

# Remuneration report

## Directors' remuneration report

The members of the remuneration committee during 2002/03 were David Salkeld (Chairman), Derek Roberts, Jamie Pike (resigned 26 July 2002) and Ken Jackson (appointed 26 July 2002). All members of the committee are regarded by the company as independent. The group chairman and the chief executive have provided advice to the committee. For guidance in recommending remuneration packages, the remuneration committee uses published surveys carried out by remuneration consultants, as well as internal research, together with other ad hoc projects to support the objective of ensuring competitive and sustainable remuneration. During the 2002/03 financial year, New Bridge Street Consultants have advised the company on a variety of remuneration related issues, including assisting the remuneration committee with a review of the performance related elements of remuneration packages. The company does not use New Bridge Street Consultants in any capacity other than as an independent adviser on remuneration and employee share scheme matters.

## Statement of policy

The company's policy is to establish remuneration packages which enable the company to attract, retain and motivate people with the skills and experience necessary to lead and manage a business of Kelda's size and complexity. Remuneration packages should be aligned with the interests of the company's stakeholders, in particular its shareholders and customers. In recommending remuneration packages, the remuneration committee follows the principle of recognition of the individual's contribution to the business. The company intends that remuneration packages continue to be developed to enable executive directors to receive remuneration which is clearly related to performance, compared to relevant market and industry comparators and taking into account individual performance, responsibilities and experience. Accordingly, a significant proportion of directors' remuneration is performance related through annual and long term incentive plan awards.

The company treats remuneration strategy and its people resource as key components in delivering its vision to the shareholders of Kelda and to the customers of Yorkshire Water and Aquarion. At the same time, the company recognises fully the sensitivities of such matters and the need for due care and attention to be taken when considering such issues.

The current remuneration package for each executive director comprises the following:-

## Annual salary and benefits

The annual salary for each executive director is reviewed each year. The review takes into account relevant market comparators and individual performance. Executive directors' salaries are set at the level of remuneration appropriate to the country in which they are based. Benefits in kind include a car and health insurance. Base salary is pensionable.

Non executive directors are paid a base fee of £26,000 per annum. In addition the chairman of the audit committee and the chairman of the remuneration committee are paid fees of £7,500 per annum and £5,000 per annum respectively. Derek Roberts also receives fees of £16,000 per annum in his capacity as a non executive director of Yorkshire Water Services Limited and £10,000 per annum as chairman of Kelda Group Pension Trustees Limited.

He does not receive a fee for chairing the nominations committee. The fees of non executive directors are determined by the board.

## Annual incentive plan

During the 2002/03 financial year, each executive director had the opportunity to earn an annual incentive award of up to 40% of their salary. Having reviewed the performance related elements of the executive directors' remuneration packages, and in order to provide comparable remuneration packages to those offered by other UK water companies, the remuneration committee has determined that with effect from year commencing 1 April 2003 the maximum potential annual incentive award shall be 60% of salary. Any bonus payment is made in June based on performance in the year ending on the preceding 31 March. Awards are entirely performance related and are assessed against demanding performance targets including a range of Ofwat measures, financial targets and corporate and personal objectives. Annual incentive payments are not pensionable for UK based directors. Payments paid to US based directors are pensionable in accordance with normal US practice. Non executive directors do not participate in the annual incentive scheme.

## Long term incentive plan (LTIP)

Under the plan, executive directors may receive, at the discretion of the remuneration committee, a conditional award of Kelda Group plc shares each year, with a value of up to 40% of base salary. The proportion of the award to be vested in the participants after a period of three years will depend upon the company's performance in terms of total shareholder return (i.e. share price movements and reinvested dividends) during the three year period, relative to a comparator group of companies. The total shareholder return of the company is calculated by an independent consultant and compared with and ranked against the comparator group. Vesting of 70% of the award is determined by a reference to the company's ranking against awg plc, Pennon Group plc, Severn Trent plc and United Utilities plc, being the UK listed companies which own and operate regulated water and sewerage companies and whose characteristics are otherwise most similar to those of the company. Vesting of the remaining 30% of the award is determined by reference to the constituents of the FTSE mid 250 index on the date of grant (excluding investment trusts). The rules of the LTIP provide for the balance between water company comparators and FTSE 250 comparators to be adjusted in the event that the number of listed water companies should fall. The remuneration committee believes that the constituents of the comparator group (subject to its expansion in accordance with the proposed variation of the rules of the plan referred to below) provide the most appropriate comparison for the company's performance but keeps this mix of components under continuous review.

In respect of the 70% of the award determined by reference to the four listed water companies, 100% of the award will vest only if the company is ranked first, 60% of the award vests if the company is ranked second, 20% of the award vests if the company is ranked third. All shares are forfeited if the company is ranked below third.

In respect of the 30% of the award determined by reference to FTSE 250, 100% of the award vests for upper quartile performance. Between 100% and 20% of the award vests for performance between upper quartile and median. All shares are forfeited for below median performance.

# Remuneration report

No benefits under the plan are pensionable.

The non executive directors do not participate in the LTIP.

Having reviewed the performance related elements of the executive directors' remuneration packages, the remuneration committee has decided to replace the existing LTIP with a new LTIP. Details of the proposal are included with the separate notice of meeting.

## Service contracts

The company's policy on the duration of contracts with executive directors is that they should not normally be of fixed duration, should be subject to twelve months notice by the company and six months notice by the director. The notice periods have been selected to be consistent with current corporate governance best practice. Termination payments are made in accordance with the terms of the contract.

The company's policy in respect of non executive directors is to make appointments generally of three years duration, the terms of which do not contain any express provision for notice periods or termination payments in the event of early termination of their appointment.

Kevin Whiteman and Martin Towers entered into service agreements with the company on 2 September 2002 and 12 February 2003, respectively. The contracts are not of fixed duration and each provide for notice periods of twelve months by the company and six months by the director. The agreements do not contain any specific provision for compensation payable on early termination, and any termination payment would be calculated to take account of the contractual notice period and any annual incentive payment which would have been paid, subject to the achievement of performance objectives.

Richard Schmidt entered into a service agreement with the company on 8 August 2002. The agreement is for a fixed duration terminating on 31 July 2004, subject to any agreed extension or early termination. The agreement provides that in the event of early termination, Mr Schmidt shall except in certain specified circumstances, be entitled to receive an immediate pension and should be compensated for the amount of any annual incentive award which would have been paid in respect of both the part of the year prior to termination, and the unexpired term of the contract, subject to the achievement of performance objectives.

John Napier's appointment as chairman of the board of Kelda Group plc took effect on 2 September 2002 and is for a three year term. The terms of appointment do not contain any provisions for notice periods or for compensation in the event of early termination.

Derek Roberts' appointment as a non executive director is with effect from 1 September 2002 and is for a three year term. The appointments of Ken Jackson and David Salkeld each took effect on 2 October 2000 for a period of three years. The terms of appointment do not contain any provisions for notice periods or for compensation in the event of early termination.

James Newman's service agreement with the company was terminated on 6 August 2002.

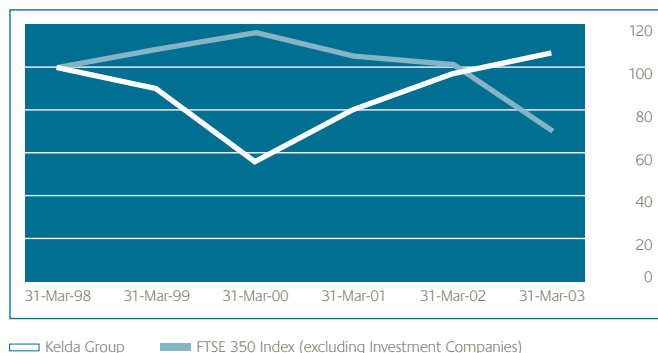
The agreement provided for 12 months notice by the company and 6 months notice by Mr Newman and in the event of termination by the company, for payment of one year's salary by the company to the benefit of pension provision. Full details of the termination payment and pension benefit are contained at pages 35 and 36.

John O'Kane's service agreement with the company was terminated on notice by Mr O'Kane with effect from 30 September 2002. The agreement provided for 12 months notice by the company and 6 months notice by Mr O'Kane. No termination payment was made.

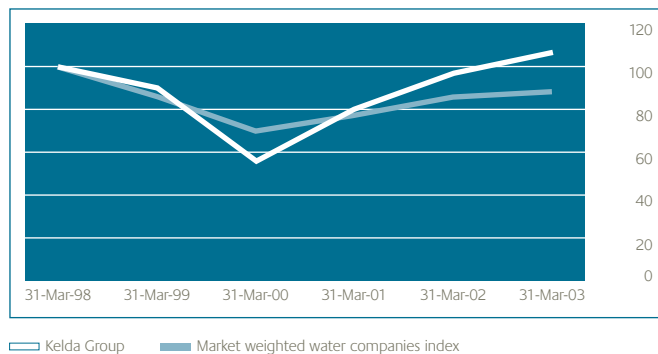
Jamie Pike's appointment as a non executive director terminated on 25 July 2002 following his resignation. His letter of appointment did not contain any express provisions for notice periods or termination payments in the event of early termination, and no termination payment was made.

## Performance graphs

The following graph shows the value, by the end of March 2003, of £100 invested in Kelda on 31 March 1998 compared with the value invested in the FTSE 350 Index (excluding Investment Companies). The other points plotted are the values at intervening financial year ends. This index has been selected as Kelda Group plc is a constituent of the FTSE 350.



The following graph shows the value, by the end of March 2003, of £100 invested in Kelda on 31 March 1998 compared with the value invested in a hypothetical market weighted index comprising six other water companies (awg, Pennon Group, Severn Trent, United Utilities, Bristol Water and Dee Valley). The other points plotted are the values at intervening financial year ends. This index has been selected as it incorporates companies with characteristics comparable to those of Kelda Group plc.



The following sections of the remuneration report, with the exception of the table of directors' beneficial interests in shares, have been audited.

### Directors' emoluments

	Salary/fees £000	Annual incentive award £000	Benefits in kind £000	Termination payments £000	Total emoluments 2003 £000	Total emoluments 2002 £000
<b>Chairman</b>						
J A Napier	192	–	18	–	<b>210</b>	337
<b>Executive directors</b>						
J H Newman (resigned 06.08.02)	65	37	12	207	<b>321</b>	267
J P O'Kane (resigned 30.09.02)	83	41	8	–	<b>132</b>	206
R K Schmidt* (appointed 02.09.02)	102	30	12	–	<b>144</b>	–
M G Towers (appointed 01.03.03)	13	–	–	–	<b>13</b>	–
K I Whiteman	204	77	19	–	<b>300</b>	221
<b>Non executive directors</b>						
K Jackson	28	–	–	–	<b>28</b>	21
J R P Pike (resigned 25.07.02)	9	–	–	–	<b>9</b>	26
D F Roberts	50	–	4	–	<b>54</b>	48
D J Salkeld	28	–	7	–	<b>35</b>	32
	774	185	80	207	<b>1,246</b>	1,158

\*Salary and benefits denominated in US dollars and translated into sterling at an average exchange rate of \$1.55 to £1.

- (i) Waste Recycling Group plc paid fees of £24,000 in respect of John Napier and £8,000 in respect of James Newman (before his resignation) for their services as non executive directors of WRG during the year. The fees were received by the company and not the individuals.
- (ii) The executive directors participated in a profit related pay scheme which is open to all UK employees who have been employed by the group for a minimum period of employment. In 2002/03 this scheme paid £370 (2002: £350) to each qualified participant and this is included in the salaries shown in the table above.
- (iii) The annual incentive awards referred to above are performance related and are fully described in the narrative section of this report.
- (iv) The amount disclosed in respect of Richard Schmidt relates to his period of appointment as a director of Kelda Group plc.

### Pensions

The following directors were members of defined benefit pension arrangements provided by the company during the year. The main features of the Kelda Group Pension Plan applicable to executive directors are:

- (i) a normal retirement age of 60;
- (ii) an accrual rate of 1/30th per year of pensionable service up to 20 years;
- (iii) four times pensionable pay for death in service;
- (iv) spouse's pension on death

Pension entitlements and corresponding transfer values increased as follows during the year.

	Total accrued pension at 31/3/02 £	Total accrued pension at 31/3/03 £	Increase in accrued pension net of inflation £	Transfer value of net increase in accrued pension over period £	Transfer value of accrued pension at 31/3/02 £	Transfer value of accrued pension at 31/3/03 £	Total change in transfer value during period £
J A Napier	–	<b>22,919</b>	22,919	343,555	–	<b>343,555</b>	343,555
J H Newman (resigned 06.08.02)	25,414	<b>42,727</b>	16,576	605,018	301,929	<b>954,475</b>	648,667
J P O'Kane (resigned 30.09.02)	15,496	<b>19,986</b>	4,041	31,179	125,717	<b>178,855</b>	48,188
R K Schmidt	82,117	<b>157,918</b>	75,801	1,078,638	735,633	<b>1,937,820</b>	1,202,187
M G Towers	–	<b>444</b>	444	4,267	–	<b>5,067</b>	4,267
K I Whiteman	18,498	<b>31,307</b>	12,273	102,975	157,286	<b>293,991</b>	124,505

# Remuneration report

- (i) Accrued pensions shown are the amounts that would be paid annually on retirement based on service to the end of the year, or date of leaving or retirement if earlier.
- (ii) The transfer value of the increase in accrued pension (net of inflation) represents the incremental value to the director of his service during the year. It is based on the accrued pension increase after deducting the director's contribution. For Mr Newman and Mr Schmidt, this figure includes the value of the change in payment date for benefits.
- (iii) Transfer values have been calculated in accordance with version 8.1 of guidance note GN11 issued by the actuarial profession.
- (iv) The change in the transfer value includes the effect of fluctuations in the transfer value due to factors beyond the control of the company and directors, such as changes in stockmarket conditions between the valuation dates. It is calculated after deducting the director's contribution.
- (v) Voluntary contributions paid by directors and resulting benefits are not shown.
- (vi) In addition to the benefits shown above, Mr Newman received an augmentation to his benefits in 2001 on a money purchase basis. The resulting pension on retirement in respect of this augmentation was £1,797 per annum.
- (vii) Mr Schmidt's benefits are payable under the Aquarion pension arrangements in the US. The transfer value figures shown have been calculated on a consistent basis to the figures for the UK directors. The benefits are denominated in dollars and have been converted to sterling for the purposes of this disclosure using a conversion factor of \$1.58 to £1.

The company contributes 12% of salary to the Kelda Group Pension Plan (KGPP) in respect of executive directors, which is an approved scheme subject to Inland Revenue limits. The company makes separate accounting provision for unfunded liabilities arising from contractual commitments above the Inland Revenue earnings cap. The figures include the unfunded element.

## Directors' shareholdings

The beneficial interests of the directors, who held office at the end of the year, and their immediate families in the ordinary shares of the company as at 31 March 2003 and at the beginning of the year (or date of appointment where later) are set out below:

	At 31 March 2003	At 1 April 2002
<b>Chairman</b>		
J A Napier	<b>30,000</b>	30,000
<b>Executive directors</b>		
R K Schmidt (appointed 02.09.02)	-	-
M G Towers (appointed 01.03.03)	-	-
K I Whiteman	<b>4,408</b>	1,936
<b>Non executive directors</b>		
K Jackson	-	-
D F Roberts	<b>1,973</b>	1,973
D J Salkeld	-	-

In addition to the above beneficial interests in the company's shares, the executive directors are regarded for Companies Act purposes as being interested in 6,161,506 ordinary shares of the company held by an employee share ownership trust (ESOT) and 34,239 ordinary shares held by a qualifying employee share ownership trust (QUEST). All employees (including executive directors) are potential beneficiaries of the trusts, the purposes of which are to provide shares to satisfy options under the company's save-as-you-earn share option scheme and, in the case of the ESOT, grants made pursuant to the long term incentive plan.

It is not anticipated that any employee or executive director will be entitled to receive from either trust a greater number of shares than that to which they are entitled on exercise of options granted to them under the share option scheme or the vesting of awards pursuant to the long term incentive plan.

There have not been any changes to the shareholdings or options of the directors between 31 March 2003 and 4 June 2003.

### Directors' share options

In common with all eligible employees of the group, executive directors are entitled to participate in the company's Inland Revenue approved save-as-you-earn share option scheme. The interest of directors in particular issues under the scheme are:

	At 1 April 2002	Granted during year	Exercised during year	Lapsed during year	At 31 March 2003	Exercise price (p)	Market price at date of exercise (p)	Date options exercisable	Date options expire
J H Newman	4,036	-	(3,914)	(122)	-	240.0	421.5	-	-
J P O'Kane	3,229	-	-	(3,229)	-	-	-	-	-

The market price of the shares subject to these options at 31 March 2003 was 409.5p (2002: 389.5p) and has ranged from 356.75p to 440.0p during the year. The aggregate gain on the exercise of share options during the year was £7,104 (2002: £nil).

### Long term incentive plan

Interests of the directors in the plan described on page 33 are:

	At 1 April 2002	Date awarded	Market price at date of award p	Granted during year	Vested 19 July 2002	Vested 12 Sept 2002	Vested 24 Oct 2002	Lapsed during year	At 31 March 2003	Earliest vesting date
J H Newman	13,134	June 1999	443.50	-	(10,937)	-	-	(2,197)	-	
	19,101	June 2000	356.00	-	-	(12,862)	(573)	(5,666)	-	
	18,379	June 2001	391.75	-	-	(7,415)	(474)	(10,490)	-	
	-	June 2002	436.00	16,972	-	(852)	(37)	(16,083)	-	
J P O'Kane	4,853	June 1999	443.50	-	(4,041)	-	-	(812)	-	
	14,045	June 2000	356.00	-	-	-	-	(14,045)	-	
	13,784	June 2001	391.75	-	-	-	-	(13,784)	-	
	-	June 2002	436.00	15,138	-	-	-	(15,138)	-	
R K Schmidt	47,363	June 2001	391.75	-	-	-	-	-	<b>47,363</b>	07.06.04
	-	June 2002	436.00	21,993	-	-	-	-	<b>21,993</b>	11.06.05
M G Towers	-	-	-	-	-	-	-	-	-	
K I Whiteman	4,947	June 1999	443.50	-	(4,120)	-	-	(827)	-	
	15,169	June 2000	356.00	-	-	-	-	-	<b>15,169</b>	21.09.03
	14,805	June 2001	391.75	-	-	-	-	-	<b>14,805</b>	07.06.04
	-	June 2002	436.00	16,514	-	-	-	-	<b>16,514</b>	11.06.05

(i) The market price on 19 July 2002 was 385.0p

(ii) The market price on 12 September 2002 was 390.0p

(iii) The market price on 24 October 2002 was 394.0p

The market price of the shares on 4 June 2003 was 436.0p. The aggregate value of shares vested during the year was £160,201 (2002: £50,674).

By order of the board  
Philip Hudson  
Group Company Secretary  
5 June 2003