan Discharge Date, the Bond Trustee or the Facility Agent may require the Security Trustee to take appropriate steps to preserve the value of the security after notifying the other. After the Loan Discharge Date, the provisions dealing with the enforcement of security allow any

one class of Secured Creditor to enforce the security without the consent of any other Secured Creditor or class of Secured Creditor. The other restrictions cease to apply. The Intercreditor Deed provides that a creditor of the Issuer or the Guarantors may execute a Deed of Accession (in the form set out in the Intercreditor Deed) as a result of which such creditor becomes a Secured Creditor entitled to share the security referred to in Section 16 — “Finance Arrangements” on page 71 of this Offering Circular.

Regulatory

There is uncertainty as to how the Regulator will exercise its powers under the Electricity Act and how the electricity industry will be regulated in the future. It is possible that changes will be made to the regulatory system or to First Hydro’s Generation Licence and in certain limited circumstances, as set out in Section 17 — “Additional Information” on page 73 of this Offering Circular, First Hydro’s Generation Licence may be revoked. If any regulatory change or amendment or revocation of First Hydro’s Generation Licence amounts to a “Restructuring Event” then Bondholders will be entitled to require the Issuer to redeem the Bonds in the circumstances described and as further provided in Condition 7.6 set out in Section 11 — “Terms and Conditions of the Bonds” on page 40 of this Offering Circular.

4. THE ELECTRICITY MARKET IN ENGLAND AND WALES

Overview

The electricity industry in England and Wales comprises four elements:

- (i) Generation: the production of electricity;
- (ii) Transmission: the bulk transfer of electricity across the Grid;
- (iii) Distribution: the delivery of electricity, transferred from the Grid, to local distribution networks; and
- (iv) Supply: the purchase and sale of electricity to the consumer.

Prior to privatisation in 1990, the electricity industry was split between the CEGB, which was responsible for generation and transmission, and the twelve area electricity boards, which were responsible for the distribution and supply of electricity within their area.

Pursuant to the Electricity Act, the electricity industry was re-organised with the objective of introducing competition in the generation and supply markets. As part of the re-organisation, the Grid, together with the PSB, was vested in NGC. Further details of the structure of the electricity industry are set out in Section 17 — “Additional Information” on page 73 of this Offering Circular.

The Pool

Central to the privatised market for electricity in England and Wales was the creation of the Pool, which started operations on vesting day, 31st March, 1990. The Pool acts under the control of NGC in order to provide a practical framework for the spot pricing and supply of electricity between Generators and Suppliers.

The Pool, an unincorporated organisation, is circumscribed by the Pooling and Settlement Agreement, a contract which describes the operational and settlement procedures and the obligations of the members of the Pool. All major Generators and Suppliers in the electricity market are members of the Pool as a condition of their licence.

The Pool operates as a market between Generators, Suppliers and certain large consumers, and is managed by NGC. Its operation is broadly summarised as follows. Each day, for the next day's electricity supply, Generators bid their plant at a price to the Pool at which they would be willing to run. The Pool operator then examines these bids and compiles an order of merit on the basis of certain criteria including the price for each half hour of power supply. At the point where projected supply meets projected demand, the Pool operator then sets the System Marginal Price (“SMP”) for each half hour of the next day. SMP and a Capacity Payment are paid to all Generators actually scheduled in the daily unconstrained schedule whatever their initial bid. If a Generator registers as available but is not called upon to generate, then it receives Availability Payments, calculated as described below.

This description of the Pool is necessarily basic and does not describe the more detailed payment mechanisms for plant that is known as “constrained on” or “constrained off”. For this information, reference should be made to the Pooling and Settlement Agreement which is available for inspection at the offices of the Issuer, the Guarantors and Milbank, Tweed, Hadley & McCloy as further set out in Section 20 — “General Information” on page 81 of this Offering Circular.

Main Pool Payments

1. *Pool Purchase Price*

The Pool Purchase Price (“PPP”) paid to Generators for each unit of electricity generated and supplied to the Pool, has two components:

- (i) SMP, as described above; and
- (ii) Capacity Payments, which are designed to incentivise Generators to make capacity available if the market requires it. Capacity Payments are calculated as the product of the Loss of Load Probability (“LOLP”) and the amount consumers would be willing to pay to avert an interruption to supply.

The willingness of customers to pay for avoiding loss of power is defined as the value of lost load (“VOLL”). VOLL is specified by the Regulator and has been set at £2/kWh in 1990/91 prices since

1990/91. A sustained rise in LOLP, reflected in increased Capacity Payments, would provide added incentive to Generators to build new capacity.

PPP is, therefore, calculated as follows:

$$PPP = SMP + LOLP(VOLL - SMP).$$

2. *Availability Payments*

If a Generator, having bid into the system, is not called upon to generate, then it will still receive Availability Payments as follows:

$$\text{Availability Payment per unit of Available Capacity} = LOLP(VOLL - \max \{SMP, \text{Bid Price}\})$$

In such case, subtracting the maximum of SMP and Bid Price from VOLL helps to ensure that plant which bids closest to SMP but which is not scheduled to generate will receive the most benefit.

3. *Pool Selling Price*

Suppliers and certain large consumers buying electricity from the Pool pay the Pool Selling Price ("PSP"), calculated as shown below:

$$PSP = PPP + \text{Uplift}.$$

Uplift is an additional component to cover the running costs of the system. A significant component of the Uplift is the cost of providing Ancillary Services, which are required in order to ensure system integrity and the quality of supply.

Contracts for Differences ("CfDs")

PPP is set on a daily basis in half-hourly segments and, due to the large differentials in demand according to the time of day, is subject to considerable volatility. As a result, many Suppliers take out CfDs with Generators in order to hedge this volatility. There are a number of differing hedge structures but, in the most straightforward, a Supplier would make an upfront payment to a Generator, in return for receiving payments from the Generator when the PPP rises above a pre-agreed price. The role of First Hydro in this market is described in more detail in Section 5 — "Description of First Hydro" on page 15 of this Offering Circular.

1. *Energy-related CfDs*

Energy-related contracts typically take the PPP as the reference price. Payments for such options are typically made by the purchaser on a monthly basis. The payment mechanism for a one-way CfD will generally provide that the Generator pays the difference between a preset strike price and the actual out-turn PPP for each half-hourly period where the actual PPP is higher than the strike price. The volume of such contracts entered into by any specific Generator will be constrained by the physical limitations on its generation capacity.

2. *Capacity-only CfDs*

Capacity-only contracts take the capacity payment element of the PPP as the reference price. Payments for such options are typically made by the purchaser on a monthly basis. The capacity element is rebated to the purchaser whenever it exceeds a preset threshold value. Capacity Payments generally become significant in relation to PPP at peak times. As a result, plants which concentrate their availability at times of peak demand are able to enter into such contracts.

3. *Electricity Forward Agreements ("EFAs")*

EFAs are standardised CfDs traded through a central broker. A standard EFA will be a two-way CfD, typically traded against PPP without an option fee, for a four hour time period. Other more sophisticated forms of EFA are also available including options and collars. EFAs are generally of short durations, typically of less than one year.

The following table sets out the volume (in MW) of existing CfDs entered into by First Hydro:

MW		Winter 1995/6	Summer/Winter 1996/97	Summer/Winter 1997/98	Summer/Winter 1998/99	Summer/Winter 1999/2000
Capacity	. .	730	80/350	80/100	80/100	80/100
Capacity/ Energy	. .	805	269/435	224/280	0/0	0/0
Total	. . . .	1,535	349/785	304/380	80/100	80/100

Source: ILEX Report (as updated by the Issuer)

Ancillary Services

Ancillary Services are provided by Generators to the NGC Ancillary Services Business ("ASB"), usually on a contracted basis, and fall into four main categories:

1. *Voltage Control*

This is achieved by varying the Reactive Output of synchronised plant.

2. *Frequency Control*

This is achieved by varying the output of synchronised plant within various timescales, typically on an automatic basis within 10 to 30 seconds.

3. *Reserve*

This is achieved by despatching a unit held in reserve which is capable of coming on line within 5 to 10 minutes.

4. *Black Start*

This is the ability to re-energise parts of the power system which have been shut down.

Contracts for Ancillary Services are entered into between ASB and the relevant Generators supplying the service. Further information concerning the arrangements between First Hydro and ASB are given in Section 5 — "Description of First Hydro" on page 15 of this Offering Circular.

5. DESCRIPTION OF FIRST HYDRO

The principal assets of First Hydro are two pumped storage stations in North Wales at Dinorwig and Ffestiniog which have a combined registered capacity of 2,088MW. These facilities were built to provide additional generation for meeting peak demand throughout the day and to provide rapid generation response to sudden changes in electricity demands.

Pumped Storage Stations

Pumped storage stations consume electricity when it is comparatively less expensive in order to pump water up for storage in an upper reservoir. Water is then allowed to flow back through turbines in order to generate electricity when its market value is higher.

This type of generation is characterised by its speed of response, its ability to work efficiently at wide variations of load and the basic reliance of revenue on the difference between the peak and trough prices of electricity during the day. As a result of these characteristics, pumped storage stations frequently occupy a central role in the grid systems of which they form a part.

Background to PSB

Dinorwig and Ffestiniog were constructed by the CEGB to carry out two main functions in support of the then integrated electricity generation and transmission system in England and Wales:

- (i) to help manage the overall demand profile for electricity in the UK during the day, by increasing demand at night through pumping, thereby reducing the amount of other generating plant which needs to be shut down and by increasing supply at daytime peaks through generation, thereby reducing the amount of open cycle gas turbines or other higher marginal cost plant which needs to be operated for short periods of time to meet the peak; and
- (ii) to respond to a sudden failure of other generation plant or an unexpected increase in demand at any time by providing a fast response generation service, thereby maintaining stability on the Grid.

Since privatisation of the industry in 1990, contractual arrangements and trading mechanisms have taken the place of the broad services outlined in (i) and (ii) above. This provides the opportunity for First Hydro to buy electricity during the least expensive periods of the day and sell back to the Pool at times of peak pricing.

Dinorwig

Dinorwig was commissioned in 1983 and comprises six pumped storage units which can act as both pumps or turbines, each connected to a motor-generator set. Water enters a tunnel from a reservoir located approximately 500 metres above the station and passes through the turbines, before discharging into a lower reservoir. In reverse mode the turbines operate as pumps and the generators operate as motors in order to refill the upper reservoir. The efficiency of the system is approximately 77 per cent., which means that the energy released in generating is approximately 77 per cent. of the energy required to pump the same amount of water into the upper reservoir. Whilst the system is currently limited to approximately 1.3 cycles per day, current practice results in the system cycling the water once per day.

Each generating unit has a registered output of 288MW with a nominal output of 300MW. The total registered output for Dinorwig is 1,728MW. The generators have an extremely fast response of approximately 14 seconds from synchronisation to full load and can respond in a shorter period of time if the generators are already operating at part load.

Ffestiniog

Ffestiniog was commissioned in 1963 and comprises four pumped storage units. Water passes through twin tunnels from the upper reservoir through the turbines in order to generate. In reverse mode, the turbines are disengaged and the pumps engaged in order to pump water back up to the upper reservoir. The efficiency of the system is approximately 72 per cent.

Each generating unit was originally designed at a rating of 75MW, and upgraded after a few years of operation to 90MW. The total registered output for Ffestiniog is 360MW. The generators have a response of approximately 60 seconds from Synchronisation to full load.

Revenues

In terms of installed capacity and revenue, Dinorwig and Ffestiniog account for approximately 80 per cent. and 20 per cent., respectively, of First Hydro's total.

The following are First Hydro's principal sources of revenue:

1. *Trading in the Pool*

First Hydro bids each of its generating units into the Pool in the same way as all other Generators and is paid in the same way i.e. it receives an Availability Payment as long as they are available to generate and PPP when despatched. Trading in the Pool accounted for approximately 42 per cent. of total revenue net of electricity purchases in the financial year ended 31st March, 1995.

2. *Contracts for Differences*

First Hydro has typically sold a high proportion of its installed capacity forward by entering into capacity-only CfDs and PPP and energy-related CfDs with Suppliers (mostly on an annual basis). These payments accounted for approximately 31 per cent. of total revenue net of electricity purchases in the financial year ended 31st March, 1995.

3. *Ancillary Services*

Assisting in maintaining system integrity is a service which First Hydro sells to ASB, currently under annual contracts.

First Hydro offers voltage control, frequency control, reserve and black start services to ASB. Payments for Ancillary Services accounted for approximately 27 per cent. of total revenue net of electricity purchases in the financial year ended 31st March, 1995, of which approximately 80 per cent. was due to frequency control.

The Ancillary Services contracts set out a rate of payment for the various services offered.

Miscellaneous Activities

First Hydro has a department named International Hydro, currently involving four employees. At present, this department is involved in the identification and appraisal of overseas investment opportunities relating to hydro electric projects. To date, First Hydro has not made any commitment to invest in any such project and there is no intention to do so.

First Hydro also operates a visitor centre at the Dinorwig and Ffestiniog sites which, in the financial year 1994/95, attracted approximately 55,000 visitors.

Operating History

The figures for the following calendar years for the Availability and Reliability of Dinorwig and Ffestiniog are set out below:

				1991	1992	1993	1994	1995 ⁽¹⁾
Dinorwig								
Availability (%)	..	..	..	94.5	92.8	91.9	90.3	91.2
Reliability (%)	..	..	..	99.4	99.4	99.6	99.5	99.2
Ffestiniog								
Availability (%)	..	..	..	86.3	91.3	85.6	90.1	91.8
Reliability (%)	..	..	..	99.9	99.9	99.8	99.8	98.6

Note:

(1) The figures for 1995 are dated as at 16th November, 1995.

Source: Merz and McLellan.

Maintenance

First Hydro is responsible for all maintenance at Dinorwig and Ffestiniog and does not have any significant maintenance contracts with third parties. From time to time, contractors are used to provide specialist services and resources.

Maintenance is split into two categories:

- (i) core maintenance is carried out at regular intervals on each unit at Dinorwig and Ffestiniog to ensure plant availability is maximised; and
- (ii) non recurring repair maintenance is carried out on an as required basis as determined by plant condition monitoring and is designed to rectify plant degradation in advance of it impacting on Availability.

Independent Technical Report

Merz and McLellan has conducted an independent technical review of both Dinorwig and Ffestiniog to assess, *inter alia*, the operating performance of each plant in terms of Availability and Reliability (since 1984 for Dinorwig, and 1986 for Ffestiniog Availability and 1991 for Ffestiniog Reliability); plant design and expected life; the maintenance regime; and operating and maintenance costs.

The findings from the review include:

- (i) **Availability and Reliability:** Overall, Merz and McLellan found that both Dinorwig and Ffestiniog can be expected to achieve high Reliability and Availability targets over the next 10 years and beyond.
- (ii) **Plant Design and Expected Life:** First Hydro's current maintenance programme is based on ensuring the continued efficient operation of Ffestiniog for at least 10 years. Merz and McLellan has expressed the view that, with an appropriate maintenance programme, the extension of Ffestiniog's life over the next 25 years is feasible.
- (iii) **Maintenance Regime:** Merz and McLellan is of the view that both the core and non recurring repair maintenance programmes are appropriate for maintaining the level of performance and Reliability and Availability which both plants have demonstrated over the past four years.
- (iv) **Operating and Maintenance Costs:** First Hydro estimates that total expenditure and refurbishment over the next 10 years, excluding care maintenance costs, will be approximately £49 million. Merz and McLellan has reviewed the content of the estimate and costs schedule and considers these to be reasonable.

A copy of the Merz and McLellan technical report (dated 15th December, 1995) is available for inspection at the registered offices of the Issuer and the Guarantors and at the offices of Milbank, Tweed, Hadley & McCloy as provided in Section 20 — "General Information" on page 81 of this Offering Circular.

Independent Insurance Report

An independent report on First Hydro's insurance arrangements has been prepared by Sedgwicks (the "Insurance Report"). A copy of the Insurance Report (dated 15th December, 1995) is available for inspection at the registered offices of the Issuer and the Guarantors and at the offices of Milbank, Tweed, Hadley & McCloy as provided in Section 20 — "General Information" on page 81 of this Offering Circular.

Sedgwicks has confirmed that First Hydro's insurance arrangements (as confirmed to them by Willis Corroon) currently provide a satisfactory level of coverage for the nature and scope of activities undertaken and are in line with currently accepted risk management best practice. Cover is provided for, but not limited to, physical loss or damage, business interruption, public liability, employers liability, machinery breakdown and business interruption following machinery breakdown and personal accident.

Independent Environmental Report

Brown & Root has prepared an independent environmental report on First Hydro dated 16th December, 1995 (the "Environmental Report") which is available for inspection at the registered offices of the Issuer and the Guarantors and at the offices of Milbank, Tweed, Hadley & McCloy as provided in Section 20 — "General Information" on page 81 of this Offering Circular.

The Environmental Report reviewed the following aspects of the site specific environmental programmes at all locations: (i) site operations; (ii) potential emissions to air; (iii) potential impact on surface and subsurface water; (iv) waste management practices; (v) site sharing practices and the activities of neighbours; (vi) presence and use of chemical and hazardous substances; (vii) proximity and status of SSSI's; (viii) containment as it relates to above- and below-ground storage tanks; (ix) facility noise and nuisance; (x) site environment management; and (xi) an investigation of the potential for soil and/or water contamination.

Based on a limited sampling programme in selected (high priority) areas of present and historical operations, site visits, discussions with management and relevant regulators, the Environmental Report concluded that no significant contamination of land or water could be found; and that provided there is a modest investment programme in relation to environmental matters, facility practices are not likely to cause any significant impacts on the environment in the future.

Independent Valuation Report

Merz and McLellan has prepared an independent valuation of Dinorwig and Ffestiniog and derived the present day value of the assets as £466,500,000 and £32,600,000, respectively as at 1st December, 1995. This valuation is based on different maximum lives for the civil works and the mechanical and electrical plant, and on probable residual lives derived from "survivor" curves. The valuation report is set out in Appendix A and forms part of this document.

The methodology used in the valuation calculates the present day value of Dinorwig and Ffestiniog from (i) the present day replacement cost; (ii) the residual value; (iii) the present age; and (iv) the probable residual life assuming straight line depreciation. The residual lives used for the valuation are not necessarily a reflection of the remaining useful operational lives of the relevant assets and are for the purposes of this valuation only. Merz and McLellan believe that given an appropriate maintenance programme, the overall useful operational life of the Dinorwig and Ffestiniog schemes should be capable of being extended to 25 years.

6. SUMMARY OF ILEX REPORT

ILEX has prepared a report (dated December, 1995) which describes the position of First Hydro within the electricity industry and the revenue sources of First Hydro. Technical terms used in this summary are defined in Section 2 — "Glossary of Terms" on page 7 of this Offering Circular. A copy of the full ILEX report is available for inspection at the registered offices of the Issuer and the Guarantors and at the offices of Milbank, Tweed, Hadley & McCloy as provided in Section 20 — "General Information" on page 81 of this Offering Circular.

The ILEX report contains, *inter alia*:

- (i) an economic model of the business of First Hydro. Each generating unit at Dinorwig and Ffestiniog is modelled separately as either operating in the peaking energy market or as dedicated to providing Ancillary Services, in order to predict the overall operational pattern of First Hydro. From this pattern, ILEX has calculated Pool energy-related revenues and electricity purchase costs;
- (ii) an overall model for the level and shape of future Pool prices based on development of three scenarios and three sets of assumptions on future fuel prices;

The three internally consistent Pool price scenarios are:

- (a) High: based on a market influenced by the major Generators with prices capped at a level which a new entrant requires to enter the market;
 - (b) Central: based on a market in which the power of the major Generators is balanced by the influence of the Regulator (the "Central Scenario"); and
 - (c) Low: based on a market where significant overcapacity exists and there is vigorous competition amongst the Generators, or where there is strong regulatory intervention to mimic this effect;
- (iii) a description of the source of future revenues of First Hydro:
 - (a) payments through the Pool for providing energy (and compensation payments arising from the provision of Ancillary Services which result in operation on an out-of-merit basis), net of electricity purchase costs;
 - (b) availability payments through the Pool, which may be preset by the sale of CfDs; and
 - (c) payments for Ancillary Services and rebates against Pool income which flow from the Ancillary Services contracts.

Central Scenario

The Central Scenario assumes the following regulatory background to the electricity industry:

- (i) although the Pool Price Cap which was agreed between the Generators and the Regulator expires at the end of the 1995/6 financial year, its influence continues beyond that date. On 12th December, 1995, the Regulator announced that the Pool Price Cap would not be extended beyond the end of the 1995/6 financial year. ILEX assumes that major Generators will not wish to raise prices and provoke further regulatory intervention, whilst the Regulator will be content to see prices at a level which he believes to be consistent with a free market;
- (ii) PPP is set at a level consistent with the methodology used by the Regulator when the Pool Price Cap was set in 1994, which assumes that Generators are free to purchase fuel from the cheapest available source for their plant, and that all Generators bid at their marginal costs of production based on these sources. None of the present distortions caused by current coal or gas contracts exist in this theoretical market. The level of capacity is set in line with calculations at the time of privatisation of the net avoidable cost of keeping old plant on the system; and
- (iii) the current ratio for time weighted average prices to demand weighted average prices would continue, i.e. prices would continue to exhibit similar intra-day price profiles to those currently seen.

Low Scenario

The Low Scenario assumes the following regulatory background to the electricity industry:

- (i) the combination of substantial and genuine overcapacity in the electricity system, combined with sufficient diversity of power station ownership, leads to a Pool in which all Generators bid at their marginal cost of production;

- (ii) bidding at marginal cost results in a PPP where the SMP component is at a fully competitive level, and the capacity element of PPP is negligible due to overcapacity. Under this position, the intra day profile of Pool prices would become flat relative to the Central Scenario; and
- (iii) a similar scenario would arise where regulatory intervention encourages Generators to bid at marginal cost.

High Scenario

The High Scenario assumes the following regulatory background to the electricity industry:

- (i) the current Generators are able to control Pool prices at times during which the marginal plant on the system is in their ownership;
- (ii) this will lead both to a rise in Pool prices and to a greater range in the intra day price profile; and
- (iii) it is assumed as an adjunct to this scenario of rising prices that eventually, prices would justify the construction of new plant. This would inevitably cap prices as competition increased.

Overall Level and Daily Profile of Pool Prices

The Central Scenario described above and central fuel price assumptions produce projected Pool prices only slightly different from levels currently seen.

A major factor will be the impact of new entrants on the market. The Central Scenario assumes a certain profile for gas prices (currently the most competitive fuel source for new power plants). If gas prices were significantly higher or lower than the figure used in the Central Scenario, then the influence of new entrants would be significantly altered.

Prices under the Central Scenario meet the Pool Price Cap in 1995/6. After this, it is assumed that the main influence will be that of the Regulator, until around 2000–2003, when the main influence becomes the price required by a new entrant.

The profile of Pool prices through the day is a major factor for overall profitability of First Hydro. The Central Scenario assumes a level of intra-day price profile which is consistent with the Pool Price Cap.

The Low Scenario envisages a rapid collapse in prices to a point where the main Generators are running at or close to break even, a point achieved in around 1997/8. Following such a point, order slowly re-establishes itself and prices begin to rise again, levelling off at the price where the cost of new entrant power becomes competitive.

The High Scenario leads to a rise in prices capped quickly by the competition from new entrant power stations.

The Impact of CfDs

The Pool price scenarios developed do not take account of the ability of First Hydro to sell CfDs. These contracts provide First Hydro with a hedge against the volatility of its Pool revenues.

The High and the Central Scenarios assume that the value of the capacity contracts entered into by First Hydro matches the value of Pool capacity payments received and that the energy component, which hedges payments against SMP, is unlikely to have a material effect on revenues.

In the Low Scenario, the minimum value of capacity contracts falls to a level at which ILEX suggest First Hydro might expect to be able to secure contracts for up to the full volume of its capacity. In years where Pool availability payments are less than this level, contract income is assumed to insulate First Hydro from such low levels.

Future Developments in Ancillary Services

Ancillary Services are provided by First Hydro to ASB, mainly for frequency control, which currently forms the majority of the total income from this revenue stream.

ILEX is not aware of any developments within the market which would prevent First Hydro from providing the current level of Ancillary Services, provided it offers competitive prices.

ILEX considers that the prices for Ancillary Services may be affected by competitive pressures arising from the introduction of incentives for ASB to reduce the costs of these services, which have resulted in the increased use of demand-side measures. ILEX considers that increased competition in the Ancillary Services market may come from two main sources:

- (i) demand-side measures; and
- (ii) impact of higher flexibility gas plant.

ILEX considers that demand-side measures will exert more competitive pressure on First Hydro as the general Pool price level increases. In the Low Scenario, the relatively low incentive leads to a lower interest in demand-side measures and less competitive pressures on Ancillary Service income.

Projections for the future value of Ancillary Services to First Hydro are based on an assessment of the value of those services in the competitive market.

The volume of services provided by First Hydro will be determined by its bidding and contracting strategy, and ILEX considers that the volume should not change significantly for as long as First Hydro offers competitive contracts and continues to optimise bidding strategy.

7. DESCRIPTION OF GROUP STRUCTURE

The Issuer was incorporated on 31st July, 1995 as a public limited company and is a wholly-owned subsidiary of First Hydro Holdings, an unlimited company incorporated on 15th December, 1995.

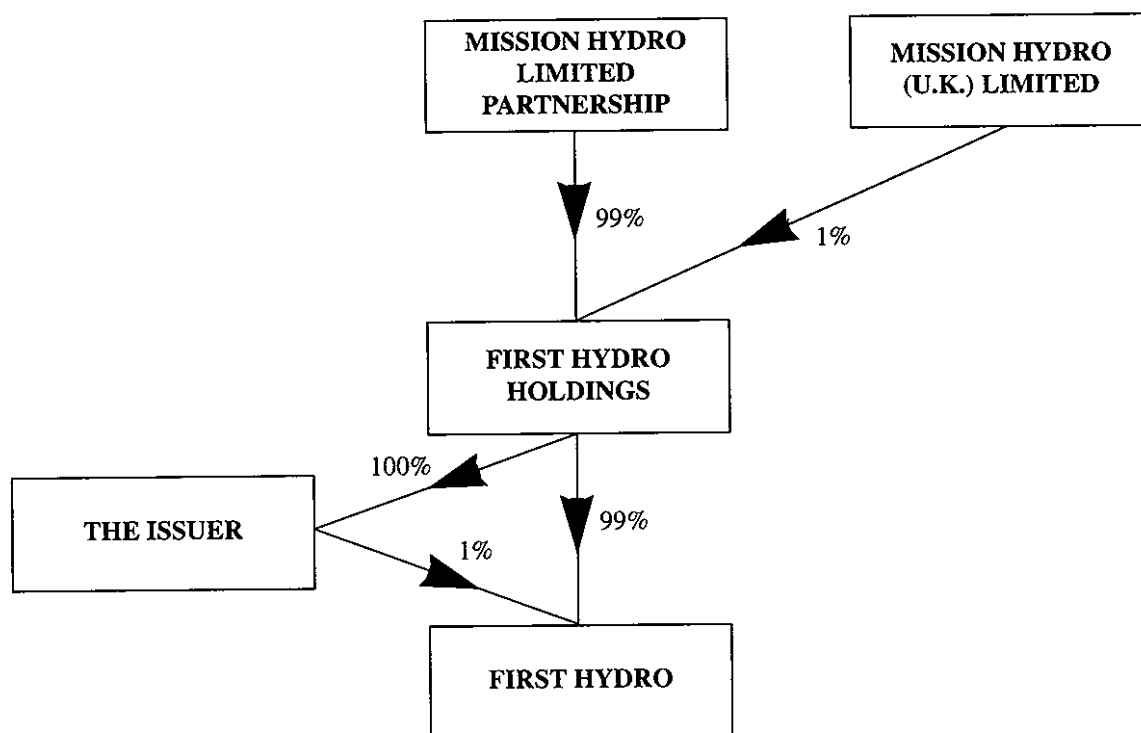
First Hydro Holdings and the Issuer own 99 per cent. and 1 per cent., respectively, of the share capital of First Hydro. First Hydro was incorporated in 1989 as a limited company and re-registered as an unlimited company on 8th January, 1996. The Terms and Conditions of the Bonds set out in Section 11 on page 40 of this Offering Circular contain provisions enabling the Issuer to transfer its one per cent. shareholding in First Hydro to a Permitted Subsidiary (as defined therein).

Ninety-nine per cent. of the share capital of First Hydro Holdings is owned by Mission Hydro Limited Partnership, a limited partnership established on 14th December, 1995 under the Limited Partnership Act 1907 and the remaining 1 per cent. is owned by Mission Hydro (U.K.) Limited. The Limited Partners of Mission Hydro Limited Partnership are Mission Energy Wales Company (a corporation incorporated in the State of California) as to 30 per cent. and MEC Wales B.V. (a company established under the laws of the Netherlands and registered as MEC Laguna Power B.V.) as to 69 per cent. The General Partner of Mission Hydro Limited Partnership is Mission Hydro (U.K.) Limited which has a 1 per cent. interest in the partnership.

The entire share capital of each of Mission Energy Wales Company, Mission Hydro (U.K.) Limited and MEC Wales B.V. is indirectly owned by Mission.

None of the shareholders of Mission nor any other affiliate of Mission, other than the Issuer, First Hydro and First Hydro Holdings has any obligation under the Bonds. The obligations of First Hydro Holdings and First Hydro under the Guarantees are non-recourse as against Mission and any other affiliate of Mission. No regard should be had to the assets of the shareholders of First Hydro Holdings when making any credit or other valuation of First Hydro Holdings. The obligations of First Hydro Holdings under its Guarantee are limited recourse to the assets over which it has granted security in favour of the Security Trustee.

An illustrative diagram containing the group structure of the Issuer and the Guarantors is set out below:



8. DIRECTORS OF THE ISSUER, FIRST HYDRO AND FIRST HYDRO HOLDINGS

The Directors of the Issuer, First Hydro and First Hydro Holdings and their positions are as follows:

The Issuer

<i>Name</i>	<i>Position</i>	<i>Other Directorships</i>
C. Dubin	Director	Mission Energy Limited, Mission Energy Services Limited, Mission Energy Company (UK) Limited, Mission (No. 2) Limited, Pride Hold Limited, Lakeland Power Limited
D. Melita	Director	Aguila Energy Company, Anacapa Energy Company, Anacostia Energy Company, Arrowhead Energy Company, Balboa Energy Company, Bergen Point Energy Company, Blue Ridge Energy Company, BN Geothermal, Inc., Bretton Woods Energy Company, Camino Energy Company, Capistrano Cogeneration Company, Capitol Energy Company, Centerport Energy Company, Chesapeake Bay Energy Company, Chester Energy Company, Chickahominy River Energy Corp., Clayville Energy Company, Colonial Energy Company, Conejo Energy Company, Coronado Energy Company, Crescent Valley Energy Company, Delaware Energy Conservers, Inc., Del Mar Energy Company, Desert Sunrise Energy Company, Devereaux Energy Company, Doga Enerji Uretim Sanayi ve Ticaret A.S., Eastern Sierra Energy Company, East Maine Energy Company, El Dorado Energy Company, EMP, Inc. (Oregon corporation), Four Counties Gas Company, Fujian Electric (Hong Kong) LDC, Hanover Energy Company, Holtsville Energy Company, Indian Bay Energy Company, ISAB Energy S.r.l., ISAB Energy Services S.r.l., Jamshedpur Power Company Limited, Jefferson Energy Company, Kings Canyon Energy Company, Kingspark Energy Company, Laguna Energy Company, La Jolla Energy Company, Lake Grove Energy Company, Lakeland Power Development Company Limited, Lakeland Power Limited, Lakeview Energy Company, Lehigh River Energy Company, Longview Cogeneration Company, Madera Energy Company, Madison Energy Company, MEC Columbia B.V., MEC Esenyurt B.V., MEC Global Services B.V., MEC IES B.V., MEC India B.V., MEC Indo Coal, B.V., MEC Indonesia B.V., MEC International B.V., MEC International Holdings B.V., MEC Laguna Power B.V., MEC Mission B.V., MEC Perth B.V., MEC Priolo B.V., MEC San Pascual B.V., MEC Turkey B.V., Mission/Eagle Energy Company, Mission Energy, Mission Energy Company, Mission Energy Company (UK) Limited, Mission Energy Construction Services, Inc., Mission Energy Fuel Company, Mission Energy Holdings, Inc., Mission Energy Holdings International, Inc., Mission Energy Indonesia, Mission Energy Limited, Mission Energy Methane Company, Mission Energy Mexico, Mission Energy New York, Inc., Mission Energy Oil and Gas Company, Mission Energy Petroleum Company, Mission Energy Services Limited, Mission Energy Wales Company, Mission Energy Westside, Inc., Mission (No. 2) Limited, Mission Operation and Maintenance, Incorporated, Mission Triple Cycle Systems Company, Niguel Energy Company, Northern Sierra Energy Company, North Jackson Energy Company, Ortega Energy Company, Panther Timber Company, Paradise Energy Company, Pleasant Valley Energy Company, Pocono Fuels Company, Pride Hold Limited, Prince George Energy Company, P.T. Paiton Energy Company, Quartz Peak Energy Company, Rapidan Energy Company, Reeves Bay Energy Company, Ridgecrest Energy Company, Rio Escondido Energy Company, Riverport Energy Company, San Felipe Energy Company, San Gabriel Energy Company, San Joaquin Energy Company, San Juan Energy Company, San Pascual Cogeneration Company, San Pedro Energy Company, Santa Ana Energy Company, Santa Clara Energy Company, Silverado Energy Company, Silver Springs Energy Company, Sonoma Geothermal Company, South Coast Energy Company, Southern Sierra

Energy Company, Southern Sierra Gas Company, Thorofare Energy Company, Viejo Energy Company, Vista Energy Company, Western Sierra Energy Company

P.C. Gracey Jr.	Director	Mission Energy Limited, Mission Energy Services Limited, Mission Energy Company (UK) Limited, Mission (No. 2) Limited, Lakeland Power Development Company Limited, Pride Hold Limited, Lakeland Power Limited, MEC International B.V., MEC International Holdings B.V., MEC Esenyurt B.V., MEC IES B.V., MEC Priolo B.V., MEC India B.V., MEC Turkey B.V., MEC Mission B.V., MEC Global Services B.V., MEC Columbia B.V., MEC Indo Coal B.V., MEC Laguna Power B.V.
R.J. Stone	Director	Mission Energy Limited, Mission Energy Services Limited, Mission Energy Company (UK) Limited, Mission (No. 2) Limited, Lakeland Power Development Company Limited, Pride Hold Limited, Lakeland Power Limited, Derwent Cogeneration Limited, Cumbria Energy Limited, Cumbria Power Limited, Cumbria Group Limited.

The business address of the directors is Lansdowne House, Berkeley Square, London W1X 5DH.

First Hydro

<i>Name</i>	<i>Position</i>	<i>Other Directorships</i>
N. Petrie	Director	Priory Hospitals Group, EEIBA
B. Stalker	Director	—
D. Lumb	Director	—
D. Frankland	Director	Electronic Precision Limited
D. Melita	Director	as above
P.C. Gracey Jr.	Director	as above
K. Smith	Director	—
T. Legro	Director	—
R. Edgell	Director	Aguila Energy Company, Anacapa Energy Company, Anacostia Energy Company, Arrowhead Energy Company, Asia Power Development Company, Balboa Energy Company, Bergen Point Energy Company, Blue Ridge Energy Company, BN Geothermal, Inc., Bretton Woods Energy Company, Camino Energy Company, Capistrano Cogeneration Company, Capitol Energy Company, Centerport Energy Company, Chesapeake Bay Energy Company, Chester Energy Company, Chickahominy River Energy Corp, Clayville Energy Company, Colonial Energy Company, Conejo Energy Company, Coronado Energy Company, Crescent Valley Energy Company, Crown Vista Urban Renewal Corporation, Delaware Energy Conservators, Inc., Del Mar Energy Company, Desert Sunrise Energy Company, Devereaux Energy Company, Eastern Sierra Energy Company, East Maine Energy Company, El Dorado Energy Company, EMP, Inc., First Hydro Limited, Four Counties Gas Company, Fujian Electric (Hong Kong) LDC, Hanover Energy Company, Holtsville Energy Company, Indian Bay Energy Company, Jefferson Energy Company, Kings Canyon Energy Company, Kingspark Energy Company, Laguna Energy Company, La Jolla Energy Company, Lake Grove Energy Company, Lakeview Energy Company, Latrobe Power Pty Ltd., Lehigh River Energy Company, Longview Cogeneration Company, Loy Yang Holdings Pty Ltd., Madera Energy Company, Madison Energy Company, Mission China Holdings Company, Mission/Eagle Energy Company, Mission Energy Asia Pty Ltd., Mission Energy Australia Ltd., Mission Energy Canada Corporation, Mission Energy Company, Mission Energy Construction Services, Inc., Mission Energy Development Australia Pty Ltd., Mission Energy Fuel Company, Mission Energy Holdings International, Inc., Mission Energy Holdings Pty Ltd., Mission Energy Indonesia, Mission Energy (Kwinana) Pty Ltd., Mission Energy Management Australia Pty Ltd., Mission Energy Methane Company, Mission Energy Mexico, Mission Energy New York, Inc., Mission Energy

Oil and Gas Company, Mission Energy Petroleum Company, Mission Energy Ventures Australia Pty Ltd., Mission Energy Wales Company, Mission Energy Westside, Inc., Mission Ningbo Holdings Company, Mission Operation and Maintenance, Incorporated, Mission Operations (Kwinana) Pty Ltd., Mission Triple Cycle Systems Company, Niguel Energy Company, Northern Sierra Energy Company, North Jackson Energy Company, Ortega Energy Company, Panther Timber Company, Paradise Energy Company, Pleasant Valley Energy Company, Pocono Fuels Company, Prince George Energy Company, P.T. Paiton Energy Company, Quartz Peak Energy Company, Rapidan Energy Company, Reeves Bay Energy Company, Ridgecrest Energy Company, Rio Escondido Energy Company, Riverport Energy Company, San Felipe Energy Company, San Gabriel Energy Company, San Joaquin Energy Company, San Juan Energy Company, San Pedro Energy Company, Santa Ana Energy Company, Santa Clara Energy Company, Silverado Energy Company, Silver Springs Energy Company, Sonoma Geothermal Company, South Coast Energy Company, Southern Sierra Energy Company, Southern Sierra Gas Company, Thorofare Energy Company, Traralgon Power Pty Ltd., Viejo Energy Company, Vista Energy Company, Western Sierra Energy Company.

The business address of the directors is Bala House, St. David's Park, Deeside, Clwyd, CH5 3XJ, Wales.

First Hydro Holdings

<i>Name</i>	<i>Position</i>	<i>Other Directorships</i>
C. Dubin	Director	as above
D. Melita	Director	as above
P.C. Gracey Jr.	Director	as above
R.J. Stone	Director	as above

The business address of the directors is Lansdowne House, Berkeley Square, London W1X 5DH.

9. MANAGEMENT OF FIRST HYDRO

There are nine directors of First Hydro, four of whom have day to day responsibility for management of First Hydro, led by the Managing Director. The Managing Director chairs a monthly executive meeting which coordinates the day to day management of First Hydro.

The Directors of First Hydro and their functions are:

<i>Name</i>	<i>Function</i>
N. Petrie	Managing Director
B. Stalker	Commercial Director
D. Lumb	Engineering Director
D. Frankland	Plant Director
P.C. Gracey Jr.	Director
D. Melita	Director
K. Smith	Director
T. Legro	Director
R. Edgell	Director

First Hydro currently employs 190 people on a full-time basis and 15 people on a part-time basis.

10. FINANCIAL INFORMATION

10.1 Accountants' report on the Issuer and First Hydro Holdings Company

The following is the text of the accountants' report on the Issuer and First Hydro Holdings Company:

The Directors
First Hydro Finance PLC
Lansdowne House
Berkeley Square
London
W1X 5DH

Coopers
&Lybrand

1 Embankment Place
London WC2N 6NN

The Directors
First Hydro Holdings Company
Lansdowne House
Berkeley Square
London
W1X 5DH

The Directors
Barclays de Zoete Wedd Limited
Ebbgate House
2 Swan Lane
London
EC4R 3TS

The Trustee
Prudential Trustee Company Limited
142 Holborn Bars
London
EC1N 2NH

10th January, 1996

Dear Sirs

We report in connection with the Offering Circular of First Hydro Finance PLC (the "Issuer") dated 10th January, 1996

First Hydro Finance PLC

We were appointed auditors of the Issuer on 9th January, 1996.

The Issuer was incorporated as Mossdrive PLC on 31st July, 1995, changed its name to Mission Funding PLC on 11th December, 1995 and subsequently changed its name to its present one on 15th December, 1995.

On the date of its incorporation the Issuer had an issued share capital of £2, comprising two fully paid up shares of £1 each and an authorised share capital of 50,000 shares of £1 each. On 15th December, 1995 the Issuer issued all its remaining authorised share capital of 49,998 shares of £1 each, of which 25p was called and is now paid up, for a consideration of £12,499.50. On 18th December, 1995 the Issuer entered into a Credit Facility Agreement (the "Facility Agreement") and on 21st December, 1995 drew down £400,000,000 under the Facility Agreement and issued non-interest bearing loan stock of £295,307,500 at par to First Hydro Holdings Company ("First Hydro Holdings"). On 21st December, 1995 the Issuer acquired the whole of the issued share capital of First Hydro Company ("First Hydro"), formerly First Hydro Limited and £120,000 of loan stock issued by First Hydro, for £682,220,000.

Also on 21st December, 1995 and subsequently, the Issuer has entered into various agreements relating to the issue of £400,000,000 Guaranteed Secured Bonds due 2021.

On 3rd January, 1996, the Issuer borrowed from First Hydro £6,940,700 which, together with existing cash at bank of £3,100,000, was used to repay £10,040,700 of the Issuer's loan stock held by First Hydro Holdings.

On 4th January, 1996 the Issuer sold 21 per cent. and on 8th January, 1996 sold 78 per cent. of the shares of First Hydro to First Hydro Holdings for a total provisional consideration of £675,397,800 paid by the

issuance of a debt instrument of £400,000,000 by First Hydro Holdings to the Issuer and the retirement of £275,397,800 of the Issuer's loan stock held by First Hydro Holdings. The amount of the consideration will be increased by a 99 per cent. share of the acquisition costs incurred by the Issuer when these have been determined and will be paid by the retirement of further Issuer's loan stock of equivalent value.

Since 31st July, 1995, no financial statements have been prepared for the Issuer and no dividends have been declared or paid by the Issuer. Save for the formation expenses, acquisition costs, interest incurred on the late payment of the purchase price to the vendor of First Hydro, bank charges, the accrual of interest payable under the Facility Agreement and on the loan from First Hydro and for the accrual of interest receivable on bank deposits and the debt instrument issued by First Hydro Holdings, the Issuer has incurred no expenditure and earned no income.

As at 8th January, 1996 (the latest practicable date prior to the publication of the Offering Circular), since 15th December, 1995 there has been no change to the authorised or issued share capital of the Issuer and since 21st December, 1995, save as disclosed above, there has been no material change to the indebtedness of the Issuer.

First Hydro Holdings Company

We were appointed auditors of First Hydro Holdings Company ("First Hydro Holdings") on 9th January, 1996.

First Hydro Holdings was incorporated as an unlimited liability company on 15th December, 1995 with an issued share capital of £1,000,000, comprising 1,000,000 A ordinary shares of £1 each and an authorised share capital of 300,000,000 A ordinary shares of £1 each and 100,000,000 B ordinary shares of £1 each. Also on 15th December, 1995 First Hydro Holdings acquired the two issued shares of £1 each fully paid up of the Issuer and subscribed to a further 49,998 shares of £1 each (25p paid up) for a total consideration of £12,501.50. As at 15th December, 1995 the authorised share capital was unchanged from incorporation.

On 20th December, 1995 First Hydro Holdings issued a further 117,128,000 A ordinary shares of £1 each and at that date all the issued share capital was fully paid up.

On 21st December, 1995 First Hydro Holdings issued non-interest bearing loan stock of £177,192,000 at par to its shareholders and acquired non-interest bearing loan stock of the Issuer of £295,307,500.

On 3rd January, 1996 First Hydro Holdings borrowed from First Hydro £22,059,300 interest free which, together with the £10,040,700 received from the Issuer, was used to repay £32,100,000 of the loan stock issued by First Hydro Holdings.

On 4th January, 1996 First Hydro Holdings acquired 21 per cent. and on 8th January, 1996 acquired a further 78 per cent. of the shares of First Hydro from the Issuer for a total consideration of £675,397,800 paid by the issuance of a debt instrument of £400,000,000 by First Hydro Holdings and the retirement of £275,397,800 of the Issuer's loan stock held by First Hydro Holdings. The consideration will be increased by a 99 per cent. share of the acquisition costs incurred by the Issuer when these have been determined and will be paid by the retirement of further Issuer's loan stock of equivalent value.

First Hydro Holdings is a Guarantor under the Facility Agreement and the various agreements relating to the issue of £400,000,000 Guaranteed Secured Bonds due 2021.

Since 15th December, 1995, no financial statements have been prepared for First Hydro Holdings and no dividends have been declared or paid by First Hydro Holdings. Save for formation expenses, the accrual of interest payable on the debt instrument issued to the Issuer, First Hydro Holdings has incurred no expenditure and earned no income.

As at 8th January, 1996 (the latest practicable date prior to the publication of the Offering Circular), since 15th December, 1995, save as disclosed above, there has been no change to the authorised or issued share capital of First Hydro Holdings and, save as disclosed above, since 21st December, 1995 there has been no material change to the indebtedness of First Hydro Holdings.

Yours faithfully

Coopers & Lybrand
Chartered Accountants

10.2 Accountants' report on First Hydro Company

The following is the text of the accountants' report on First Hydro Company:

The Directors
First Hydro Finance PLC
Lansdowne House
Berkeley Square
London
W1X 5DH

Coopers
&Lybrand

1 Embankment Place
London WC2N 6NN

The Directors
First Hydro Company
Bala House
Lakeside Business Village
St David's Park
Deeside
Clwyd
CH5 3XJ

The Directors
Barclays de Zoete Wedd Limited
Ebbgate House
2 Swan Lane
London
EC4R 3TS

The Trustee
Prudential Trustee Company Limited
142 Holborn Bars
London
EC1N 2NH

10th January, 1996

Dear Sirs

We report in connection with the Offering Circular of First Hydro Finance PLC dated 10th January, 1996.

First Hydro Company

We were appointed auditors of First Hydro Company ("First Hydro") on 5th January, 1996.

First Hydro was incorporated with limited liability as Intercede 746 Limited on 17th November, 1989, changed its name to NGC Pumped Storage Limited on 15th January, 1990 and to First Hydro Limited on 27th June, 1995. It re-registered as an unlimited liability company and changed its name to its present one on 8th January, 1996.

On 17th November, 1989, First Hydro had an issued share capital of £2, comprising two shares of £1 each. Subsequently on 9th November, 1995 each share was sub-divided into four shares of 25p each. On 9th November, 1995 a further four shares of 25p each were allotted. On 17th November, 1995, 401,669,985 redeemable shares of 25p each were allotted for a consideration of £450,000,000 to give a total issued share capital at that date of £100,417,499.25. On 10th November and 13th November, 1995, respectively First Hydro issued £99,000 and £21,000 of 8 per cent. convertible unsecured loan stock. On 21st December, 1995 a further 88 ordinary shares of 25p each were issued. On 5th January, 1996 the redeemable ordinary shares were converted to ordinary shares.

Following the acquisition described below, First Hydro commenced trading on 17th November, 1995. No audited financial statements have been prepared since incorporation and no dividend has been declared or paid.

On 17th November, 1995 the Pumped Storage Business division ("PSB") of The National Grid Company plc ("NGC") was acquired by First Hydro. The activities acquired comprised the Generation Business of NGC, as defined in its Transmission Licence issued on 26th March, 1990 (the "Transmission Licence"), and the unlicensed activities of InterNational Hydro and of the visitor centres.

As a division of NGC, the PSB was not required to prepare separate statutory accounts, although its results were audited as part of the annual audit of NGC. Under the Transmission Licence, NGC was required to produce separate audited regulatory accounts prepared under the current cost convention. Those regulatory accounts included the accounts of the Generation Business.

The regulatory accounts of NGC for the three years ended 31st March, 1995 were audited by us and we issued unqualified reports thereon. No audited regulatory accounts have been prepared for any period subsequent to 31st March, 1995 although accounts for the six months ended 30th September, 1995 have been prepared as described below and audited by us.

The financial information set out in this report for the three years ended 31st March, 1995 is based on the audited regulatory accounts relating to the Generation Business, restated on an historical cost basis and adjusted to include the results and net assets of the unlicensed activities. Accounts for the six months ended 30th September, 1995 have been prepared on a similar basis and audited by us. Other adjustments have been made as we consider necessary.

Our work has been carried out in accordance with the Auditing Guideline: "*Prospectuses and the reporting accountant*".

In our opinion, the financial information set out below gives, for the purpose of the Offering Circular, a true and fair view of the state of affairs of the PSB as at 31st March, 1993, 1994, and 1995 and at 30th September, 1995 and of its profit, total recognised gains and cash flows for each of the periods then ended.

Principal accounting policies

The financial information contained in this report has been prepared in accordance with Accounting Standards currently applicable in the United Kingdom. The principal accounting policies, which have been applied consistently for all the periods covered by this report, are set out below.

(a) Basis of preparation of the financial information

The financial information has been prepared on the historical cost basis of accounting and represents the licensed and unlicensed activities of the PSB as described above.

(b) Inter-divisional funding

As a division of NGC, the PSB was financed by NGC via an inter-divisional funding account. This account also included all other items relating to inter-divisional charges, allocations and apportionments which have been separately disclosed in the financial information as described in (c) below.

(c) Inter-divisional charges, allocations and apportionments

In preparing the financial information, categories of revenues, costs, assets, liabilities and provisions have been credited, charged or allocated, wherever appropriate, to the PSB by NGC. Because of the integrated nature of NGC's activities, it has been necessary to apportion certain elements of these categories to determine those amounts reasonably attributable to each of the divisions as an individual activity. Elements that are not attributable to an individual activity such as capital liabilities and interest thereon have been excluded.

(d) Tangible fixed assets and depreciation

Tangible fixed assets are included in the balance sheets at cost less depreciation.

No depreciation is provided on freehold land. Other tangible fixed assets are depreciated, principally on a straight line basis, at rates estimated to write off their book values over their estimated useful lives. In assessing estimated useful lives, which are reviewed on a regular basis, consideration is given to contractual arrangements and operational requirements relating to particular assets. Unless otherwise determined by operational requirements, the depreciation periods for the principal categories of assets are, in general, as follows:

	Years									
Freehold and leasehold buildings	Up to 40
Plant and machinery										
Civil engineering works	80
Other plant and machinery	40
Motor vehicles and office equipment	3/5

Following a review of asset lives, with effect from 1st April, 1994 the depreciation period for certain computing equipment was reduced from 5 to 3 years. The adoption of revised asset lives had no material effect on the depreciation charge.

(e) Stocks

Stocks are stated at the lower of cost and net realisable value.

(f) Turnover

Turnover includes inter-divisional and inter-company transactions and is stated net of value added tax.

(g) Pensions

Contributions to the Electricity Supply Pension Scheme are assessed by a qualified actuary. The cost of providing pensions is charged to the profit and loss account on a systematic basis over the estimated remaining service lives of the employees allocated to the PSB.

(h) Research and development

Research and development expenditure is charged to the profit and loss accounts in the period in which it is incurred.

(i) Provisions

Non-recurring revenue ("NRR") maintenance: Provision is made for the estimated average annual cost of major future maintenance and refurbishment works. The cost of major maintenance and refurbishment works is charged against the resulting provision. Other maintenance expenditure is charged as incurred.

Contracts for differences: Provision is made for the estimated potential uninsured losses that would arise from the loss of availability of the plant in either an emergency situation or as a result of planned maintenance, as well as for losses that may arise in the course of normal commercial activity.

(j) Taxation

As a division of NGC, the PSB was not liable to corporation tax. The taxation charges included in the profit and loss accounts are calculated using a tax rate of 33 per cent. applied to the profit before tax adjusted for the treatment of depreciation of, and tax allowances relating to, tangible fixed assets and for the tax treatment of provisions. Payment for such taxation charges has been made through the inter-divisional funding account.

(k) Deferred taxation

No provision has been made for deferred taxation since, taking NGC as a whole including the PSB, it was not considered probable that timing differences would reverse and a liability would crystallise in the foreseeable future. The excess of depreciation over tax allowances in respect of the PSB as a stand alone business has been treated as a permanent difference in the financial information.

Profit and loss accounts

	Notes	Year ended 31st March,			6 months ended 30th September,
		1993	1994	1995	1995
		£'000	£'000	£'000	£'000
Turnover	1				
Contracts for differences option income ..		41,101	49,848	40,522	5,567
Pool trading income		50,010	43,803	78,705	37,333
Ancillary services		33,924	37,194	33,779	13,122
Other income		729	675	618	437
		<u>125,764</u>	<u>131,520</u>	<u>153,624</u>	<u>56,459</u>
Operating costs					
Purchases of electricity		(34,468)	(27,431)	(23,588)	(14,261)
Use of systems charges		(17,790)	(21,293)	(22,628)	(12,595)
Core and NRR maintenance costs		(7,485)	(9,015)	(4,307)	(3,828)
Payroll costs	2	(6,724)	(6,259)	(6,584)	(3,362)
Depreciation		(4,806)	(4,878)	(4,930)	(2,332)
Rates and insurance		(11,960)	(12,283)	(14,215)	(5,524)
Other operating costs		(4,002)	(5,092)	(2,635)	(1,389)
		<u>(87,235)</u>	<u>(86,251)</u>	<u>(78,887)</u>	<u>(43,291)</u>
Operating profit		38,529	45,269	74,737	13,168
Interest income	8	1,280	161	277	190
Profit after interest income and before taxation		39,809	45,430	75,014	13,358
Taxation	5	(14,258)	(17,713)	(25,574)	(5,214)
Profit retained for financial period	11	<u>25,551</u>	<u>27,717</u>	<u>49,440</u>	<u>8,144</u>

The above results are all in respect of continuing operations of the PSB.

There is no difference between the operating profits and their historical cost equivalents.

There are no recognised gains and losses other than those included in the profit and loss accounts above and therefore no separate statements of total recognised gains and losses have been presented.

No interest payable is included above as explained in note (c) of the Principal accounting policies.

Balance sheets

	Notes	31st March,			30th September,
		1993	1994	1995	1995
		£'000	£'000	£'000	£'000
Fixed assets					
Tangible fixed assets	6	187,706	183,797	178,276	175,920
Current assets					
Stocks-consumable stores		—	430	616	674
Debtors	7	8,371	8,279	7,097	7,860
Cash at bank	8	624	604	6,688	14,167
		<u>8,995</u>	<u>9,313</u>	<u>14,401</u>	<u>22,701</u>
Creditors: amounts falling due within one year	9	(25,751)	(29,047)	(38,472)	(38,511)
Net current liabilities		<u>(16,756)</u>	<u>(19,734)</u>	<u>(24,071)</u>	<u>(15,810)</u>
Total assets less current liabilities		170,950	164,063	154,205	160,110
Provisions for liabilities and charges	10	(6,601)	(11,569)	(10,379)	(12,134)
Net assets		<u>164,349</u>	<u>152,494</u>	<u>143,826</u>	<u>147,976</u>
Inter-divisional funding account	11	<u>164,349</u>	<u>152,494</u>	<u>143,826</u>	<u>147,976</u>

No provision has been made for deferred taxation. Details are given in note 14.

Cash flow statements

					Year ended 31st March,			6 months ended 30th September,
					1993	1994	1995	1995
					£'000	£'000	£'000	£'000
Net cash flow from operating activities	..	Notes	12		42,333	54,618	81,037	11,259
Returns on investments and servicing of finance								
Interest received					1,280	161	277	190
Taxation								
Payments to NGC					(11,170)	(14,258)	(17,713)	—
Investing activities								
Purchase of tangible fixed assets					(200)	(254)	(100)	(7)
Receipts from disposals of fixed assets ..					—	43	57	23
Inter-divisional transfers of fixed assets ..					(650)	(758)	634	8
Net cash flow (to)/from investing activities	.. .. .				(850)	(969)	591	24
Net cash flow before financing	.. ..				31,593	39,552	64,192	11,473
Financing								
Financing payments to NGC		11			(30,969)	(39,572)	(58,108)	(3,994)
Movements in cash and cash equivalents	..	13			624	(20)	6,084	7,479

Notes to the financial information

1. Turnover

All turnover arises in the United Kingdom.

2. Payroll costs and employees

					Year ended 31st March,			6 months ended 30th September,	
					1993	1994	1995	1995	
					£'000	£'000	£'000	£'000	
(a)	Payroll costs								
	Wages and salaries	..	..	..	..	6,177	5,308	5,565	2,847
	Social security costs	..	..	..	..	—	450	477	228
	Other pension costs	..	..	..	..	—	501	542	287
	Severance costs	..	..	..	..	547	—	—	—
						<u>6,724</u>	<u>6,259</u>	<u>6,584</u>	<u>3,362</u>
						No.	No.	No.	No.
(b)	Average number of employees								
	Full time	..	..	..	..	200	197	194	190
	Part time	..	..	..	..	9	12	4	15
						<u>209</u>	<u>209</u>	<u>198</u>	<u>205</u>

Social security costs and other pensions costs have been included in wages and salaries for the year ended 31st March, 1993, because the payroll system was changed during the year and the detail was not held on the previous system.

3. Directors' emoluments

As the PSB was a division of NGC during the period of review, there were no directors and consequently no directors' emoluments are disclosed.

4. Auditors' remuneration

Auditors' remuneration was charged directly to NGC for all regulated businesses. Accordingly, separate auditors remuneration has not been disclosed for the PSB.

5. Taxation

The taxation charges have been calculated at 33 per cent. of taxable profits and have been increased by the excess of depreciation over tax allowances and timing differences in respect of the NRR maintenance and the contract for differences provisions as follows:

					Year ended 31st March,			6 months ended 30th September,
					1993	1994	1995	1995
					£'000	£'000	£'000	£'000
Excess of depreciation over tax allowances ..	..				1,058	1,082	1,198	539
NRR maintenance provision .. .. .	..	..	..	..	63	1,243	(379)	267
Contracts for differences provision .. .. .	..	..	..		—	396	—	—
					1,121	2,721	819	806

			Land	Buildings	Plant and machinery	Motor vehicles and office equipment	Total
			£'000	£'000	£'000	£'000	£'000
Cost							
At 31st March, 1993	..	..	1,266	248,689	175,566	1,999	427,520
Additions	..	..	—	96	—	158	254
Transfers	..	..	124	364	—	253	741
Disposals	..	..	—	—	—	(71)	(71)
At 31st March, 1994	..	..	1,390	249,149	175,566	2,339	428,444
Additions	..	..	9	3	—	88	100
Transfers	..	..	(140)	(510)	—	—	(650)
Disposals	..	..	—	—	—	(295)	(295)
At 31st March, 1995	..	..	1,259	248,642	175,566	2,132	427,599
Additions	..	..	—	—	—	7	7
Transfers	..	..	—	—	—	(16)	(16)
Disposals	..	..	—	—	—	(164)	(164)
At 30th September, 1995	..	..	1,259	248,642	175,566	1,959	427,426
Aggregate depreciation							
At 31st March, 1993	..	..	—	171,937	66,497	1,380	239,814
Disposals	..	..	—	—	—	(28)	(28)
Transfers	..	..	—	(21)	—	4	(17)
Charge for year	..	..	—	1,113	3,443	322	4,878
At 31st March, 1994	..	..	—	173,029	69,940	1,678	244,647
Disposals	..	..	—	—	—	(238)	(238)
Transfers	..	..	—	(16)	—	—	(16)
Charge for year	..	..	—	1,101	3,443	386	4,930
At 31st March, 1995	..	..	—	174,114	73,383	1,826	249,323
Disposals	..	..	—	—	—	(141)	(141)
Transfers	..	..	—	—	—	(8)	(8)
Charge for period	..	..	—	551	1,722	59	2,332
At 30th September, 1995	..	..	—	174,665	75,105	1,736	251,506
Net book value							
31st March, 1993	..	..	1,266	76,752	109,069	619	187,706
31st March, 1994	..	..	1,390	76,120	105,626	661	183,797
31st March, 1995	..	..	1,259	74,528	102,183	306	178,276
30th September, 1995	..	..	1,259	73,977	100,461	223	175,920

For the purposes of the acquisition of the PSB by First Hydro on 17th November, 1995 the tangible fixed assets were fair valued at £440 million and this amount has been reflected in the accounting records of First Hydro.

7. Debtors

	31st March,		30th
	1994	1995	September,
	£'000	£'000	1995
Trade debtors	2,312	3,741	5,633
Inter-divisional balances			
Ancillary services debtors	3,158	2,476	2,153
Prepayments and accrued income	1,429	277	—
Other debtors	1,380	603	74
	<u>8,279</u>	<u>7,097</u>	<u>7,860</u>

Ancillary services debtors were part of inter-divisional balances with NGC, but were separately identifiable and relate to on going activities of the PSB.

8. Cash

Prior to 17th November, 1995, the PSB kept a separate memorandum bank account as part of NGC's banking arrangements, the balance on which was included in the inter-divisional balance with NGC. The amounts disclosed in the balance sheets are the balances on that bank account. Interest related to this account has been included in the profit and loss accounts and cash flow statements. The balances have been treated as cash and cash equivalents for cash flow purposes.

9. Creditors: amounts falling due within one year

	31st March,		30th
	1994	1995	September,
	£'000	£'000	1995
Trade creditors	1,054	1,689	827
Accruals	3,644	4,474	4,855
Inter-divisional balances			
VAT	2,836	6,182	1,441
Other	3,800	553	600
Taxation	17,713	25,574	30,788
	<u>(29,047)</u>	<u>(38,472)</u>	<u>(38,511)</u>

VAT and other inter-divisional balances represent amounts which were part of inter-divisional balances with NGC, but were separately identifiable and relate to ongoing activities of the PSB.

10. Provisions for liabilities and charges

	NRR maintenance	Contracts for differences	Other	Total
	£'000	£'000	£'000	£'000
At 1st April, 1993	2,601	4,000	—	6,601
Charged to profit and loss account	6,507	1,200	—	7,707
Utilised	(2,739)	—	—	(2,739)
At 31st March, 1994	6,369	5,200	—	11,569
Charged to profit and loss account	1,880	—	—	1,880
Utilised	(3,070)	—	—	(3,070)
At 31st March, 1995	5,179	5,200	—	10,379
Charged to profit and loss account	2,034	—	—	2,034
Utilised	(1,179)	—	—	(1,179)
Inter-divisional transfer	—	—	900	900
At 30th September, 1995	6,034	5,200	900	12,134

11. Movements in inter-divisional funding accounts

	Year ended 31st March,		6 months ended 30th September,
	1994	1995	1995
	£'000	£'000	£'000
Profit retained for financial period	27,717	49,440	8,144
Financing payments to NGC	(39,572)	(58,108)	(3,994)
	(11,855)	(8,668)	4,150
Opening inter-divisional funding	164,349	152,494	143,826
Closing inter-divisional funding	152,494	143,826	147,976

12. Net cash inflow from operating activities

	Year ended 31st March,			6 months ended 30th September,
	1993	1994	1995	1995
	£'000	£'000	£'000	£'000
Operating profit	38,529	45,269	74,737	13,168
Depreciation of tangible fixed assets	4,806	4,878	4,930	2,332
(Increase) in stocks	—	(430)	(186)	(58)
(Increase)/decrease in debtors	(2,695)	92	1,182	(763)
Increase/(decrease) in creditors	1,493	(159)	1,564	(5,175)
Increase/(decrease) in provisions	200	4,968	(1,190)	1,755
Net cash flow from operating activities	42,333	54,618	81,037	11,259

13. Reconciliation of movements in cash and cash equivalents

	Year ended 31st March,			6 months ended 30th September,
	1993	1994	1995	1995
	£'000	£'000	£'000	£'000
Cash at bank				
Balance at start of period	..	..	..	..
Movement	..	..	..	..
Balance at end of period	..	..	..	..
	624	604	6,688	14,167

14. Deferred taxation

As explained in note (k) of the principal accounting policies, deferred taxation has not been provided for in the financial information. The difference in net book values and tax written down values of the tangible fixed assets on the date of acquisition of the PSB by First Hydro will give rise to an excess of depreciation over tax allowances. The directors of First Hydro have decided that this excess should be treated as a permanent difference resulting in an increased taxation charge in the profit and loss account each year. Based on the net book values of tangible fixed assets in the balance sheets, the full potential liability is given below and the impact on the profit and loss accounts is detailed in note 5:

	31st March,			30th September,
	1993	1994	1995	1995
	£'000	£'000	£'000	£'000
Potential liability				
Excess of depreciation over taxation allowances	60,300	58,800	57,000	56,500

Based on the valuation of the fixed assets as at 17th November, 1995 described in note 6, the full potential liability would amount to approximately £140 million, resulting in an impact on the profit and loss account, in addition to that detailed in note 5, of approximately £2 million per year.

15. Commitments and contingent liabilities

(a) Redundancy programme

A redundancy programme is currently in progress, associated with the conversion of the Ffestiniog facility to remote operation, which is due to be completed by April 2000. No provision has been made for this programme and all staff losses are expected to be made through voluntary severance and the non-replacement of retiring staff.

(b) Operating leases

The PSB has entered into certain non-cancellable operating leases. At 30th September, 1995 the PSB had annual commitments under these leases as follows:

	Land and buildings		Other
	£'000		£'000
Expiring between two and five years	..	..	61
Expiring in over five years	..	..	—
	50	50	61

(c) Other contingent liabilities

There are certain other contingent liabilities as at 30th September, 1995 arising in the normal course of business, which are not expected to have a significant effect on the financial position of the PSB or First Hydro.

16. Pension schemes

The staff of the PSB are entitled to join the Electricity Supply Pension Scheme (the "Scheme") which provides pension and other related benefits based on final pensionable pay to employees throughout the Electricity Supply Industry. The assets of the Scheme are held in a separate trustee administered fund. The PSB's part of the Scheme has been included within the NGC section of the overall Scheme.

The latest full actuarial valuation of NGC's section of the Scheme was carried out as at 31st March, 1992 and the results of this valuation have been used as the basis for assessing pension cost. The attained age method was used for the valuation and the principal actuarial assumptions adopted were that the real annual rate of return on investments would average 4 per cent.; that the real annual rate of increase in dividends would average 0.5 per cent. below the rate of inflation; that real annual increases in salary would average 2 per cent. and that pensions would increase in line with inflation at 5.5 per cent. per annum.

The valuation showed that the actuarial value of the assets of NGC's section of the Scheme as at 31st March, 1992 represented approximately 109 per cent. of the actuarial value of the accrued benefits. The accrued benefits include all benefits for pensioners and other former members as well as benefits based on service completed to date for active members, allowing for future salary rises.

The total market value of the assets of the Scheme at 31st March, 1992 was £9,492 million of which £616.4 million related to the members and beneficiaries of NGC, including those of the PSB.

17. Post balance sheet events

(a) *Employee Shadow Share Option Scheme*

Many of the PSB employees participated in NGC's approved savings related share option schemes for the purchase of shares in The National Grid Group plc. Following the demerger of the PSB from NGC those employees could not exercise their options.

In recognition of this, NGC established an unapproved "Shadow Scheme" which exactly mirrored the terms of the original scheme and under which, option holders are treated as if they had remained employees of NGC. However, as the scheme is unapproved for income tax purposes, option holders are liable to income tax on the amount by which the market value of the shares acquired exceeds the exercise price paid. Consequently, First Hydro has agreed to compensate employees at the basic rate of tax (25 per cent.) for the income tax suffered.

The additional income tax and National Insurance contributions payable on the number of outstanding options amounts to approximately £850,000. This is payable when the options are exercised. The exercise periods for the schemes are from 1st March, 1996 to 30th August, 1999 with approximately 50 per cent. of the potential cost arising on options exercisable before 30th August, 1996.

(b) *Sale of First Hydro*

On 21st December, 1995 the whole of the issued share capital of First Hydro was acquired by First Hydro Finance PLC.

(c) *Guarantees and security given*

As part of the acquisition referred to in (b) above, First Hydro has given guarantees and a first floating charge over its undertakings and all its assets both present and future in respect of the obligations of First Hydro Finance PLC and First Hydro Holdings Company under the £400,000,000 Facility Agreement with Barclays Bank PLC and under the trust deed in respect of the intended issue of the Guaranteed Secured Bonds.

Further details are given in Sections 11 — "Terms and Conditions of the Bonds" and 16 — "Finance Arrangements" of the Offering Circular of First Hydro Finance PLC dated 10th January, 1996.

(d) On 3rd January, 1996 First Hydro lent £22,059,300 to First Hydro Holdings Company. This loan is repayable on demand and interest free. Also on 3rd January, 1996 First Hydro lent £6,940,700 to First Hydro Finance PLC. This loan is repayable in 10 years' time and bears interest at Barclay's Bank base rate.

Yours faithfully

Coopers & Lybrand
Chartered Accountants

10.3 Capitalisation and Indebtedness Statement of First Hydro

The authorised and issued share capital of First Hydro as at 8th January, 1996 (the latest practicable date prior to the publication of the Offering Circular) was:

	Ordinary shares of 25p each	
	£	No.
Authorised	<u>110,250,000</u>	<u>441,000,00</u>
Issued and fully paid	100,417,496	401,669,985
Called up and not paid	25	100
	<u>100,417,521</u>	<u>401,670,085</u>

As at 8th January, 1996 (the latest practicable date prior to the publication of the Offering Circular) First Hydro had outstanding indebtedness and cash at bank as follows:

	£'000
Convertible unsecured loan stock	<u>120</u>
Cash at bank	<u>10,359</u>

The contingent liabilities as at 8th January, 1996 are the same as those disclosed in notes 15(a), 15(c), 17(a) and 17(c) of the Accountant's Report on First Hydro set out in Section 10.2 of the Offering Circular.

11. TERMS AND CONDITIONS OF THE BONDS

The following, subject to amendment, are the Terms and Conditions of the Bonds, substantially as they will appear on the reverse of the Bearer Bonds in definitive form:

The issue of the £400,000,000 9 per cent. Guaranteed Secured Bonds due 2021 (the "Bonds") was authorised by a resolution of the Board of Directors of First Hydro Finance PLC (the "Issuer") passed on 18th December, 1995 and will be constituted by a trust deed (the "Bond Trust Deed") between the Issuer, First Hydro Company ("First Hydro"), First Hydro Holdings Company ("First Hydro Holdings") and Prudential Trustee Company Limited (together with its successors and assigns, the "Bond Trustee") as trustee for the holders of the Bonds (the "Bondholders"). References in these Terms and Conditions (the "Conditions") to Guarantors shall be construed as references to each of First Hydro and First Hydro Holdings and to any Permitted Subsidiary (as defined below).

Under the terms of the Debentures (as defined below) the Bonds have the benefit of an unlimited unconditional and irrevocable guarantee from First Hydro and an unconditional and irrevocable guarantee from First Hydro Holdings limited as to recourse against assets over which First Hydro Holdings has created security in favour of the Security Trustee. The Bonds also have the benefit of first fixed charges granted by (a) the Issuer in respect of, *inter alia*, all the shares it holds in First Hydro, (b) First Hydro Holdings in respect of, *inter alia*, all the shares it holds in the Issuer and First Hydro, and (c) the Issuer in respect of Authorised Investments (as defined below) which it holds. In addition, the Bonds benefit from first floating charges granted by each of the Issuer and First Hydro over the whole of its respective undertaking, property and assets, both present and future, including any uncalled capital and by First Hydro Holdings over all of the shares it holds in the Issuer and First Hydro, its book debts, bank accounts, investments, uncalled capital and goodwill. The Bonds have the further benefit of assignments by way of security of (a) the Accounts held by the Issuer, the Revenue Support LC and any other letters of credit in favour of the Issuer, (b) the Issuer's rights under the Sale and Purchase Agreement, the Further Sale Agreement (as defined in the Bond Trust Deed) and the Inter-Company Credit Agreement (as defined in the Bond Trust Deed) and First Hydro's rights under the Asset Acquisition Agreement (as defined in the Bond Trust Deed) and (c) First Hydro Holding's rights under the Further Sale Agreement with the Issuer for the sale to it of shares in First Hydro dated 4th January, 1996. Such security is created pursuant to the Debentures.

Arrangements relating to the benefit of such security, which will rank *pari passu* with equivalent security granted or to be granted by the Issuer in respect of any Secured Liabilities, are contained in a security trust and intercreditor deed dated 21st December, 1995 (the "Intercreditor Deed") between, *inter alia*, Prudential Trustee Company Limited (together with its successors and assigns, the "Security Trustee"), the Bond Trustee and Barclays Bank PLC (as Facility Agent for the Loan Banks, as defined therein). The benefit of such security will be held by the Security Trustee and the respective rights and liabilities of the Bondholders and other Secured Creditors in respect of such security are regulated by the terms of the Intercreditor Deed.

In the event of the winding up of First Hydro, the Security Trustee undertakes for the benefit of First Hydro Holdings that it will pay an amount equal to any proceeds of such winding up actually received by it by virtue solely of the holding of shares in First Hydro by First Hydro Holdings (except to the extent of any uncalled share capital in First Hydro) to First Hydro Holdings provided that any sums received from First Hydro Holdings by virtue of the Guarantee, as defined in the Debenture entered into by First Hydro Holdings, shall not fall to be so paid to First Hydro Holdings.

The Bonds also have the benefit jointly with the Secured Creditors of an irrevocable letter of credit having a maturity of five years from its date of issue, issued by an authorised institution under the Banking Act 1987 having a short-term credit rating of A-1 or better, issued by Standard & Poor's Rating Services, and P-1 or better by Moody's Investors Service, Inc. (in a maximum amount of £12,000,000) in favour of the Issuer and assigned by way of security to the Security Trustee as provided in Condition 14.3 and callable as provided in Condition 14.4.

The statements set out in these Conditions are summaries of, and are subject to, the detailed provisions of the Bond Trust Deed, which includes the forms of the Bonds and the coupons appertaining to the Bonds in bearer form with one talon for further interest coupons (a "Talon" and, together with the interest coupons, where the context so permits, the "Coupons"). The Bondholders and the holders of the Coupons (the "Couponholders") are entitled to the benefit of, and are bound by, and deemed to have notice of, all the provisions of the Bond Trust Deed, the Debentures and the Intercreditor Deed and those applicable to them of the paying agency agreement to be dated 17th January, 1996 (the "Agency Agreement") relating to the Bonds between the Issuer, First Hydro, First Hydro Holdings, the Bond Trustee, Barclays Bank PLC (the "Principal Paying Agent", which expression shall include any successor as principal paying agent under the Agency Agreement), the other

paying agents for the time being (such persons, together with the Principal Paying Agent, being referred to below as the "Paying Agents", which expression shall include their successors as paying agents under the Agency Agreement), and the registrar referred to below (the "Registrar", which expression shall include any successor as registrar under the Agency Agreement), copies of each of which are available for inspection during normal business hours at the principal office for the time being of the Bond Trustee (being at the date of issue hereof at 142 Holborn Bars, London EC1N 2NH) and at the specified offices of the Paying Agents and the Registrar.

1. Interpretation

1.1 Definitions

Where used in any part of these Conditions and the Bond Trust Deed:

"Account Bank" means Barclays Bank PLC, 1 Pall Mall East, London SW1Y 5AX;

"Accounts" means the Bond Interest Reserve Account and the Bond Redemption Reserve Account;

"Adjusted Share Capital and Reserves" means, as at any particular time, the aggregate (expressed in sterling) of:

- (a) the amount paid up or credited as paid up on the issued share capital of First Hydro Holdings (other than any share capital redeemable at the instance of the holder thereof);
- (b) the principal amount outstanding (excluding any capitalised interest) of any Subordinated Loan Stock issued by First Hydro Holdings; and
- (c) the amount standing to the credit of the consolidated capital and revenue reserves of the Group,

less any amount included in the above which is attributable to:

- (i) any debit balance on the Group's consolidated profit and loss account as at the date (the "balance sheet date") as at which the Group's then latest audited consolidated balance sheet included in the latest accounts delivered to the Bond Trustee pursuant to the provisions described in Condition 11 below was prepared;
- (ii) amounts set aside for Tax;
- (iii) the amount by which the book value of any asset has been written up after the Closing Date by way of revaluation. However, no deduction shall be made to the extent that a revaluation is based on, and the written-up value does not exceed the value shown by, a written valuation prepared by an independent professional valuer; and
- (iv) any redemption of the issued share capital or any dividend or other distribution declared, recommended or made by First Hydro Holdings out of profits earned up to and including the balance sheet date but not provided for in it (or, as the case may be, in the balance sheet of the relevant subsidiary of First Hydro Holdings used for the purpose of the Group's balance sheet),

plus any amount included in the above which is attributable to intangible assets or goodwill arising upon consolidation except that any amount attributable to goodwill shall not be counted to the extent that the assets have been revalued by an independent professional valuer at more than the value of the assets when first included in the relevant balance sheet,

plus or, as the case may be, minus any variation in the credit or debit balance on the Group's consolidated profit and loss account since the balance sheet date except insofar as reflected in any later Group's consolidated profit and loss statement delivered to the Bond Trustee pursuant to the provisions described in Condition 11 below,

Provided that no amount included in the above definition shall be counted twice;

"Affiliate" of a person means any person (a) which has Control of such person, (b) of which such person has Control, or (c) of which a person, which has Control of such person, has Control;

"Applicable Accounting Principles" means those accounting principles, standards and practices on which the preparation of the audited accounts of the pumped storage business formerly owned by NGC as at 31st March,

1995 and for the financial year ended on that date was based and those accounting policies which were used in the preparation of such accounts;

"Auditors" means the Auditors as defined in the Bond Trust Deed;

"Authorised Investments" at any time means any of the following:

- (a) gilt-edged securities issued by the Government of the United Kingdom and other freely negotiable and marketable debt securities issued by the Government of the United Kingdom, in each case (i) denominated in sterling and maturing before 31st July, 2021 and (ii) with a maximum maturity of five years from the date of purchase, and which constitute direct, primary and unsubordinated obligations;
- (b) certificates of deposit, denominated in sterling, of any bank having a short term senior debt rating of A-1 or better issued by Standard & Poor's Rating Services or P-1 or better issued by Moody's Investors Service, Inc., for a term not exceeding 12 months and which is an authorised institution under the Banking Act 1987;
- (c) commercial paper, denominated in sterling, constituting direct, primary and unsubordinated obligations, the issuer or the guarantor of which has a short term senior debt rating of A-1 or better issued by Standard & Poor's Rating Services or P-1 or better issued by Moody's Investors Service, Inc., for a term not exceeding 12 months; and
- (d) bank deposits with any bank which is an authorised institution under the Banking Act 1987 and having a short term senior debt rating of A-1 or better issued by Standard & Poor's Rating Services or P-1 or better issued by Moody's Investors Service, Inc., for a term not exceeding 12 months on terms whereby any amounts payable on early withdrawal reduce the amount of interest payable and not the amount of the bank deposit;

"Bond Interest Reserve Account" means the account entitled "First Hydro Finance PLC: Bond Interest Reserve Account" (including any sub-accounts into which such account may be divided) opened by the Account Bank and any account (and sub-accounts) opened by any successor to the Account Bank, in each case as such account may be renewed, redesignated or renumbered from time to time;

"Bond Redemption Reserve Account" means the account entitled "First Hydro Finance PLC: Bond Redemption Reserve Account" (including any sub-accounts into which such account may be divided) opened by the Account Bank and any account (and sub-accounts) opened by any successor to the Account Bank, in each case as such account may be renewed, redesignated or renumbered from time to time;

"Borrowings" means, as at any particular time, the aggregate outstanding principal, capital or nominal amount of the indebtedness for borrowed money, expressed in sterling and determined on a consolidated basis (such that no account will be taken of intra-Group indebtedness), of members of the Group which shall in any event include:

- (a) the outstanding amount of any bills of exchange or promissory notes on which any member of the Group is liable as drawer (but only if the relevant bill is not beneficially owned by it), acceptor, issuer, endorser or otherwise; and
- (b) any fixed or minimum premium payable on redemption or repayment of any moneys borrowed,

but:

- (i) moneys borrowed which are on a particular day outstanding or repayable in a currency other than sterling shall on that day be taken into account (1) if that day is a date as at which an audited consolidated balance sheet of the Group has been prepared, in their sterling equivalent at the rate of exchange used for the purpose of preparing that balance sheet and (2) in any other case in their sterling equivalent as at 11.00 a.m. on the last London Business Day of the previous month;
- (ii) no deduction shall be made in respect of any cash in hand or at bank belonging to any member of the Group, or any moneys borrowed owing to any member of the Group by another person; and
- (iii) Subordinated Debt shall be excluded from Borrowings;

"Closing Date" means 17th January, 1996;

“Competent Authority” means any local, national or supranational agency, authority, department, inspectorate, minister, official, court, tribunal or public or statutory person (whether autonomous or not) of the United Kingdom or the United States (or the government thereof), any other jurisdiction or the European Community which has jurisdiction over any member of the Group or the subject matter of any of the Finance Documents;

“Control” of one person by another person (or persons acting in concert) means that the other (whether directly or indirectly and whether by the ownership of share capital, the possession of voting power, contract or otherwise) has the power to appoint and/or remove the majority of the members of the governing body of that person (and references to “Controlled” and “Controlling” shall be construed accordingly);

“Debentures” means the Fixed and Floating Charge Debentures dated 21st December, 1995 between each Guarantor and the Security Trustee and the Fixed and Floating Charge Debenture dated 21st December, 1995 between the Issuer and the Security Trustee;

“Distribution” means any payment of dividends or other distribution and any return of capital including, without limitation, any payment in respect of, or on the redemption of, any share capital whether at a premium or otherwise, or any payment in respect of indebtedness for borrowed money to any person in the Group or Controlling any person in the Group or to any person on their behalf, whether in cash or in kind and whether by way of interest, repayment of principal or otherwise and shall, for the avoidance of doubt, include any payment in respect of Subordinated Debt and Subordinated Loan Stock;

“Early Redemption Price” has the meaning ascribed to it in Condition 7.3.1;

“Environmental Laws” means The Environmental Protection Act 1990, The Water Resources Act 1991, The Water Industry Act 1991, The Public Health Act 1936, The Clean Air Acts 1958 and 1968, The Fire Precautions Act 1971, The Health and Safety at Work etc Act 1974, The Control of Pollution Act 1974, The Building Act 1984 and any other applicable law, statute and subordinate legislation, European Community Regulations and Directives, judgments and decisions, notices, orders, circulars and official codes of practice and guidance notes in each case, with which any member of the Group is obliged to comply and including any amendment, re-enactment, consolidation or other legislation (whether or not applicable at the date hereof) with regard to:

- (a) the pollution or protection of the environment;
- (b) harm to the health of humans, animals or plants including, without limitation, relating to public and workers’ health and safety;
- (c) emissions, discharges or releases into, or the presence in, the environment of chemicals or any other pollutants or contaminants, or industrial, radioactive, dangerous, toxic or hazardous substances or wastes (whether in solid, semi-solid, liquid or gaseous form and including noise and genetically modified organisms); or
- (d) the manufacture, processing, use, treatment, storage, distribution, disposal, transportation or handling of the substances or wastes described in (c) above;

“Environmental Permits” means any permits, licences, consents, approvals, certificates, qualifications, specifications, registrations, other authorisations including, without limitation, any conditions which attach to any of the above, and the filing of all notifications, reports and assessments required under Environmental Laws for the operation of any business by any member of the Group and/or in relation to the occupation, use or holding of any of the Property;

“Event of Default” has the meaning ascribed to it in Condition 17;

“Facility Agent” has the meaning set out in the Facility Agreement;

“Facility Agreement” means the £400,000,000 Credit Facility Agreement dated 18th December, 1995 entered into by, *inter alia*, the Issuer, First Hydro Holdings and the banks named therein;

“Final Redemption Date” means 31st July, 2021;

“Finance Documents” means the Bond Trust Deed, the Security Documents and any other agreement, document, deed, notice or certificate entered into or executed and delivered by any member of the Group pursuant to the terms hereof or thereof or otherwise in connection herewith or therewith which relates to the rights of Bondholders;

"Future Cash Collateral Accounts" means any principal redemption reserve account of the Issuer in respect of a Secured Liability charged to the benefit of the Security Trustee (including any sub-accounts into which such account may be divided) on terms whereby (i) no amounts can be credited to such account within five years from the date of creation of such Secured Liability and (ii) thereafter, only amounts as to principal and not interest can be credited to such account;

"Future Debt Service Reserve Accounts" means any interest reserve account of the Issuer in respect of a Secured Liability charged to the benefit of the Security Trustee (including any sub-accounts into which such account may be divided) on terms whereby the maximum amount standing to the credit of such account at any time shall not exceed the amount of interest payable for the following six month period on such Secured Liability;

"Group" means the Issuer and the Guarantors and any Permitted Subsidiary and "member of the Group" shall be construed accordingly;

"Harm to the Environment" means "Harm" as that expression is defined in The Environmental Protection Act 1990;

"Insurances" means each of the contracts for insurance taken out by or on behalf of any member of the Group in accordance with Condition 13.1 and the Security Documents and any other contracts or policies of insurance taken out by any member of the Group from time to time;

"Insurance Broker" means Willis Corroon London Limited or such other reputable firm of insurance brokers who may be acting as such for the Group from time to time;

"Intercreditor Deed" means the Security Trust and Intercreditor Deed dated 21st December, 1995 between, *inter alia*, the Issuer, the Security Trustee, First Hydro and First Hydro Holdings;

"Interest Payable" includes, in relation to any period, the aggregate amount of all of the following insofar as they are payable by, or accrue in respect of indebtedness of, any member of the Group (except to another member of the Group) during that period: interest, commissions and fees in respect of moneys borrowed, discounts in respect of bills, notes or debts discounted, and that part of any amount under a financing lease or hire purchase, credit sale, conditional sale or deferred payment agreement which represents any of the foregoing save for interest payments in respect of Subordinated Debt or which constitute Distributions. For this purpose, a discount shall be apportioned in accordance with Applicable Accounting Principles over the period for which that bill, note or debt is to be outstanding and shall be deemed to accrue from day to day during that period;

"Interest Payment Date" has the meaning ascribed to it in Condition 6;

"Loan Discharge Date" means the date on which all the indebtedness of the Issuer or any Guarantor owed to the Facility Agent or the Banks under the Facility Agreement has been fully and irrevocably paid or discharged and no further such indebtedness is capable of becoming outstanding;

"London Business Day" means a day, excluding Saturdays and Sundays, on which commercial banks and foreign exchange markets are generally open for business in London;

"London Stock Exchange" means the London Stock Exchange Limited;

"Material Adverse Effect" means an effect which might, in the opinion of the Bond Trustee, reasonably be expected materially to impair the financial condition of the Group, the value of the Property or the ability of the Group to perform and comply with any of its material obligations (including, without limitation, all of its payment obligations) under the Bond Trust Deed;

"Net Borrowings" means, as at any particular time, Borrowings at that time less the amount standing to the credit of the Bond Redemption Reserve Account and any Future Cash Collateral Accounts at that time;

"Net Revenues" means, in relation to any period, the consolidated profit of First Hydro Holdings for that period before Tax, inclusive of interest income and before all extraordinary items, all as shown in the consolidated profit and loss account of the Group for that period, adding back Interest Payable and all amounts provided (through the consolidated profit and loss account) for depreciation, goodwill and amortisation;

"Permitted Subsidiary" means a wholly owned subsidiary of First Hydro Holdings (a) the only asset of which is the one per cent. shareholding in First Hydro currently owned by the Issuer, (b) which conducts no business

other than owning one per cent. of First Hydro, (c) which has granted a fixed and floating charge debenture over all its undertaking and assets in terms substantially equivalent to the Debentures and in terms satisfactory to the Security Trustee and (d) which has agreed to be bound by the terms and conditions of the Intercreditor Deed as if it were named therein as an Obligor and in terms satisfactory to the Security Trustee;

"Potential Event of Default" means any event which would become (with the passage of time, the giving of notice, the making of any determination hereunder or any combination thereof) an Event of Default;

"Property" means the properties included in the Reports on Title;

"Prudent Operating Practice" means recognised good and prudent industry practice;

"Record Date" has the meaning ascribed to it in Condition 18.1;

"Register" has the meaning ascribed to it in Condition 4;

"Reports on Title" means the reports prepared by the solicitors acting for PSB Holding Limited in connection with the Sale and Purchase Agreement;

"Retail Prices Index" means the general index of retail prices published by the United Kingdom Central Statistical Office in respect of all items or if, in the reasonable opinion of the Bond Trustee, a material change occurs in the basis of such index rendering it unsatisfactory as a means of indexation hereunder or such index ceases to exist, such other index or indexation procedure as may be proposed by the Issuer and approved by the Bond Trustee or, failing which, such indexation procedure as the Bond Trustee reasonably deems appropriate in the circumstances;

"Revenue Support LC" means the letter of credit in an amount of £12,000,000 as the same may be reduced pursuant to Condition 14.4 and having a maturity of five years from the Closing Date, expressed to be in favour of the Issuer and assigned by way of security to the Security Trustee, on terms whereby the Issuer may draw amounts under the letter of credit if (a) the Issuer certifies to the Security Trustee that it would otherwise be unable to make a payment of interest falling due in respect of any Secured Liabilities or (b) the Issuer would be in breach of Condition 14.2. The amount which may be drawn is, in the case of (a), such amount which is necessary to meet the shortfall and, in the case of (b), such amount, which if it had been added to Net Revenues would have resulted in the ratio set out in Condition 14.2 being not less than 1.05 to 1.0;

"Sale and Purchase Agreement" means the sale and purchase agreement dated 21st December, 1995 between the Issuer and PSB Holdings Limited under which the Issuer acquired all of the share capital of First Hydro;

"Secured Creditors" has the meaning set out in the Intercreditor Deed;

"Secured Finance Documents" has the meaning set out in the Intercreditor Deed;

"Secured Liabilities" has the meaning set out in the Intercreditor Deed;

"Security Documents" means the Debentures and the Intercreditor Deed;

"Subordinated Debt" means any indebtedness for borrowed money of any member of the Group which ranks subordinate to Secured Liabilities under the terms of the Intercreditor Deed;

"Subordinated Loan Stock" means any loan stock issued by First Hydro Holdings which is not redeemable at the instance of the holder thereof on terms whereby all payments thereunder rank subordinate to Secured Liabilities under the terms of the Intercreditor Deed;

"Taxes" or "Tax" means any present or future taxes of any nature (including, without limitation, value added tax), levy, impost, duty or other charge of a similar nature now or hereafter imposed by the laws of the United Kingdom or the United States or any other jurisdiction or any political subdivision thereof (including, without limitation, any penalty or interest payable in connection with any failure to pay or any delay in paying the same);

"Termination Date" means the first date on which no Bonds remain outstanding; and

"United States" means the United States of America and all its territories and possessions.

1.2 *Construction of References*

Any reference in these Conditions or the Bond Trust Deed to:

an "agency" of a state is a reference to any political sub-division thereof, and any ministry, department or authority thereof and any company or corporation which is controlled and of which 50 per cent. or more of the issued share capital is owned by one or more of such agencies;

an "approval" shall be construed as a reference to any approval, consent, authorisation, exemption, permit, licence, registration, filing or enrolment by or with any Competent Authority or any other person;

an "encumbrance" shall be construed as a reference to a mortgage, charge (whether legal or equitable), pledge, lien or other encumbrance securing any obligation of any person or any other type of preferential arrangement (including, without limitation, title transfer or retention, sale and leaseback or sale and purchase arrangements) having a similar effect;

"indebtedness" shall be construed so as to include any obligation (whether incurred as principal or as surety) for the payment or repayment of money, whether present or future, actual or contingent;

"indebtedness for borrowed money" shall be construed so as to include, without limitation, any indebtedness of any person for or in respect of:

- (a) moneys borrowed or raised (whether or not for cash);
- (b) amounts raised by acceptance under any acceptance credit facility;
- (c) amounts raised under any note purchase facility;
- (d) the amount of any liability in respect of leases or hire purchase contracts which would, in accordance with generally accepted accounting standards in the United Kingdom (as used in the most recent annual audited consolidated financial statements from time to time), be treated as finance or capital leases;
- (e) the amount of any liability in respect of any purchase price for assets or services, the payment of which is deferred for a period in excess of 90 days;
- (f) redeemable preference shares;
- (g) amounts payable or deemed payable under any swap, option, cap, collar, floor or other derivative or hedging instrument;
- (h) loan stock; and
- (i) amounts raised under any transaction (including, without limitation, any forward sale or purchase agreement) having the commercial effect of a borrowing;

a "person" shall be construed as a reference to any person, firm, company, corporation, government, state, agency of a state or any association or partnership (whether or not having separate legal personality) of two or more of the foregoing;

a "subsidiary" of a person shall be construed as a reference to any person:

- (a) which is Controlled, directly or indirectly, by the first-mentioned person;
- (b) more than half the issued share capital of which is beneficially owned, directly or indirectly, by the first-mentioned person; or
- (c) which is a subsidiary of another subsidiary of the first-mentioned person;

the "winding-up", "dissolution" or "administration" of a company shall be construed so as to include any equivalent or analogous proceedings under the laws of any relevant jurisdiction in which such company is incorporated or any relevant jurisdiction in which such company carries on business.

1.3 *Sterling*

"£", "sterling" and "pounds sterling" denote the lawful currency of the United Kingdom.

1.4 *References to Certain Documents etc.*

Save where the contrary is indicated, any reference in these Conditions and the Bond Trust Deed to:

- (a) the Bond Trust Deed, any Security Document, the Intercreditor Deed, any Finance Document, any licence, permission or any other agreement or document shall be construed as a reference to the Bond Trust Deed, any Security Document, the Intercreditor Deed, such Finance Document, licence,

permission or other agreement or document as the same may have been, or may from time to time be, amended, varied, novated or supplemented;

- (b) a statute shall be construed as a reference to such statute as the same may have been, or may from time to time be, amended or re-enacted and all instruments, orders, plans, regulations, by-laws, permissions and directions at any time made thereunder; and
- (c) a time of day shall be construed as a reference to London time.

1.5 *Accounting Terms etc.*

The definitions of Adjusted Share Capital and Reserves, Borrowings, Interest Payable and Net Revenues contained in this Condition shall, save as otherwise provided herein, be construed in accordance with Applicable Accounting Principles. All calculations to be made thereunder shall be made in sterling.

1.6 *Accounts*

Any reference in the Conditions to the balance standing to the credit of one of the Accounts will be deemed to include a reference to the Authorised Investments in which all or part of such balance is for the time being invested.

2. **Form, Denomination and Title**

2.1 *Form and Denomination*

The Bonds are in bearer form ("Bearer Bonds") or in registered form ("Registered Bonds"). Registered Bonds will be in units of £1 or integral multiples thereof ("authorised denominations") without Coupons attached. Bearer Bonds will be serially numbered, each with Coupons attached on issue, in denominations of £10,000 and £100,000. Bearer Bonds of one denomination may not be exchanged for Bearer Bonds of the other denomination.

2.2 *Title*

Title to the Bearer Bonds and Coupons will pass by delivery. Title to the Registered Bonds will pass by transfer and registration as described in Condition 5.3. The holder of any Bearer Bond or Coupon and the registered holder of any Registered Bond will (except as otherwise required by law or as ordered by a court of competent jurisdiction) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any interest in it or its theft or loss) and no person will be liable for so treating such person. In these Conditions, (in relation to a Bond) "Bondholder" and (in relation to a Bond or Coupon) "holder" mean the holder of any Bearer Bond or Coupon (as the case may be) or the person in whose name a Registered Bond is registered, as the case may be.

3. **Guarantee and Security**

3.1 *Guarantee*

The Bonds have the benefit of an unlimited unconditional and irrevocable guarantee from First Hydro and an unconditional and irrevocable guarantee from First Hydro Holdings limited as to recourse against assets over which First Hydro Holdings has created security in favour of the Security Trustee.

3.2 *Security*

- 3.2.1 The Bonds have the benefit of first fixed charges granted by (a) the Issuer in respect of, *inter alia*, all the shares it holds in First Hydro, (b) First Hydro Holdings in respect of all the shares it holds in the Issuer and First Hydro, and (c) the Issuer in respect of Authorised Investments which it holds. The Bonds also benefit from first floating charges granted by each of the Issuer and First Hydro over the whole of its respective undertaking, property and assets both present and future including any uncalled capital and by First Hydro Holdings over all of the shares it holds in the Issuer and First Hydro, its book debts, bank accounts, investments, uncalled capital and goodwill. The Bonds have the further benefit of assignments by way of security of (a) the Accounts held by the Issuer, the Revenue Support LC and any other letters of credit in favour of the Issuer, (b) the Issuer's rights under the Sale and Purchase Agreement, the Further Sale

Agreement and the Inter-Company Credit Agreement and First Hydro's rights under the Asset Acquisition Agreement and (c) First Hydro Holding's rights under the Further Sale Agreement.

- 3.2.2 The benefit of the security described in Condition 3.2.1 will be held by the Security Trustee on behalf of the Bondholders and other Secured Creditors. The respective rights and liabilities of the Bondholders and other Secured Creditors in respect of such security are regulated by the terms of the Intercreditor Deed. The Intercreditor Deed provides, *inter alia*, that if Secured Creditors recover more on an insolvency of First Hydro than they would have done if First Hydro had been a limited liability company, then such excess will be paid to the shareholders of First Hydro.

At all times, the Secured Creditors rank pari passu with each other, except in respect of security which, in accordance with the terms of the Secured Finance Documents, is created in priority to other security. The security over the Accounts will be for the prior benefit, in point of payment, of the Bondholders.

4. Register

The Issuer will cause to be kept at the specified office of the Registrar a register (the "Register") on which shall be entered the names and addresses of the holders of the Registered Bonds and the particulars of the Registered Bonds held by them and of all transfers of Registered Bonds and exchanges of Bearer Bonds for Registered Bonds. Holders of Registered Bonds will be entitled to receive one Registered Bond in respect of their holding.

5. Registered Bonds

5.1 Exchange of Bearer Bonds for Registered Bonds

At the option of the holder thereof upon presentation, at any time on or after 27th February, 1996 (the "Exchange Date"), of a duly completed and signed request for exchange in the form for the time being obtainable from the specified office of the Registrar (a "Registration Request") together with the relevant Bearer Bonds, subject to the terms of the Agency Agreement and to Condition 5.5 below, Bearer Bonds are exchangeable for the same aggregate principal amount of Registered Bonds, provided that (save as provided below) all unmatured Coupons relating thereto are attached thereto or are surrendered therewith. Bearer Bonds surrendered in exchange for Registered Bonds in the period from, and including, the Record Date in respect of any Interest Payment Date up to, and including, such Interest Payment Date will not be required to be surrendered with the Coupon relating to the interest payable on such Interest Payment Date. Interest on a Registered Bond issued on exchange will accrue from but excluding the immediately preceding Interest Payment Date, except where issued in respect of a Bearer Bond surrendered in the period from and including the Record Date in respect of any Interest Payment Date up to, and including, such Interest Payment Date, in which event interest shall accrue from but excluding such Interest Payment Date. Registration Requests may only be presented, and Bearer Bonds may only be surrendered in exchange for Registered Bonds, at the specified office of the Registrar.

The Registrar will within seven London Business Days of the date of presentation of any Registration Request together with the relevant Bearer Bonds deliver a Registered Bond to the Bondholder at the specified office of the Registrar or (at the risk and, if mailed at the request of the Bondholder otherwise than by ordinary mail, at the expense of the Bondholder) mail the Registered Bond by uninsured mail to such address, other than an address in the United States, as the Bondholder may request. A Bondholder will receive only one Registered Bond for all of the Bearer Bonds which are the subject of a single Registration Request upon certification that the proposed holder of the relevant Registered Bonds (a) is not Euroclear, Cedel, First Chicago Clearing Center or any other person whose business is or includes the provision of clearance services within Section 96 of the Finance Act 1986 nor is it a nominee for any of them and (b) is not a person whose business is or includes issuing depositary receipts within Section 93 of the Finance Act 1986 nor is it a nominee or agent for any such person.

5.2 No Exchange of Registered Bonds for Bearer Bonds

Registered Bonds may not in any circumstances be exchanged for Bearer Bonds.

5.3 Transfer of Registered Bonds

Registered Bonds may, subject to the terms of the Agency Agreement and to Condition 5.5 below, be transferred in whole or in part in an authorised denomination by lodging the relevant Registered Bond (with

the form of application for transfer in respect thereof duly executed and duly stamped where applicable) at the specified office of the Registrar. No transfer of a Registered Bond will be valid unless and until entered on the Register. A Registered Bond may be registered only in the name of, and transferred only to, a named person (or persons, not exceeding four in number).

The Registrar will, within seven London Business Days of the date of lodging of any duly made application for the transfer of a Registered Bond, deliver a Registered Bond to the transferee (and, in the case of a transfer of part only of a Registered Bond, deliver a Registered Bond for the untransferred balance to the transferor) at the specified office of the Registrar, or (at the risk and, if mailed at the request of the transferee or, as the case may be, the transferor otherwise than by ordinary mail, at the expense of the transferee or, as the case may be, the transferor) mail the Registered Bond by uninsured mail to such address, other than an address in the United States, as the transferee or, as the case may be, the transferor may request.

5.4 Formalities Free of Charge

Any such exchange or transfer as aforesaid will be effected without charge subject to (a) the person making such request for exchange or such application for transfer procuring the payment of any taxes, duties and other governmental charges payable in connection therewith, (b) the Registrar (in the case of exchange of Bearer Bonds or the transfer of Registered Bonds) being satisfied with the documents of title and/or identity of the person making the request or application and (c) such reasonable regulations as the Issuer may from time to time agree with the Registrar. The exchange of Bearer Bonds for Registered Bonds will be subject to the provisions of all applicable fiscal or other laws and regulations in effect at the time of such exchange.

5.5 Closed Periods

Neither the Issuer nor the Registrar will be required:

- (a) (i) to register the transfer of any Registered Bond or (ii) to exchange any Bearer Bond for a Registered Bond during the period of 10 London Business Days immediately prior to 31st July, 2021 or any earlier date fixed for redemption pursuant to Condition 7.3; or
- (b) to register the transfer of any Registered Bond, or part of a Registered Bond, called for partial redemption; or
- (c) to exchange any Bearer Bond called for redemption,

except that a Bearer Bond called for redemption may, however, be exchanged for a Registered Bond which is simultaneously surrendered not later than the relevant Record Date.

6. Interest

The Bonds will bear interest from the Closing Date at the rate of 9 per cent. per annum payable semi-annually in arrear on 31st January and 31st July in each year (each an "Interest Payment Date"), except that the first payment of interest on the Bonds will be made on 31st July, 1996 for the period from the Closing Date to 31st July, 1996 and will amount to £483.29 per £10,000 in principal amount of the Bonds subject to any tax required to be deducted. Each Bond will cease to bear interest from the due date for redemption unless, upon due presentation, payment of principal is improperly withheld or refused. In such event such Bond shall continue to bear interest at the aforesaid rate (both before and after judgment) in the manner provided in the Bond Trust Deed. If interest is required to be calculated for a period of less than a full half year, it will be calculated on the basis of a 365-day year and the actual number of days elapsed.

7. Redemption and Purchase

7.1 Final Redemption

Any of the Bonds not previously purchased or redeemed as herein provided will be repaid at their principal amount on the Final Redemption Date. The Bonds may not be redeemed at the option of the Issuer other than in accordance with this Condition 7.

7.2 Purchase

The Issuer or the Guarantors may at any time purchase Bonds at any price (a) by tender (available to all Bondholders alike) or (b) by private treaty, provided that:

- 7.2.1 if the Bonds are then listed on the London Stock Exchange, such purchases must comply with the applicable requirements thereof (if any); and
- 7.2.2 such purchases, if made out of amounts standing to the credit of the Bond Redemption Reserve Account, must be effected at a price at or below par.

7.3 *Early Redemption at the option of the Company*

- 7.3.1 The Issuer may, having given not less than 45 nor more than 60 days' notice in writing to the Bondholders, redeem all or (subject to Condition 7.3.2) some only (being of a principal amount which is an integral multiple of £100,000) of the Bonds at any time at a price (the "Early Redemption Price") which shall be the higher of the following, together with interest accrued up to and including the date of redemption:

- (a) par; and
- (b) the price (as reported to the Issuer and the Bond Trustee by a market maker in the gilt-edged securities market selected by the Issuer (failing whom the Bond Trustee), and approved by the Bond Trustee expressed as a percentage and rounded to three decimal places (0.0005 being rounded upwards) at which the Gross Redemption Yield on the Bonds on the Relevant Date is equal to the Gross Redemption Yield at 3.00 p.m. on that date of $8\frac{3}{4}$ per cent. Treasury Stock 2017 while that stock is in issue, and thereafter such government stock as the Bond Trustee, with the advice of a market maker in the gilt-edged securities market selected by the Issuer (failing whom the Bond Trustee) and approved by the Bond Trustee, may determine to be appropriate. For the purposes of this Condition 7.3.1(b), "Relevant Date" means the date which is two London Business Days prior to the despatch of the notice of redemption referred to in this Condition 7.3.1, and "Gross Redemption Yield" means a yield calculated on the basis indicated by the Joint Index and Classification Committee of the Institute and Faculty of Actuaries as reported in the Journal of the Institute of Actuaries, Vol 105, part I, 1978 page 18.

- 7.3.2 Amounts standing to the credit of the Bond Redemption Reserve Account may be used to effect redemption of all but not some only of the Bonds in accordance with Condition 7.3.1.

7.4 *Partial Redemption*

Any redemption of some but not all of the Bonds shall be on the basis of selection by drawings in a manner to be approved by the Bond Trustee at the relevant time.

7.5 *Cancellation*

Any Bond purchased or redeemed in accordance with any of the provisions of these Conditions will be cancelled together, in the case of Bearer Bonds, with all relative unmatured Coupons attached thereto and will not be available for resale or reissue.

7.6 *Early Redemption at the Option of Bondholders*

- 7.6.1 If, at any time while any of the Bonds remains outstanding, a Restructuring Event occurs and, within the Restructuring Period, either:

- (a) if at the time the relevant Restructuring Event occurs there are Rated Securities, a Rating Downgrading in respect of that Restructuring Event also occurs; or
- (b) if at such time there are no Rated Securities, the Issuer would be unable as a result of such Restructuring Event to obtain a rating of the Bonds or any other secured debt of the Issuer or the Guarantors having an initial maturity of five years from a Rating Agency of at least investment grade (BBB-/Baa3, or their respective equivalents for the time being) (a "Negative Rating Event"),

and in any such case such Restructuring Event is certified in writing by an independent financial adviser appointed by the Issuer and approved by the Bond Trustee (or, if the Issuer shall not have

appointed such an adviser within 21 days after becoming aware of the occurrence of such Restructuring Event, appointed by the Bond Trustee (following consultation with the Issuer)) as being in its opinion materially prejudicial to the interests of the Bondholders (a "Negative Certification") (that Restructuring Event and the relevant Rating Downgrading or, as the case may be, Negative Rating Event and, in each case, the Negative Certification together constituting a "Put Event"), then (unless at any time the Issuer shall have given a notice under Condition 7.3 above to redeem all of the Bonds) the holder of each Bond will, upon the giving of a Put Event Notice (as defined below), have the option to require the Issuer to redeem or, at the option of the Issuer, purchase (or procure the purchase of) that Bond on the Put Date (as defined below) at its Early Redemption Price together with interest accrued up to and including the Put Date. Any certification by an independent financial adviser as aforesaid as to whether or not any Restructuring Event is materially prejudicial to the interests of the Bondholders shall, in the absence of manifest error, be conclusive.

- 7.6.2 A Rating Downgrading or a Negative Rating Event shall be deemed not to have occurred as a result or in respect of a Restructuring Event if the Rating Agency making the relevant reduction in rating or declining to assign a rating of at least investment grade as provided in this Condition 7.6 does not announce or publicly confirm that the reduction or declining was the result, in whole or in part, of any event or circumstance comprised in or arising as a result of the applicable Restructuring Event.
- 7.6.3 Promptly upon the Issuer becoming aware that a Put Event has occurred, and in any event not later than 14 days after the occurrence of a Put Event, the Issuer shall, and at any time upon the Bond Trustee becoming similarly so aware the Bond Trustee may, and if so requested by the holders of at least one-quarter in principal amount of the Bonds then outstanding, shall, give notice (a "Put Event Notice") to the Bondholders in accordance with Condition 24 specifying the nature of the Put Event and the procedure for exercising the rights described herein.
- 7.6.4 To exercise the right to require redemption of a Bond as described in Condition 7.6.1 above, the holder of the Bond must deliver such Bond on any business day (as defined in Condition 18.7) falling within the period (the "Put Period") of 45 days after the date of a Put Event Notice at the specified office of any Paying Agent, accompanied by a duly signed and completed notice of exercise in the form (for the time being current) obtainable from any specified office of any Paying Agent (a "Put Notice") and in which the holder must specify a bank account with a branch of a bank in London to which payment is to be made under this Condition 7.6.4. Bearer Bonds should be delivered together with all relative Coupons appertaining thereto maturing after the day (the "Put Date") being the fifteenth day after the date of expiry of the Put Period, failing which the full amount of any such missing unmatured Coupon (or, in the case of payment not being made in full, that proportion of the full amount of such missing unmatured Coupon which the sum of principal so paid bears to the total principal amount due) will be deducted from the sum due for payment. Each amount so deducted will be paid in the manner provided in Condition 18 against presentation and surrender (or, in the case of part payment only, endorsement) of the relevant missing Coupon not later than 10 years after the Relevant Date (as defined in Condition 19.2) for the relevant payment of principal. Payment in respect of any Bonds so delivered shall be made, subject as provided in Condition 18, to the bank account specified in the relevant Put Notice on the Put Date by transfer to that bank account. A Put Notice, once delivered, shall be irrevocable and the Issuer shall redeem or, as the case may be, purchase all Bonds delivered therewith on the applicable Put Date.
- 7.6.5 For the purposes of this Condition:
- (a) "Pooling and Settlement Agreement" means the agreement dated 30th March, 1990 made by The National Grid Company plc and others setting out the rules and procedures for the operation of an electricity trading pool and of a settlement system and, while the same has effect, the Initial Settlement Agreement also dated 30th March, 1990 and made between the same parties.
 - (b) "Rated Securities" means the Bonds, if at any time and for so long as they shall have a rating from a Rating Agency, and otherwise any other secured debt of the Issuer or either Guarantor having an initial maturity of five years or more which is rated by a Rating Agency.
 - (c) "Rating Agency" means Standard & Poor's Rating Services or any of its subsidiaries and their successors or Moody's Investors Service, Inc. or any of its subsidiaries and their successors or

any rating agency substituted for either of them (or any permitted substitute of them) by the Issuer from time to time with the prior written approval of the Bond Trustee.

- (d) A "Rating Downgrading" shall be deemed to have occurred in respect of a Restructuring Event if the current rating assigned to the Rated Securities by any Rating Agency is withdrawn or reduced from an investment grade rating (BBB-/Baa3, or their respective equivalents for the time being, or better) to a non-investment grade rating (BB+/Ba1, or their respective equivalents for the time being, or worse) or, if the Rating Agency shall have already rated the Rated Securities below investment grade (as described above), the rating is lowered one full rating category.
- (e) "Restructuring Event" means the occurrence of any one or more of the following events:
 - (i) (aa) the Secretary of State gives First Hydro written notice of revocation of the electricity generation licence (the "Generation Licence") granted by the Secretary of State for Energy to First Hydro under the Electricity Act 1989; or
 - (bb) First Hydro agrees in writing with the Secretary of State for Energy to any revocation or surrender of the Generation Licence; or
 - (cc) any legislation (whether primary or subordinate) is enacted terminating or revoking the Generation Licence; or
 - (ii) any modification is made to the terms and conditions of the Generation Licence; or
 - (iii) (aa) the Pooling and Settlement Agreement is terminated under Clause 61.4 thereof or (bb) First Hydro is given notice pursuant to Clause 61.3.2 of the Pooling and Settlement Agreement requiring it to cease to be a party thereto or (cc) any notice declaring an event of default (as defined in the Pooling and Settlement Agreement) is given to First Hydro under Clause 60.1.1 or 60.2 thereof or (dd) any modification is made to the Pooling and Settlement Agreement in accordance with its terms or (ee) any legislation (whether primary or subordinate) is enacted terminating or modifying the Pooling and Settlement Agreement, provided that:
 - (x) in the case of (dd) or (ee) any such modification is material (in the opinion of a consultant appointed by the Issuer and approved by the Bond Trustee) in the context of the rights and obligations of First Hydro under the Pooling and Settlement Agreement; and
 - (y) any modification shall to the extent it grants or confers powers or discretions on the Director General of Electricity Supply (or any successor) under or in respect of the Pooling and Settlement Agreement be deemed not to be material as aforesaid, but for the avoidance of doubt any modification to the Pooling and Settlement Agreement made by the Director General of Electricity Supply (or any successor) by virtue of or pursuant to any such powers or discretions and which otherwise would be a material modification as provided above shall not by virtue of this (y) be deemed not to be material;
 - (iv) any legislation (whether primary or subordinate) is enacted removing, reducing or qualifying the duties of the Secretary of State for Energy and/or the Director General of Electricity Supply (or any successor) under Section 3 of the Electricity Act 1989 as compared with those in effect on the Closing Date.
- (f) "Restructuring Period" means:
 - (i) if at the time a Restructuring Event occurs there are Rated Securities, the period of 90 days starting from and including the day on which a Restructuring Event occurs; or
 - (ii) if at the time a Restructuring Event occurs there are no Rated Securities, the period starting from and including the day on which a Restructuring Event occurs and ending on the day 90 days following the date on which a Negative Certification shall have been given to First Hydro in respect of that Restructuring Event.

8. Bond Interest Reserve Account

8.1 Minimum Balance

- 8.1.1 The Issuer shall ensure that at the Closing Date the aggregate of (a) the amount standing to the credit of the Bond Interest Reserve Account and (b) the amount payable under Relevant LCs (as

defined below) in respect of the Bond Interest Reserve Account is not less than an amount equal to the amount of six months' interest payable on the Bonds (the "Minimum Balance").

8.1.2 For the purposes of these Conditions, a "Relevant LC" means an irrevocable letter of credit issued in favour of the Issuer by an authorised institution under the Banking Act 1987 having a short-term credit rating of A-1 or better issued by Standard & Poor's Rating Services and P-1 or better by Moody's Investors Service, Inc. which:

- (a) is in the form set out in Schedule 5 to the Bond Trust Deed or with such amendments as shall have been approved by the Bond Trustee;
- (b) is payable in sterling;
- (c) expires not earlier than one month after the next Interest Payment Date; and
- (d) may be called by the Issuer in the event that either of Condition 8.1.1 or 9.1.1 is not complied with and the Issuer covenants with the Bond Trustee that it will call such Relevant LC unless the Bond Trustee agrees otherwise.

8.1.3 If on any Interest Payment Date the aggregate of (a) the amount standing to the credit of the Bond Interest Reserve Account and (b) the amount payable under Relevant LCs issued in respect of the Bond Interest Reserve Account is less than the Minimum Balance, then prior to making any repayment or prepayment of the principal (or part thereof) of any Secured Liabilities on or prior to the next succeeding Interest Payment Date, the Issuer shall make such payment into the Bond Interest Reserve Account or procure that Relevant LCs are issued in such an amount as will result in the Minimum Balance standing to the credit of such Account and/or payable under such Relevant LCs immediately prior to making such repayment or prepayment.

8.2 *Withdrawals*

The Issuer shall not withdraw any amount from time to time standing to the credit of the Bond Interest Reserve Account other than:

- 8.2.1 for the purposes of acquiring Authorised Investments in accordance with Condition 10;
- 8.2.2 on any Interest Payment Date, to the extent of any excess over the amount required to stand to the credit of such Account pursuant to Condition 8.1.1;
- 8.2.3 in an amount equal to the amount payable under a Relevant LC in respect of the Bond Interest Reserve Account provided at that time, to the extent of any excess over the amount required to stand to the credit of such Account pursuant to Condition 8.1.1;
- 8.2.4 amounts in respect of interest payable on the Bonds in accordance with the Conditions.

Provided that no withdrawal shall be made from the Bond Interest Reserve Account pursuant to Condition 8.2.4 until the full amount capable of being drawn under the Revenue Support LC has been drawn by the Issuer.

9. **Bond Redemption Reserve Account**

9.1 *Redemption Payments*

9.1.1 *Amortisation*

Subject to Condition 9.3, the Issuer shall ensure that, on each Interest Payment Date in each of the following years, the aggregate of (a) the amount standing to the credit of the Bond Redemption Reserve Account and (b) the amount payable under Relevant LCs in respect of the Bond Redemption Reserve Account is not less than an amount equal to the percentage of the principal amount of the Bonds outstanding on such date set out against that date:

<i>Interest Payment Date</i>	<i>Percentage of Principal Amount of Bonds outstanding on relevant Interest Payment Date</i>
31st July, 2017	20%
31st July, 2018	40%
31st July, 2019	60%
31st July, 2020	80%

9.1.2 Repayments in respect of Secured Liabilities

- (a) If the Issuer repays or prepays any amount pursuant to Clause 23(G)(3) of the Facility Agreement, the Issuer shall, on the date of such repayment or prepayment, credit to the Bond Redemption Reserve Account an amount which bears the same proportion to the principal amount of the Bonds then outstanding as the amount of such repayment or prepayment bears to the then principal amount of all amounts of principal outstanding in respect of Secured Liabilities immediately before such repayment or prepayment.
- (b) Subject to Condition 9.1.2(c), the Issuer may only repay or prepay in each case at its option at any time after the Loan Discharge Date any amount in respect of any Secured Liability before the stated maturity of such amount (i) if the Auditors have certified to the Bond Trustee, on the basis of the latest audited consolidated accounts for the Group or a combination of the unaudited consolidated accounts for the latest first half year and the last six months of the latest audited consolidated accounts (whichever is the latest, the "Reference Accounts") for the Applicable Reference Period, that the ratio set out in Condition 14.2 was not less than 1.2 to 1.0; and (ii) subject to the Auditors certifying as aforesaid, if such repayment or prepayment is made within three months of the date such Reference Accounts are delivered to the Bond Trustee pursuant to Condition 11.
- (c) If (i) the Issuer repays or prepays in each case at its option at any time after the Loan Discharge Date any amount in respect of any Secured Liability before the stated maturity of such amount, and (ii) the Auditors have certified to the Bond Trustee, on the basis of the latest audited consolidated accounts for the Group or a combination of the unaudited consolidated accounts for the latest first half-year and the last six months of the latest audited consolidated accounts (whichever is the latest, the "Reference Accounts") for the Applicable Reference Period, that the ratio set out in Condition 14.2 was less than 1.2 to 1.0, the Issuer shall, on the date of such repayment or prepayment, credit to the Bond Redemption Reserve Account an amount which bears the same proportion to the principal amount of the Bonds then outstanding as the amount of such repayment or prepayment bears to the then principal amount of all amounts of principal outstanding in respect of Secured Liability immediately before such repayment or prepayment.

Provided that:

- (i) "Applicable Reference Period" means:
 - (a) in respect of the period from 1st January, 1996 to 31st March, 1996, the three months ending 31st March, 1996;
 - (b) in respect of the period from 1st January, 1996 to 30th September, 1996, the nine months ending 30th September, 1996; and
 - (c) thereafter, the 12 months ending on the final date of the Reference Accounts;
- (ii) in the case of (i)(a) and (i)(b) above, such certificate shall be given on the basis of three months and nine months of Reference Accounts, respectively;
- (iii) no amount shall be required to be credited to the Bond Redemption Reserve Account pursuant to this Condition 9 to the extent that it would result in the amount then standing to the credit of the Bond Redemption Reserve Account equalling or exceeding 100 per cent. of the principal amount of the Bonds then outstanding; and
- (iv) the provisions of Condition 9.1.2 shall not apply to any repayments or prepayments by the Issuer in respect of a Secured Liability made out of new permitted Borrowings.

9.2 Withdrawal

The Issuer shall not withdraw any amount from time to time standing to the credit of the Bond Redemption Reserve Account other than:

- 9.2.1 for the purposes of making a payment on such date as the Bonds (or any of them) become repayable pursuant to Condition 7.1, 7.3.2 or Condition 17 in an amount equal to the amount repayable by the Issuer on such date in redemption of the Bonds in accordance with the Bond Trust Deed;
- 9.2.2 for the purposes of acquiring Authorised Investments in accordance with Condition 10;
- 9.2.3 on any Interest Payment Date when the ratio set out in Condition 14.2 was at the end of the immediately preceding financial year greater than 1.2 to 1.0, in an amount equal to the aggregate of the amounts credited to such Account pursuant to Condition 9.1.2 (except, for the avoidance of doubt, to the extent such withdrawal would result in a breach of Condition 9.1.1);
- 9.2.4 on any Interest Payment Date, to the extent the amount standing to the credit of such Account exceeds the aggregate amount required to be credited thereto pursuant to Condition 9.1; or
- 9.2.5 for the purposes and in the circumstances set out in Condition 9.3 below.

9.3 *Redemption and Purchase*

The Issuer may, from time to time, apply moneys standing to the credit of the Bond Redemption Reserve Account towards:

- 9.3.1 the purchase of Bonds in accordance with Condition 7.2;
- 9.3.2 redemption of any Bonds prior to their stated maturity in accordance with Condition 7.3.2.

10. **Authorised Investments**

10.1 *Restrictions on Authorised Investments*

The Issuer may, subject as provided in the Bond Trust Deed, give instructions that amounts standing to the credit of the Accounts shall be applied by the Account Bank in the acquisition of Authorised Investments in accordance with the Bond Trust Deed.

10.2 *Delivery of Schedule*

With each set of financial statements delivered pursuant to Condition 11.1.1, the Issuer will deliver to the Bond Trustee or will procure the delivery to the Bond Trustee of a schedule of the investments acquired or disposed of during the previous six month period in respect of each Account, in such detail as the Bond Trustee may require.

11. **Financial Information**

11.1 *Delivery of Accounts*

11.1.1 The Issuer shall:

- (a) as soon as the same become available, but in any event within 120 days after the end of each of its financial years (beginning with the current financial year), deliver to the Bond Trustee three copies of its audited, First Hydro Holding's audited, consolidated and First Hydro's audited, financial statements for such financial year together with the Auditors' reports accompanying such financial statements; and
- (b) as soon as the same become available, but in any event within 60 days after the end of the first half of each of its financial years (beginning with the current financial year), deliver to the Bond Trustee, three copies of its unaudited, First Hydro Holdings' unaudited, consolidated and First Hydro's unaudited financial statements for such half year.

11.2 *Contents and Certification of Accounts*

The Issuer and the Guarantors shall procure that the financial statements delivered pursuant to Condition 11.1 shall:

- 11.2.1 include such financial statements as are required by the laws of England in respect of public limited companies and accounting principles, standards and practices generally accepted in the

United Kingdom and, save as stated in the notes thereto, were prepared and audited in accordance with accounting principles, standards and practices generally accepted in the United Kingdom and consistently applied and in accordance with the Companies Act 1985; and

- 11.2.2 together with those notes, give a true and fair view of their respective state of affairs and profits, financial condition and operations (or, in the case of consolidated accounts, the consolidated state of affairs and profits, financial condition and operations of the Group) as at that date and for the financial year then ended.

11.3 *Certification of Compliance with Financial Ratios*

With each set of financial statements delivered pursuant to Condition 11.1.1 (and within 10 London Business Days after any request made by the Bond Trustee from time to time), the Issuer will deliver to the Bond Trustee a certificate signed on its behalf by two of its directors:

- 11.3.1 confirming compliance with Conditions 14.1 and 14.2 as at the end of the relevant financial period (or, as the case may be, as at, in the case of Condition 14.1, the date specified in the Bond Trustee's request, which date must be not less than 30 nor more than 45 days before the date of the request);
- 11.3.2 confirming compliance with Conditions 8.1 and 9.1 as at the end of the relevant financial year (or, as the case may be, as at the date specified in the Bond Trustee's request, which date must be not less than 30 nor more than 45 days before the date of the request); and
- 11.3.3 setting out in reasonable detail and in a form satisfactory to the Bond Trustee the computations necessary to demonstrate such compliance.

11.4 *Auditors' Certification of Compliance*

With each set of financial statements delivered pursuant to Condition 11.1.1(a) (and, in relation to (a) below, within 28 days of any request made by the Bond Trustee from time to time) the Issuer will deliver to the Bond Trustee a certificate of the Auditors confirming (a) compliance with Condition 14.1 at a date being not less than 60 nor more than 75 days before the date of the certificate and (b) compliance with Condition 14.2 as at the end of the relevant financial period.

11.5 *Certificate of Withdrawals*

At least two business days before making any withdrawal from the Bond Interest Reserve Account or the Bond Redemption Reserve Account under Conditions 8.2 (other than 8.2.1) and 9.2 (other than 9.2.1 and 9.2.2) respectively, the Issuer shall deliver a certificate signed on its behalf by two of its directors confirming that the provisions of Condition 8.1 or 9.1, as the case may be, will be complied with immediately after such withdrawal is made.

12. **Reporting Covenants**

12.1 *Notification of Events of Default etc.*

- 12.1.1 The Issuer will notify the Bond Trustee of the occurrence of any Event of Default or Potential Event of Default promptly upon becoming aware of it.
- 12.1.2 The Issuer shall deliver to the Bond Trustee, (a) with each document delivered by it under Condition 11.1.1, and (b) promptly after any request therefor made by the Bond Trustee from time to time, a certificate signed on its behalf by two of its directors or by one of its directors and its secretary (i) confirming that, having made all reasonable enquiries, to the best of the knowledge, information and belief of the Issuer and (if applicable) except as previously waived by the Bond Trustee or by Extraordinary Resolution as defined in the Bond Trust Deed, no Potential Event of Default or Event of Default has occurred since the date of the last such certificate or, in the case of the first such certificate, since the date of the Bond Trust Deed, or (as the case may be) setting out details of any such Potential Event of Default or Event of Default which has occurred and of which the Issuer is aware having made all reasonable enquiries, and of any action taken or proposed to be taken to remedy such Potential Event of Default or Event of Default and (ii) dealing with such other matters in relation to which the Bond Trustee may require to be satisfied or to receive information for the purposes of the Bond Trust Deed.

- 12.1.3 The Issuer will deliver to the Bond Trustee, with each document delivered by it under Condition 11.1.1, certificates signed on its behalf by two of its directors specifying whether any Restructuring Event or any event which would be likely to lead to a Restructuring Event has occurred in the period since the date of the last such certificate or, in the case of the first such certificate, since the date of the Bond Trust Deed, and, if so, detailing the same.

12.2 *Other Information*

- 12.2.1 The Issuer shall deliver to the Bond Trustee two copies of any notice, circular, report, document or other written information required by law to be sent to its shareholders.
- 12.2.2 The Issuer shall promptly give to the Bond Trustee or to such other person or persons as may be nominated by it (not being a person or persons to whom the Issuer may reasonably object) such information as it shall require and in such form as it shall require for the purpose of the discharge of its duties, powers and discretions under the Bond Trust Deed.
- 12.2.3 The Issuer shall, promptly upon becoming aware of the same, inform the Bond Trustee of the occurrence of the following:
- (a) the commencement of any action, arbitration or administrative proceeding before any court or agency which, if resolved adversely to the interests of any member of the Group, would have a Material Adverse Effect and provide to the Bond Trustee as soon as practicable thereafter details of any such action, arbitration or administrative proceeding;
 - (b) any event which will or could give rise to a claim by First Hydro under any Insurance where the amount of any such claim exceeds £5,000,000 (as such amount may be increased each year by a percentage equal to the annual percentage increase in the Retail Prices Index for such year).
- 12.2.4 The Issuer shall deliver to the Bond Trustee a certificate signed on its behalf by two of its directors or by one of its directors and its secretary confirming, on an annual basis, that:
- (a) the insurance maintained by First Hydro pursuant to Condition 13.1 is in accordance with Prudent Operating Practice;
 - (b) there has been no material change in the operation of the business of First Hydro and that First Hydro is doing all necessary maintenance for the operation of its business and is complying with applicable statutory obligations.

12.3 *Amendments*

The Issuer will promptly deliver to the Bond Trustee a copy (certified a true copy by a duly authorised officer of the Issuer) of any material amendment to, modification or variation of any licences, consents, approvals or registrations relating to the business or assets of First Hydro.

13. **Positive Covenants**

13.1 *Insurance*

The Issuer and First Hydro Holdings shall procure that:

- 13.1.1 subject to Condition 13.1.2, First Hydro shall effect and maintain or cause to be effected and maintained in full force and effect and on terms (including with respect to deductibles) and with reputable underwriters or insurance companies insurance, including insurances required by any applicable law, rule or regulation on and in relation to the Property, its other assets and its business, at least for such risks and such amounts as conform to Prudent Operating Practice, and as further set out in the Bond Trust Deed; and
- 13.1.2 First Hydro shall maintain or cause to be maintained the insurances required under Condition 13.1.1 unless such insurance (a) is not available at reasonable cost or (b) is not material in relation to the Property, First Hydro's other assets and its business. The Bond Trustee may request evidence including if necessary a certificate from a qualified insurance broker confirming that the insurance maintained by First Hydro is in accordance with Prudent Operating Practice.

13.2 *Compliance with Environmental Laws*

Each of the Issuer and the Guarantors shall ensure that it:

- 13.2.1 (a) complies with all Environmental Laws and obtain, maintain and comply with all necessary Environmental Permits, and (b) adopts and maintains all reasonable safeguards, in accordance with recognised good and prudent industry practice, to prevent Harm to the Environment in each case to the extent that failure to do so would have a Material Adverse Effect; and
- 13.2.2 promptly notifies the Bond Trustee (which notice shall describe in detail the relevant circumstances giving rise thereto) of any contamination of any Property, Harm to the Environment, non-compliance with any Environmental Laws or Environmental Permits, prosecution, action (including any enforcement or prohibition action), civil claim or statutory or other notice or other communication served on it or issued by any Competent Authority in respect of any Environmental Permit or any Environmental Law including without limitation any alleged breach thereof which would be likely, if substantiated, to have a Material Adverse Effect and shall immediately take such action as may be reasonably necessary to ensure compliance with Environmental Law and the terms of any Environmental Permit.

13.3 *Approvals*

The Issuer and each of the Guarantors shall obtain, comply with the terms of and do all that is necessary to maintain in full force and effect, all approvals at any time or from time to time required by it under any applicable law, rule or regulation binding on it (a) for the establishment, maintenance, repair and development of the assets and business of the Group and the disposal of emissions, waste and by-products produced therefrom (save for approvals which are not necessary for the proper and efficient operation of their respective businesses), (b) to enable it lawfully to enter into, exercise its rights under and perform and comply with its obligations under each of the Finance Documents and (c) to ensure the legality, validity, enforceability or admissibility in evidence in the United Kingdom of each such document or agreement and, from time to time upon any reasonable request of the Bond Trustee, supply the Bond Trustee with evidence (in form and substance reasonably satisfactory to the Bond Trustee) that all such approvals have been so obtained and maintained.

13.4 *Ranking of Obligations*

Each of the Issuer and the Guarantors undertakes that their respective payment obligations under these Conditions rank and will at all times rank at least equally and rateably in all respects with all their respective other unsecured indebtedness save for such indebtedness as would, by virtue only of the law in force in its jurisdiction of incorporation, be preferred in the event of its winding-up.

14. **Financial Covenants**

14.1 *Gearing*

The Issuer shall ensure that at all times the ratio of Adjusted Share Capital and Reserves to Net Borrowings shall not be less than 1.0 to 2.5.

14.2 *Interest Cover*

The Issuer shall ensure that (a) at each financial year end and (b) at the end of each half year, the ratio of Net Revenues to Interest Payable in respect of the immediately preceding 12 months shall not be less than 1.05 to 1.0.

14.3 *Revenue Support LC*

The Issuer shall ensure that (a) the Revenue Support LC is issued on or before the Closing Date and assigned by way of security to the Security Trustee, and (b) at all times until the fifth anniversary, there remains outstanding a Revenue Support LC issued by an authorised institution under the Banking Act 1987 having a short-term credit rating of A-1 or better issued by Standard & Poor's Rating Services and P-1 or better by Moody's Investor Service, Inc.

14.4 *Revenue Support*

The Issuer may avoid or cure any breach of the financial ratio contained in Condition 14.2, so that no Event of Default will occur as a result of the breach of Condition 14.2, by drawing under the Revenue Support LC

and adding such amounts to Net Revenues as would increase Net Revenues to such an amount that the Issuer would have complied with the ratio set out in Condition 14.2 at the end of the Applicable Reference Period in question.

15. Restriction on Distributions and Management Fees

15.1 Distributions

The Issuer and the Guarantors shall not pay, make or declare, or otherwise make any payment in respect of, any Distribution or pay any Management Fees (as defined below) unless at that time:

15.1.1 there is no outstanding Event of Default or Potential Event of Default; and

15.1.2 the Auditors have certified to the Bond Trustee that, on the basis of the audited consolidated accounts of the Group for the latest financial year or a combination of the unaudited consolidated accounts of the Group for the latest first half year and the last six months of the latest consolidated accounts (whichever is the latest, the "Reference Accounts") for the Applicable Reference Period the ratio described in Condition 14.2 was not less than 1.2 to 1.0;

Provided that:

- (a) no such Distribution may be made from the date as of which the Reference Accounts were prepared to the date of delivery thereof to the Bond Trustee pursuant to Condition 11.1;
- (b) no such Distribution may be made on any date when the amount standing to the credit of the Bond Interest Reserve Account or the amount of Relevant LCs issued in respect of the Bond Interest Reserve Account is less than the Minimum Balance;
- (c) the Issuer or the Guarantors may pay Management Fees (at any time when Condition 15.1.1 and/or Condition 15.1.2 would not be complied with) if such fees are certified in writing by an independent consultant, appointed by the Issuer and approved by the Bond Trustee, as being in its opinion on arm's length terms for full commercial value;
- (d) "Applicable Reference Period" means:
 - (i) in respect of the period from 1st January, 1996 to 31st March, 1996, the three months ending 31st March, 1996;
 - (ii) in respect of the period from 1st January, 1996 to 30th September, 1996, the nine months ending 30th September, 1996; and
 - (iii) thereafter, the 12 months ending on the final date of the Reference Accounts; and
- (e) in the case of (d)(i) and (d)(ii) above, such certificate shall be given on the basis of three months and nine months of Reference Accounts, respectively.

"Management Fees" means any amounts paid by each of the Guarantors and the Company in respect of directors' and management expenses and any other fees paid to any Affiliate (other than a member of the Group).

15.2 Distributions intra-Group

Condition 15.1 shall not apply to Distributions by one member of the Group to another member of the Group.

16. Negative Covenants

Each of the Issuer, First Hydro Holdings and First Hydro shall not:

16.1 Amendments

(a) agree to any material amendment to, variation or waiver of any of, the terms and conditions of any of the approvals held by it or (b) agree to any amendment to or variation of its Articles of Association and its Memorandum of Association which would have a Material Adverse Effect or a material adverse effect on the security granted in favour of the Security Trustee;

16.2 Abandonment or Suspension

permit the abandonment or suspension of its business in whole or in any part such as would have a Material Adverse Effect other than (a) where required to do so by a Competent Authority or (b) for the purpose of

routine maintenance in accordance with Prudent Operating Practice or emergency repairs Provided that such abandonment or suspension is in accordance with Prudent Operating Practice and each member shall use all reasonable endeavours to resume its business as soon as practicable after any such abandonment or suspension;

16.3 *Liquidation*

voluntarily enter into liquidation or dissolution or voluntarily enter into any merger or consolidation with any other person;

16.4 *Negative Pledge*

create or permit to subsist any encumbrance over all or any of its present or future revenues or assets other than:

- (a) liens arising solely by operation of law in the ordinary course of business and securing indebtedness not more than 60 days overdue for payment;
- (b) any encumbrance created by, or pursuant to, any of the Security Documents;
- (c) encumbrances arising out of title retention arrangements to secure indebtedness, other than indebtedness for borrowed money, incurred in the ordinary course of business;
- (d) encumbrances securing indebtedness which ranks *pari passu* with the Bonds provided that the person having the benefit of such encumbrance (or a representative on such person's behalf) becomes a party to the Intercreditor Deed in accordance with the terms thereof;
- (e) Future Cash Collateral Accounts and Future Debt Service Reserve Accounts; and
- (f) Authorised Investments, to the extent that there are amounts standing to the credit of the accounts referred to in (e) above;

16.5 *Loans and Guarantees*

grant any credit or give any indemnity to or for the benefit of any person (other than in the ordinary course of business) or make any loan or give any guarantee in either case in aggregate in excess of 1 per cent. of the Adjusted Share Capital and Reserves or otherwise voluntarily assume any liability, whether actual or contingent, in respect of any obligation of any other person save for any such liability (a) in relation to Secured Liabilities or (b) owed by one member of the Group to another;

16.6 *Disposals*

sell, lease, transfer or otherwise dispose of, by one or more transactions or series of transactions (whether related or not) the whole or any part of its revenues or its assets other than:

- (a) sales of electricity and other sales in the ordinary course of business;
- (b) as provided in, or pursuant to, any of the Finance Documents;
- (c) the sale or other disposal in the ordinary course of business of any worn out or obsolete assets;
- (d) disposals of assets on arm's length terms for full commercial value which will not be required for its business in accordance with Prudent Operating Practice provided that, if the consideration for any disposal exceeds £5,000,000, the Issuer shall have delivered to the Bond Trustee a certificate of two directors confirming that such asset is not required for its business in accordance with Prudent Operating Practice;
- (e) disposals with the prior written approval of the Bond Trustee;
- (f) payments of cash for the acquisition on arm's length terms of goods or services not prohibited under the Finance Documents;
- (g) Distributions in accordance with Condition 15; or

- (h) the disposal by the Issuer of its one per cent. shareholding in First Hydro to a Permitted Subsidiary.

16.7 *Subsidiaries*

acquire any subsidiary (other than, in respect of First Hydro Holdings, the Issuer, First Hydro and a Permitted Subsidiary) whether by formation or otherwise;

16.8 *Restrictions on Transactions with Affiliates*

enter into any transaction or agreement with any Affiliate (other than a member of the Group) save on the basis that such transaction or agreement shall have fair and commercially reasonable terms no less favourable to the Issuer or the Guarantors, as the case may be, than could reasonably be expected to be obtained in a comparable arm's length transaction with a person which is not such an Affiliate;

16.9 *Restrictions on Acquisitions*

in the case of First Hydro Holdings, acquire any asset not subject to the security created by the First Hydro Holdings Debenture.

17. **Events of Default**

If any of the following events (each an "Event of Default") occurs, subject to the terms of the Intercreditor Deed, the Bond Trustee may, and if so requested in writing by the holders of at least one-quarter in nominal amount of the Bonds then outstanding or if so directed by an Extraordinary Resolution shall, give notice to the Issuer that the Bonds are, whereupon they shall immediately become, due and payable at the Early Redemption Price together with accrued interest as provided in the Bond Trust Deed:

17.1 *Non-Payment*

default is made in the payment of any principal, premium or interest due on the Bonds on the due date and, in the case of interest only, such default continues for a period of five London Business Days; or

17.2 *Breach of other Obligation*

the Issuer or either of the Guarantors fails duly and punctually to comply with any of its obligations set out in these Conditions or under the Bond Trust Deed or the Security Documents and (unless, in the opinion of the Bond Trustee, such failure is incapable of remedy) such failure is not remedied within 30 days (or such longer period as the Bond Trustee may permit) of service of notice by the Bond Trustee on the Issuer or the relevant Guarantor (as the case may be) requiring the same to be remedied; or

17.3 *Cross Default*

any indebtedness for borrowed money of the Issuer or either of the Guarantors is not paid when due (or within any applicable grace period), is declared to be or otherwise becomes due and payable prior to its stated maturity by reason of an event of default (however described) provided that none of the events mentioned above in this Condition 17.3 shall constitute an Event of Default unless and until the aggregate amount of the indebtedness in respect of which one or more of the events mentioned above in this Condition 17.3 has/have occurred and are continuing (whether of one or more persons) equals or exceeds £6,000,000 or its equivalent; or

17.4 *Arrangements with Creditors*

the Issuer or either of the Guarantors is (or is, or could be, deemed by law or a court to be) insolvent or unable to pay its debts as they fall due or makes a general assignment for the benefit of or a composition with its creditors; or

17.5 *Meeting convened to consider winding-up resolution*

any general meeting of the Issuer or either of the Guarantors is convened for the purposes of considering any resolution for its winding-up, dissolution or re-organisation (save for the purpose of a solvent amalgamation

or reconstruction on terms previously approved by the Bond Trustee or an Extraordinary Resolution of the Bondholders), or any such resolution is proposed (save for the purposes as aforesaid) whether in general meeting or otherwise by the Issuer or either of the Guarantors (or any director or shareholder thereof); or

17.6 Legal proceedings for winding-up

any legal proceedings are started (or renewed after a stay) for (a) the winding-up, dissolution or re-organisation of the Issuer or either of the Guarantors (save for the purposes of a solvent amalgamation or reconstruction of any such person on terms previously approved in writing by the Bond Trustee or an Extraordinary Resolution of the Bondholders) or (b) for the making of an administration order (or any order having the same or a similar effect) in relation to the Issuer or either of the Guarantors and either:

- (a) such legal proceedings are started (or renewed) by the Issuer or either of the Guarantors (as the case may be) or any of its directors or shareholders; or
- (b) in any other case, such legal proceedings are not discharged, stayed, withdrawn or vacated within 30 days after such legal proceedings are started (or renewed); or

17.7 Order for winding-up

an order is made by a competent court or a resolution is passed for the winding-up, dissolution, administration or reorganisation of the Issuer or either of the Guarantors or any receiver, administrator, administrative receiver or similar officer is appointed in relation to it or any or all of its property, assets or revenues; or

17.8 Analogous Events

any event occurs which under the laws of any relevant jurisdiction has an analogous effect to any of the events referred to in any of Conditions 17.4 to 17.7; or

17.9 Repudiation of Agreements

the Issuer or either of the Guarantors repudiates any of the Finance Documents or does or causes to be done any act or thing evidencing an intention to repudiate any of the Finance Documents; or

17.10 Obligations Unlawful

at any time it is or becomes unlawful for the Issuer or either of the Guarantors to perform or comply with any or all of its obligations assumed by it in any Finance Document or all or any of the obligations of the Issuer or either of the Guarantors thereunder are not or cease to be legal, valid and binding; or

17.11 Change of business

except as permitted under the Finance Documents or with the prior written consent of the Bond Trustee (or an Extraordinary Resolution of the Bondholders), the Issuer or either of the Guarantors makes any material (in the opinion of the Bond Trustee) change in the nature of its business as presently conducted whether by disposal or otherwise; or

17.12 Inadmissibility of Finance Documents

at any time any act, condition or thing required to be done, fulfilled or performed in order to make each Finance Document admissible in evidence in England is not done, fulfilled or performed; or

17.13 Change of Control

the Issuer ceases to be wholly owned and Controlled by First Hydro Holdings or First Hydro ceases to be owned as to 99 per cent. by First Hydro Holdings and as to 1 per cent. by the Issuer or a Permitted Subsidiary;

17.14 Restrictions on ownership and business

First Hydro Holdings shall:

- (a) only carry on the business of owning the Issuer, First Hydro and any Permitted Subsidiary; and

- (b) procure that First Hydro at no time transfers its Property, business, undertaking or any fixed assets to the Issuer or First Hydro Holdings or a Permitted Subsidiary.

18. Payments

18.1 *Payments other than on Interest Payment Dates*

Payments of principal or premium on the Bonds or accrued interest payable other than on an Interest Payment Date will be made (a) in the case of Bearer Bonds, against presentation and surrender of the relevant Bonds at the specified office of any of the Paying Agents or (b) in the case of Registered Bonds, to the persons shown in the Register at the close of business on the seventh London Business Day prior to the relevant payment date (the "Record Date") and subject to surrender of the Registered Bonds at the specified office of the Registrar.

18.2 *Payments of Interest*

Payments of interest due on an Interest Payment Date will be made (a) in the case of Bearer Bonds, against presentation and surrender of the relevant Coupons at the specified office of any of the Paying Agents or (b) in the case of Registered Bonds, to the persons shown in the Register at the close of business on the Record Date.

18.3 *Method of Payment*

Each such payment will be made (a) in the case of Bearer Bonds, at the relevant specified office by sterling cheque drawn on, or by transfer to a sterling account maintained by the payee with, a bank in London, and (b) in the case of Registered Bonds, by sterling cheque drawn on a bank in London and mailed, not later than the London Business Day preceding the due date for payment (at the risk and, if mailed at the request of the holder otherwise than by ordinary mail, at the expense of the holder) to the holder or to the first named of joint holders of the relevant Registered Bonds at his registered address or in accordance with mandate instructions acceptable to the Registrar. In no event will interest payments be mailed to an address in the United States. Payments will be subject in all cases to any applicable fiscal and other laws and regulations, but without prejudice to the provisions of Condition 19.1.

18.4 *Presentation of Bearer Bonds for Redemption*

Bearer Bonds should be presented for redemption together with all unmatured Coupons relating thereto. Unmatured Coupons relating to such Bonds (whether or not attached) shall become void and no payment shall be made in respect of them.

18.5 *Unmatured Coupons*

For the purposes hereof and save as otherwise provided herein, "unmatured Coupons" means Coupons maturing after the date of redemption of the Bonds to which they appertain.

18.6 *Initial Paying Agents and Registrar*

The names of the initial Paying Agents and the Registrar and their specified offices are set out below. The Issuer reserves the right under the Agency Agreement at any time with the prior written approval of the Bond Trustee to remove any Paying Agent or the Registrar and to appoint other or further Paying Agents or another Registrar, provided that it will at all times maintain (a) a Paying Agent having its specified office in London and a Paying Agent having its specified office in one city approved by the Bond Trustee in continental Western Europe and (b) a Registrar with a specified office in a town approved by the Bond Trustee in the United Kingdom. Notice of any such removal or appointment and of any change in the specified office of any Paying Agent or the Registrar will as soon as practicable be given to Bondholders in accordance with Condition 24.

18.7 *Business Days*

In the case of payments in respect of Bearer Bonds, if the due date for payment of any Bond or Coupon or any later date upon which a Bearer Bond or Coupon is presented for payment is not a business day at the place where the relevant Bearer Bond or Coupon is presented for payment, then the holder shall not be entitled to payment at such place of the amount due until the next following business day at such place and shall not be

entitled to any further interest or other payment in respect of any such delay. For the above purposes, "business day" means any day (other than a Saturday or a Sunday) on which commercial banks and foreign exchange markets are open for business in the relevant place of presentation for payment and (in the case of payment by transfer to a sterling account as mentioned above) on which dealings in sterling may be carried on both in London and in such place.

18.8 *Fractions*

When making payments to Bondholders or Couponholders, fractions of one penny will be rounded down to the nearest penny.

19. **Taxation**

19.1 *Payments clear of Tax*

All payments of principal, premium and interest in respect of the Bonds or under the Guarantees shall be made without withholding for or deduction of any taxes, duties, assessments or governmental charges of whatever nature imposed or levied by or in the United Kingdom or any political subdivision of, or by any authority of or in the United Kingdom unless such withholding or deduction is required by law. In such event (other than in the case of payments in respect of Registered Bonds which will be made subject to the deduction of any United Kingdom income tax required to be withheld or deducted at source) the Issuer or, as the case may be, the Guarantors shall pay such additional amounts as may be necessary in order that the net amounts received by the holders of Bonds or Coupons after such withholding or deduction shall equal the amounts which would have been receivable by them had no such withholding or deduction been required, except that no additional amounts shall be payable in respect of any Bond or Coupon presented for payment:

- (a) by or on behalf of a holder who is liable to such taxes, duties, assessments or governmental charges in respect of such Bond or Coupon by reason of his being connected with the United Kingdom otherwise than merely by the holding of the Bond or Coupon;
- (b) in the case of Bearer Bonds, more than 30 days after the Relevant Date except to the extent that the holder thereof would have been entitled to such additional amounts on duly presenting the same for payment on the last day of such period of 30 days.

19.2 *Definitions*

- (a) For this purpose, the "Relevant Date" in respect of any such payment means the date on which payment becomes due but, if the full amount of the moneys payable has not been received by the Principal Paying Agent or, as the case may be, the Registrar or by the Bond Trustee on or prior to such due date, it means the date on which the full amount of such moneys has been so received and notice to that effect shall have been given to the Bondholders in accordance with Condition 24 and, in the case of Registered Bonds, cheques shall have been despatched or payment made in accordance with mandate instructions in accordance with Condition 18.
- (b) Any reference herein to principal and/or interest in respect of the Bonds shall be deemed to include any additional amounts which may be payable under this Condition or under any obligations undertaken in addition thereto or in substitution therefor pursuant to the Bond Trust Deed.

20. **Prescription**

20.1 *Bearer Bonds*

Bearer Bonds and Coupons will become void unless presented for payment within periods of 10 years and five years, respectively, from the Relevant Date (as defined in Condition 19) and thereafter no claim may be made in respect thereof.

20.2 *Registered Bonds*

Claims against the Issuer for the payment of principal, premium (if any) and interest and other sums payable in respect of Registered Bonds shall be prescribed unless made within 10 years (in the case of principal) and five years (in the case of interest) from the Relevant Date and thereafter any principal, interest or other sums payable in respect of such Bonds shall be forfeited and revert to the Issuer.

21. Enforcement of Rights

At any time after the Bonds become due and repayable, the Bond Trustee may, at its discretion and without further notice, institute such proceedings against the Issuer or take such steps as it may think fit to enforce the terms of the Bond Trust Deed and the Security Documents, but it need not take any such proceedings or such steps unless (a) it shall have been so directed by an Extraordinary Resolution of the Bondholders or so requested in writing by Bondholders holding at least one-quarter in principal amount of the Bonds outstanding, and (b) it shall have been indemnified to its satisfaction. No Bondholder or Couponholder may proceed directly against the Issuer unless the Bond Trustee, having become bound to proceed, fails to do so within a reasonable time and such failure is continuing.

22. Replacement of Bonds and Coupons

Should any Bond or Coupon be lost, stolen, mutilated, defaced or destroyed it may be replaced at the specified office of the Paying Agent in London for the time being (in the case of Bearer Bonds or Coupons) or at the specified office of the Registrar (in the case of Registered Bonds) in each case upon payment by the claimant of the expenses, taxes and duties incurred in connection therewith and on such terms as to evidence, indemnity and security as the Issuer may reasonably require. Mutilated or defaced Bonds or Coupons must be surrendered before replacements will be issued.

23. Meetings of Bondholders; Modifications; Waiver; Substitution

23.1 Meetings

The Bond Trust Deed contains provisions for convening meetings of Bondholders to consider any matter affecting their interests, including the modification by Extraordinary Resolution of these Conditions or the provisions of the Bond Trust Deed or the modification of the Finance Documents or the Security Documents. The quorum at any such meeting for passing an Extraordinary Resolution will be two or more persons holding or representing a clear majority in principal amount of the Bonds for the time being outstanding, or at any adjourned meeting two or more persons being or representing Bondholders whatever the principal amount of Bonds so held or represented, provided that at any meeting the business of which includes the modification of certain of these Conditions and certain of the provisions of the Bond Trust Deed or the Security Documents (including, *inter alia*, those relating to status and the currency, amount (but not to increase such amount) and due date of payment of redemption moneys and interest or other amounts in respect of the Bonds) the necessary quorum for passing an Extraordinary Resolution will be two or more persons holding or representing not less than two-thirds, or at any adjourned such meeting not less than one-third, of the principal amount of the Bonds for the time being outstanding. An Extraordinary Resolution duly passed in accordance with the provisions of the Bond Trust Deed at any meeting of Bondholders will be binding on all Bondholders, whether or not they are present at the meeting and whether or not they vote in favour, and on all Couponholders.

23.2 Bond Trustee's Discretion as to Modifications etc.

The Bond Trustee may agree, without the consent of the Bondholders or Couponholders, to any modification to any of these Conditions or the Bonds or the Coupons or any of the provisions of the Bond Trust Deed, Finance Documents and Security Documents which in its opinion is of a formal, minor or technical nature, is made to correct a manifest error or (not being such a modification as is mentioned in the proviso to the second sentence of the preceding paragraph) is not materially prejudicial to the interests of the Bondholders. The Bond Trustee may also agree without the consent of the Bondholders or Couponholders but only if in its opinion so to do will not be materially prejudicial to the interests of the Bondholders (a) to the waiver or authorisation of any breach or proposed breach of any of the provisions of the Bond Trust Deed, Finance Documents and Security Documents or of these Conditions or the Bonds or the Coupons or (b) that any Event of Default or any event, condition or act which, with the giving of notice and/or lapse of time and/or issue of a certificate, would be an Event of Default shall not be treated as such.

23.3 Modifications Binding

Any such modification, waiver, authorisation or substitution shall be binding on the Bondholders and the Couponholders and, unless the Bond Trustee agrees otherwise, shall be notified to the Bondholders by the Issuer in accordance with Condition 24 as soon as practicable.

23.4 No Regard to Domicile

In connection with the exercise of its powers, trusts, authorities or discretions (including but not limited to those in relation to any proposed modification, waiver, authorisation, determination or substitution as

aforesaid) the Bond Trustee shall not have regard to the consequences of such exercise for individual Bondholders or Couponholders resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory and the Bond Trustee shall not be entitled to require, nor shall any Bondholder or Couponholder be entitled to claim from the Issuer or the Bond Trustee, any indemnification or payment in respect of any tax consequence of any such exercise upon individual Bondholders or Couponholders except to the extent provided for in Condition 19 and/or in any undertakings given in addition thereto or in substitution therefor pursuant to the Bond Trust Deed.

23.5 *Substitution*

The Bond Trustee may agree without consulting the Bondholders, to the substitution of either of the Guarantors as principal debtor under the Bond Trust Deed, the Bonds and the Coupons, subject to the relevant provisions of the Bond Trust Deed and the Intercreditor Deed and to such requirements as the Bond Trustee may direct in the interests of the Bondholders.

24. **Notices**

24.1 *Notice of Redemption*

Notices to holders of Registered Bonds under Condition 7 will be mailed to them at the respective addresses in the Register and deemed to have been given on the fourth weekday after the date of mailing, provided that, if at any time by reason of the suspension or curtailment (or expected suspension or curtailment) of postal services within the United Kingdom or elsewhere the Issuer is unable effectively to give notice to holders of Registered Bonds through the post, notices to holders of Registered Bonds will be valid if given in the same manner as other notices as set out below.

24.2 *Other Notices*

Other notices to Bondholders will be valid if published in at least one leading English language daily newspaper published in London or, if this is not, in the opinion of the Bond Trustee, practicable, in at least one leading English language daily newspaper approved by the Bond Trustee with circulation in Europe or in such other manner as the Bond Trustee may approve. It is expected that publication will be made in the *Financial Times*. Such notices shall be deemed to have been given on the date of publication or, if published more than once, on the date of first publication.

24.3 *Couponholders*

The Couponholders shall be deemed for all purposes to have notice of the contents of any notices given to the Bondholders in accordance with this Condition.

25. **Further Issues**

The Issuer is at liberty from time to time without the consent of the Bondholders or Couponholders to create and issue further bonds or notes (whether in bearer or registered form) either (a) ranking *pari passu* in all respects (or in all respects save for the first payment of interest thereon) and so that the same shall be consolidated and form a single series with the outstanding bonds or notes of any series (including the Bonds) constituted by the Bond Trust Deed or any Deed supplemental to the Bond Trust Deed or (b) upon such terms as to interest, conversion, redemption and otherwise as the Issuer may determine at the time of the issue. Any further bonds or notes which are to form a single series with the outstanding bonds or notes of any series (including the Bonds) constituted by the Bond Trust Deed or any Deed supplemental to the Bond Trust Deed shall, and any other further bonds or notes may (with the consent of the Bond Trustee), be constituted by a Deed supplemental to the Bond Trust Deed. The Bond Trust Deed contains provisions for convening a single meeting of the Bondholders and the holders of bonds or notes of other series in certain circumstances where the Trustee so decides.

26. **Bond Trustee's Indemnity**

The Bond Trust Deed will contain provisions for the indemnification of the Bond Trustee and for its relief from responsibility, including provisions absolving it from registering or procuring the registration of any notice or other entry under the Land Registration Acts (as defined in the Bond Trust Deed) against any registered land for the time being subject to any floating charge securing the Bonds or a guarantee thereof. Power will also be

granted to the Bond Trustee to waive any breaches or proposed breaches of the Bond Trust Deed, the Security Trust Deed and the Debentures, either prospectively or retrospectively, as the Bond Trustee sees fit. The Bond Trustee shall not be obliged to take any action or institute any proceedings to enforce the security created under the Debentures and Intercreditor Deed unless it has been so directed by an Extraordinary Resolution (as defined in the Bond Trust Deed), and before the Loan Discharge Date, in accordance with the terms of the Intercreditor Deed, and has been indemnified to its satisfaction.

The Bond Trustee has not investigated the validity, value, sufficiency or enforceability of the security created by the Security Documents and shall accept without investigation, requisition or objection such right and title as the Issuer and the Guarantors have to the Property over which such security is created. The Bond Trustee will not be responsible for any deficiency which may arise because the Security Trustee or the Bond Trustee is liable to tax in respect of the property over which the security is created.

The Bond Trustee will rely on the certificates signed by two directors of the Issuer on its behalf and the certificates of the Auditors, in each case delivered to it pursuant to these Conditions and the Bond Trust Deed and shall not be responsible for any failure otherwise to monitor compliance with the obligations imposed on the Issuer and/or the Guarantors under these Conditions and particularly under Conditions 13 and 14, which the Trustee is not in a position to monitor.

27. Replacement of Bond Trustee

The Bond Trustee may resign at any time without assigning any reason and without being responsible for any expenses thereby occasioned. The statutory power of appointing a new Bond Trustee will be vested in the Issuer but, before being appointed, a new Bond Trustee must be approved by an Extraordinary Resolution (as defined in the Bond Trust Deed).

28. Contracts with the Bond Trustee

Notwithstanding its fiduciary position, the Bond Trustee will be entitled to enter into contracts or other transactions with any member of the Group and may deal therewith without accounting for any profit resulting therefrom and the Bond Trustee may exercise its discretion as trustee with regard thereto notwithstanding its interest.

29. Listing

The Issuer will use its best endeavours to obtain and, so long as any of the Bonds remains outstanding, maintain a listing for the Bonds on the London Stock Exchange.

30. Governing Law

The Bonds and the Bond Trust Deed are governed by and shall be construed in accordance with English law.

12. USE OF PROCEEDS

The net proceeds of the issue of the Bonds, expected to amount to approximately £395,700,000, will be used to refinance borrowings under the Facility Agreement, further details of which are set out in Section 16 — “Finance Arrangements” on page 71 of this Offering Circular.

13. YIELD

At the issue price of 100p per £1 in principal amount of Bonds, the gross redemption yield on the Bonds is 9 per cent. based on a gross annual interest payment of 9p per £1 in principal amount of Bonds payable semi-annually. The gross redemption yield is calculated on the basis indicated by the Joint Index and Classification Committee of the Institute and Faculty of Actuaries as reported in the Journal of the Institute of Actuaries Vol. 105, Part I, 1978 Page 18.

14. INITIAL COVER RATIOS

Interest cover

The Net Revenues of First Hydro, as defined in Section 11 — “Terms and Conditions of the Bonds” on page 40 of this Offering Circular, taken from the financial information shown in Section 10 — “Financial Information” on page 26 of this Offering Circular for the years ended 31st March, 1995 and 31st March, 1994, are as follows:

Financial Year ended	Net Revenues
31st March, 1994	£50,308,000
31st March, 1995	£79,944,000

On the basis of an Interest Payable, as defined in Section 11 — “Terms and Conditions of the Bonds” on page 40 of this Offering Circular, of £36,000,000 per annum, Interest Cover (the ratio of Net Revenues to Interest Payable in respect of the immediately preceding 12 months) would have been as follows:

Financial Year ended	Interest Cover
31st March, 1994	1.40
31st March, 1995	2.22

Capital Cover

The value of the plant specified in the Valuation Certificate set out in Appendix A amounts to £499,100,000, equal to approximately 1.24775 times the outstanding Borrowings, as defined in Section 11 — “Terms and Conditions of the Bonds” on page 40 of this Offering Circular, as taken from the financial information shown in Section 10 — “Financial Information” on page 26 of this Offering Circular.

15. ACQUISITION ARRANGEMENTS

Acquisition of the PSB

First Hydro purchased the PSB from NGC on 17th November, 1995 pursuant to an asset acquisition agreement of that date (the "Asset Acquisition Agreement"). This agreement contains a limited number of warranties in favour of First Hydro. Rights of recovery under the warranties are restricted in a number of respects and are excluded in relation to information disclosed to First Hydro prior to the acquisition. No claim may be made which is for less than £100,000 in respect of any single item or which, when aggregated with other claims does not exceed £5,000,000. Liability in respect of the warranties is capped at £60,000,000 and ceases 18 months after the date of sale of First Hydro to the Issuer. First Hydro must give notice to NGC upon becoming aware of a claim and must commence litigation with respect thereto within six months. It must provide access to NGC to relevant information and comply with NGC's requests in relation to conduct of any matter relating to a claim. First Hydro loses any right to claim if it fails to comply with its obligations in relation to the warranties.

First Hydro undertakes in the Asset Acquisition Agreement that the principal use of the properties at Dinorwig and Ffestiniog shall be for an electricity activity as defined in paragraph 6, Schedule 1 of a Property Clawback Debenture dated 30th October, 1990 between NGC and the Secretary of State for Energy, during the period to 31st March, 2000. Any disposal of an interest in all or part of these properties is to be conditional upon and the subject of an undertaking on identical terms to the foregoing. If any of the properties at Dinorwig and Ffestiniog are used other than for an electricity activity, this could result in a liability under the Asset Acquisition Agreement in respect of the Property Clawback Debenture.

Acquisition of First Hydro

The Issuer purchased all of the issued share capital of First Hydro under an agreement with PSB Holding Limited (the "Vendor") for the sale and purchase of shares in First Hydro dated 21st December, 1995 (the "Sale and Purchase Agreement"), with the completion date thereof being 21st December, 1995. The consideration comprised £652,500,000 plus consideration for existing loan stock of First Hydro being £120,000 and the sum of £29,600,000. This last figure comprised the Vendor's estimate of the Completion Date Cash Position (as defined in the Sale and Purchase Agreement) being the aggregate of First Hydro's debtors and cash in hand less creditors as at the Completion Date. The agreement allows for post-completion adjustments within three months, in order to verify the Completion Date Cash Position whereupon an amount will fall due to or by the Issuer depending on whether the actual Completion Date Cash Position is greater or less than the Vendor's estimate thereof.

The Issuer financed its acquisition through the issue of loan stock of £295,307,500 in favour of First Hydro Holdings and a drawdown under the Facility Agreement of £400,000,000. First Hydro Holdings financed the purchase of loan stock from the proceeds of the subscription of 118,128,000 of its Ordinary Shares of £1 each by Mission Hydro Limited Partnership and the issue of loan stock of £177,192,000 to Mission Hydro Limited Partnership.

The Sale and Purchase Agreement contains warranties which are more limited in number than those in the Asset Acquisition Agreement. They relate to the period from 17th November, being the date of acquisition of the PSB by First Hydro and are qualified in a number of material respects. Rights of recovery under the warranties are strictly limited. Liability is capped at £60,000,000 but claims must be made within six months from completion with legal proceedings commenced within three months after notice. The Vendor has no liability if the claims do not in aggregate exceed £1,000,000 or individually £100,000. A claim will not arise if it is covered by insurance or would have been if First Hydro had placed insurances normally effected by prudent companies. Similarly, no claim will arise if it relates to any matter disclosed to or known by or contained or referred to in any report prepared for the Issuer prior to completion. The Issuer is obliged to use best endeavours to recover claims from third parties who may be liable and is under detailed obligation to provide notice, relevant information and comply with instructions regarding conduct of any claim. Rights of recovery under the warranties are contingent on compliance with these provisions.

There are no significant warranties in relation to title to the physical property. The Issuer has the benefit of the Reports on Title in relation to these assets prepared by the solicitors of the Vendor. Liability in relation to the Reports on Title is limited to £60,000,000.

The Issuer undertakes to compensate employees of First Hydro for income tax liability on certain share options in the Group. This liability has been estimated to be in the region of £600,000.

A deed of warranty has been granted by NGC dated 17th November, 1995 (the "Deed of Warranty") the benefit of which was assigned to the Issuer by assignment in its favour dated 21st December, 1995. This deed

provides certain limited warranties in relation to the activities of First Hydro prior to its acquisition of the PSB on 17th November, 1995.

Transfer to First Hydro Holdings

On 4th January, 1996 the Issuer sold 21 per cent. of the issued share capital in First Hydro to First Hydro Holdings pursuant to a share sale agreement of that date (the "Further Sale Agreement"). The consideration therefor was settled in part by the discharge of loan stock of £143,266,200 owed by the Issuer to First Hydro Holdings. By way of further consideration, loan stock in an amount equal to 21 per cent. of the costs incurred by the Issuer in the acquisition of First Hydro will be discharged once those costs have been determined.

On 8th January, 1996 the Issuer sold 78 per cent. of the issued share capital in First Hydro to First Hydro Holdings pursuant to the Further Sale Agreement. The consideration therefor was settled in part by the discharge of loan stock of £132,131,600 owed by the Issuer to First Hydro Holdings and the balance (of £400,000,000) was left outstanding as indebtedness on the terms of the Inter-Company Credit Agreement between First Hydro Holdings and the Issuer. By way of further consideration, loan stock in an amount equal to 78 per cent. of the acquisition costs referred to above will be discharged once they have been determined. The Issuer assigned to First Hydro Holdings on 8th January, 1996 all of its rights under the Sale and Purchase Agreement under which it acquired First Hydro and the Deed of Warranty granted by NGC, each as referred to above.

16. FINANCE ARRANGEMENTS

Facility Agreement

The Issuer has entered into a credit facility agreement dated 18th December, 1995 (the "Facility Agreement") with Barclays Bank PLC ("Barclays") pursuant to which Barclays has provided to the Issuer the following facilities (the "Facilities"):

- (i) a bridging facility of up to £200 million (the "Bridging Facility") which has been utilised in full by the Issuer to finance a portion of the costs of the acquisition of First Hydro (the "Acquisition"); and
- (ii) a term advances facility of up to £200 million (the "Term Facility") which has been utilised in full by the Issuer to finance a portion of the costs of the Acquisition.

Barclays has also agreed to continue certain ancillary credit facilities up to £10 million used by First Hydro for general working capital purposes. Barclays, as provider of the ancillary credit facilities, is a Secured Creditor and benefits from the security referred to below.

The Issuer expects to repay amounts outstanding under the Facility Agreement in full, together with interest, on the Closing Date. The Loan Discharge Date will therefore occur on or about the Closing Date.

Security

(i) The Issuer guarantees the obligations of the Guarantors and has granted a floating charge over its undertaking and all its assets. It has also created the following fixed security:

- (a) an assignment of the Accounts (as defined in Section 11 — "The Terms and Conditions of the Bonds" on page 40 of this Offering Circular) and certain accounts which it is required to maintain pursuant to the Facility Agreement (the "Issuer Loan Facility Accounts") together with an assignment of the Relevant LCs (as defined in Section 11 — "Terms and Conditions of the Bonds" on page 40 of this Offering Circular) and certain letters of credit (issued for equivalent purposes in relation to the Issuer Loan Facility Accounts) and a fixed charge over authorised investments into which monies standing to the credit of such accounts can be converted;
- (b) a fixed charge over all shares held by the Issuer in First Hydro;
- (c) an assignment of the Issuer's rights under the Sale and Purchase Agreement, the Further Sale Agreement and the Inter-Company Credit Agreement;
- (d) an assignment of its rights under the Revenue Support LC; and
- (e) a fixed charge over the £120,000 First Hydro Loan Stock.

On the Loan Discharge Date, the fixed security over the Issuer Loan Facility Accounts will be released.

(ii) First Hydro guarantees the obligations of the Issuer and First Hydro Holdings and has granted a floating charge over its undertaking and all its assets. It has also granted the following fixed charges:

- (a) an assignment of all insurances of First Hydro;
- (b) an assignment of certain accounts which it is required to maintain pursuant to the Facility Agreement; and
- (c) an assignment of its rights under the Asset Acquisition Agreement.

On the Loan Discharge Date, the fixed security over the insurances and the accounts described in (ii)(a) and (ii)(b) above will be released. The Intercreditor Deed provides, *inter alia*, that if Secured Creditors recover more on an insolvency of First Hydro than they would have done if First Hydro had been a limited liability company, then such excess which is attributable to First Hydro Holdings will be paid to First Hydro Holdings.

(iii) First Hydro Holdings guarantees the obligations of the Issuer and First Hydro and has granted a floating charge over the assets assigned or subject to the fixed charges listed below and all its bank accounts, book debts, uncalled capital, goodwill and investments. It has also granted the following fixed charges:

- (a) assignment of an account which it is required to maintain pursuant to the Facility Agreement and fixed charges over investments bought with monies standing to the credit of those accounts;

- (b) fixed charge over all shares in the Issuer and all shares in First Hydro (when acquired from the Issuer pursuant to the Further Sale Agreement) held by First Hydro Holdings; and
- (c) assignment of rights under the Further Sale Agreement.

On the Loan Discharge Date, the security over the account described in (iii)(a) above will be released.

None of the shareholders of Mission nor any other affiliate of Mission, other than the Issuer, First Hydro and First Hydro Holdings has any obligation under the Bonds. The obligations of First Hydro Holdings and First Hydro under the Guarantees are non-recourse as against Mission and any other affiliate of Mission. No regard should be had to the assets of the shareholders of First Hydro Holdings when making any credit or other valuation of First Hydro Holdings. The obligations of First Hydro Holdings under its Guarantee are limited recourse to the assets over which it has granted security in favour of the Security Trustee.

Intercreditor Arrangements

The guarantees and security described above will be given to the Security Trustee, which will hold the benefit of such guarantees and security on trust for the Secured Creditors pursuant to the Security Trust and Inter-Creditor Deed. At all times, the Secured Creditors will rank *pari passu* with each other, except in respect of security which, in accordance with the terms of the Secured Finance Documents, is permitted to be created in priority to the other security in any respects. The security over the Accounts (as defined in the Terms and Conditions) will be for the prior benefit, in point of payment, of the Bondholders. Security granted over the Issuer Loan Facility Accounts maintained pursuant to the Facility Agreement will be for the prior benefit, in point of payment, of the Facility Banks but will be released on the Loan Discharge Date. The mechanisms for controlling the benefit of the guarantees and the security differ before and after the Loan Discharge Date.

- (i) Before the Loan Discharge Date:

Before the Loan Discharge Date any Secured Creditor will have the right to impose a suspension of payments by the Issuer or the Guarantors to any Secured Creditor under any Secured Finance Document on the occurrence of an event of default (however described) under any Secured Finance Document. The rights of any Secured Creditor to take action to enforce the obligations of the Issuer or the Guarantors under any Secured Finance Document will also be limited except where the security is being enforced. The right to enforce security will itself be limited in that any Secured Creditor to which more than 25 per cent. of the principal amount of all the Secured Liabilities are owed will be able to veto such enforcement except in respect of assets which are secured for their prior benefit or in respect of steps necessary, *inter alia*, to preserve or protect the security.

- (ii) On or after the Loan Discharge Date:

On or after the Loan Discharge Date the provisions dealing with the enforcement of security allow any class of Secured Creditors to enforce the security without the consent of any other Secured Creditor or class of Secured Creditors. The other restrictions cease to apply.

Subordination

All indebtedness of the Issuer and the Guarantors to each other and all indebtedness of First Hydro Holdings to First Hydro Limited Partnership are subordinated on insolvency to the rights of the Secured Creditors. The right to receive payment of any indebtedness which is subordinated in this manner may be suspended by any Secured Creditor on an event of default.

17. ADDITIONAL INFORMATION

The Electricity Regulatory Regime

The Electricity Act introduced a new regime providing for the appointment of the Regulator and a system of licensing in respect of the generation, transmission, distribution and supply (and certain other related activities) of electricity. The provisions of the Electricity Act, the regulations and orders made under it, and the conditions of the licences granted, together with environmental and competition legislation, are the principal components of the regulatory regime applicable to the electricity industry.

The Regulator, together with the Secretary of State for Trade and Industry, has specific responsibility for regulating the electricity industry in England and Wales. Each must exercise his powers and duties under the Electricity Act in the manner each considers is best calculated:

- (i) to secure that all reasonable demands for electricity are satisfied;
- (ii) that all licence holders are able to finance the carrying on of activities which they are authorised to carry on by their licences; and
- (iii) to promote competition in the generation and supply of electricity.

Subject to these duties, in exercising their functions under the Electricity Act the Regulator and Secretary of State have the following duties:

- (i) to protect the interest of consumers of electricity in respect of prices charged and other terms of supply, continuity of supply and the quality of the electricity supply services provided;
- (ii) to promote efficiency and economy on the part of licensees authorised to supply or transmit electricity and efficiency of use by consumers;
- (iii) to promote research into and development and use of new techniques by or on behalf of persons authorised to generate, transmit or supply electricity;
- (iv) to protect the public from dangers arising from the generation, transmission or supply of electricity; and
- (v) to secure the establishment and maintenance of machinery for promoting the health and safety of persons employed in the generation, transmission or supply of electricity.

Furthermore, the Regulator and Secretary of State, when exercising these duties, must take into account the effect of activities connected with generation, transmission and supply on the physical environment and consider the interests of consumers in rural areas and consumers who are described as of pensionable age.

The Licences

The Regulator, in accordance with a general authority given by the Secretary of State, is responsible for granting licences permitting generation, transmission or supply. It is an offence to carry out any of these activities without the relevant licence (unless one of the Electricity Act exemptions is applicable).

Enforcement of the licensing regime is the responsibility of the Regulator who is assisted by the Office of Electricity Regulation (OFFER). In circumstances where there may be a monopoly situation under the Fair Trading Act 1973 or where there is alleged conduct which has or is intended or is likely to have an effect on competition under the Competition Act 1980 in relation to the generation, transmission or supply of electricity, the Regulator may exercise certain powers concurrently with the Director General of Fair Trading. Failure to comply with a licence condition may result in an enforcement order being made by the Regulator or revocation of a licence if the enforcement order is not complied with.

Licence Modifications

The Regulator, subject to a power of veto exercisable by the Secretary of State, may with the agreement of the licence holder modify licence conditions. The Regulator may refer to the MMC for investigation whether any matters which relate to the generation, transmission or supply of electricity in pursuance of a licence operate or may be expected to operate against the public interest and, if so, whether the adverse effects found by the MMC can be remedied or prevented by modifications of the conditions of the licence. If the MMC report concludes that matters may operate against the public interest and that licence modifications could prevent or remedy such adverse effects, the Regulator must make such modifications as appear to him to be requisite to remedy or prevent such adverse effects. The Secretary of State has a power of veto in respect of a modification

reference. The Secretary of State may also order licence modifications pursuant to his powers under the Fair Trading Act 1973 and Competition Act 1980.

First Hydro's Generation Licence

The pumped storage business division of NGC was, until recently, regulated by a Generation Licence issued to NGC which came into effect on 31st March, 1990. A Generation Licence was issued to First Hydro on 14th November, 1995 which came into force on its acquisition of the PSB on 17th November, 1995. It continues until determined by not less than 25 years' notice in writing given by the DGES; such notice cannot be served until after the licence has been in effect for 10 years. The licence contains conditions including a requirement for separate accounting for separate businesses, a prohibition against discrimination regarding the terms on which electricity is offered to persons not affiliated or related to the licensee, an obligation to comply with the Grid and Distribution Codes. These codes together with the Master Connection and Use of System Agreement and the relevant Supplemental Connection Agreement constitute the principal rules governing the technical aspects of connection to, and the operation of, the transmission and distribution systems respectively, and assist operational planning by setting out the information and forecasts needed to match demand and supply over time on both systems.

The licensee is obliged to submit all of its available generation sets to central despatch by the NGC. The licensee is also obliged to be a Pool member in accordance with the Pooling and Settlement Agreement.

The Licensee is obliged upon request by NGC to offer terms for the provision of ancillary services and must upon request by the Regulator provide a report containing details of prices offered and an explanation of the factors justifying those prices. The licence may be revoked on 30 days' notice on the occurrence of certain specified events including agreement by the licensee, non-payment of fees, failure to comply with an enforcement order of the Regulator not remedied within three months after the Regulator has given notice of such failure, failure to comply with certain orders under the Fair Trading Act 1973 or Competition Act 1980, ceasing to carry on a generation business, making false statements and certain insolvency related events.

All licence holders are subject to the Fuel Security Code made by the Secretary of State under the Electricity Act which provides for certain amendments to the regulatory system and certain requirements for generation during a fuel security period.

Use of System

NGC is required to offer terms for connection to, and use of, the transmission system on a non-discriminatory basis. Provisions relating to connection of a generator's equipment, use of the transmission system, connection charges, use of systems charges and provisions for enforcement of the Grid Code are included in the Master Connection and Use of System Agreement between NGC and others dated 30th March, 1990. First Hydro became a party to this Agreement pursuant to an Accession Agreement dated 17th November, 1995. It has also entered into a supplemental Connection Agreement in relation to each of Dinorwig and Ffestiniog dated 17th November, 1995. Each Supplemental Agreement contains certain specific provisions concerning operational requirements, connection charges and use of system charges, the obligation to provide ancillary services, provisions for de-energisation and disconnection and other site specific technical conditions. These agreements continue until the generation equipment is disconnected from NGC's transmission system. The Agreement may also terminate if the generation sets are de-energised following a breach by First Hydro and the breach is unremedied after six months.

Ancillary Services Agreements

The provision of Ancillary Services is governed by ancillary services agreements entered into between a Generator and NGC's Ancillary Services Business which acts as the procurement agent of the Pool ("Ancillary Services Agreements"). The Ancillary Services Agreements are in fact a number of interrelated agreements. The principal terms under which Ancillary Services are provided are governed by the Master Ancillary Services Agreement ("MASA"). This Agreement is not site specific and continues for so long as a generator is a party to Supplemental Ancillary Services Agreements ("SASA"), subject to certain rights of termination on the part of NGC where the Generator ceases to be a member of the Pool or ceases to be a party to the Pooling and Settlement Agreement, the Master Connection Agreement or to hold a Generation Licence. In addition to entering into a MASA, a generator is also required to enter into SASA in respect of each specific power station. The SASA sets out the details of the particular Ancillary Services to be provided by the Generator and the specific payment provisions to be made in respect of those services. The SASAs for Ffestiniog and Dinorwig expire on 31st March, 1996. Negotiations for the renewal of these contracts have already commenced.

A Generator may also enter into a Reserve Ancillary Services Agreement under which the Generator agrees to provide certain reserve services to NGC. The principal terms and conditions for a Reserve Ancillary Services Agreement are similar to those of the MASA.

Competition in the Electricity Industry

The electricity generation industry is characterised as a duopolistic market in which the major Generators, acting together, enjoy significant market power.

The Regulator has a duty to promote competition in the electricity industry and has published a number of reports relating to competition and prices, some of which have dealt specifically with the operation of the Pool and the behaviour of National Power and PowerGen. In February 1994, following a review of Pool prices, the Regulator concluded that he would have to make a reference to the MMC unless other appropriate measures could be agreed with the Generators. This resulted in the Regulator issuing a statement accepting voluntary undertakings from National Power and PowerGen relating to pricing in the Pool and the disposal of a total of 6,000 MW of capacity (National Power 4,000 MW and PowerGen 2,000 MW). On 12th December, 1995, the Regulator issued a further statement to the effect that competition in the generation market has increased as new independent capacity has come on-stream and further plant is under construction. The Regulator noted that National Power and PowerGen have taken steps to secure the sale and disposal of plant (as foreseen in February 1994) and that on this basis, he does not consider it appropriate to seek any extension of the voluntary undertakings on prices. The Regulator stated that he would continue to monitor compliance by National Power and PowerGen with the undertakings given and future developments in the generation market.

UK and EU Law

The Fair Trading Act 1973 allows the Secretary of State or the Director General of Fair Trading to refer a monopolistic situation to the MMC for investigation.

The Electricity Act transfers to the Regulator certain functions exercisable by the Director General of Fair Trading relating to monopoly situations which exist or may exist in relation to commercial activities connected with the generation, transmission or supply of electricity and in respect of courses of conduct which have or are intended to have or are likely to have the effect of restricting, distorting or preventing competition in connection with the generation, transmission or supply of electricity. The Regulator will exercise these powers concurrently with the Director General of Fair Trading under the Fair Trading Act 1973 and the Competition Act 1980.

The extension of the Fair Trading and Competition Acts to the Regulator does not affect the Director General of Fair Trading's own functions under those Acts so that the usual competition rules will apply to monopoly and merger situations and to actual or potential anti-competitive practices.

The merger provisions of the Fair Trading Act applies to any "merger situation qualifying for investigation" by the Monopolies and Mergers Commission ie. any situation to which the EC Merger Regulation does not apply and (i) in which two or more enterprises cease to be distinct by coming under common control and (ii) at least one of the two enterprises is carried on in the UK or by or under the control of a body corporate incorporated in the UK; and (iii) either a share of the relevant market of 25 per cent. or more is created or enhanced or the value of the assets acquired exceeds £70 million. On 14th December, 1995, clearance was granted by the OFT in respect of the acquisition of First Hydro.

The EC Treaty includes certain competition provisions. Article 85(1) prohibits agreements between undertakings, decisions of undertakings and concerted practices which may affect trade between Member States and have as their object or effect, the prevention, restriction or distortion of competition within the common market. Article 86 prohibits any abuse by one or more undertakings of a dominant position within the common market or a substantial part of it, insofar as it affects trade between Member States. An agreement which infringes Article 85 and which is not notified to the European Commission is void and unenforceable in respect of the infringing provisions and third parties may be entitled to claim for damages and the European Commission may impose substantial fines. Behaviour which infringes Article 86 may also lead to third party actions for damages and fines imposed by the European Commission.

The Environmental Regulatory Regime

The principal environmental regulations which affect the activities carried out by First Hydro and the bodies with responsibility for enforcing the environmental regulations are outlined below:

Water Abstraction

Water abstraction rights for the generating operations of First Hydro stem from licences originally issued pursuant to the North Wales Hydro Electric Power Acts of 1955 and 1973.

Licences to abstract water are now governed by the Water Resources Act 1991 (the "WRA 1991") under the control of the National Rivers Authority ("NRA"). From 1st April, 1996, the functions of the NRA will be

exercised by the Environment Agency, which is shortly to be established under the Environment Act 1995. The WRA 1991 allows for the transfer of licences. Once the holder of a licence ceases to be the occupier of the whole of the relevant land, the successor automatically becomes the holder of the licence. The successor must give the NRA notice of the change in occupation of the relevant land. First Hydro informed the NRA of the change of ownership of Ffestiniog and Dinorwig on 30th November, 1995.

Under the WRA 1991, the NRA may levy a charge for water abstraction. However, the licensee may apply to the NRA for an agreement that it be exempted from the payment of charges or that the charges be levied at a reduced rate. NGC entered such an agreement with the NRA for payment of reduced charges. On 30th November, 1995, First Hydro requested that these charging agreements be re-issued in its name.

Water Pollution

Under the WRA 1991 it is an offence to cause or knowingly permit pollution of controlled waters (including rivers, lakes and groundwater), unless discharges are made in accordance with the terms and conditions of a NRA consent (there are two such discharge consents relating to Ffestiniog). The NRA can take steps to prevent or remedy pollution of controlled waters and can recover their reasonable costs from the polluter. The new Environment Agency will have similar powers to investigate the source of pollution and recover the expenses and costs of doing so.

Surface water discharges can pose a threat to the water environment, where oil or other polluting substances are mixed with such discharges. If any such unauthorised discharges result in pollution of controlled waters, the discharger will have committed an offence under the WRA 1991. Pumped storage schemes are not prescribed processes under the Environmental Protection Act 1990, so HM Inspectorate of Pollution are not involved in the control of pollution from the PSB.

The discharge of trade effluent into a public sewer is regulated under the Water Industry Act 1991 (the "WIA 1991") by the sewerage undertaker in whose area the relevant trade premises are situated.

The Salmon and Freshwater Fisheries Act 1975 makes it an offence in England and Wales knowingly to permit waters to be polluted to the extent that they are poisonous or injurious to fish or their spawning grounds, spawn or food.

Air pollution

Local authorities have powers to control the effects of air pollution under Parts II and III of the Environmental Protection Act 1990 (the "EPA 1990") which includes statutory nuisance problems.

Waste

Activities involving waste may require licensing under the waste regulation regime governed by Part II of the EPA 1990 and the Waste Management Licensing Regulations 1994 (the "1994 Regulations"). County Councils, acting as Waste Regulation Authorities, are responsible for the licensing and enforcement of waste management activities, although it is the Government's intention that Waste Regulation Authorities will, in due course, become part of the Environment Agency.

Under the EPA 1990, it is a criminal offence to deposit, treat, keep or dispose of controlled waste or knowingly cause or permit such activities in or on land, except in accordance with a waste management licence. The 1994 Regulations require an applicant for a waste management licence to demonstrate that he is a "fit and proper person" without relevant criminal convictions and able to make financial provision to fulfil the licence obligations. A licence holder who contravenes any condition of his licence will commit an offence. The 1994 Regulations also set out those activities classified as exempt from licensing.

A waste management licence may only be surrendered on acceptance of it by the Waste Regulation Authority, who must be satisfied that there are no continuing risks of environmental harm.

Contaminated Land

Section 57 of the Environment Act 1995 introduces a new system for the control and remediation of contaminated land, requiring remediation to a level which makes the land suitable for future use. Local authorities will be required to identify contaminated lands within their areas and serve remediation notices specifying what is required by way of remediation. These rules replace Sections 61 and 143 of the Environmental Protection Act 1990.

Abandoned Mines

The Environment Act 1990 amends the Water Resources Act 1991 to remove, with effect from 31st December, 1999, the exemption from liability currently enjoyed by any person permitting the pollution of controlled waters by water from an abandoned mine.

Wildlife and Habitat

Parts of Dinorwig and Ffestiniog are subject to designations as Sites of Special Scientific Interest (SSSI), namely in respect of Llyn Padarn, Llyn Peris and Afon Goedol, which may limit the extent of future developments on site. The Countryside Council for Wales, the relevant regulatory body, has stated that it does not view the power stations as having any significant effect on these sites.

It is understood that a site in the area may be proposed for designation as a Special Area of Conservation (SAC) under the 1992 Habitats Directive.

The Planning Regime

The principal planning regulations which affect the activities carried out by First Hydro are outlined below.

Development of the dam and related power stations at Dinorwig and Ffestiniog were authorised by Acts of Parliament, respectively the North Wales Hydro Electric Power Acts of 1973 and 1955. From the information available at the offices of the relevant planning authorities there is no indication that the development was not carried out in compliance with the statutes. Subsequent ancillary permissions were granted under the Town and Country Planning Act 1990 (and predecessor legislation).

Development proposals in relation to First Hydro would be subject to careful control as regards the nature and extent of such development (including any further transmission lines) because of the sensitive landscape setting of Dinorwig and Ffestiniog. Constraints connected with National Park status, SSSIs, ancient monuments and an SSSI affecting Ffestiniog are reinforced by statutory development plan policies that seek to protect natural heritage interests. Development proposals promoted by way of the Electricity Act 1989 procedures would similarly be constrained by virtue of the requirements under schedule 9 of that legislation to take account of the effect on the physical environment of activities connected with the generation, transmission or supply of electricity.

New applications for consent under the Electricity Act may also involve the applicant providing an environmental statement under the Electricity and Pipe-line Works (Assessment of Environmental Effects) Regulations 1990. These regulations implement the requirements of EC Directive 85/337 (on the assessment of the effects of development projects on the environment) in respect of those projects subject to Electricity Act 1989 procedures. By virtue of regulation 2 the Secretary of State for Trade and Industry is obliged to require an environmental statement if the extension of an existing facility would result in a facility with a heat output of more than 300 megawatts. If the proposed extension would result in a heat output below this figure then he may request an environmental statement if he considers that the proposed development would be likely to have significant effects on the environment by virtue of factors such as its nature, size or location. Given the sensitive location of both facilities even proposals falling into this second category are likely to involve the provision of an environmental statement. The likely significant effects (both direct and indirect) on matters such as water resources, flora, fauna and the landscape would have to be addressed in any such statement. The document would also have to describe the measures envisaged in order to avoid, reduce or remedy those effects. The material assessed in this way would also form the basis of meeting the requirements imposed on the Secretary of State for Trade and Industry under schedule 9 of the Electricity Act.

18. TAXATION

The comments below are of a general nature based on the Issuer's understanding of current United Kingdom law and Inland Revenue practice and are not intended to be exhaustive. The comments relate to the position of persons who are the absolute beneficial owners of their Bonds and Coupons and may not apply to certain classes of persons such as dealers.

PROSPECTIVE BONDHOLDERS WHO ARE IN ANY DOUBT AS TO THEIR TAX POSITION OR WHO MAY BE SUBJECT TO TAX IN A JURISDICTION OTHER THAN THE UNITED KINGDOM SHOULD SEEK INDEPENDENT ADVICE.

(i) Interest on Registered Bonds will be paid after deduction of United Kingdom income tax (currently at the rate of 25 per cent. but this will be reduced to 20 per cent. with effect from 6th April, 1996 if the provisions announced in the Budget on 28th November, 1995 are enacted), subject to any direction to the contrary by the Inland Revenue under the provisions of an applicable double taxation treaty.

(ii) The Bearer Bonds will constitute "quoted Eurobonds" within the terms of section 124 of the Income and Corporation Taxes Act 1988 provided they remain in bearer form and continue to be quoted (except that references to the word "quoted" will be replaced by the word "listed" if the provisions published in the U.K. Finance Bill 1996 are enacted) on a "recognised stock exchange" within the meaning of section 841 of that Act. Accordingly, payments of interest on such Bearer Bonds may be made without deduction or withholding for or on account of United Kingdom income tax where:

- (a) the payment is made by a paying agent outside the United Kingdom; or
- (b) the payment is made by a paying agent inside the United Kingdom; and either
 - (i) the Bond and related Coupons are held in a "recognised clearing system" (Cedel and Euroclear have each been designated as a "recognised clearing system" for this purpose); or
 - (ii) it is proved to the satisfaction of the Commissioners of Inland Revenue, on a claim made in that behalf, that the person who is the beneficial owner of the Bond and the relevant Coupon (or, where the provisions of United Kingdom tax legislation deem the interest to be that of some other person, that person) is not resident in the United Kingdom for tax purposes.

In all other cases interest will be paid under deduction of United Kingdom income tax (currently at the rate of 25 per cent. but this will be reduced to 20 per cent. with effect from 6th April, 1996 if the provisions published in the U.K. Finance Bill 1996 are enacted) subject to any direction to the contrary by the Inland Revenue under the provisions of an applicable double taxation treaty.

(iii) In respect of Bearer Bonds, a collecting agent in the United Kingdom obtaining payment of interest whether in the United Kingdom or elsewhere from which United Kingdom income tax has not already fallen to be deducted or realising in the United Kingdom any interest on behalf of a Bondholder or Couponholder may be required to withhold or deduct United Kingdom tax (currently at the rate of 25 per cent. but this will be reduced to 20 per cent. with effect from 6th April, 1996 if the provisions published in the U.K. Finance Bill 1996 are enacted) unless it is proved, on a claim in that behalf made in advance to the Inland Revenue, that the person who is the beneficial owner of the Bearer Bond and entitled to the interest is not resident in the United Kingdom and the interest is not deemed for United Kingdom tax purposes to be the income of any other person.

(iv) Interest on the Bonds constitutes United Kingdom source income for United Kingdom tax purposes and, as such, remains subject to United Kingdom taxation by direct assessment even where paid without withholding or deduction. However, under Inland Revenue Extra Statutory Concession B13, the interest will not be assessed to United Kingdom taxation in the hands of Bondholders who are not resident in the United Kingdom (throughout the year of assessment in which they receive the relevant interest) except where such persons:

- (a) are chargeable under Section 78 of the Taxes Management Act 1970 in the name of a trustee or other person as defined in Section 72 of that Act, or in the name of an agent or branch in the United Kingdom having the management or control of the interest; or
- (b) seek to claim relief in respect of taxed income from United Kingdom sources (insofar as the tax on the interest can be recovered by set off against the claim); or
- (c) are chargeable to United Kingdom corporation tax on the income of a United Kingdom branch or agency to which the interest is attributable; or

- (d) are chargeable to United Kingdom income tax on the profits of a trade carried on in the United Kingdom to which the interest is attributable.

With effect from, generally, 6th April, 1996, legislation will come into effect which will, in broad terms, put the terms of Extra Statutory Concession B13 on a statutory basis. Under the new rules Bondholders who are not resident in the United Kingdom will only be liable to be taxed in respect of interest on the Bearer Bonds if the Bondholder has a UK representative in relation to the interest (or in the case of Registered Bonds, in relation to tax withheld). However, recent legislation contained in the Finance Act 1995 (which confirms the longstanding Inland Revenue practice described above) generally limits tax charged to tax, if any, deducted at source where the beneficial owner of such interest is not resident in the United Kingdom unless the interest is attributable to a branch or agency carrying on a trade in the United Kingdom.

(v) Bondholders should note that the provisions relating to additional amounts referred to in Section 11 — “Terms and Conditions of the Bonds — Taxation” above do not apply to payments of interest on Registered Bonds and would not apply if the Inland Revenue sought to assess the person entitled to the relevant interest paid on any Bonds directly to United Kingdom tax on income. However, exemption from or reduction of such United Kingdom tax liability might be available under the provisions of an applicable double taxation treaty. However, recent legislation contained in the Finance Act 1995 (which confirms the longstanding Inland Revenue practice described above) generally limits tax charged to tax, if any, deducted at source where the beneficial owner of such interest is not resident in the United Kingdom unless the interest is attributable to a branch or agency carrying on a trade in the United Kingdom.

(vi) The Bonds will constitute “qualifying corporate bonds” within the meaning of Section 117 of the Taxation of Chargeable Gains Act 1992. Accordingly, neither a chargeable gain nor an allowable loss will arise on a disposal of the Bonds for the purposes of United Kingdom taxation of chargeable gains. The United Kingdom government has published draft legislation in the Finance Bill 1996, containing proposals to reform the taxation of corporate debt (whether or not in the form of securities). If the legislation is enacted, the new regime will take effect for companies from 1st April, 1996. Under the proposals, in the case of corporate investors resident in the United Kingdom for tax purposes, all returns including fluctuations in value attributable to the Bonds, whether of a capital or income nature, will be taxed as income on an accruals or mark to market basis. Individual investors will be outside the scope of the new regime. Non-resident investors will be unaffected by the new rules unless they carry on a trade, profession or vocation in the United Kingdom through a United Kingdom branch or agency to which the Bonds are attributable. There will be transitional provisions to deal with United Kingdom Government Securities and debts which have been held before the start of the new regime.

(vii) A transfer of a Bond by a Bondholder who is resident or ordinarily resident in the United Kingdom or who carries on a trade in the United Kingdom through a branch or agency to which the Bonds are attributable may give rise to a charge to United Kingdom tax on income in respect of an amount representing interest on the Bond which has accrued since the preceding interest payment date under the accrued income scheme. If the draft legislation described in paragraph (vi) above is enacted charges to tax under the accrued income scheme will be replaced by charges under the new legislation.

(viii) No United Kingdom stamp duty or stamp duty reserve tax is payable on the issue of a Bond or on its transfer.

19. SUBSCRIPTION AND SALE

BZW has, pursuant to a Subscription Agreement dated 18th December, 1995, agreed with the Issuer and the Guarantors, subject to the satisfaction of certain conditions, to subscribe the Bonds at 100 per cent. of their principal amount less a combined management, underwriting and selling concession of $\frac{3}{8}$ per cent. of such principal amount. The Issuer will also pay to BZW a separate structuring fee. In addition, the Issuer has agreed to reimburse BZW for certain of its expenses in connection with the issue of the Bonds. The Subscription Agreement entitles BZW to terminate it in certain circumstances prior to payment being made to the Issuer.

The Bonds have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

The Bearer Bonds are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code and regulations thereunder.

BZW has agreed that, except as permitted by the Subscription Agreement, it will not offer, sell or deliver the Bonds, (i) as part of their distribution at any time or (ii) otherwise until 40 days after the later of the commencement of the offering and the Closing Date within the United States or to, or for the account or benefit of, U.S. persons, and it will have sent to each dealer to which it sells Bonds during the restricted period a confirmation or other notice setting forth the restrictions on offers and sales of the Bonds within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until 40 days after the commencement of the offering, an offer or sale of Bonds within the United States by a dealer that is not participating in the offering may violate the registration requirements of the Securities Act.

BZW has agreed that:

- (i) it has not offered or sold and will not offer or sell any Bonds to persons in the United Kingdom prior to admission of the Bonds to listing in accordance with Part IV of the Financial Services Act 1986 (the "Act") except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 or the Act;
- (ii) it has complied and will comply with all applicable provisions of the Act with respect to anything done by it in relation to the Bonds in, from or otherwise involving the United Kingdom; and
- (iii) it has only issued or passed on, and will only issue or pass on, in the United Kingdom any document received by it in connection with the issue of the Bonds, other than any document which consists of or any part of listing particulars, supplementary listing particulars or any other document required or permitted to be published by listing rules under Part IV of the Act, to a person who is of a kind described in Article 11(3) of the Financial Services Act 1986 (Investment Advertisements) (Exemptions) Order 1995 or is a person to whom the document may otherwise lawfully be issued or passed on.

20. GENERAL INFORMATION

1. The Bearer Bonds have been accepted for clearance through Cedel and Euroclear under a Common Code of 6299202. The International Securities Identification Number for the Bearer Bonds is XS0062992028. The Issuer's Registrars are Barclays Registrars, Bourne House, 34 Beckenham Road, Beckenham, Kent BR3 4TU.
2. The listing of the Bonds on the London Stock Exchange will be expressed as a percentage of their principal amount (exclusive of accrued interest). It is expected that listing of the Bonds on the London Stock Exchange will be granted on 12th January, 1996 subject only to the issue of the Temporary Global Bond and the Renounceable Letters of Allotment. Official dealings in the Bonds will commence on 18th January, 1996. Prior to official listing, however, dealings will be permitted by the London Stock Exchange in accordance with its rules. Transactions will normally be effected for settlement in sterling and for delivery on the third working day after the day of the transaction in respect of Bearer Bonds and for rolling seven day settlement through the Talisman system in respect of the Registered Bonds.
3. The Issuer and the Guarantors have obtained all necessary consents, approvals and authorisations in respect of the United Kingdom in connection with the issue and performance of the Bonds and the Guarantees. The issue of the Bonds was authorised by resolution of the Board of Directors of the Issuer passed on 18th December, 1995 and the giving of the Guarantees by the Guarantors was authorised by resolution of respective Boards of Directors of the Guarantors passed on 21st December (in respect of First Hydro) and 18th December, 1995 (in respect of First Hydro Holdings).
4. Except as disclosed in this document, there has been no significant change in the financial or trading position of the PSB or First Hydro since the last audited accounts for the six months ended 30th September, 1995 and no material adverse change in the financial position or prospects of First Hydro since 31st March, 1995. Except as disclosed in this document, there has been no significant change in the financial or trading position of the Issuer since its incorporation on 31st July, 1995 and First Hydro Holdings since its incorporation on 15th December, 1995 and no material adverse change in the financial position or prospects of the Issuer and First Hydro Holdings since their respective dates of incorporation.
5. Neither the Issuer nor the Guarantors nor any of their respective subsidiaries is involved in any litigation or arbitration proceedings which may have, or have had during the twelve months preceding the date of this document, a significant effect on the financial position of the Issuer, the Guarantors and their subsidiaries nor is the Issuer or the Guarantors aware that any such proceedings are pending or threatened.
6. The Bearer Bonds and Coupons will bear the following legend: "Any United States person who holds this obligation will be subject to limitations under the United States tax laws, including the limitations provided in Sections 165(j) and 1287(a) of the Internal Revenue Code".
7. Coopers & Lybrand, Merz and McLellan, ILEX, Brown & Root and Sedgwicks have each given and have not withdrawn their respective written consents to the inclusion in this document of the references to their names and, where appropriate, to their valuations and reports in the form and context in which they appear and have each authorised the contents of those parts of the listing particulars which comprise the references, their valuations and reports for the purposes of section 152(1)(e) of the Financial Services Act 1986.
8. Coopers & Lybrand have audited, and issued unqualified audit reports on, the regulatory accounts of NGC which included the accounts of the generation business of the PSB for the three years ended 31st March, 1995. Copies of the latest regulatory accounts of NGC which includes the generation business of the PSB and the audited accounts for the six months ended 30th September, 1995 of the PSB may be obtained, and copies of the Bond Trust Deed, the Security Documents and the Intercreditor Deed will be available for inspection so long as any of the Bonds is outstanding, at the specified offices of each of the Paying Agents during normal business hours. Neither the Issuer nor First Hydro Holdings has published interim accounts since its incorporation.
9. Copies of the following documents may be inspected at the offices of Milbank, Tweed, Hadley & McCloy during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted) for 14 days from the date of this document:
 - (i) the Memorandum and Articles of Association of each of the Issuer and the Guarantors;

- (ii) the audited regulatory annual accounts of NGC which included the generation business of the PSB for the three years ended 31st March, 1995, the audited accounts of the PSB for the six month period ended 30th September, 1995, the Accountants' Reports on the Issuer and the Guarantors and the statements of adjustments in respect of the regulatory and six month accounts;
- (iii) the Subscription Agreement, the Sale and Purchase Agreement, the Asset Acquisition Agreement, the Further Sale Agreement, the Deed of Warranty, the Property Clawback Debenture and the Reports on Title referred to above;
- (iv) drafts (subject to modification) of the Paying Agency Agreement, the Bond Trust Deed to constitute the Bonds, the form of the Temporary Global Bond, definitive Bonds and Coupons and final executed copies of the Intercreditor Deed and the Security Documents;
- (v) the Merz and McLellan technical report dated 15th December, 1995 and valuation report dated 15th December, 1995, the ILEX report dated December, 1995, the Environmental Report dated 16th December, 1995 and the Insurance Report dated 15th December, 1995;
- (vi) the Pooling and Settlement Agreement; and
- (vii) the written consents referred to in paragraph 7 above.

APPENDIX A
VALUATION CERTIFICATE FROM MERZ AND McLELLAN LIMITED

MERZ AND McLELLAN
CONSULTING ENGINEERS

FIRST HYDRO
VALUATION OF DINORWIG AND FFESTINIOG
PUMPED STORAGE SCHEMES

●
MERZ AND McLELLAN
CONSULTING ENGINEERS

A PARSONS BRINCKERHOFF COMPANY

First Hydro Limited
Bala House
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Deeside
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First Hydro Finance Plc
Lansdowne House
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First Hydro Holdings
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Berkeley Square
London
W1X 5DH

BZW
Ebbgate House
2 Swan Lane
London EC4R 3TS

The Directors
Prudential Trustee Company Limited
142 Holborn Bars
London EC1N 2NH

15th December, 1995

Dear Sirs

FIRST HYDRO

1. INTRODUCTION AND VALUATION SUMMARY

The Dinorwig and Ffestiniog pumped storage schemes are owned and operated by First Hydro Limited, formerly the Pumped Storage Business. Merz and McLellan were instructed by Barclays de Zoete Wedd, on behalf of Mission Energy Company, to prepare a valuation of First Hydro Limited on a depreciated capital cost basis.

The valuation was performed in association with Sir Alexander Gibb and Partners and Binnie, Black and Veach.

Facilities for data gathering were made available by First Hydro at the Dinorwig Control Centre and these were used by Engineers from Merz and McLellan and Sir Alexander Gibb and Partners from 27th November, 1995 to 29th November, 1995. Visits to each of the sites was made during this period in the company of First Hydro's civil engineer, Mr O. P. Williams.

This is the report of the valuation of the Dinorwig and Ffestiniog pumped storage schemes. The reference document for this report is the updated due diligence report on the Dinorwig and Ffestiniog schemes (Volumes I and II respectively), prepared in November 1995 by Merz and McLellan for the National Grid Holdings PLC (Ref 1).

The valuation of the assets at 1st December, 1995 is:

£499,100,000
(four hundred and ninety nine million
one hundred thousand pounds)

2. DESCRIPTION OF THE SCHEMES

2.1 General

Both schemes are located in North Wales, Dinorwig being some 3 km south-east of Llanberis and Ffestiniog some 3 km south-west of the town of Blaenau Ffestiniog.

The Dinorwig scheme utilises existing lakes as reservoirs, their usable storage capacity having been increased to $7 \times 10^6 \text{ m}^3$. On the upper side the existing Marchlyn Mawr reservoir was enlarged by the construction of a new rock-filled embankment dam with upstream asphalt membrane; the lower reservoir (Llyn Peris) was also enlarged by the construction of a 4 m high rock-filled embankment dam and isolated from the natural river flow by a bypass tunnel. A low pressure tunnel connects with a single high pressure tunnel system via a surge chamber; a manifold supplies water to six steel-lined penstocks leading to an underground cavern housing the six 300 MW reversible units. Three tailrace tunnels connect with the lower reservoir.

The Ffestiniog scheme's upper reservoir is created by a buttress-type dam, having twin intakes and tunnels leading to a portal. Buried penstocks lead to a surface-type power station which is adjacent to the lower reservoir. There is provision for three sets to be operated from one hydraulic system. The $4 \times 90 \text{ MW}$ sets each comprise Francis turbines coupled through intermediate shafts to four generators and four pumps situated directly above and below the turbines respectively. The Ffestiniog units were originally designed for a rating of 75 MW, however soon after entering service the units were uprated to 90 MW by replacing the generator stator bars and using more modern Class 'F' insulation. For the Ffestiniog scheme, the modern-day equivalent units would be of the reversible Francis type, similar to Dinorwig.

The main parameters and performance data of the schemes are as follows:

Scheme	Dinorwig	Ffestiniog
Number of units	6	4
Turbine rated head (m)	513	296
Output per unit (MW)	317	90
Pump rated discharge (m^3/s)	55.5	21
Pump rated head (m)	545	305
Pump input (MW)	283	70
Speed (r/min)	500	428

2.2 Operating histories

The months in which the Dinorwig units were commissioned are as follows:

Unit 3	December 1982
Unit 4	July 1983
Unit 2	November 1983
Unit 1	March 1984
Unit 6	June 1984
Unit 5	August 1984

For the purposes of the valuation we have taken the 'average' commencement of commercial operation to be December 1983.

The commencement of commercial operation for the Ffestiniog units has been taken as January 1963.

In relation to the criteria by which the sets were designed, the operational history of neither scheme is considered to have been unduly onerous. Comments on the overall condition, and some details of the operating histories of the schemes are documented in Ref 1.

3. VALUATION METHODOLOGY

3.1 Present day replacement costs

The present-day values (or "net book values") of the assets have been calculated from present-day costs of acquiring the modern equivalent assets ("gross book values"), adjusted for decreased usefulness caused by age, ie for depreciation.

An allowance of 5 per cent. is included in our estimates to cover Engineering. There is no allowance for costs associated with the purchase of land.

Interest during construction (IDC) for each scheme is shown separately in Figures 2 and 3. For Dinorwig the IDC is estimated at £57m and for Ffestiniog it is estimated at £9.8m. These estimates are based on an interest rate of 7.5 per cent., fees of 0.5 per cent. and an overall construction period of 7 years.

The bases of the estimates, for the civil works and plant, are as follows:

Civil works and dams. Since detailed principal quantities for the schemes were not available, the present day civil engineering costs have been developed by escalating original component costs. The appropriate Public Works Cost Indices for construction and civil engineering works, issued by the Department of Environment Construction Market Intelligence, have been applied. Original costs were sourced from Refs 2 and 3. The expected lives of the civil components of the schemes have been sourced from Ref 4, the lives in Table E1 being judged to give a reasonable estimate of the physical life of assets which have been well constructed and maintained, but not accounting for the possibility that their usefulness may be curtailed as the result of obsolescence.

Power station mechanical and electrical plant. The estimates of replacement capital costs for the main items of mechanical and electrical plant (pump-turbines, motor-generators and transformers) are based on budgetary prices from European manufactures and, for the remaining equipment, on recent international rendering experience and information from our own database.

Although the boundary of ownership of assets at the Dinorwig scheme is at the 400 kV isolator we have, at BZW's request, included a valuation of the 400 kV switchgear and grid cable connection. This is shown in Figure 2 for information.

3.2 Residual life connection

The adjustment of depreciation is often made by reducing the gross book value of an asset by the same proportion in each year of an estimated useful (or "economic" or "book") life which takes no account of the asset's condition. We have made the adjustment more strictly in accordance with principles of life-expectancy for assets, which follow those related to expectation of human life commonly used by insurance companies. On that basis, the adjustment depends on the probable residual life of the asset, which in turn depends on its present age and on its maximum possible service life, taking due account of its condition. For example, the "book" life of an asset may be 20 years, but under severe operating conditions, or with poor maintenance standards, its maximum life expectancy can be substantially lower.

When life expectancy is represented graphically, it is usually as a "survivor" curve in which for a given group of items (all of the same type) the number or percentage surviving at any time is plotted against the service age or life (present age plus probable residual life), and the probable life curve is derived from it. If an age scale is added to the vertical axis (percentage or number surviving), the zero is at the top and the maximum age at the bottom (since at age zero 100 per cent. of the items are "surviving" and at maximum age none are surviving). At age zero the probable life of an item is the average life for that group or type of asset.

A life-expectancy table, Figure 1, derived from a survivor curve which, from our experience of the valuation of electricity-supply undertakings elsewhere, is used to establish the probable residual life of an asset. If the asset is considered to be in significantly better-than-average or worse-than-average condition the residual life figure can be adjusted accordingly.

3.3 Residual values

At the end of its service life, an asset may still have a value, depending on whether:

- a. it is suitable for sale to another undertaking, or transfer to another part of the same undertaking — for example when it has become redundant because it has been superseded by larger plant;
- b. a significant proportion of its parts can be salvaged for re-use as spares on similar equipment still in service; or

- c. it contains materials, such as steel and copper, which can be sold for scrap — the scrap value of steel, particularly when recover costs are taken into consideration, is often insignificant; but the scrap value of copper, for example in electrical equipment, can be substantial, provided there is a market for it.

3.4 Present-day values

The present-day value of an individual asset or asset group is then calculated from:

- a. its present-day replacement cost,
- b. its residual value,
- c. its present age, and
- d. its probable residual life

assuming straight-line depreciation, as

$$v = \left[\frac{d}{c + d} (a - b) \right] + b$$

This system of valuation has been used on a number of similar projects which we have carried out for both UK and international clients.

The present-day values for the civil works and plant for the Dinorwig and Ffestiniog pumped storage schemes are summarised by category and shown in Figures 2 and 3 respectively.

4. VALUATION SUMMARY

As detailed in Figures 2 and 3 the present-day valuation of assets of First Hydro Limited at the Dinorwig and Ffestiniog pumped storage schemes at 1st December, 1995 is:

	(£)
Dinorwig:	466,500,000
Ffestiniog:	32,600,000
Total:	499,100,000

Yours faithfully

Merz and McLellan

Figure 1
Life expectancy table

Completed age of asset at date of valuation (% max life)	Probable life of asset (% max life)	Probable residual life of asset (% max life)
0.0	65.325	65.5
2.5	65.328	63
5.0	65.332	60.5
7.5	65.339	58
10.0	65.349	55.5
12.5	65.366	53
15.0	65.391	50.5
17.5	65.427	48
20.0	65.474	45.5
22.5	65.541	43
25.0	65.636	40.5
27.5	65.758	38.5
30.0	65.910	36
32.5	66.101	33.5
35.0	66.355	31.5
37.5	66.660	29
40.0	67.018	27
42.5	67.430	25
45.0	67.939	23
47.5	68.516	21
50.0	69.155	19
52.5	69.853	17.5
55.0	70.637	15.5
57.5	71.506	14
60.0	72.471	12.5
62.5	73.549	11.5
65.0	74.797	10
67.5	76.209	9
70.0	77.734	8.5
72.5	79.377	7.5
75.0	81.137	6
77.5	82.895	5.5
80.0	84.692	4.5
82.5	86.556	4
85.0	88.556	3.5
87.5	90.433	3
90.0	92.314	2.5
92.5	94.280	2
95.0	96.693	1.5
97.5	98.750	1
100.0	100.000	0

Figure 2
Summary of present day values — Dinorwig Scheme

Item	Maximum possible life (years)	Present day replacement cost (£) _a	Residual value (£) _b	Present age (years) _c	Residual life (years) _d	Present day value (£) _v
1. Pump-turbines, valves and cranes	40	57,600,000	0	12	14.4	31,400,000
2. Motor-generators and starting equipment	40	70,900,000	0	12	14.4	38,700,000
3. 18 kV equipment and motor-generator transformers	40	22,000,000	0	12	14.4	11,900,000
4. Auxiliary electrical equipment	40	12,500,000	0	12	14.4	6,800,000
5. Preliminary civil works	100	24,000,000	0	15	50.5	18,500,000
6. Marchlyn dam	100	37,800,000	0	15	50.5	29,100,000
7. Underground power station, tunnels and shafts	100	414,600,000	0	15	50.5	319,900,000
8. Access roads	60	14,200,000	0	15	24.3	8,800,000
9. Offices	40	3,400,000	0	15	11.6	1,400,000
Total	—	657,000,000	0	—	—	466,500,000
400 kV transmission and switchgear	40	69,000,000	0		14.4	37,400,000
Total		726,000,000				502,900,000
Interest during construction	£57,000,000					

The residual lives shown above are not a reflection of the remaining useful operational lives of the relevant assets and are used for the purposes of this valuation only. Merz and McLellan believe that given an appropriate maintenance programme, the overall useful operational life of the Dinorwig/Ffestiniog facility should be capable of being extended by 25 years.

Figure 3
Summary of present day values — Ffestiniog Scheme

Item	Maximum possible life (years)	Present day replacement cost (£) a	Residual value (£) b	Present age (years) c	Residual life (years) d	Present day value (£) v
1. Pump-turbines, valves and cranes	40	16,100,000	0	33	1.6	700,000
2. Motor-generators and starting equipment	40	23,900,000	0	33	1.6	1,100,000
3. 16 kV equipment and motor-generator transformers	40	4,000,000	0	33	1.6	200,000
4. Auxiliary electrical equipment	40	2,800,000	0	33	1.6	100,000
5. Stwlan dam and intakes	100	10,300,000	0	35	31.5	4,900,000
6. Tan-y-Grisiau dam	100	6,500,000	0	35	31.5	1,000,000
7. Penstocks	60	5,600,000	0	35	7.8	1,000,000
8. Power station, tunnels and shafts	100	43,900,000	0	35	31.5	20,800,000
9. Access roads	60	3,700,000	0	35	7.8	700,000
Total	—	116,800,000	—	—	—	32,600,000
Interest during construction	£9,800,000					

The residual lives shown above are not a reflection of the remaining useful operational lives of the relevant assets and are used for the purposes of this valuation only. Merz and McLellan believe that given an appropriate maintenance programme, the overall useful operational life of the Dinorwig/Ffestiniog facility should be capable of being extended to 25 years.

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