SLAUGHTER AND MAY

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FAX TRANSMISSION

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Horizon - Termination Options

Further to your fax of yesterday and as discussed this morning, I have had a quick look at the provisions in the Related Agreements (as amended by the Letter Agreement of 24th May, 1999) regarding termination for convenience and set out my comments below.

Summary

1. Under the Related Agreements, POCL may terminate the Authorities Agreement and the POCL Agreement on not less than 12 months' notice. On termination, POCL is obliged to pay to Pathway an amount although the method of calculation of that amount and the extent to which that amount is capped is unclear. Termination by POCL with a shorter notice period would expose POCL to a damages claim from Pathway for the amounts that would have been payable by POCL to Pathway had 12 months' notice been given.

Authorities Agreement

2. Under Clause 902.6 of the Authorities Agreement, POCL may terminate the Authorities Agreement on not less than 12 months' notice. On such termination, POCL is obliged to pay to Pathway the Termination Charge as calculated in accordance with Schedule A9 of the Authorities Agreement. As that schedule has been left blank intentionally and the definition of Termination Charge in respect of the Authorities Agreement refers only to Schedule A9 of that agreement, I do not believe that any amount is payable in these circumstances.

POCL Agreement

3. Under Clause 902.6 of the POCL Agreement, as with the Authorities Agreement, POCL may terminate the POCL Agreement on not less than 12 months' notice. Again, on such termination, POCL is liable to Pathway for the Termination Charge although this time, that charge is to be calculated in accordance with Schedule A7 of the POCL Agreement.

Schedule A7 of the POCL Agreement

4. It is not entirely clear to what extent, if any, Schedule A7 of the POCL Agreement (paragraph 5 attached) has been amended by the Letter Agreement, particularly, in light of the payments that are to be made under Schedule 2 of the Letter Agreement.

5. In brief, the Termination Charge equals (i) sunk costs (less amounts recovered under the Scorecard) plus (ii) costs flowing from termination plus (iii) 15% of expected Scorecard based revenues less (iv) 80% of the payment made on the acquisition of the project assets.

6. With regard to Pathway's costs under paragraph 5.1(a) of Schedule A7, on a literal view, there would be no netting off of costs recovered after 24th May, 1999 as there is arguably no longer any Scorecard. On the other hand, it would make sense to reduce those costs by the amounts paid to Pathway pursuant to Schedule 2 of the Letter Agreement which sets out the new charging arrangements. A wider question is whether Pathway's sunk costs should be reduced by the amount written off in ICL's accounts given that ICL had to bear some of the financial costs as part of the new deal.

7. With regards to the profit allowance under paragraph 5.1(c) of Schedule A7, again, a literal approach would result in the expected profit being nil if there is no Scorecard anymore. Alternatively, it could be argued that a profit allowance based on the new deal should be included. However, I am not sure whether simply taking 15% of the Schedule 2 payments would necessarily reflect the underlying profit assumptions of that schedule, if that is what the parties wish to do.

8. The deduction for the asset purchase price at first glance is only 80 pence. It might, however, be possible to argue that a proportion of the Schedule 2 payments should be apportioned to the asset price.

9. Although there are caps on the Termination Charge, it is arguable whether they are still valid in light of the new pricing regime and the method of calculating the Termination Charge. If the caps were to remain as they are, then based on a

termination for convenience notice being sent before February 2000, the cap on the Termination Charge would be £141 million.

I hope the above is of some assistance. Please feel free to call to discuss.

Regards,

GRO

Paul Lam-Po-Tang

attach.

transfer of the services shall be separately reimbursable in accordance with Clause 904.2.3.

4.5. Expected Transfer Price

The expected values at year end consistent with the formulae set out in Paragraph 4.4, assuming that all assets are transferred, are as follows:

Transfer during Roll-out

Year End	Transfer Price £millions
February 1997	4.0
February 1998	48.0
February 1999	84.0
February 2000	62.0

Transfer during Steady State

Year End	Transfer Price £millions
February 2000	86.0
February 2001	65.0
February 2002	51.0
February 2003	36.0
February 2004	31.0
February 2005	36.0

5. TERMINATION CHARGE

5.1. Where a Termination Charge is payable to the CONTRACTOR, such payment shall include:

a) all costs (whether already incurred or committed and unavoidable) which have not yet been recovered via the Scorecard-based charges; plus

b) all costs associated with the termination or transfer of the service, including but not limited to the closure of the CONTRACTOR's facilities and termination of its personnel, plus any termination charges payable to suppliers and sub-contractors (the CONTRACTOR being required to mitigate such exposure); plus

c) an allowance for lost profit, equal to 15% of expected future Scorecard-based revenues assuming the Workload brief Mid-line business volumes; minus

d) 80% of any Transfer Payment paid.

All costs shall be determined in accordance with the CONTRACTOR's standard accounting practice, supported by proper vouchers and records and verified by the CONTRACTOR's auditors.

5.2. Expected Termination Charges

The Termination Charge calculated in accordance with paragraph 5.1 of this Schedule for each year up to the year end listed below shall not exceed:

Year End	£m
February 1998	198
February 1999	245
February 2000	205
February 2001	141
February 2002	80
February 2003	36
February 2004	18

Termination Charges assume that one year's notice has been given prior to the date identified against each figure.

The values exclude any netting allowance for Transfer Payment.

In the event that any one POCL Service is terminated the Termination Charge for such POCL Service shall not exceed an appropriate proportion of the figures listed above.