

Directors' remuneration report

In this report, which will be submitted for approval at the Annual General Meeting on 30 July 2009, we describe how the executive directors are remunerated. Those parts of the Remuneration Report which are subject to audit by Ernst & Young are marked 'audited'.

The Remuneration Committee

The role of the Remuneration Committee

The Remuneration Committee of the Board (the Committee) determines the remuneration and terms of employment of the Chairman of the Company, executive directors of NWG and NWL and a further seven senior managers, in accordance with a remuneration policy approved by the Board. The terms of reference for the Committee are published on our website at www.nwg.co.uk (in the 'about us: corporate governance' section) or a copy can be requested from the Company Secretary.

The Committee is always available to engage with major shareholders and their representatives to discuss remuneration matters, although no such approaches were received in 2008/09.

Remuneration Committee members

The Committee members are Martin Nègre (Chairman), Sir Patrick Brown, Alex Scott-Barrett, who are all considered by the Company to be independent, and Sir Derek Wanless. The membership of the Committee was, therefore, compliant with the Combined Code throughout the year. Martin Parker, the Company Secretary, is secretary to the Committee.

External advice

The Committee continued to receive advice during the year from Hewitt New Bridge Street (HNBS) and also from the Managing Director (although never about his own remuneration). HNBS was paid £15,825 for these services in 2008/09 and continues to assist the Committee in maintaining best practice in relation to remuneration. HNBS does not provide any other service to the Company.

The Committee's work in 2008/09

The Committee met three times during the year with 100% attendance by all members, except Sir Derek Wanless who attended two meetings, to:

- agree bonus payments for 2007/08;
- agree salaries for 2009/10;
- determine the vesting percentage to be applied to the LTIP awards made on 9 December 2005, which vested on 9 December 2008;
- grant LTIP awards on 15 December 2008 (to vest on 15 December 2011); and
- set performance targets for executive directors and senior managers.

As the Committee works closely with NWL's remuneration committee, Committee papers and minutes are circulated to all NWL and NWG non-executive directors, who can give their views direct to the Committee Chairman and can attend meetings if they wish.

Remuneration policy

The Committee considers the principles and provisions of the Combined Code when setting its policy and believes it is fully compliant. The policy of the Company, which applied throughout 2008/09 and applies for 2009/10 and subsequent financial years, is to provide remuneration that is sufficient to attract, retain and motivate directors of the quality required to run the Company successfully, while paying fairly. Although HNBS provides the Committee with detailed comparative data on other companies in the sector, the Committee is aware of, and avoids the risk of, remuneration being ratcheted up as a result of benchmarking exercises.

Consistent with its fair pay policy, when considering the remuneration packages of senior executives and directors, the Committee takes into account pay awards to other employees in the Group. The Committee also considers environmental, social, risk management and governance issues when setting remuneration terms.

The remuneration policy of the Committee is:

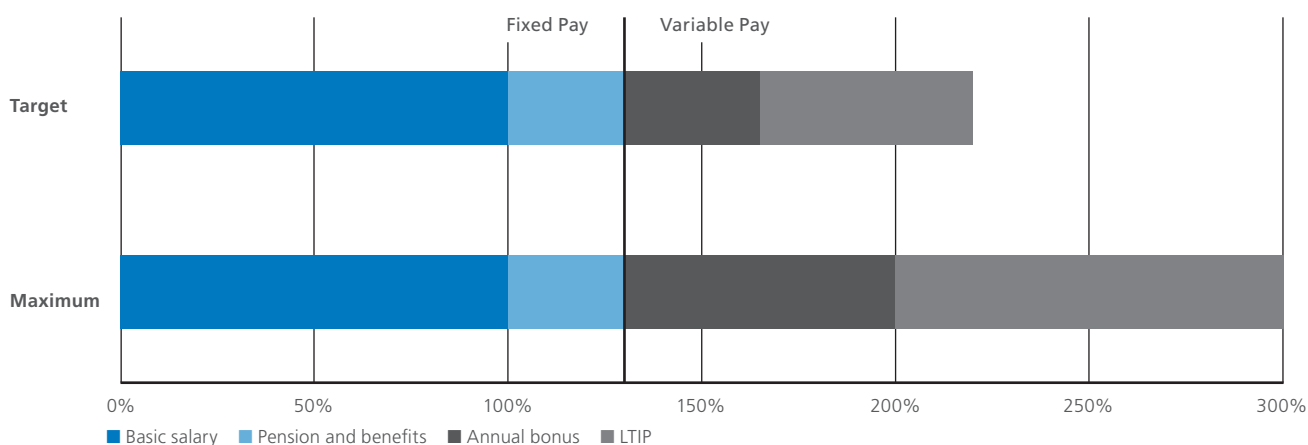
- that the setting of base salaries is largely influenced by individual contributions and internal relativities rather than external comparators (although for 2009/10 the Committee has been influenced by general economic conditions);
- that the annual bonus plan recognises the interests of all of the Company's stakeholders (shareholders, customers and employees) rather than being focused solely on profit; and
- that management shares in the longer term value created for the Company's investors, but equity incentive schemes should only reward if there is clear outperformance of the market and other relevant companies.

Elements of remuneration

The remuneration of the executive directors comprises:

- basic salary;
- benefits (including pension and participation in the Company's SIP);
- a performance related annual bonus; and
- annual LTIP awards.

In addition to reviewing each constituent element, the Committee reviews the remuneration packages as a whole to ensure that they remain appropriate in terms of structure, gearing and quantum. The chart below shows the composition of the Managing Director's remuneration (as a percentage of basic salary) both at 'target' and 'maximum' levels of performance. Maximum performance assumes the achievement of maximum bonus and full vesting of LTIP awards.



Basic salary and benefits

Basic salary is reviewed annually based on individual contributions and internal relativities. The Committee also has regard to market practice in other quoted water companies and similar sized companies more generally.

Current basic salaries, together with the previous year's salaries, are set out below:

	As at 1.4.2009	As at 1.4.2008
John Cuthbert	£295,000	£295,000
Chris Green	£225,000	£225,000

The basic salaries of the executive directors have not been increased for 2009/10 in recognition of the fact that RPI at the date of the review was zero. All other employees have been awarded a 3% increase (in line with the November 2008 RPI) in basic pay for 2009/10.

Benefits provided to the executive directors comprise membership of a defined benefit pension scheme, car allowance and healthcare.

Directors' remuneration report continued

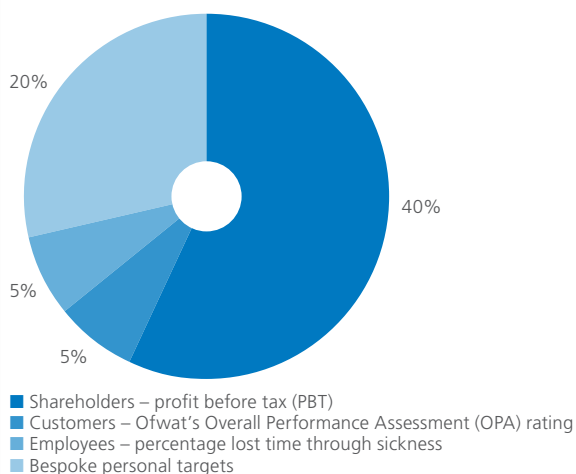
Pensions

The main features of the Northumbrian Water Pension Scheme are set out in note 25 to the financial statements. Basic salary is the only pensionable element of the executive directors' remuneration packages.

The executive directors' pensions were modified with effect from 1 January 2008, in line with the changes proposed for the pension scheme as a whole, and the executive pension arrangements were closed to new entrants on that date. The accrued defined benefit pensions and corresponding transfer values for the executive directors are set out in Table 5 on page 62.

Annual bonus

The annual bonus plan has been designed to reflect the interests of all of the Company's stakeholders. Consistent with prior years, maximum annual bonus potential for the executive directors for 2009/10 is 70% of salary, which is apportioned as follows:



Actual performance against the 2008/09 targets was as follows:

Bonus metric	Max bonus (% of salary)	John Cuthbert Actual bonus (% of salary)	Chris Green Actual bonus (% of salary)
PBT	40	–	–
OPA rating	5	1.0	1.0
Percentage lost time through sickness	5	1.5	1.5
Bespoke personal targets	20	15.0	15.0
Total	70	17.5	17.5
		£51,625	£39,375

Notes:

- The PBT bonus is based on actual PBT performance compared to the budget PBT set by the Board at the beginning of the year. PBT has been chosen because it is a primary financial measure for the Company, for which the executive directors are accountable. In 2008/09, PBT was below budget.
- NWL's estimated OPA score for 2008/09 is 356, against a range for bonus purposes of 341 to 419, being the published range of performance across the ten water and sewerage companies in 2007/08. NWL's score was adversely affected by sewer flooding.
- The year end percentage of time lost through sickness was 2.94%, against a range for bonus purposes of 2.6% to 3.1%.
- In 2008/09, John Cuthbert's personal targets related principally to managing the PR09 process, maintaining key financial ratios and measures, ensuring that good relationships are maintained with major investors and analysts, implementing the agreed approach to succession planning, ensuring that investment needs are properly quantified and the investment programme is delivered with regulatory outputs met and identifying further opportunities to impact the cost base of NWL and improve its efficiency ranking. Chris Green's personal targets were focused mainly on managing the PR09 process, maintaining key financial ratios and measures, relationships with major investors and analysts, positioning NWL to respond to Ofwat's proposals on accounting separation, ensuring that investment needs are properly quantified and the investment programme is delivered with regulatory outputs met and identifying further opportunities to impact the cost base of NWL and improve its efficiency ranking.
- The Remuneration Committee has decided that, in respect of the bonus for 2009/10 and beyond, the calculation of PBT performance will be adjusted to exclude the impact of any variance between the actual and budget interest charge on index linked bonds issued by Northumbrian Water Finance plc, which depends entirely on RPI in July of each year and is, therefore, outside of management control.

LTIP

Under the LTIP, executive directors and senior managers may receive, at the discretion of the Remuneration Committee, annual conditional awards of shares in the Company worth up to 100% of annual salary at grant, although only the executive directors participate at this level. All awards have three year pre-vesting performance conditions. These are described in detail below but, in summary, the current policy is for half of an award to be subject to relative total shareholder return (TSR) performance against the FTSE 250 (excluding investment trusts) and the other half to be subject to a relative return on capital target as monitored by Ofwat.

The Committee, with advice from HNBS, has reviewed the LTIP and is still of the view that it remains the most appropriate equity incentive plan, particularly in the light of the Company's dividend policy.

TSR remains an appropriate performance measure because it ensures that executives are rewarded fairly for value created for the Company's investors. Relative return on capital employed was chosen as a complementary measure because:

- it directly compares NWL's financial performance against that of its peers;
- it is objectively measured and verified by a third party (Ofwat);
- there is no subjectivity in determining what level of return would be a good and excellent result (it being a relative measure to which quartile analysis is applied); and
- the comparative approach should be able to deal with the five year pricing reviews without the Remuneration Committee having to reset targets.

On 15 December 2008, the Remuneration Committee granted the following LTIP awards:

	Number of conditional awards granted	Face value of awards granted as a % of salary [†]
John Cuthbert	103,100	88%
Chris Green	78,650	88%

[†] Based on a closing share price on 15 December 2008 of 251.5 pence.

For the awards set out above, the three years to be reviewed are 2008/09, 2009/10 and 2010/11. Over the three year performance period, the return on capital employed will be calculated on a compounded annualised return basis.

In addition, awards will only vest if the Committee is satisfied that the Company's TSR performance is consistent with the underlying business performance of the Company. An independent firm is engaged by the Committee to calculate the TSRs and to assess the extent to which the performance conditions have been met, so that the process is rigorous and transparent.

In the event of a change of control, the Committee would determine the extent to which the performance conditions had been met and the proportion of the performance period that had elapsed in deciding whether or not any vesting of awards would take place.

The LTIP award, granted on 9 December 2005, became available to vest on 9 December 2008. The Committee instructed PricewaterhouseCoopers (PwC) to assess the level of vesting of this award. PwC reported that 29.7% of the award was available to vest (being 99% of the award relating to the Company's TSR performance against the FTSE 250 Index and 0% of the award relating to the Company's TSR performance against the other listed water companies). Prior to vesting, the Committee satisfied itself that the recorded TSR performance was a genuine reflection of the Company's underlying performance. Details of the number of awards which lapsed and those which were exercised by the directors of the Company are shown in Table 3 on page 61.

Full details of award levels and performance conditions are shown in Table 2 on pages 60 and 61.

Responsible investment

The Committee is aware of Guideline 3.2 of the ABI Guidelines on Responsible Investment Disclosure and is satisfied that neither the executive directors' annual bonus targets nor the LTIP performance conditions are likely, inadvertently, to motivate irresponsible behaviour.

Directors' remuneration report continued

Non-executive directors' fees

The Company's remuneration policy is that the Chairman and the non-executive directors should receive a fixed fee for their normal duties. Reflecting the added responsibilities and time commitment, chairing the Remuneration and Audit Committees attracts an additional fee over the non-executive directors' standard base fee.

Fees payable during 2008/09 and the Company's policy from 1 April 2009 (in line with the approach taken in respect of the salaries of the NWG executive directors) are:

	2008/09 £	2009/10 £
Chairman	157,500	157,500
Non-executive director base fee	36,750	36,750
Audit Committee chairing fee	10,500	10,500
Remuneration Committee chairing fee	5,250	5,250

The Chairman and the non-executive directors do not receive benefits in kind and do not participate in bonus, pension or share schemes operated by the Company. Further details of non-executive directors' remuneration are set out in Table 1 on page 60.

Directors' interests in LTIP awards

The directors' conditional interests in the ordinary 10 pence shares of the Company, awarded in accordance with the terms of the LTIP as at 31 March 2009, are set out in Table 3 on page 61.

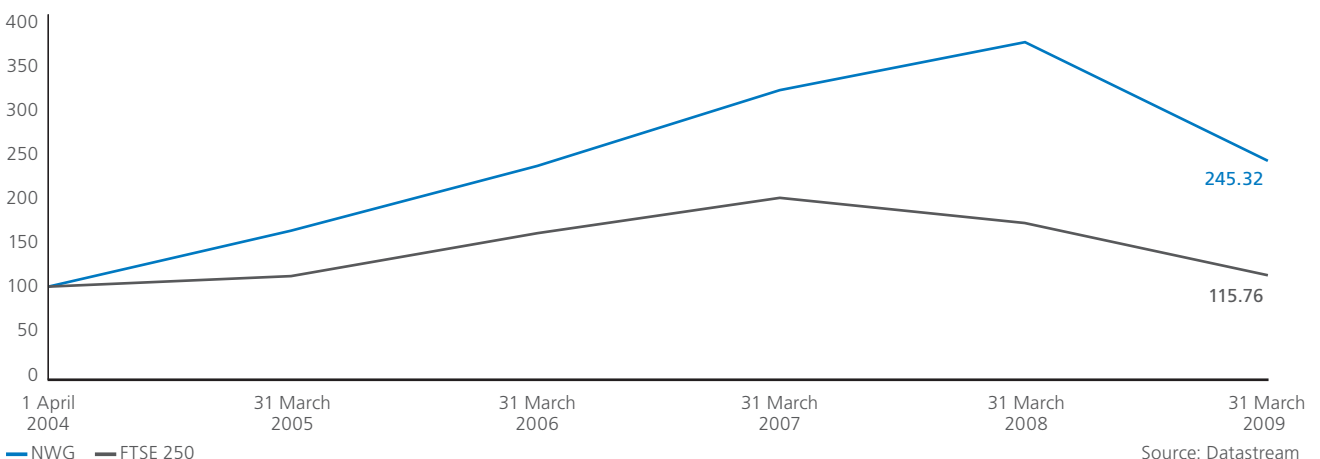
Ordinary 10 pence shares required to fulfil LTIP awards which have vested may be provided by the Northumbrian Water Group plc Employee Trust, through Northumbrian Water Share Scheme Trustees Limited. The Trustees are Sir Patrick Brown, Martin Nègre and Anita Frew (a non-executive director of NWL). At 31 March 2009, the Trust held a total of 1,038,252 ordinary 10 pence shares. This represents 0.2% of the Company's total issued share capital, so is materially less than the 5% limit on shares that can be held in trust. In line with the ABI Guidelines, dividends are waived on these shares and the voting rights attached to these shares will not be exercised at the AGM.

Share dilution

The Company's share plans contain dilution limits that comply with the ABI Guidelines. Shares for both the LTIP and SIP schemes are provided by purchase on the market. There has, therefore, been no dilution to date and there is no commitment to issue new shares in relation to either scheme.

Performance graph

The graph below shows a comparison between the TSR for the Company's shares for the five year period to 31 March 2009, and the TSR for the companies comprising the FTSE 250 Index (excluding investment trusts) over the same period. This index has been selected as the Company is a constituent of the FTSE 250.



Note:

This graph shows the value, by 31 March 2009, of £100 invested in Northumbrian Water Group plc on 1 April 2004 compared with the value of £100 invested in the FTSE 250 Index (excluding investment trusts) over the same period.

Service contracts

All non-executive directors are appointed for a term of 12 months with a six month notice period for the Company and the director. The executive directors have service contracts with 12 months' notice periods and which expire when the directors reach normal retirement age. Details of the contracts of the executive and non-executive directors who served during the year are shown in Table 4 on page 62.

Terms and conditions of appointment of non-executive directors are available for inspection at the Company's registered office during normal business hours and at the AGM. The terms of appointment set out the expected time commitment for each non-executive director.

External appointments of executive directors

The Board's position on external appointments is described in the corporate governance report on page 50. To date, no fees for external appointments have been retained by executive directors.

Directors' interests in shares

The directors' beneficial interests in the ordinary 10 pence shares of the Company, as at 31 March 2009, are set out in Table 6 on page 63.

Directors' interests in shares under the SIP

The Company SIP is open to UK employees with more than three months service. Further details of the SIP are set out in the directors' report and business review on page 17. During the year, the executive directors had the opportunity to participate in the SIP and their interests in the ordinary 10 pence shares of the Company, purchased and held in accordance with the terms of the SIP, are set out in Table 7 on page 63.

This directors' remuneration report, which has been produced in accordance with Schedule 7A of the Companies Act 1985, as introduced by the Directors' Remuneration Report Regulations 2002, was approved by the Board and signed on its behalf by the Chairman of the Remuneration Committee. It will be put to the shareholders for approval at the Company's AGM.

Martin Nègre

Chairman of Remuneration Committee

2 June 2009

Directors' remuneration report continued

These tables form the part of the directors' remuneration report which are audited (except for Tables 2 and 4 which do not require auditing).

Table 1
Directors' emoluments (audited)

The emoluments of the directors of the Company for their services as directors of the Company and (where relevant) its subsidiaries, are set out below, rounded to the nearest thousand pounds:

	Fees £000	Basic salary £000	Benefits ¹ £000	Bonus ² £000	Total for the year ended 31.3.2009 £000	Total for the year ended 31.3.2008 £000
Executive Directors						
John Cuthbert	–	295	8	52	355	403
Chris Green	–	225	9	39	273	317
Non-executive Directors						
Sir Derek Wanless	158	–	–	–	158	150
Sir Patrick Brown ³	47	–	–	–	47	45
Claude Lamoureux ⁴	37	–	–	–	37	35
Martin Nègre ⁵	42	–	–	–	42	40
Alex Scott-Barrett	37	–	–	–	37	35
Jenny Williams	37	–	–	–	37	35
Total remuneration	358	520	17	91	986	1,060

Notes:

1. The remuneration of each executive director includes non-cash benefits comprising the provision of car allowances and healthcare.
2. The annual bonus is payable in June 2009, for performance during the year ended 31 March 2009.
3. Includes additional fee paid as Chairman of Audit Committee.
4. Up until 15 February 2008, fee was payable to OTPP.
5. Includes additional fee paid as Chairman of Remuneration Committee.

Table 2
Summary of LTIP performance conditions (unaudited)

LTIP award made 9 December 2005

Maximum award	75% of salary permitted. Actual grants to executive directors related to shares worth 70% of salary.
Performance conditions	<p>Comparison of TSR with two comparator groups over three years:</p> <p>(1) 70% of award depends on the Company's TSR performance against other listed water companies: AWG plc, Bristol Water Group plc, East Surrey Holdings plc, Kelda Group plc, Pennon Group plc, Severn Trent plc and United Utilities plc; and</p> <p>(2) 30% of award depends on the Company's TSR performance against the FTSE 250 Index, excluding investment trusts.</p> <p>East Surrey Holdings plc de-listed on 28 October 2005, Bristol Water Group plc de-listed on 18 May 2006, AWG plc de-listed on 21 December 2006 and Kelda Group de-listed on 12 February 2008. These companies have been left in the comparator group for the purpose of the awards and their performance was frozen on the date each company de-listed. This means that a constant TSR has been applied at each date after the de-listing.</p>
Vesting schedules	<p>(1) 30% vests at median performance and 100% if the Company tops the group. Between median and upper quartile, the vesting will be calculated on a straight line basis comparing the Company's TSR to that of the median and upper quartile positions. Where the Company's TSR performance is below the median, none of that element of the award will vest.</p> <p>(2) 30% vests at median performance with straight line pro-rating of TSR performance against the members of the FTSE 250 Index, excluding investment trusts, to 100% for upper quartile performance. Where the Company's TSR performance is below the median, none of that element of the award will vest.</p>

Table 2 continued**LTIP award made 21 December 2006**

Maximum award	75% of salary permitted. Actual grants to executive directors related to shares worth 70% of salary.
Performance conditions	(1) 50% of award depends on NWL's return on capital employed relative to that of the other water and sewerage companies of England and Wales. (2) 50% of award depends on the Company's TSR performance against the FTSE 250 Index, excluding investment trusts.
Vesting schedules	(1) 30% vests at median performance. At upper quartile or above, all of that half of the award will vest. Between median and upper quartile, straight line pro-rating will apply. Where the return on capital employed performance is below the median, none of this element of the award will vest. (2) 30% vests at median performance with straight line pro-rating of TSR performance against the members of the FTSE 250 Index, excluding investment trusts, to 100% for upper quartile performance. Where the Company's TSR performance is below the median, none of this element of the award will vest.

LTIP award made 13 December 2007 and future awards

Maximum award	100% of salary permitted and actual grants to executive directors related to shares worth 100% of salary.
Performance conditions and vesting schedules	As per LTIP award made 21 December 2006.

Table 3**Directors' interests in LTIP awards (audited)**

As at 31 March 2009, the directors had the following conditional interests in the ordinary 10 pence shares of the Company, awarded in accordance with the terms of the LTIP:

	Award date	Awards held at the start of the year	Awards awarded during the year	Awards lapsed during the year	Awards vested during the year	Awards held as at 31.3.2009 ¹
John Cuthbert	9.12.2005 ²	75,903	–	53,359	22,544 ³	–
	21.12.2006 ⁴	66,721	–	–	–	66,721
	13.12.2007 ⁵	79,230	–	–	–	79,230
	15.12.2008 ⁶	–	103,100	–	–	103,100
Totals		221,854	103,100	53,359	22,544	249,051
Chris Green	9.12.2005 ²	50,602	–	35,573	15,029 ³	–
	21.12.2006 ⁴	49,423	–	–	–	49,423
	13.12.2007 ⁵	61,620	–	–	–	61,620
	15.12.2008 ⁶	–	78,650	–	–	78,650
Totals		161,645	78,650	35,573	15,029	189,693

Notes:

- There have been no changes to any of the above interests in awards under the LTIP from the end of the year to 2 June 2009.
- The market value of the shares on the date of the award was 252.00 pence per share. The three year performance period ran from 1 October 2005 to 30 September 2008.
- Shares vested on 9 December 2008 and the closing price on that date was 245.75 pence per share.
- The market value of the shares on the date of the award was 302.75 pence per share. The three year performance period runs from 1 October 2006 to 30 September 2009.
- The market value of the shares on the date of the award was 334.00 pence per share. The three year performance period runs from 1 October 2007 to 30 September 2010.
- The market value of the shares on the date of the award was 251.50 pence per share. The three year performance period runs from 1 October 2008 to 30 September 2011.
- The cost of conditional awards is charged to the income statement over the three year performance period to which they relate after taking account of the probability of performance criteria being met. In the year, £0.5 million was charged to the income statement (2008: £0.5 million).
- Details of the performance conditions are shown at Table 2 on pages 60 and 61.
- The market price of the shares on 31 March 2009 was 218.25 pence per share. During the year, the highest market price was 352.31 pence per share and the lowest market price was 206.75 pence per share.
- Aggregate gross gains made by directors on exercise of awards at date of vesting was £92,336 (2008: £277,516).

Directors' remuneration report continued

Table 4
Directors' service contracts (unaudited)

Details of the contracts of the directors who served during the year are shown below:

	Initial appointment	Current contract start date	Unexpired term ¹	Notice period by either party	Current contract end date
Executive Directors²					
John Cuthbert	23.5.2003	23.5.2003	Not fixed term	12 months	Normal retirement age (65)
Chris Green	23.5.2003	23.5.2003	Not fixed term	12 months	Normal retirement age (65)
Non-executive Directors³					
Sir Derek Wanless	1.12.2003	1.12.2008	6 months	6 months	30.11.2009
Sir Patrick Brown	12.5.2003	12.5.2009	11 months	6 months	11.5.2010
Martin Nègre	12.5.2003	12.5.2009	11 months	6 months	11.5.2010
Alex Scott-Barrett	26.9.2006	26.9.2008	4 months	6 months	25.9.2009
Claude Lamoureux	1.12.2006	1.12.2008	6 months	6 months	30.11.2009
Jenny Williams	27.5.2004	27.5.2009	12 months	6 months	26.5.2010

Notes:

1. Calculated as at 2 June 2009 and rounded to nearest whole month.
2. The service contracts of the executive directors do not contain provisions relating to compensation for termination. In the event of termination by the Company, the Remuneration Committee would make recommendations to the Board on what payments, if any, should be made to the director, depending on the circumstances of the termination, taking into account the Combined Code which discourages payment for failure. The Company would also expect directors to seek to mitigate their loss.
3. Contracts do not provide for compensation for loss of office in excess of fees accrued.

Table 5
Directors' pensions and pension benefits (audited)

The accrued defined benefit pensions and corresponding transfer values for the executive directors are set out below:

	Accrued pension at 31.3.2008 £000	Accrued pension at 31.3.2009 £000	Increase in accrued pension £000	Increase in accrued pension net of inflation £000	Transfer value of net increase in accrued pension less directors' contributions £000	Transfer value of accrued pension at 1.4.2008 £000	Transfer value of accrued pension at 31.3.2009 £000	Total change in transfer value less directors' contributions £000
John Cuthbert	141.7	163.4	21.7	22.3	327.9	2,503.1	3,119.0	615.9
Chris Green	88.0	99.3	11.3	11.6	189.3	1,492.1	1,838.4	346.3

Notes:

1. Accrued pensions shown are the amounts that would be paid annually at the normal retirement age based on service to the end of the year.
2. Voluntary contributions paid by the directors and resulting benefits are not shown.
3. The change in transfer value reflects fluctuations in the transfer value due to factors beyond the control of the Company and directors, such as changes in stock market conditions.
4. The transfer values have been calculated in line with the relevant legislation and using actuarial assumptions agreed by the Trustee.
5. The directors participate in a salary sacrifice arrangement and, therefore, paid no contributions to the scheme during the year.

Table 6
Directors' interests in shares (audited)

The directors had the following beneficial or family interests in the ordinary 10 pence shares of the Company as at 31 March 2009:

	Number of shares held at the start of the year	Number of shares held as at 31.3.2009	Number of shares held as at 2.6.2009
Sir Patrick Brown	43,000	43,000	43,000
John Cuthbert	163,892 ¹	232,436²	232,436
Chris Green	107,865 ³	152,894⁴	152,894
Claude Lamoureux	–	25,000	25,000
Martin Nègre	70,000	70,000	70,000
Alex Scott-Barrett	10,000	10,000	10,000
Sir Derek Wanless	30,000	30,000	30,000
Jenny Williams	6,000	6,000	6,000

Notes:

1. At 1 April 2008, 46,892 of these shares were beneficially owned by Mrs Lynn Cuthbert, 8,000 were beneficially owned by Mr I M Cuthbert and 9,000 were beneficially owned by Miss S L Cuthbert.
2. At 31 March 2009, 69,436 of these shares were beneficially owned by Mrs Lynn Cuthbert, 4,000 were beneficially owned by Mr I M Cuthbert and 9,000 were beneficially owned by Miss S L Cuthbert.
3. At 1 April 2008, these shares were beneficially owned by Mrs Geraldine Green.
4. At 31 March 2009, 137,894 of these shares were beneficially owned by Mrs Geraldine Green, and 5,000 were beneficially owned by each of Miss P J Green, Mr M F Green and Mr J M Green.

Table 7
Directors' interests in shares under the SIP (audited)

The directors who held office as at 31 March 2009 had the following interests in the ordinary 10 pence shares of the Company, purchased and held in accordance with the terms of the SIP:

	Number of SIP shares held at the start of the year ¹	Number of SIP shares held as at 31.3.2009 ¹	Number of SIP shares held as at 2.6.2009 ¹
John Cuthbert	4,176	4,785	5,652
Chris Green	4,176	4,785	5,652

Notes:

1. These figures include the shares paid for by the participant and the free shares granted by the Company.
2. A summary of the SIP can be found in the directors' report and business review on page 17.