

MEMBERS' REMUNERATION REPORT

Quoted companies are required to include in their Annual Report a Directors' Remuneration Report with specified contents. Even though Scottish Water is not a quoted company, the report follows the format and content required of quoted companies; where that is not possible, it is explicitly noted.

1) Remuneration Committee

a. Remit

The Remuneration Committee meets regularly to consider issues, in particular Executive Members terms and conditions, and makes recommendations to the Board. In respect of levels of Executive Members remuneration and bonus arrangements, its proposals have formed the basis of recommendations to the Scottish Government. No Executive Members are involved in deciding their own remuneration.

b. Membership

For the financial year under review, the Remuneration Committee has consisted of:

Mr Graeme Crombie (Chair of the Committee, Non-Executive Member)
Professor Paul Jowitt (Non-Executive Member)
Mr Pat Kelly (Non-Executive Member)
Mrs Rita Theil (Non-Executive Member)
Mr Ian McMillan (Non-Executive Member)

With effect from 1 April, 2008 Mr Donald Emslie replaced Professor Paul Jowitt, and Mr Ian McMillan ceased to be a member of the Committee.

During the year external independent advice has been provided by Hay Group Management Consultants, a consultancy re-appointed by the Remuneration Committee in September, 2007. In addition, Hay Group Management Consultants provided Scottish Water with remuneration survey data. Internal advice was provided by the Chair of Scottish Water, the Chief Executive, and the Director of Human Resources & Development and Health and Safety. No Executive Member was present during discussions about their own remuneration.

c. Meetings

There were four meetings of the Committee in 2007/08. At each meeting a quorum of independent, Non-executive Members was present.

2) General Remuneration Policy

Scottish Water must continue to build on the progress made since its inception to create a successful water services company that provides the levels of service and value for money expected by its customers, regulators, the Scottish Government and benchmarked against the performance of the water companies in the United Kingdom.

Scottish Water considers staff remuneration to be a major contributor to achieving its goals. Scottish Water will continue to ensure that its working environment

matches the expectations it places on its people to deliver best value outcomes in an empowered organisation. This requires terms of employment for all employees that, taken together, ensure Scottish Water is perceived as a fair employer that encourages excellence, rewards productivity and empowers its people as well as providing scope for personal development.

Scottish Water's overall remuneration policy aims are to:

- Attract, develop, motivate and keep highly talented people at all levels of the organisation
- Pay competitive salaries and benefits to all Scottish Water's people. When pay levels are set, account is taken of the work an employee does, what is paid in other organisations for similar work and how well Scottish Water is performing
- Incentivise and reward good individual performance in a remuneration structure that is seen as fair when viewed as a whole

3) Policy on Executive Members' Remuneration

a. Comparator Organisations

Scottish Water is publicly owned and accountable to the Scottish Parliament and Scottish Ministers. Within the context of public sector ownership, Scottish Water seeks to attract, retain and motivate leadership talent in competition not just with other utilities and other organisations in the public sector, but with organisations across the economy.

Scottish Water uses the remuneration database of Hay Group Management Ltd to ascertain the remuneration practices of industry in general. This is the largest remuneration database in the UK with each job subjected to the same method of job sizing.

b. Remuneration Elements

Scottish Water's Remuneration Policy for Executive Members consists of five principal elements:

- Base Salary;
- Annual Incentive Scheme;
- Long Term Incentive Plan (LTIP);
- Pension; and
- Allowances (for business needs, car, relocation, etc.).

c. Relative Importance of Performance Related Elements to Base Pay

Scottish Water is a performance-orientated organisation. It believes that Executive Members' remuneration should be closely related to both corporate performance and individual performance.

The aim is to pay a base salary that is as competitive as possible within public sector ownership and provide the opportunity for extra discretionary pay to be earned for out-performance of demanding targets.

The potential annual incentives attainable by the Executive Members are 40% of base salary and are non-pensionable.

d. Performance Conditions for Annual Incentives and Awards Made – 2007/08

Bonus Basis	% allocated	% awarded
<ul style="list-style-type: none"> Cumulative net debt in comparison with the targets in the Final Determination 	10%	10%
<ul style="list-style-type: none"> Profit before Tax excluding depreciation in comparison with the targets in the Final Determination 	30%	30%
<ul style="list-style-type: none"> Out-performing the Final Determination OPA target of 213 	40%	40%
<ul style="list-style-type: none"> Investment Out-turn 	20%	15.4%

Overall bonus awards in 2007/08 were 38% of annualised salary.

Non-executive Members are not eligible for incentive payments.

Scottish Water out-performed the stretch targets on all measures, apart from the investment spend where performance was between target and stretch target. The targets, stretch targets and actual performance for each measure are set out below.

	Target	Stretch target	Actual performance
Cumulative net debt	£2,751.7m	£2,726.7m	£2,555.6m
Profit before tax, excluding depreciation and amortisation	£433.7m	£448.7m	£484.7m
OPA score	213	239	248
Investment			
- Outputs	85%	110%	150%
- Q&S investment	£610m	£650m	£625.3m

e. Long Term Incentive Plans for 2006 - 2010

The Long Term Incentive Plan (LTIP) has been agreed with the Scottish Government and provides clear targets for out-performance of the Water Industry Commission's Final Determination. Payments under the scheme will only be made to Executive Members remaining in employment with Scottish Water on 1st January 2011 if there is overall financial out-performance of the Final Determination.

The plan is based on:-

- 50% for performance against financial targets, being the extent to which net debt is lower in March 2010 than was assumed in the Final Determination. Maximum bonus would be payable for at least £100M out-performance.
- 50% for out-performance of OPA targets above those set out in the Final Determination. Maximum bonus will be payable for an OPA score of at least 271, 30 points higher than the Final Determination target of 241. These targets have been reduced by 9 points from those set out in the 2007

Remuneration Report following the removal of one OPA measure as a result of the separation of Business Stream from Scottish Water.

The LTIP will be funded by 15% of annual salary being accumulated each year for ultimately vesting if earned after four years by eligible Executive Members. Any LTIP payment will only be funded from financial out-performance after payment of any bonuses to staff.

4) Service Contracts

Details of Executive Members' contracts are set out below.

Executive Member	Name	Date of Contract	Unexpired Term	Notice Period
Chief Executive	Richard Ackroyd	25 March 08	All Members have Permanent contracts	All Members are required to give six months notice of resignation. Scottish Water is required to give Members twelve months notice of termination.
Asset Management Director	Geoff Aitkenhead	1 April 02		
Finance & Regulation Director	Douglas Millican	1 April 02		
Commercial Director	Chris Banks	1 April 02		

Non-executive Board Member Appointments

The Non-executive Members do not have service contracts. Non-executive Members are expected to work four days per month for Scottish Water with the exception of the Chair, Ronnie Mercer, who works 2 days per week. No compensation is payable to any Non-executive Member if their appointment is terminated early. The expiry dates of Non-executive appointments are as follows:

Ronnie Mercer	30 September 2011
Professor Paul Jowitt	31 March 2008
Rita Theil	31 March 2009
Ian McMillan	31 March 2009
Graeme Crombie	31 March 2009
Pat Kelly	31 March 2009
Alistair Buchanan	31 March 2012 *
Donald Emslie	31 March 2012 *
David Gray	31 March 2012

* Mr Buchanan and Mr Emslie joined the Board with effect from 1 April 2008.

The auditors are required to report on information contained in the following sections of the Remuneration Report.

5) Members' Remuneration

Details of Members' Remuneration and other Directors, as defined in the Accounts Direction for 2007/08 by Scottish Ministers, are set out below for the year.

	Salary /Fees £000	Bonus £000	Benefits £000	Total 2008 £000	Total 2007 £000
Executive Members					
Richard Ackroyd (i)	5	-	2	7	-
Jon Hargreaves (ii)	140	53	5	198	312
Geoff Aitkenhead	172	64	7	243	234
Chris Banks	160	59	10	229	230
Douglas Millican	185	69	7	261	235
Non - Executive Members					
Ronnie Mercer (Chair)	90	-	8	98	65
Graeme Crombie	20	-	-	20	19
David Gray	20	-	-	20	19
Pat Kelly	20	-	-	20	19
Professor Paul Jowitt	20	-	-	20	19
Ian McMillan	20	-	-	20	19
Rita Theil	20	-	-	20	19
Total Members' remuneration	872	245	39	1,156	1,190
Former Directors and Members					
Cheryl Black (iii)	-	-	-	-	114
Mark Adderley (iv)	-	-	-	-	153
Total	872	245	39	1,156	1,457

- (i) From date of appointment to the Board on 25 March 2008.
- (ii) To date of resignation from the Board on 30 November 2007.
- (iii) To date of resignation from the Board on 26 November 2006.
- (iv) To date of resignation from Scottish Water on 8 February 2007.
- (v) Payments to Geoff Aitkenhead (£5,000), Chris Banks (£5,000) and Douglas Millican (£17,582) are included within salary/fees in the above table. These payments were for additional responsibilities associated with the period between the resignation of Jon Hargreaves on 30 November 2007 and Richard Ackroyd joining Scottish Water on 25 March 2008.
- (vi) In addition to the above Jon Hargreaves was paid a contractual sum associated with his pension top-up arrangements of £342,555 when he resigned from Scottish Water.
- (vii) Richard Ackroyd does not participate in the pension scheme but Scottish Water contributes a sum equating to 35% of his salary to his pension arrangements. The payment in 2007/08 was £1,732 and is included within the benefits section of the above table.
- (viii) A car or car allowance is provided to all Executive Members and the Chair for business needs. The associated benefit is included in the benefits section of the table above. The benefits section also includes values for any holiday sale backs.
- (ix) The comparative figures for 2007 include the payments made (£170,966) in respect of the cash-based LTIP award for the regulatory period covering the four years from 1 April 2002 to 31 March 2006.
- (x) The bonus criteria are explained in section '3d' of the Members' Remuneration Report.

6) Pension

The Executive Members, other than Richard Ackroyd, participate in the Lothian Pension Fund – a defined benefit scheme. Details of their benefits under this scheme are set out below.

	Increase in accrued benefits during the year net of inflation			Accumulated total accrued benefits at 31 March 2008		Transfer Values (note 5)		
	Years in Scheme	Pension £'000	Lump sum £'000	Pension (note 4) £'000	Lump sum (note 4) £'000	At 31 March 2008 £'000	At 31 March 2007 £'000	Increase in 2007/08 net of Members' own contributions and inflation £'000
Jon Hargreaves	5.2	-1	3	9	34	197*	153	35
Geoff Aitkenhead	29.4	12	36	61	183	1,040	803	218
Chris Banks	13.7	5	15	27	80	388	304	73
Douglas Millican	13.1	9	26	30	89	375	254	117

* Transfer value at date of retirement

Notes:-

- Members of the pension scheme have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the above table.
- The normal retirement age of Executive Members is 65.
- The pension entitlement shown is that which would be paid annually on retirement along with the lump sum, based on service to the end of the year.
- The increase in accrued pension, lump sum and transfer value during the year excludes any increase for inflation.
- The transfer value of accrued pension is calculated in a manner consistent with Actuarial Guidance Note GN11.
- On death, a spouse's pension is payable equal to one half of the Member's pension, and children's pension may also be payable.

7) Executive Members' Paid Directorships of Other Companies and Public Bodies

The Remuneration Committee supports active development of Executive Members including their involvement with other companies and public bodies where this is compatible with fulfilling their responsibilities for Scottish Water.

This report was approved by the Board on 25 June 2008 and signed on its behalf by Mr Graeme Crombie, Chair of the Remuneration Committee.