

Corporate governance report

Compliance with the Combined Code

Throughout the accounting period covered by this report (1 August 2005 to 5 August 2006), the Company has been in full compliance with the Combined Code on Corporate Governance (July 2003 issue) (the Code) applicable under the Listing Rules of the UK Listing Authority, with one exception – the Chairman is a member of the Remuneration Committee (which is now permitted by the June 2006 version of the Code). The Board continues to consider that the Chairman should participate in decisions concerning remuneration of the executive directors and that his membership of the Committee helps to ensure that the Company's remuneration policy is aligned with its strategic objectives.

The Code requires listed companies to report how the main and supporting principles of the Code have been applied, giving enough detail to enable shareholders to evaluate the report, and to state whether there has been compliance with the provisions of the Code, giving an explanation for any points of non-compliance. Reference in this report to principles and provisions are to those of the Code from which the following headings are taken.

Directors

The Board

The first main principle requires the Company to have an effective Board which is collectively responsible for its success. Supporting principles describe the Board's role to provide entrepreneurial leadership within a framework of controls that allow risk to be assessed and managed. The Board should set strategic aims and the Company's values, ensuring that obligations to shareholders are met. Non-executive directors have a particular role in overseeing the development of strategy, scrutinising management performance and ensuring the integrity of financial information and systems of risk management. The Board is satisfied that it has met these requirements.

During the last year the membership of the Board has changed. Lord Robertson of Port Ellen, a non-executive director, resigned from the Board on 27 February 2006 and Sir Kevin Tebbit was appointed as a non-executive director on 14 June 2006. Sadly Mr O'Leary died on 14 August 2006. Mr Thomson retired as Finance Director on 6 September 2006 and he was succeeded on that date by Mr Langston, who had been appointed Finance Director designate with effect from 1 August 2006. Sir Julian Horn-Smith, who has been a non-executive director since February 2000, will retire at the conclusion of the Annual General Meeting on 21 November 2006.

As at 27 September 2006, the Board comprises Mr Brydon, Chairman, Mr Butler-Wheelhouse, Chief Executive, three other executive directors and five independent non-executive directors. Mr Jackson is the senior independent director. Biographies of these directors, giving details of their experience and other main commitments, are set out on page 31. The wide ranging experience and backgrounds of the non-executive directors ensure that they can debate and constructively challenge management in relation to both the development of strategy and performance against the goals set by the Board.

The Board normally holds formal meetings at least eight times a year to make and review major business decisions and monitor current trading against plans which it has approved. It additionally exercises control by determining matters specifically reserved to it in a formal schedule which only the Board may change: these matters include the acquisition of companies, the issue of shares, significant contractual commitments, the review of the effectiveness of risk management processes and major capital expenditure. Once a year the Board meets in conference with a particular focus on long-term

strategy and developments affecting the Company. Additional meetings are arranged as necessary to deal with urgent items.

The Board sets the Company's values and standards and has adopted a Code of Corporate Responsibility and Business Ethics which is referred to on page 26.

The Chairman meets the non-executive directors without the executive directors present at least three times per annum. The senior independent director meets the other non-executive directors without the Chairman present at least annually.

Directors and officers of the Company and its subsidiaries have the benefit of a directors' and officers' liability insurance policy.

The following table shows the number of scheduled Board and Board Committee meetings held during the period ended 5 August 2006 and opposite each director's name the number of meetings attended. However, directors attend many other meetings and visits during the year. The Board views directors' contributions as measured beyond simplistic meeting attendance records.

Number held	Board 8	Audit 4	Remuneration 6	Nomination 3
D H Brydon	8	–	6	3
K O Butler-Wheelhouse	8	–	–	–
Sir Nigel Broomfield	7	4	6	–
D J Challen	8	4	6	–
J Ferrie	8	–	–	–
Sir Julian Horn-Smith	7	1(1)*	6	–
P J Jackson	8	4	–	3
J Langston	8	–	–	–
D P Lillycrop	8	–	–	–
R W O'Leary	8	3(3)*	4	2(2)*
Lord Robertson of Port Ellen	4(4)*	2(2)*	–	1(1)*
Sir Kevin Tebbit	0(1)*	0(0)*	–	0(0)*
A M Thomson	8	–	–	–

*The figure in brackets indicates the maximum number of meetings the director could have attended in view of the period during which he was a Board or Committee member.

– indicates not a member of that Committee in 2005/06

Chairman and Chief Executive

Another main principle requires a clear division of responsibilities between the running of the Board and executive responsibility for running the business, so that no one person has unfettered powers of decision.

The Board has met this requirement by establishing clearly defined roles for the Chairman and the Chief Executive. The Chairman is responsible for leadership of the Board, ensuring its effectiveness and setting its agenda. Once agreed by the Board as a whole, it is the Chief Executive's responsibility to ensure delivery of the strategic and financial objectives.

Board balance and independence

The Company complies with the requirement of the Code that there should be a balance of executive and non-executive directors such that no individual or small group can dominate the Board's decision taking. Throughout the period the Company complied with the requirements that at least half the Board, excluding the Chairman, should be independent non-executive directors.

In deciding the chairmanship and membership of the Board Committees, the need to refresh membership of the Committees is taken into account.

All the non-executive directors are considered to be independent and Mr Brydon was, in compliance with the Code, considered independent at the time of his appointment as Chairman.

Appointments to the Board

The Code requires there to be a formal, rigorous and transparent procedure for the appointment of new directors, which should be made on merit and against objective criteria. The Nomination Committee fulfils these requirements and its report is set out on page 39.

Information and professional development

Another main principle requires that information of appropriate quality is supplied to the Board in a timely manner and that, in addition to induction programmes on joining the Company, directors should regularly update their skills and knowledge.

The Board is provided with detailed information several days in advance on matters to be considered at its meetings and non-executive directors have ready access to the executive directors. Regular site visits are arranged and non-executive directors are encouraged to visit sites independently. During site visits, briefings are arranged and the Board is free to discuss aspects of the business with employees at all levels.

Newly-appointed directors undergo a structured induction programme to ensure that they have the necessary knowledge and understanding of the Company and its activities. Starting at the time of their appointment, and continuing on an incremental basis over the first six months, they undertake briefing sessions on corporate governance, strategy, stakeholder issues, finance and risk management and HR strategy, as well as meetings and site visits to business locations in the UK and overseas. Each director's individual experience and background is taken into account in developing a programme tailored to his own requirements.

Ongoing training is provided as and when necessary. The suitability of external courses is kept under review by the Company Secretary who is charged with facilitating the induction of new directors and with assisting in the ongoing training and development of directors.

All directors have access to the advice and services of the Company Secretary and a procedure is in place for them to take independent professional advice at the Company's expense should this be required.

Performance evaluation

The Code requires the Board to undertake a formal and rigorous annual evaluation of its own performance and that of its Committees and the directors. The Board is satisfied that it continues to meet these requirements. It is confirmed that all the non-executive directors have sufficient time to fulfil their commitments to the Company, that the Chairman does not hold the office of chairman of another FTSE100 company and that no executive director holds more than one non-executive directorship of another FTSE100 company.

A formal evaluation of the performance of the Board, its Committees and the directors was conducted by means of detailed questionnaires that were designed by an independent senior academic and were completed by each director. The answers to the questionnaires formed the basis of a review by the whole Board, led by the Chairman and the senior academic. Regarding the Board, comments were invited on a wide range of issues including the appropriateness of matters specifically reserved for the Board, its contribution to the development and review of strategy, the terms of reference of its Committees, the effectiveness of the process for identifying and managing risks, logistics of Board Meetings and the composition

and operation of the Board. For the Board Committees, the matters addressed included the appropriateness of their responsibilities, the logistics of their meetings, the availability of internal and external support and the composition and operation of the Committees. The questionnaire relating to each director's performance addressed several issues including the director's contribution at Board Meetings, with particular reference to the development of strategy and risk management, how effectively the director refreshes his knowledge and skills and, specifically for each non-executive director, his willingness to devote time and effort for the benefit of the Company.

The performance evaluation of the Chairman was led by the senior independent director who obtained the views of both the executive and non-executive directors.

Re-election

Under the Code directors should offer themselves for re-election at regular intervals and there should be a planned and progressive refreshing of the Board.

Non-executive directors are appointed for a specified term of three years and reappointment for a second term is not automatic. In exceptional circumstances and only after rigorous review, a non-executive director may serve for a third term. Any non-executive director who has served for more than nine years is subject to annual re-election. Directors stand for reappointment by the shareholders at the first Annual General Meeting following their appointment and subsequently at least every three years. The report from the Nomination Committee set out on page 39 explains the process for selection of directors and succession planning.

Remuneration

Information regarding the Remuneration Committee is set out on page 39 and the Directors' remuneration report is on pages 40 to 47.

Accountability and audit

Financial reporting

The Board is required to present a balanced and understandable assessment of the Company's position and prospects, not only in the Annual Report and Accounts but also in the Summary Financial Statement, and in interim and other public reports. The Board is satisfied that it has met this obligation. A summary of the directors' responsibilities for the financial statements is set out on page 48.

The 'going concern' statement required by the Code is set out in the Group directors' report on page 33.

Internal control

The Code requires the Company to maintain a sound system of internal control to safeguard shareholders' investment and the Company's assets. The Board must review the effectiveness of the internal control system at least annually, covering all material controls, including financial, operational and compliance controls and risk management systems, and report to shareholders that they have done so. The 1999 Turnbull Report, adopted by the UK Listing Authority, provides guidance for compliance with that part of the Code.

The Company's internal control is based on assessment of risk and a framework of control procedures to manage risks and to monitor compliance with procedures. The procedures for accountability and control, which accord with the guidance on internal control issued by the Turnbull Committee, are outlined below.

The Board accepts its responsibility for maintaining and reviewing the effectiveness of the Company's internal control systems. These are designed to meet the Company's particular needs and the risks

to which it is exposed and, by their nature, can provide only reasonable, not absolute, assurance against material loss to the Company or material misstatement in the financial accounts.

The Group has an embedded process for the identification, evaluation and management of significant business risks. The process is reviewed through the Audit Committee and monitored by the Group Internal Audit Department. The Company has during the year identified and evaluated the key risks under three categories – strategic; operational; and information – and has ensured that effective controls and procedures are in place to manage these risks.

In the highly regulated environment of the industries in which the Company operates, procedures are codified in detailed operating procedures manuals and are reinforced by regular educational programmes. These are designed to ensure compliance not only with the regulatory requirements but also with general principles of business integrity.

A key element in any system is communication and a number of committees enable the executive directors and senior corporate staff to address financial, human resource, risk management and other control issues. Experience is shared by subsidiaries through company-wide seminars.

Throughout the period the Board, through the Audit Committee, has reviewed the effectiveness of internal control and the management of risks at its regular Board meetings. In addition to financial and business reports, the Board has reviewed medium and longer-term strategic plans; capital expenditure and development programmes; management and product development programmes; reports on key operational issues; tax; treasury; risk management; insurance; legal matters; and Audit Committee reports, including internal and external auditor reports.

Audit Committee and Auditor

A principle of the Code is that the Board should establish formal and transparent arrangements for considering how it should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the external auditor, PricewaterhouseCoopers LLP. This obligation is satisfied through the work of the Audit Committee which is described on this page.

Relations with shareholders

Dialogue with shareholders

The Company is required to have a dialogue with shareholders, based on the mutual understanding of objectives, and it is the responsibility of the Board as a whole to ensure that a satisfactory dialogue does take place.

The Code recognises that primary contacts are likely to be by the Chief Executive and the Finance Director but requires the Chairman and senior independent director, and other directors as appropriate, to maintain contact with major shareholders in order to understand their concerns.

The Finance Director and the Director, Investor Relations, communicate with institutional investors through analysts' briefings and extensive investor roadshows in the UK, US and continental Europe, as well as timely Stock Exchange announcements, meetings with management and site visits. Members of the Board, and in particular non-executive directors, are kept informed of investors' views in the main through distribution of analysts' and brokers' briefings. At least twice a year a report is made to the Board on the number and types of meetings between the Company and institutional shareholders. The Chairman is available in the event of shareholder concerns which cannot be addressed through

management. At the time of appointment of new non-executive directors they are available to meet shareholders on request.

Constructive use of the Annual General Meeting

All directors normally attend the Company's Annual General Meeting and shareholders are invited to ask questions during the meeting and to meet directors after the formal proceedings have ended. Shareholders have, at previous meetings, been advised as to the level of proxy votes received including the percentages for and against and the abstentions in respect of each resolution following each vote on a show of hands. It is intended that there shall be a poll vote on each resolution at the 2006 AGM.

It is confirmed that the Chairmen of the Audit, Remuneration and Nomination Committees were available at the 2005 AGM to answer shareholders' questions, that all directors were in attendance and that notice of the AGM and related papers were sent to shareholders twenty working days before the meeting.

Board Committees

The full terms of reference of the following Board Committees are available upon request and on the Company's website.

Audit Committee

From 1 August 2005 to 27 February 2006 the Audit Committee comprised Mr Challen, as Chairman of the Committee, Sir Nigel Broomfield, Mr Jackson, Mr O'Leary and Lord Robertson of Port Ellen. On 27 February 2006 Lord Robertson resigned from the Board, on 14 March 2006 Sir Julian Horn-Smith replaced Mr O'Leary as a member of the Committee and Sir Kevin Tebbit joined the Committee on 12 July 2006. From that date the Committee comprised Mr Challen, as Chairman of the Committee, Sir Nigel Broomfield, Mr Jackson, Sir Julian Horn-Smith and Sir Kevin Tebbit.

The Board has determined that the Committee members have the skills and experience necessary to contribute meaningfully to the Committee's deliberations. In addition, the Chairman of the Committee has requisite experience in accounting and financial management.

The Committee meets at least three times per year. Under its terms of reference, the Committee monitors the integrity of the Company's financial statements and the effectiveness of the external audit process. The Committee also monitors Corporate Governance issues and, in particular, the implementation of the Company's Code of Corporate Responsibility and Business Ethics and the arrangements for employees to raise anonymously concerns about possible wrongdoing in financial reporting and other matters. It is responsible for ensuring that an appropriate relationship between the Company and the external auditor is maintained, including reviewing non-audit services and fees and implementing the Company's audit partner rotation policy. The Committee has primary responsibility for making recommendations to the Board on the appointment, reappointment and removal of the external auditor.

The Committee also reviews annually the Group's systems of internal control and the processes for monitoring and evaluating the risks facing the Group. It reviews the effectiveness of the internal audit function and is responsible for approving the appointment and removal of the Director, Internal Audit. The Committee reviews annually its terms of reference and its effectiveness and recommends to the Board any changes required as a result of such review.

In July 2006 the Board amended the Committee's terms of reference to reflect the Committee's increased emphasis upon Risk Assessment/Management and to formalise the process by which the Committee, in reviewing the effectiveness of the audit, obtains assurance that there is no relevant audit information of which the auditors are not aware.

In the year to 5 August 2006, the Audit Committee discharged its responsibilities by reviewing:

- the Group's 2005 financial statements and 2006 interim results statement prior to Board approval and the external auditor's detailed reports thereon;
- the Company's 2005 full year results restated under the International Financial Reporting Standards and a draft of the IFRS announcement released in November 2005;
- the audit fee and non-audit fees payable to the Group's external auditor;
- the external auditor's effectiveness and plan for the audit of the Group's 2005/06 accounts, which included confirmations of auditor independence and the proposed audit fee, and approving the terms of engagement for the audit;
- an annual report on the Group's systems of internal control and their effectiveness, reporting to the Board on the results of the review and receiving regular updates on key risk areas of financial control;
- the risks associated with major business programmes; and
- the internal audit function's terms of reference, its 2005/06 work programme and regular reports on its work during the year.

The Committee has authority to investigate any matters within its terms of reference, to access resources, to call for information and to obtain external professional advice at the cost of the Company.

No one other than the members of the Committee is entitled to be present at meetings. However, the Chairman and the non-executive directors who are not members of the Committee, the Chief Executive, Finance Director, General Counsel, Group Financial Controller, Director, Internal Audit and external auditor are normally invited to attend. Others may be invited to attend by the Committee. The papers for and Minutes of each Committee Meeting are sent to all directors. At least once a year, there is an opportunity for the external auditor, the Director, Internal Audit and the Director of Business Ethics to discuss matters with the Committee without any executive management being present. The Director, Internal Audit, the Director of Business Ethics and the external auditor have direct access to the Chairman of the Committee outside formal Committee meetings.

The Audit Committee has the specific task of keeping under review the nature and extent of non-audit services provided by the external auditor in order to ensure that objectivity and independence are maintained. Under the audit independence policy, approved by the Committee, certain non-audit services may not be provided by the external auditor, certain services require the approval of the Finance Director and other services require the approval of the Chairman of the Committee. Where the cost of the services is expected to exceed £100,000, the engagement will normally be subject to competitive tender. The external auditor has in place processes to ensure that its independence is maintained including safeguards to ensure that where it does provide non-audit services, its independence is not threatened. The external auditor has written to the Audit Committee confirming that, in its opinion, it is independent.

Remuneration Committee

During the year the Remuneration Committee comprised Sir Julian Horn-Smith, as Chairman of the Committee, Mr Brydon, Sir Nigel Broomfield and Messrs Challen and O'Leary. As previously mentioned, Mr O'Leary died on 14 August 2006.

The Committee's responsibilities are described in the Directors' Remuneration Report on page 40.

The Committee meets periodically when required but at least three times per annum. No one other than the members of the Committee is entitled to be present at meetings but the non-executive directors who are not members of the Committee and the Chief Executive are normally invited to attend and external advisers may be invited by the Committee to attend. No executive is present when the Committee considers matters relating to himself or acts in matters relating to himself. Mr Brydon is absent when his own remuneration as Chairman of the Company is under discussion.

The Committee has access to such information and advice both from within the Group and externally, at the cost of the Company, as it deems necessary. It is responsible for appointing any consultants in respect of executive directors' remuneration. The Committee reviews annually its terms of reference and effectiveness and recommends to the Board any changes required as a result of such review.

Nomination Committee

From 1 August 2005 to 27 February 2006 the Nomination Committee comprised Mr Brydon, as Chairman of the Committee, Mr Jackson and Lord Robertson of Port Ellen. On 27 February 2006 Mr O'Leary replaced Lord Robertson as a member of the Committee and Sir Kevin Tebbit joined the Committee on 12 July 2006. As previously mentioned, Mr O'Leary died on 14 August 2006. From that date the Committee comprised Mr Brydon, as Chairman of the Committee, Mr Jackson and Sir Kevin Tebbit.

The Committee leads the process for identifying, and makes recommendations to the Board regarding, candidates for appointment as directors of the Company and as Company Secretary, giving full consideration to succession planning and the leadership needs of the Group. It also makes recommendations to the Board on the composition of the Nomination Committee and the composition and chairmanship of the Audit and Remuneration Committees. It reviews regularly the structure, size and composition of the Board, including the balance of skills, knowledge and experience and the independence of the non-executive directors, and makes recommendations to the Board with regard to any changes.

The Committee meets periodically when required. No one other than members of the Committee is entitled to be present at meetings but the non-executive directors who are not members of the Committee and the Chief Executive are normally invited to attend and external advisers may be invited by the Committee to attend.

The Committee has access to such information and advice both from within the Group and externally, at the cost of the Company, as it deems necessary. This may include the appointment of external search consultants, where appropriate. The Committee reviews annually its terms of reference and effectiveness and recommends to the Board any changes required as a result of such review.

The procedures referred to above were used by the Nomination Committee in the appointment of Sir Kevin Tebbit as a non-executive director with effect from 14 June 2006 and Mr Langston as Finance Director with effect from 6 September 2006.