

BOARD GOVERNANCE – NORTHUMBRIAN WATER LIMITED

Chairman's Introduction

Northumbrian Water Limited (“NWL” or the “Company”) is a well-run, customer-focused company, which is striving to be the national leader in the provision of sustainable water and waste water services. NWL's Board firmly believes that excellence in corporate governance is a cornerstone of first class customer service. It is therefore committed to ensuring that the Company continues to operate within a framework in which strong governance, transparency and excellent corporate citizenship are of paramount importance. This commitment is underpinned by the existing requirement under Condition F of NWL's Instrument of Appointment (its “Licence”) to have particular regard to the UK Corporate Governance Code (the “UK Code”).

NWL will continue to achieve a high standard of compliance with the UK Code and, as the UK Code itself requires, it will explain, clearly and carefully, if there are circumstances where compliance is not practicable or appropriate. In those instances the Board will ensure that strong standards of corporate governance are achieved through appropriate alternative arrangements.

NWL's Board has carefully considered the governance principles published by Ofwat in January 2014 (“Ofwat's Principles”). This document sets out how NWL intends to apply the governance framework created by NWL's existing obligations, taking account of Ofwat's Principles, in a manner which achieves excellent governance, and which is compatible with NWL's ownership structure.

Andrew J Hunter
Chairman

Disclosure and Transparency of Reporting

We will report on our financial affairs in accordance with all applicable accounting standards and with the Disclosure and Transparency Rules (the “DTR”), to the extent that the DTR are practicable for a private company with NWL's ownership structure. We will also publish an annual corporate governance statement in accordance with the DTR as if NWL were a listed company.

We will ensure that all disclosures are readily accessible to the relevant audiences; our statutory and regulatory reports and accounts will be published promptly on the NWL website.

Acting as if a publicly listed company, with a clear focus on regulatory obligations

We will conduct our appointed business as if this was our sole business and as if NWL were a separate public listed company (whilst taking due account of NWL's ownership structure).

In particular:

- we will have regard to the UK Code and will include detailed reports on compliance in our annual statutory and regulatory reporting and explain any non-compliances clearly and carefully;
- we will comply with the requirements of our Licence that:
 - each director discloses both to NWL and to Ofwat any conflicts between their duties as directors of NWL and other duties;
 - our directors act exclusively in NWL's interests as a water and sewerage undertaker and independently of our parent companies;
 - our directors will not vote on any contract, arrangement or other proposal in which they have an interest by virtue of other directorships;
 - our dividend policy will be approved by the Board and will reward efficiency and the management of economic risk, whilst not impairing our ability to finance the appointed business.

Our Board will have control of the business, providing clear direction for management and creating a framework that supports directors in meeting their statutory and regulatory duties. It will have the power to make strategic and sustainable decisions in the long term interests of NWL and its customers. The Board will keep corporate governance arrangements under review, to ensure that they remain fit for purpose.

Our Board will set the tone for risk management and will determine the appropriate risk appetite. It will monitor the management of fundamental risk and approve major decisions affecting the Company's risk profile. The Board will review, annually, the Company's terms of reference which set out matters reserved to the Board for approval and matters which are, or can be, delegated to committees and management. The Board will also review, annually, financial approval rules which set out the authorisation processes and financial limits to be applied to financial transactions involving the Company.

A strong and balanced Board

NWL will have a unitary Board, with a good balance of backgrounds, skills, experience and knowledge. This will enable the Board to make sound strategic decisions about all aspects of the business. The Board will include independent non-executive directors ("INeDs") with the ability, experience and strength of character to enhance the Board's effectiveness and to constructively challenge the Company's management where this is appropriate and to help develop strategy. The INeDs will normally include a senior chartered accountant as well as individuals with significant experience of customer-facing industries and knowledge of environmental matters, as well as the other qualities described in Condition P of the Licence.

New INeDs (and executive directors) will be appointed on an objective basis and by means of a formal, rigorous and transparent procedure, in which INeDs will participate. The Board will ensure that the recruitment process for INeDs is such as to ensure that a diverse field of candidates is encouraged to apply.

We will comply with the requirement of Condition P that the Board contains at least three INeDs and it is our intention that, by 1 April 2015, NWL's Board will comprise:

- (i) a Chairman appointed by the shareholders;
- (ii) four INeDs (including a Senior INeD, as detailed below);
- (iii) four Non-executive Directors who are not independent; and
- (iv) three Executive Directors (including the Chief Executive Officer).

There will be no routine use of alternate directors. Directors will be expected to make best efforts to attend Board meetings; attendance at Board and Committee meetings will be disclosed in the Company's annual reporting.

The composition of the Board will be reviewed periodically; INeDs will be appointed for successive twelve-month terms, subject to earlier termination by six months' notice on either side. INeDs will, in the normal course, serve for up to six years, and any extension beyond such a term will be subject to a particularly rigorous review. New INeDs will receive induction on joining the Board and will be encouraged and assisted to regularly update their skills and knowledge.

We will carry out regular, formal and rigorous evaluations of the Board's performance and that of its committees and individual directors, and report on how these have been conducted. The INeDs will regularly appraise the performance of the Chairman. We intend to commence such evaluations and appraisals in 2015.

All directors will have access to independent legal advice, at NWL's expense, where they believe this to be necessary in order to fulfil their duties.

We will seek to maintain the current, transparent, arrangement with our holding company, Northumbrian Water Group Limited ("NWG"), under which all NWL's INeDs attend and participate in all Board meetings of NWG.

Senior Independent Non-executive Director (SINeD)

Our Board will include a suitably experienced and skilled SINeD, who, in addition to the Chairman and executive management, will be available, at Ofwat's request, to discuss any regulatory matters. Our annual regulatory accounts will include a report by the SINeD on how the Board has worked during the relevant period, with particular reference to corporate governance. The SINeD's report will also clearly set out any material matters that have been reserved or referred to the Board of NWG during the year.

Board committees

The Group will operate Audit, Risk & Compliance and Remuneration Committees. It is our intention that, by 1 April 2015, the Audit and Risk & Compliance Committees will be chaired by the SINeD and will include a majority of INeDs. The Remuneration Committee will comprise an appropriate balance of directors. The INeDs on each committee will have the knowledge and experience to provide appropriate challenge. Details of membership, the number of meetings and attendance will be reported clearly.

The Audit Committee will assist both executive and non-executive directors to discharge their individual and collective responsibilities in relation to:

- ensuring NWL's financial and accounting systems are providing accurate and up-to-date information on its current position;
- ensuring the published financial statements represent a true and fair reflection of this position; and
- assessing the scope and effectiveness of the Company's risk management systems and the integrity of its internal financial controls.

The Audit Committee will also review NWL's arrangements for assuring the content and balance of the annual Risk and Compliance Statement and report to the Board. The Committee Chairman will report formally to the Board following each meeting of the Committee and the Committee minutes will be circulated to the Board.

The Risk & Compliance Committee will focus on risk and compliance matters and will strengthen the overall assurance provided to the Board. The Committee Chairman will report formally to the Board following each meeting of the Committee and the Committee minutes will be circulated to the Board.

Reporting on the Group structure

Our annual reporting will disclose the structure of the Northumbrian Water Group clearly and in a way that is easy to understand, and will clearly disclose NWL's direct shareholders.

31 March 2014