

CORPORATE GOVERNANCE

THE BOARD AND ITS PRINCIPAL COMMITTEES

Details of the Board and its principal Committees are set out below. Attendance at meetings by individual Directors during 2006 is shown next to the Director's name. All of the Committees are authorised to obtain legal or other professional advice as necessary, to secure the attendance of external advisers at their meetings and to seek information required from any employee of the Company in order to perform their duties. The full terms of reference of the Committees are available on the Company's website at www.nationalexpressgroup.com.

The Board of Directors

Ten meetings were held during the year.

Richard Bowker <i>Chief Executive</i> (appointed to the Board 12 September 2006)	(4)
Jorge Cosmen <i>Non Executive Director</i>	(10)
Sir Andrew Foster <i>Non Executive Director</i>	(9)
Barry Gibson <i>Senior Independent Director</i>	(9)
Sue Lyons <i>Non Executive Director</i>	(10)
Ray O'Toole <i>Chief Operating Officer</i>	(10)
David Ross <i>Chairman</i>	(10)
Tim Score <i>Non Executive Director</i>	(10)
Phil White <i>Chief Executive</i> (resigned from the Board 11 September 2006)	(6)
Adam Walker <i>Finance Director</i>	(10)

Company Secretary: Tony McDonald (also acts as Secretary to the Board Committees).

There is a formal schedule of matters reserved for the Board's attention which includes the review and approval of Group strategy and policies, major business acquisitions or disposals, major capital projects, Group budgets, significant changes to accounting policies, capital structure and dividend policy.

Audit Committee

Four meetings were held during the year.

Tim Score <i>Chairman</i>	(4)
Sir Andrew Foster	(4)
Barry Gibson	(3)

The Committee oversees the process for selecting the external auditor, assesses the continuing independence of the external auditor and recommends approval of the audit fee to the Board. It is responsible for ensuring that provision of non audit services does not impair the external auditors' independence or objectivity. It discusses with the external auditor the nature and scope of the audit and any issues or concerns arising from the audit process. The Committee reviews the internal audit programme, considers major findings of the internal audit investigations and reviews management's financial reporting and risk management. The Committee reviews the half-year and annual financial statements and the effectiveness of the Company's internal control and risk management systems.

Remuneration Committee

Seven meetings were held during the year.

Barry Gibson <i>Chairman</i>	(6)
Sue Lyons	(7)
Tim Score	(7)

The Committee is responsible for determining broad policy for the remuneration of the Executive Directors (including the Chief Executive), the divisional Chief Executives, the Chairman of the Company and the Company Secretary. Within the terms of the agreed policy the Committee will determine the total individual remuneration package of each Executive Director including, where appropriate, bonuses, incentive payments, pension arrangements and share options. The Committee is responsible for selecting, appointing and setting the terms of reference for any remuneration consultants who advise the Committee. The Committee ensures that contractual terms on termination, and any payments made, are fair to the individual and the Company, that failure is not rewarded and the duty to mitigate loss is, where appropriate, fully recognised.

Nomination Committee

Three meetings were held during the year.

David Ross <i>Chairman</i>	(3)
Sir Andrew Foster	(3)
Sue Lyons	(3)
Jorge Cosmen	(3)

The Committee is responsible for identifying and nominating for the approval of the Board, candidates to fill Board vacancies as and when they arise. It will give full consideration to succession planning, and keep under review the leadership needs of the organisation, both executive and non executive. The Committee reviews annually the time required from a Non Executive Director and uses performance evaluation to assess whether the Non Executive is spending enough time to fulfil their duties.

Safety and Environment Committee

Four meetings were held during the year.

Sue Lyons <i>Chairman</i>	(4)
Jorge Cosmen	(4)
Sir Andrew Foster	(3)
Barry Gibson	(3)
David Ross	(4)
Tim Score	(4)

The Committee reviews the Group's safety and environment practices, procedures and record.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Annual Report and Accounts contain the accounts and reports of the Directors, including the Report on Directors' Remuneration, in accordance with applicable United Kingdom law and International Financial Reporting Standards as adopted by the European Union or, in the case of the Company's accounts, UK GAAP. The Directors are required to prepare accounts for each financial year that present fairly the financial position of the Company and of the Group and the financial performance and cash flows of the Group for that period. The financial statements of the Company are required by law to give a true and fair view of the state of affairs and of the profit or loss for that period. In preparing those accounts the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- present information and accounting policies in a manner that provides relevant, reliable and comparable information; and
- state that the Company and the Group have complied with applicable accounting standards, subject to any material departures disclosed and explained in the accounts.

The Directors confirm that these accounts comply with the above requirements.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

CORPORATE GOVERNANCE

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The Board supports the highest standards of corporate governance and ethical practices within all its operations and continues to review its policies on an ongoing basis. The Board has endorsed a set of principles which establish the framework for how its businesses operate. Key to these is working in an open and honest manner.

STATEMENT OF COMPLIANCE WITH THE COMBINED CODE

In the opinion of the Directors the Company has complied with Section 1 of the Combined Code on Corporate Governance published in 2003 (the 'Combined Code') throughout the year apart from provision B.1.6.9 (notice periods) as follows:

- the notice period of Ray O'Toole, which previously had been 12 months, was increased to 24 months as at 1 September 2006. This period reduces on a daily basis such that on 1 September 2007 the notice period will be 12 months. This change was approved by the Remuneration Committee on the appointment of a new Chief Executive to the Group to try to ensure continuity of management.

APPLYING THE PRINCIPLES OF GOOD GOVERNANCE

The Board of Directors, Chairman and Chief Executive

The Directors believe it is essential for the Group to be led and controlled by an effective Board that provides entrepreneurial leadership within a framework of sound controls. The Board is responsible for setting the Group's strategic aims, its values and standards and ensuring the necessary financial and human resources are in place to achieve its goals.

The Board consists of the Chairman, three Executive and five Non Executive Directors. The offices of Chairman and Chief Executive are held separately and the division of responsibilities between the Chairman and Chief Executive is shown below.

Main responsibilities of the Chairman include:

- chairing and managing the business of the Board;
- together with the Chief Executive, leading the Board in developing the strategy of the business and ensuring this is effectively implemented by the executive management team;
- ensuring that there is effective dialogue with investors concerning mutual understanding of objectives;
- in conjunction with the Nomination Committee, taking responsibility for the composition and replenishment of the Board;
- periodically reviewing with the Board its working practices and performance; and
- ensuring there is effective contribution from the Non Executive Directors and a constructive relationship between the Executive and Non Executive Directors.

Main responsibilities of the Chief Executive include:

- the development and implementation of management strategy;
- the day-to-day management of the Group;
- managing the executive management team; and
- fostering relationships with key stakeholders.

Barry Gibson is the Senior Independent Director. The Board considers all of the Non Executive Directors to be independent other than Jorge Cosmen, and considered David Ross to be independent prior to his appointment as Chairman. Mr Cosmen is not considered to be independent by the Board due to his close links with the Alsa business and significant interests in the shares of the Company which are held through European Express Enterprises Limited. The Non Executives bring a variety of different experiences and considerable knowledge to assist with Board decisions. Non Executive Directors do not participate in any of the Company's share option or bonus schemes and their service is non pensionable. Short biographies of the Directors are to be found on page 29.

The Board meets at least eight times during the year. In 2006 the Board visited businesses in Spain and North America. There is a formal schedule of matters reserved for the Board's decision, the main terms of which are shown on page 32 together with the attendance record of the Directors. During the year the Chairman met on several occasions with the Non Executives without the Executive Directors present to allow informal discussions on a variety of issues.

The Executive Directors are responsible for the day-to-day management of the Group's businesses, implementation of its strategy, policies and budgets and its financial performance. Executive management meetings, involving the Executive Directors and senior management from the divisions are held regularly to discuss current issues.

The Company purchases liability insurance to cover the directors and officers of the Company and its subsidiaries.

COMMITTEES OF THE BOARD

The Board has established a number of Committees with defined terms of reference and receives reports of their proceedings. The principal Committees are the Remuneration Committee, the Nomination Committee, the Audit Committee and the Safety and Environment Committee. The members of each Committee, attendance and main duties are shown on pages 32 to 33. In addition there is an Executive Committee with authority to approve routine matters of business and a Tax and Treasury Committee which reviews the Group's tax planning, banking facilities and treasury reports.

APPOINTMENTS TO THE BOARD

The Nomination Committee leads the process for Board appointments and makes recommendations to the Board. The Committee will prepare a description of the role and requirements for any particular appointment based on its evaluation of the Board as a whole.

The terms and conditions of appointment of the Non Executive Directors are available for inspection at the Company's registered office during normal business hours and at the Annual General Meeting of the Company. The Non Executive Directors disclose to the Board their other significant commitments. External advisers are normally appointed when recruiting Board members; they use as a basis for their search a description of the role and capabilities required for a particular appointment proposed by the Nomination Committee.

THE WORK OF THE NOMINATION COMMITTEE

The members of the Nomination Committee are David Ross (Chairman), Sir Andrew Foster, Sue Lyons and Jorge Cosmen.

Before making a recommendation for an appointment to the Board the Nomination Committee:

- prepares a job specification and a description of the capabilities required for a particular post;
- considers the current composition of the Board and mix of skills and experience; and
- where appropriate, and in particular where a vacancy for a Non Executive Director arises, will use an external search consultancy and/or open advertising.

During the year the Committee:

- considered the appointment of a new Chief Executive in view of the forthcoming retirement of Phil White;
- appointed search consultants for the Chief Executive's position;
- interviewed candidates for this position following which Richard Bowker was appointed as the new Chief Executive in September 2006.

INFORMATION AND PROFESSIONAL DEVELOPMENT

Reports from the Executive Directors, which include in-depth financial information, are circulated to Board members prior to every Board meeting. Senior management and advisers give presentations to the Board on significant matters during the year.

Under the direction of the Chairman, the Company Secretary is responsible for ensuring Board procedures are followed and applicable rules and regulations are complied with and advises the Board on governance matters. All Directors have access to the advice and services of the Company Secretary and the appointment or removal of the Company Secretary is a matter for the Board as a whole. There is a procedure in place for any Director to take independent professional advice where considered necessary.

On appointment, Directors are offered an appropriate training course and are thereafter encouraged to keep abreast of matters affecting their duties as a Director and to attend training courses relevant to their role. An induction process is in place for new Directors the aims of which are to:

- build an understanding of the nature of the Company, its business and the markets in which it operates;
- establish a link with the Group's employees;
- build an understanding of the Group's main relationships including stakeholders and customers.

PERFORMANCE EVALUATION

During the year the annual performance evaluation, led by the Senior Independent Director, was undertaken by an external third party. The evaluation covered in scope the Board's performance, its Committees and the Chairman. The evaluation process involved a detailed questionnaire with input from all of the Directors followed by individual interviews. Feedback was given to individual Directors and to the Board as a whole and action plans were developed as appropriate. These will be reviewed as part of the 2007 evaluation.

RE-ELECTION

In accordance with the Company's Articles of Association all Directors submit themselves for election at the Annual General Meeting following their appointment and thereafter by rotation at least once every three years. Non Executive Directors are appointed for specific terms, subject to re-election. Non Executive Directors will only be put forward for re-election if, following performance evaluation, the Board believes the Director's performance continues to be effective and demonstrates commitment to the role.

REMUNERATION AND SERVICE CONTRACTS

The report on Directors' remuneration including details of remuneration policy and service contracts is set out on pages 38 to 44.

ACCOUNTABILITY AND AUDIT

Statements of the responsibilities of the Directors and Auditors are set out on pages 33 and 45 respectively.

Internal control

The Board's responsibilities

The Board has overall responsibility for the Group's system of internal control and for reviewing its effectiveness. The Board maintains full control and direction over appropriate strategic, financial, operational and compliance issues and has put in place an organisational structure with formally defined lines of responsibility, delegated authorities and clear operating processes. The systems that the Board has established are designed to safeguard both the shareholders' investment and the assets of the Group, and are described below.

CORPORATE GOVERNANCE

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Key elements of the control framework

Strategic and financial planning – an annual budgeting and strategic planning process has been established whereby each division and constituent operating company assesses its competitive position and goals, taking account of the strategic risks faced. This strategy is translated into a financial plan with clear milestones and performance indicators.

Performance management – the performance of each division and operating company against its plan is closely monitored by a formal monthly reporting process and by the attendance of the Executive Directors at monthly divisional board meetings.

Annual fitness check process – a self assessment review takes place at each operating company to assess the integrity of the balance sheet and to challenge the effective operation of key financial and information systems controls within each material accounting cycle. This process is led by divisional finance Directors and is closely monitored by group finance and validated by the internal audit function.

Capital investment – a clear process is in place for the approval of capital expenditure, which includes detailed appraisal of the benefits of the proposed investment and any associated key risks. Material capital expenditure requires Board approval.

Health and Safety – Health and safety standards and benchmarks have been established in all our businesses and the performance of operating companies in meeting these standards is closely monitored.

Risk management reporting process – each division and operating company evaluates its internal control environment and key risks, and the results are cascaded through management levels and the Audit Committee before being presented to the Board. This process is reviewed on a regular basis to ensure the validity and relevance of the key risks reported and presented to the Board on a quarterly basis, unless exceptional issues arise. The review covers strategic, financial, compliance and risk management controls. These procedures are mandated and designed to manage the risk in order to ensure that the operations achieve their business objectives.

Internal audit – the internal control system is independently monitored and supported by an outsourced internal audit function. The internal audit function reports to management and the Audit Committee on the Group's financial and operational controls, and reviews the extent to which its recommendations have been implemented.

Board-level reporting on internal control – during the year the Audit Committee has reviewed regular reports from the internal audit function, the external auditors, and executive management on matters relating to internal control, financial reporting and risk management. The Audit Committee provides the Board with an independent assessment of the Group's financial position, accounting affairs and control systems. In addition, the Board receives regular reports on how specific risks that are assessed as material to the Group are being managed.

Review of internal control effectiveness

The system of internal control and risk management, described above, has been in place for the year under review and up to the date of approval of this Annual Report and Accounts. Such a system is designed to manage, rather than to eliminate, the risks inherent in achieving the Group's business objectives, and can therefore provide only reasonable and not absolute assurance against material misstatement or loss. The effectiveness of this system has been regularly reviewed by the Directors in line with the Guidance for Directors in the Combined Code published by the Financial Reporting Council (Turnbull guidance).

Audit Committee and auditors

THE WORK OF THE AUDIT COMMITTEE

Members of the Committee are Tim Score (Chairman), Sir Andrew Foster and Bary Gibson. Attendance by the members is shown on page 32.

The Committee meets at least three times a year and met four times in 2006. The agenda reflects the duties delegated to it by its Terms of Reference details of which are summarised on page 32. There are a number of standing items considered during the year such as consideration of the internal and external audit reports, review of the annual report and accounts, review of the preliminary and interim announcements, and review of the Corporate Governance Report.

Other items that were considered and discussed during 2006 included a review of the 2006 internal and external audit plans, Alsa financial integration, annual fitness checks within the subsidiaries and the external auditors' performance and fees.

At the invitation of the Committee, and as appropriate to the matters under discussion, meetings may be attended by the Executive Directors and internal and external auditors. Full minutes are kept by the Secretary of the matters considered and decisions taken by the Committee. Outside of the meeting process the Committee Chairman has regular contact with the Executive Directors, other Committee members and the auditors on a variety of topics.

Review of external auditors

The Audit Committee assesses and reviews on a regular basis the independence of the external auditors. As part of their determination the Audit Committee considers a report by the external auditors on the firm's independence which is required in order to carry out their professional duties and responsibilities as auditors.

Policy on auditors providing non audit work

The Committee has an approved policy on the provision of non audit services. The policy sets the approvals policy for the following types of service:

- services that are considered to have 'general pre-approval' by the Audit Committee, by virtue of the approval of the policy;
- services that require 'specific pre-approval', on a case-by-case basis, before any work can commence; and
- services that cannot be supplied by the external auditors ('prohibited services').

The services that require specific pre-approval are tax, transaction, investigation and valuation, advisory and corporate finance services. The fees for these services are pre-approved up to a level of 25% of the total fees paid to the external auditors. For services exceeding this limit specific pre-approval is required.

In deciding whether or not to grant approval for the provision of specific services by the external auditors, the Audit Committee includes in its consideration the following factors:

- i) whether the external auditing firm is best placed to provide an effective and efficient service, given its familiarity with the Company's processes, systems and people; and
- ii) the level of non audit fees paid to the external auditors in the year as a proportion of the annual external audit.

The majority of non audit work undertaken by the external auditors during the year relates to two items. These were tax advisory and compliance services and financial due diligence work for North American acquisitions. These items the Committee believes would be impractical and costly to provide through another party.

WHISTLEBLOWING POLICY

A Group 'whistleblowing' policy has been issued to all group companies to ensure a consistent approach across the Group.

RELATIONS WITH SHAREHOLDERS

Dialogue with institutional shareholders

The Board maintains regular dialogue with its institutional shareholders and fund managers through a variety of meetings and presentations throughout the year. Presentations are given by the Executive Directors following the full year and half year results to institutional investors, analysts and brokers which the Non Executive Directors may attend. In addition, the Company's brokers provide confidential feedback to the Company on the views of the major institutions following the interim and final results. An informal review of the opinions of the Company's major investors was undertaken in 2006. In 2007 it is intended that a formal review is undertaken asking for feedback on financial performance and management.

During the year written responses are given to correspondence received from shareholders and all shareholders receive copies of the Annual Report and Accounts or the Annual Review and Summary Financial Statement and the Interim Report. The Company has introduced an electronic communications facility to enable shareholders to receive documentation such as the Annual Report and Accounts electronically and also to cast their votes by proxy electronically. The Company has also introduced an electronic proxy appointment service for CREST members.

The Company's website, www.nationalexpressgroup.com, houses wide-ranging information about the Group, including the final and interim announcements, Annual Report and Accounts, press releases, share price data and links to subsidiary company websites.

The Annual General Meeting

The Annual General Meeting provides an opportunity for all shareholders to question the Chairman and Directors on a variety of topics, and information is provided at the meeting on different aspects of the Group's activities. All of the Company's Directors are present at the meeting. Proxy votes, including the number of abstentions, are displayed on the resolutions following the result on a display of hands. Notice of the Annual General Meeting and related papers are sent to shareholders at least 20 working days before the meeting.