



**Fiona Smith**

General Counsel and  
Company Secretary

**Compliance with the Combined Code**

The Combined Code sets out standards of good practice that listed companies are expected to follow in areas such as board composition and development, remuneration, accountability and audit and relations with shareholders. This report describes how Severn Trent has applied the principles of good corporate governance as set out in the Combined Code on Corporate Governance issued by the Financial Reporting Council in 2006 (Combined Code).

Throughout the year ended 31 March 2009, Severn Trent was compliant in its application of the Combined Code, with the exception of Code Provision A.3.2 which requires that at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. Martin Houston retired from the board as an independent non-executive director on 23 January 2009 and the board announced its intention to commence the search for a suitable independent non-executive director to appoint to the board at that date. Gordon Fryett was appointed to the board on 22 May 2009, effective from 1 July 2009.

**Review of governance framework**

In 2008, we undertook a review of the Severn Trent Governance Framework. The purpose of the review was to ensure that:

- the framework accurately reflected recent changes to the Severn Trent organisation and structure;
- the framework set out and reinforced Severn Trent's values and supported the Severn Trent group in working and behaving in the right way;
- the risk and assurance processes were a robust and integral part of the framework; and
- the framework reflected best governance practices.

The review completed in November 2008. We have now embarked on a plan to embed the framework throughout Severn Trent.

The Severn Trent Governance Framework has three key elements:

- the way Severn Trent is structured, our organisation is structured to allow for effective and efficient decision making with clear accountabilities;
- the way we work at Severn Trent, our Code of Conduct sets out the way in which we work at Severn Trent and comprises our vision and values. The Code of Conduct is supported by our policies, standards, procedures and processes. Our values, set out in our Code of Conduct, can be viewed in full on our website. Our values are supported by 15 high level policies which define in more detail how we will carry out our responsibilities and the general rules under which we will operate. Our policies are approved by the board; and
- the way we assure our performance, management assurance is provided by a combination of effective management processes and embedded risk and compliance activities. Independent assurance is provided primarily by internal audit, by our independent external auditors and by other external bodies.

**The way we are structured**

**The board**

The role of the Severn Trent board is to promote and protect the interests of the group, setting highest standards of governance and corporate behaviour.

The board has processes in place regarding:

- its own tasks and activities (board membership and administration);
- the matters specifically reserved for board decision making, the authority delegated to the Chief Executive (CEO), the accountability of the CEO for that authority, and guidance on managing the relationship between the board and the CEO; and
- the boundaries on CEO action (CEO limits).

An approved Board Governance document outlines those processes and is available on our website [www.severntrent.com](http://www.severntrent.com)

**Membership**

The board consists of a non-executive Chairman, five executive directors and five independent non-executive directors, ensuring an appropriate balance of experience and independence. The board announced the appointment of Gordon Fryett with effect from 1 July 2009. Gordon will also sit on the Corporate Responsibility Committee.

The members of the board are:

**Non-executive directors**

Sir John Egan – Chairman  
Dr Bernard Bulkin  
Richard Davey  
Gordon Fryett\*  
Martin Lamb  
Baroness Noakes

**Executive directors**

Tony Wray – CEO  
Tony Ballance  
Martin Kane  
Michael McKeon  
Andy Smith

\* appointed with effect from 1 July 2009

**Chairman**

Sir John Egan joined the board in October 2004 and became Chairman on 1 January 2005. The role of the Chairman is to facilitate the work of the board at its meetings, and be responsible for ensuring that the principles and processes of the board are maintained in line with the Board Governance document. The Chairman sets the agenda for each meeting in consultation with the CEO and Company Secretary. Any director may request that an item be added to the agenda. The Chairman has authority to act and speak for the board between its meetings, including engaging with the CEO. The Chairman reports to the board and committee Chairmen as appropriate on decisions and actions taken between meetings of the board. The Chairman also meets with the non-executive directors without the executive directors present to consider their performance and provide feedback.

**Senior independent non-executive director**

Richard Davey is the senior independent non-executive director. He chairs the Remuneration Committee and is a member of the Audit and Nominations Committees. The board has agreed that Richard Davey will act as Chairman of the board in the event that the Chairman is unable to do so for any reason. The non-executive



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directors, led by the senior independent non-executive director, meet at least once a year, without the Chairman present, where there is an opportunity for them to appraise the Chairman's performance.

#### Non-executive directors – role and independence

The Chairman and the non-executive directors contribute external expertise and experience in areas of importance to the group such as corporate finance, general finance, corporate strategy, environmental matters, general management and corporate governance. They also provide independent challenge and rigour in the board's deliberations.

The board has reviewed the status of the non-executive directors and considers them all to be independent in character and judgment and within the definition of this term in the Combined Code.

#### Reappointment

At this year's annual general meeting (AGM), to be held on 21 July 2009 it is proposed that the directors listed below stand for reappointment.

- Sir John Egan
- Tony Ballance
- Tony Wray

In accordance with the company's articles of association, a total of three directors (being nearest to, but not more than one third of the board) are required to stand for reappointment at least every three years. Directors chosen for reappointment will vary and these directors have the longest service since their last reappointment.

The Nominations Committee formally reviewed the performance, contribution and commitment of each of the retiring directors in March 2009. The committee supports and recommends their reappointment to the board. The committee has confirmed that each director standing for reappointment continues to perform well on an individual and collective basis, making a valuable contribution to the board's deliberations and demonstrating commitment to the long term interests of the company.

In addition, Gordon Fryett will stand for election having been appointed to the board since last year's annual general meeting.

#### Administration

The Chairman has prime responsibility for the effective workings of the board.

The board has reserved the following for its own consideration:

- the appointment of the CEO, directors, the Company Secretary and the Director of Internal Audit;
- the strategy and budgets of the company;
- the Group Authorisation Arrangements which set out the group's delegated approval limits;
- decisions regarding the company and its subsidiaries required to be made by the company's Group Authorisation Arrangements, constitutional documents, statute or external regulation; and
- the approval or adoption of documents (including the publication of reports and statements to shareholders), required to be made by the board by the company's Group Authorisation Arrangements, constitutional documents, statute or external regulation.

The board has regular scheduled meetings throughout the year and committees of the board are established to deal with specific issues or approvals, as and when necessary. During the financial year, 10 committee meetings of the board were convened to consider such matters as results announcements and the submission of the Severn Trent Water Limited Draft and Final Business Plans to Ofwat.

In addition to the formal board meetings, two full day strategy sessions were held this year, where the board and executive management team together considered the cost of capital for the Price Review 2009, the business plan for 2010-15, as submitted to Ofwat and the opportunities presented by competition in the water sector.

Papers, including minutes of board committees held since the previous board meeting and performance reports are circulated in advance of each meeting.

There is an agreed procedure in place which allows directors to take independent professional advice in the course of their duties and all directors have access to the advice and services of the Company Secretary. Where a director has a concern over any unresolved matter he/she is entitled to require the Company Secretary to minute that concern. Should the director later resign over the issue, the Chairman will bring it to the attention of the board.

#### Board attendance in 2008/09

Sir John Egan	11/11	Martin Lamb	9/11
Tony Ballance	11/11	Michael McKeon	11/11
Dr Bernard Bulkin	11/11	Baroness Noakes	11/11
Richard Davey	11/11	Andy Smith	11/11
Martin Houston	8/10	Tony Wray	11/11
Martin Kane	11/11		

#### Induction

On joining the board, directors are provided with a comprehensive induction pack, tailored to their individual requirements, including notes on the group structure, the regulatory framework of the operating businesses within the group, financial reports and business plans and information on the governance framework. Meetings are arranged with members of the executive management team, management and external advisers who provide support to the relevant board committees the directors may serve on. Visits to operational sites across the group are also arranged for directors joining the board.

#### Continuing professional development

Regular seminars, arranged to coincide with board meetings, are held to update and refresh the board's knowledge and understanding on a variety of topics.

#### Succession planning

The board plans for its own succession with the assistance of the Nominations Committee. In doing this, the board:

- considers the skills, knowledge and experience necessary to allow it to meet the strategic vision for the business;

- assesses the skills, knowledge and experience currently represented;
- identifies any skills, knowledge and experience not adequately represented and agrees the process necessary to ensure a candidate is selected who brings those qualities; and
- reviews how board performance might be enhanced, both at an individual director level and for the board as a whole.

When considering new appointments to the board, the Nominations Committee oversees the preparation of a position specification that is provided to an independent recruitment organisation retained to conduct a global search. In addition to the specific skills, knowledge and experience deemed necessary, the specification contains criteria such as:

- a proven track record of creating shareholder value;
- unquestioned integrity;
- a commitment to the highest standards of governance;
- having the required time available to devote to the job;
- strategic mind set, an awareness of market leadership, outstanding monitoring skills;
- a preparedness to question, challenge and openly assess; and
- an independent point of view.

Newly appointed directors must submit themselves to shareholders for election at the first AGM following their appointment.

#### Performance and effectiveness reviews

During the last financial year the board participated in a formal evaluation of its own performance and that of individual directors. To ensure independence and objectivity the review was undertaken by Praesta Partners LLP.

The three core conclusions from the formal independent review were that:

- (1) the board is effective across key aspects of its role and supporting processes;
- (2) the directors wish to continue to move the emphasis of the board's attention from detailed operational issues to long term strategic issues; and
- (3) the board want to structure the future corporate meetings calendars and content of the agendas to support the move in emphasis.

Collectively, the board is satisfied that the actions undertaken during 2008/09 have aided it in achieving its objective. The board is also satisfied that it has all of the necessary skills, experience and qualities to lead the company.

#### Remuneration

The Directors' remuneration report is set out on pages 40 to 53.

#### Interests

No director had a material interest at any time during the year in any contract of significance with the company or any of its subsidiary undertakings.

#### Conflicts of interests

The Companies Act 2006 (the Act) rules on directors' conflicts came into force on 1 October 2008. These rules provide statutory duties:

- a duty not to accept benefits from third parties;
- a duty to disclose any interest in a proposed transaction or arrangement with the company and a separate and independent duty to disclose any interest in an existing transaction or arrangement with the company (transactional conflicts); and
- a duty to avoid conflicts of interest (situational conflicts) unless authorised.

The Act allows board authorisation of situational conflicts where the directors have the relevant powers. The shareholders of the company approved a change to the articles of association at the 2008 AGM to allow the board to authorise conflicts.

In September 2008, the directors were requested to complete a questionnaire to determine whether any actual or potential conflicts needed authorisation. The board fully reviewed the completed questionnaires and noted that no conflicts arose.

For any actual or potential conflicts that arise post 1 October 2008, the following procedure has been adopted by the board to consider and, if it sees fit, to authorise situations where a director has an interest that conflicts, or may possibly conflict, with the interests of the company:

- the director will notify the Chairman and Company Secretary of the actual or potential conflict;
- the Nominations Committee will consider the notification and determine whether it needs to be proposed to a board meeting for authorisation; and
- the conflict will be considered by the board at a scheduled board meeting.

Full details of the conflict will be sent to directors in advance of the meeting. If there is a major conflict or it is decided that authorisation should not wait until the next scheduled meeting, the board would be asked to authorise the conflict by way of written resolution.

In addition to reviewing any conflicts notified and proposing them for authorisation by the board, the Nominations Committee monitors changes to previously notified conflicts and any conditions imposed. Half yearly reports are made to the board of all directors' conflicts and directors are reminded from time to time of their obligations. An annual review of conflicts is carried out and this is incorporated into the year end process of verifying directors' interests.

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### Insurance and indemnities

Severn Trent purchases directors' and officers' liability and indemnity insurance to cover its directors and officers against the costs of defending themselves in civil proceedings taken against them in that capacity, and in respect of damages resulting from the unsuccessful defence of any proceedings.

### Terms and conditions of appointment

The terms and conditions of appointment of the directors are available for inspection by any person at the company's registered office during normal business hours and will be available at the AGM.

### Board committees

The board has established four permanent committees to assist in the execution of its responsibilities and has delegated some of its responsibilities to those board committees. The committees assist the board by focusing on their specific activities, fulfilling their roles and responsibilities, reporting to the board on decisions and actions taken, and making any necessary recommendations.

The terms of reference of the Audit, Remuneration and Nominations Committees (the Principal Committees) comply with the provisions of the Combined Code and are available for inspection, together with the terms of reference of the Corporate Responsibility Committee, on the company's website ([www.severntrent.com](http://www.severntrent.com)) or may be obtained on written request from the Company Secretary at the address given on the back cover.

Each of the committees has reviewed its effectiveness and terms of reference during the year and any necessary actions have been identified and reported to the board.

The committees of the board, their roles and membership are as follows.

#### *Audit Committee*

This report provides details of the role of the Audit Committee and the work it has undertaken during the year. The purpose of the committee is to assist the board in discharging its responsibilities for the integrity of the company's financial statements, the assessment of the effectiveness of the systems of internal controls and monitoring the effectiveness and objectivity of the internal and external auditors. The full terms of reference for the committee can be found on the company's website ([www.severntrent.com](http://www.severntrent.com)) and are also available from the Company Secretary.

Baroness Noakes, a Fellow of the Institute of Chartered Accountants of England and Wales, is a former senior partner of KPMG and former member of the Court of the Bank of England. Richard Davey is the non-executive Chairman of London Capital Holdings Plc and a non-executive director of Yorkshire Building Society and the former Head of Investment Banking at N M Rothschild & Sons. The board is satisfied that these directors have recent and relevant financial experience.

The Chairman, Chief Executive, the Finance Director, the Director of Internal Audit, the Director of Regulation, the Group Financial Controller, the Company Secretary and the external auditor normally attend, by invitation, all meetings of the committee. Other members of senior management are also invited to attend as appropriate to present reports. In performing its duties, the committee has access to the services of the Director of Internal Audit, the Company Secretary and external professional advisers.

The committee follows an agreed annual work plan. It reviews, with members of management and the internal and external auditors, the company's financial announcements, including the annual report and accounts, to shareholders and associated documentation. It places particular emphasis on their fair presentation and the reasonableness of the judgmental factors and appropriateness of significant accounting policies used in their preparation. At each meeting, the committee receives a report from the Director of Internal Audit concerning the company's systems of internal control, including any significant new issues and actions taken on previously reported issues. The committee also reviews the annual work plan for the group's internal audit function. The committee reports to the board regarding the effectiveness of the group's overall systems of internal control including the risk management systems in relation to the financial reporting process.

The committee additionally reviews the integrity of the processes that ensure the quality and reliability of the information within the annual regulatory return (June Return) of Severn Trent Water Limited, submitted to the Water Services Regulation Authority (Ofwat) and the integrity of the processes that ensure compliance with the requirements of the annual principal statement submitted to Ofwat, including the intentions and the rationale behind tariff proposals for the coming charging year and compliance with licence Condition E. The committee receives reports from the Reporter, an independent professional appointed by Severn Trent Water Limited and approved by Ofwat. The Reporter's role is to act as a professional commentator and certifier on the regulated activities of Severn Trent Water Limited.

The committee receives reports from the external auditor and regularly holds discussions with both the internal and external auditors in the absence of management. The Chairman of the committee reports to the subsequent meeting of the board on the committee's work and the board receives a copy of the minutes of each meeting of the committee.

#### *Internal audit*

The group's internal audit function reports to management on the effectiveness of the company's systems of internal controls, the adequacy of these systems to manage business risk and to safeguard the group's assets and resources. The internal audit function and Director of Internal Audit are employed by Severn Trent Plc. Through the Director of Internal Audit, the internal audit function provides objective assurance on risks and controls to the committee.

The plans, the level of resources and the budget of the internal audit function are reviewed at least annually by the committee.

**External auditor**

Deloitte LLP (Deloitte) was appointed auditor of the company in 2005. Following the annual external audit effectiveness review the committee recommended that the auditor be proposed for reappointment at the annual general meeting. Deloitte audits all significant subsidiaries of the group.

During the year, the company reviewed and approved a formal policy on the provision of non audit services aimed at safeguarding and supporting the independence and objectivity of the external auditor. The revised policy aims to provide greater clarity on what services may and may not be provided by the group's external auditor.

The policy sets out the approach to be taken by the group when using the services of the external auditor, including requiring that certain services provided by the external auditor are pre-approved by the Audit Committee or Audit Committee Chairman. It distinguishes between those services where an independent view is required and that should be performed by the external auditor (such as statutory and non statutory audit and assurance work), prohibited services where the independence of the external auditor could be threatened and they must not be used, and other non audit services where the external auditor may be used. Non audit services where the external auditor may be used include (not exclusively): non recurring internal controls and risk management reviews (i.e. excluding outsourcing of internal audit work), advice on financial reporting and regulatory matters, due diligence on acquisitions and disposals, project assurance and advice, tax compliance services, and employee tax services. The approval of the Audit Committee or its Chairman is always required if a non audit service provided by the auditors is expected to cost more than £100,000 or if non audit fees for the year would thereby exceed the amount of the audit fee.

Annually, the committee reviews information provided by the external auditor confirming its independence and objectivity within the context of applicable regulatory requirements and professional standards.

Details of the amounts paid to Deloitte for audit and non audit services are provided in note 7 to the accounts (page 68).

**Audit Committee Members in 2008/09**

Baroness Noakes (Chairman)                      Richard Davey  
Dr Bernard Bulkin

**Secretary**

Kerry Porritt

**Audit Committee Attendance in 2008/09**

Baroness Noakes                      4/4  
Dr Bernard Bulkin                      4/4  
Richard Davey                          4/4

**Corporate Responsibility Committee**

The purpose of the committee is to provide guidance and direction to the group's corporate responsibility (CR) programme, review the

key CR risks and opportunities and to monitor progress. The full terms of reference for the committee can be found on the company's website ([www.severntrent.com](http://www.severntrent.com)) and are also available from the Company Secretary.

The Corporate Responsibility Committee assists the board by focusing on the following activities, reporting to the board on decisions and actions taken, and making any necessary recommendations:

- review the effectiveness of the group's policies and systems for identifying and managing the health, safety, environment and community risks that are material to the group, including those reports made under the group's Whistleblowing Policy;
- review the policies and systems within the group for ensuring compliance with health, safety, environment and community regulatory requirements;
- review the performance of the group having regard to the impact of health, safety, environment and community decisions and actions on employees, communities and third parties and on the reputation of Severn Trent; and
- review the quality and integrity of corporate responsibility reporting to external stakeholders.

During the year, the Corporate Responsibility Committee's agenda included such items as the review and recommendation for approval to the board the company's Health and Safety Policy, Corporate Responsibility Policy, Community Policy, Environment Policy and Whistleblowing Policy; approval of the group's annual Corporate Responsibility Measures and Targets; and the review of the introduction of new Employee and Contractor Safety Rules for the group; the group supply chain process; and, the consideration of a report on reducing the group's carbon footprint.

More information on our approach to corporate responsibility can be found at [www.severntrent.com/corporateresponsibility](http://www.severntrent.com/corporateresponsibility)

**Corporate Responsibility Committee Members in 2008/09**

Dr Bernard Bulkin (Chairman)                      Martin Houston\*  
Sir John Egan    Tony Wray

\* retired 23 January

**Secretary**

Kerry Porritt

**Corporate Responsibility Committee Attendance in 2008/09**

Sir John Egan    5/5  
Dr Bernard Bulkin                                      5/5  
Martin Houston    1/1  
Tony Wray    5/5

**Nominations Committee**

This report provides details of the role of the Nominations Committee and the work it has undertaken during the year. The main purpose of the committee is to assist the board by keeping the composition of the board under review and conducting a rigorous and transparent process when making or renewing appointments of directors to the board. It also advises the board on issues of

directors' conflicts of interest and independence. The full terms of reference for the committee can be found on the company's website ([www.severntrent.com](http://www.severntrent.com)) and are also available from the Company Secretary.

The committee keeps under review the balance of skills on the board and the knowledge, experience, length of service and performance of the directors. It also reviews their external interests with a view to identifying any actual, perceived or potential conflicts of interests, including the time available to commit to their duties to the company. The committee monitors the independence of each non-executive director and makes recommendations concerning such to the board. The results of these reviews are important when the board considers succession planning and the election and reappointment of directors. Members of the committee take no part in any discussions concerning their own circumstances.

During the year the board accepted the committee's recommendations that Gordon Fryett join the board. The appointment of Gordon Fryett as a new non-executive director from 1 July 2009 also helps to maintain the balance of the board in the context of the retirement of Martin Houston during 2009. In respect of Mr Fryett's appointment the committee engaged an external search agency to help it identify suitable candidates with the skills and capabilities required and to assist with the preparation of an interview list.

#### *Nominations Committee Members in 2008/09*

Sir John Egan (Chairman)	Martin Lamb
Dr Bernard Bulkin	Baroness Noakes
Richard Davey	Tony Wray
Martin Houston*	

\* retired 23 January

#### *Secretary*

Fiona Smith

#### *Nominations Committee Attendance in 2008/09*

Sir John Egan	3/3
Dr Bernard Bulkin	3/3
Richard Davey	3/3
Martin Houston	2/2
Martin Lamb	3/3
Baroness Noakes	3/3
Tony Wray	3/3

#### *Remuneration Committee*

The Remuneration Committee assists the board by focusing on the following activities, reporting to the board on decisions and actions taken, and making any necessary recommendations:

- the remuneration policy and its application to the CEO and executives reporting to the CEO;
- the adoption of annual and longer term incentive plans;
- determination of levels of reward to the CEO and approval of reward to executives reporting to the CEO;
- guidance to the Chairman on the annual evaluation of the CEO; and

- the communication to shareholders on remuneration policy and the committee's work on behalf of the board.

Further details on the work of the committee during the year can be found in the remuneration report on pages 40 to 53. A resolution to approve the Directors' remuneration report will be proposed at the AGM.

#### *Remuneration Committee Members in 2008/09*

Richard Davey (Chairman)	Sir John Egan
Dr Bernard Bulkin	Martin Houston*

\* retired 23 January

#### *Secretary*

Fiona Smith

#### *Remuneration Committee Attendance in 2008/09*

Sir John Egan	6/6
Dr Bernard Bulkin	6/6
Richard Davey	6/6
Martin Houston	5/5

#### *Company Secretary*

All directors have access to the advice and services of the Company Secretary, Fiona Smith, and the Company Secretariat team. The Company Secretary is responsible for ensuring that the board operates in accordance with the governance framework it has adopted and that there are good information flows to the board and its committees and between senior management and the non-executive directors.

The appointment and resignation of the Company Secretary is a matter for consideration by the board as a whole.

#### *Chief Executive*

The board has delegated all responsibility beyond its matters reserved to the CEO to achieve the company's strategy. The CEO, Tony Wray, is empowered to take all decisions and actions that further the company's strategy and which in his judgment are reasonable, having regard to the CEO limits set out in the company's Group Authorisation Arrangements.

The CEO is supported by the executive management team, who together comprise the Executive Committee. During the year, the Executive Committee comprised the executive directors and senior executive managers responsible for key operational and central functions.

#### *Executive Committee*

The Executive Committee is chaired by the CEO, Tony Wray, and oversees the development and execution of the Severn Trent strategy. It also has accountability for achieving business results. The terms of reference of the Executive Committee are available on the company's website ([www.severntrent.com](http://www.severntrent.com)) or may be obtained on written request from the Company Secretary at the address given on the back cover.



Shareholder 2008  
Networking  
Programme

The visit to the water treatment facility enabled us to get a good oversight of the processes involved. I was particularly interested in your ability to produce electricity from the sludge to power the process itself and to sell the surplus to the National Grid.

### Talent review and succession planning

Talent review and succession planning are annual company wide processes designed to give Severn Trent a clear and objective view of the capability of our current and potential leadership population to deliver our future business performance.

They also enable the organisation to focus its company wide future leadership development activity and develop succession plans for senior roles.

In 2007/08 the processes included Executive Committee to middle manager levels across the group, and employees at the next level down in 2008/09. The executive team identified from the talent review individuals with the potential to develop as successors for their own roles and for a role or roles in their individual leadership teams. As a result each Executive Committee member has a succession plan, highlighting both roles where we are at risk as there is no or little internal resource identified as a successor and potential future roles for discussion with individuals identified in the succession plan, in order to inform their development plans. Individuals identified as having potential to be future leaders are then invited to participate in a range of development activities or programmes, depending on their needs, to ensure we maximise their ability to realise their potential.

### The way we work

#### Code of Conduct

Our Code of Conduct provides a common framework for all Severn Trent employees irrespective of their specific job, direct employer or location.

Further details of the Code of Conduct can be found on our website [www.severntrent.com](http://www.severntrent.com)

#### Governance of subsidiaries

The board of the listed company, Severn Trent Plc, is the same as that of its regulated water subsidiary, Severn Trent Water Limited. This decision was taken in 2007 when it was decided to integrate the management of the listed company with the management of the regulated entity to gain greater focus, transparency and effectiveness around the regulated business.

The two companies operate as distinct legal entities. The boards have regard to the Severn Trent Plc Board Governance document and the Severn Trent Water Limited Matters Reserved to the board, and are assisted through the management of separate agendas, meetings and minutes by the Company Secretariat and are advised in their meetings by the Company Secretary where appropriate.

Subsidiary company boards are required to be managed scrupulously with respect to all legal, fiscal and administrative matters. In particular, the relationships between Severn Trent Water Limited, the regulated entity, and our non-regulated companies such as Severn Trent Services are monitored and controlled to ensure that we comply with our Ofwat obligations on arm's length transactions. Certain overseas subsidiaries may have specific

obligations to comply with local requirements and the Company Secretariat will define these.

#### Group Authorisation Arrangements

The Group Authorisation Arrangements (GAA) are the framework through which the Severn Trent Plc board authorises the right people, at the right level, to take important decisions as we manage legal, financial and administrative issues throughout the group. The GAA are designed to facilitate good control, efficient decision making and demonstrable compliance.

The flow of authority is from the Severn Trent Plc board. In respect of certain issues, the delegated authority is subject to an obligation to work with specialist Corporate Centre Departments (such as Taxation, Treasury, Finance and Company Secretariat) that provide additional expertise and a group wide perspective.

#### Reporting obligations

As a publicly listed company, the company has a range of reporting obligations to meet which are set out by law and regulation. The company is committed to the promotion of investor confidence by taking steps within its power to ensure that trade in its securities takes place in an efficient and informed market.

The company recognises the importance of effective communication as a key part of building shareholder value and that, to prosper and achieve growth, it must (among other things) earn the trust of security holders, employees, customers, suppliers and communities, by being open in its communications and consistently delivering on its commitments.

The company announces its results on a half yearly basis and complies with its requirement to make interim management statements.

#### Shareholders

The board recognises the importance of representing and promoting the interests of its shareholders and that it is accountable to shareholders for the performance and activities of the company.

#### Institutional shareholders and analysts

Presentations are made to shareholders and analysts following the release of the interim and year end results. The CEO and Finance Director meet shareholders during the year. The Chairman and, if appropriate, the senior independent non-executive director are available to meet shareholders if required. The board receives written feedback following meetings with institutional shareholders.

#### Retail shareholder engagement strategy

The board has an active shareholder engagement strategy, the main elements of which are set out below.

The annual report and accounts is the principal means of communicating with shareholders. E-communications were approved by shareholders as an alternative means of receiving company information at the 2007 annual general meeting. As at



Everyone explained their part in the work of the company clearly, and showed that it has a commercial workforce.

Shareholder 2008  
Networking  
Programme

31 March 2009, 42,773 shareholders receive company communications via electronic methods whilst 26,323 shareholders continue to receive communications by post.

The company's website ([www.severntrent.com](http://www.severntrent.com)), was redesigned and relaunched in May 2008. The relaunched website is now easier to navigate and use and contains an archive of annual reports together with other information relevant to investors. This includes comprehensive share price information, financial results and financial calendars.

From July 2009, to coincide with the company's final dividend, the company is offering a Dividend Reinvestment Plan (DRIP). Details of the DRIP were sent to shareholders in January and June 2009 and are available on the company website and the website of Equiniti, our Registrars.

Further shareholder information can be found on pages 115 to 116.

#### Annual General Meeting

The Severn Trent Plc AGM will take place at 2pm on 21 July 2009 at the International Convention Centre in central Birmingham.

The AGM is shareholders' opportunity to feedback to the company on performance, management and the way we work in a very direct fashion – through the way they vote – either in favour of the resolution, against the resolution or by withholding their vote so that it does not count either for or against. It is also shareholders' opportunity to meet informally with directors and senior management before and after the meeting and ask formal questions during the meeting.

The board encourages shareholders to attend the company's AGM and exercise their right to vote. The notice of meeting and related papers are sent to shareholders at least 20 working days before the meeting. Separate resolutions are proposed on each substantially separate issue.

Presentations are made on the group's activities and performance prior to the formal business of the meeting. Shareholders have the opportunity to ask questions of the board and present their views. The Chairmen of the Audit, Corporate Responsibility, Remuneration and Nominations Committees, together with all other directors will attend the AGM.

In 2008, the company introduced electronic voting at the AGM, allowing shareholders present at the meeting to register one vote per share held. The company intends to continue with this initiative at the 2009 AGM. Results of the poll on each resolution, including details of the votes for and against registered prior to and at the meeting, proxy votes and the number of abstentions will be displayed at the meeting.

The poll results and a list of questions and answers from the AGM will be made available on our website after the meeting.

The exhibition area planned for the 2009 AGM will include informative, and some interactive, stands based around a selection of the company's operational areas of the business and approach to corporate responsibility.

At the 2008 AGM, 52 shareholders registered for Severn Trent's Shareholder Networking Programme. The programme allows a small number of shareholders the opportunity to find out first hand how the company works.

The 2008 site visit was fully attended and shareholders spent a day visiting one of our Customer Relations sites and a sewage treatment works in Derbyshire accompanied by two of our executive directors. Our shareholders attended a small number of presentations informing them of the business improvements being made in each of the Customer Relations, Water and Waste Water service areas and also had an opportunity to observe and speak with our employees.

We received very constructive feedback from the visits and the board encourages those shareholders attending the 2009 AGM to register for this year's visit.

#### The way we assure our performance

##### Internal controls

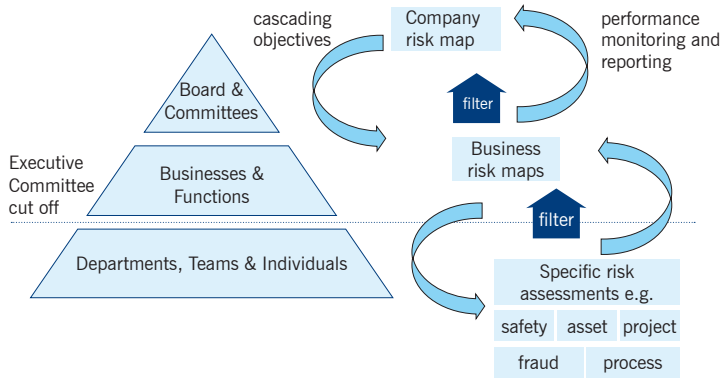
The board has overall responsibility for the group's system of internal control and for reviewing its effectiveness. The board reviews the effectiveness of the system of internal control, including financial, operational, compliance and risk management, at least annually in accordance with the requirements of the Combined Code and the guidance set out within it. The system of internal control is reviewed for effectiveness and adequacy. The internal control system can only provide reasonable and not absolute assurance against material misstatement or loss, as it is designed to manage rather than eliminate the risk of failure to achieve business objectives.

The board reviews the risk management process and the effectiveness of the system of internal control through the Audit Committee. The board also keeps under review ways in which to enhance the control and audit arrangements in the group. The Audit Committee receives reports every six months from the CEO on the significant risks and uncertainties faced by the group, an assessment of the effectiveness of controls over each of those risks and an action plan to improve controls where this has been assessed as necessary. Any significant control weaknesses that have been identified as requiring remedy are also reported to the Audit Committee. The internal audit department provides objective assurance and advice on risk management and control. The external auditors also report on significant control issues to this committee.

The board confirms that procedures providing an ongoing process for identifying, evaluating and managing the principal risks and uncertainties faced by the group have been in place for the year to 31 March 2009 and up to the date of the approval of the Annual Report.

# Risk assurance

## Risk management process



### Risk Management

Severn Trent carried out a fundamental review of its approach to risk management, which commenced around 18 months ago.

The journey to implement the process started with our core business activities, and the company is now implementing the approach throughout our substantial change programme in order to give a consistent approach to the management of risks across all key programmes.

Our process includes both top down and bottom up elements and established reporting thresholds. The risk management process focuses on strategic risks managed by executive and senior management, with a process for escalation of significant risks identified at lower levels.

The approach the company uses is objective driven, making this a useful tool for both business planning and performance management, and the company aims to increase the use of risk management information within these processes.

The use of graphical reporting presents the risk information in a simple and understandable format. The reports include an assessment of the effectiveness of controls which allows management to focus its attention on those areas requiring the most improvement.

On a six monthly basis, the Executive and Audit Committees receive a risk map highlighting the key risks faced by the group, together with a 'change in risk profile' report illustrating how the risks have moved over the last six months including new risks identified, risks closed, changes in the assessment of financial impact or likelihood of the risks, changes in the overall assessment of control effectiveness, information on completed improvement actions and an overview of key actions still in progress. In addition, the board and other committees receive detailed information on specific risks identified throughout the year.

### Principal Risks and Uncertainties

During the year, the board and the Executive and Audit Committees have received relevant reports to allow them to consider and monitor our key risks and uncertainties. The key risk themes which we are currently facing, and a high level summary of some of our responses to those risks, are described in the table on page 33.

More detailed information on specific financial risk factors can be found on pages 84 and 85.

### Key to impacts

F = Financial      E = Environmental      B = Brand / reputation  
 H = Health & Safety      R = Regulatory      O = Operational

### Assurance Framework

Severn Trent is building a robust governance framework based on clear organisational structure and decision making, sound policies and standards, and assurance of the outcomes. The board and other key stakeholders need a transparent methodology which delivers and validates the outcome of activities.

The company expects roles to be performed in line with specific annual job objectives. Employees performing their roles properly, preparing and reporting outcomes on time and to the required standard is a key component in our Assurance Framework.

The company is working to embed the compliance, verification and performance activities in Severn Trent. These are within business areas and sometimes within discrete functions. These confirm that operational activities have been performed properly in the line.

Lastly, the company maintains an independent perspective on the overall framework by obtaining confirmation that the governance structure is working properly. In Severn Trent, this is obtained primarily from the internal audit function and the external auditor.

In order to provide an appropriate understanding of how these responsibilities come together for Severn Trent, the company has developed a description of the key elements over which assurance is required by the board. This is maintained by the Director of Internal Audit on behalf of the Executive.

A map details the areas over which Severn Trent has decided to gain specific assurance. These may vary from year to year. The criteria by which each area for assurance is selected are:

- potentially damaging to reputation;
- material financial impact; and
- linked to the corporate KPIs.

Internal audit will confirm the details of the assurance provision to cover:

- who is responsible;
- what is the activity; and
- how is this recorded.

Internal audit deliver an audit plan to confirm that key business risks are being mitigated. It also delivers specific, tested opinions on those areas for which it, as a function, is responsible.

Risk area / impacts	Risk theme	Response
<b>Financial</b> <i>F, B, R, O</i>	Achieve funding for the Group to meet business needs.	We have a diversified source of funds and have recently successfully raised £400m through a sterling bond issue.
	Effectively manage counterparty exposure and risk for investments.	We have policies in place which limit the available counterparties and ensure a spread of investments. There is also regular monitoring of counterparties and investment performance.
<b>Legal / Regulatory</b> <i>F, B, R</i>	Deliver robust, reliable and timely information to regulators and other relevant bodies.	We have a defined process in place with clear ownership for activities and an established quality assurance process requiring business sign off on all information submitted, together with independent audits by both internal and external auditors.
	Effectively manage compliance with existing and future laws and regulations affecting our business operations.	We monitor actual and proposed changes in law and regulation and seek to ensure that we change our processes to reflect any relevant requirements.
<b>Strategy and Growth</b> <i>F, B, R</i>	Achieve an acceptable final determination from Ofwat for Severn Trent Water Limited.	We have submitted our final business plan and will continue to work closely with Ofwat. As part of our business plan, we have formulated responses to a number of different aspects of this risk including deflation, reduced consumption and increased bad debt.
	Achieve sustainable benefits through the Severn Trent Water Limited change programme which includes elements such as managerial upskilling, office rationalisation and substantial technology changes.	We are implementing a programme governance framework including risk and issue management, dependency management and benefits tracking. There is regular and close monitoring of performance.
	Achieve the growth plans for our unregulated business.	We have strong, market leading products and good market knowledge, and we are establishing a local presence in our target markets. We have reviewed our organisation design and implemented changes where appropriate. In addition, there is a regular and close monitoring of performance.
<b>Operational</b> <i>F, B, R, H, O, E</i>	Achieve a 'zero by choice' approach in relation to Health and Safety issues.	We have Health and Safety policies which are communicated across the organisation, including to our contractors. We have defined systems and processes for the reporting, investigation and management of accidents and near misses. There is regular and close monitoring of performance, including audits.
	Effectively maintain and improve our asset base to improve performance and operational resilience and meet customer demands.	We have a programme of capital investment to maintain and improve our asset base, together with a programme of asset inspection to identify and resolve potential problems. We are investing to ensure that no community with a population greater than 30,000 is reliant on a single source of supply by the end of AMP5. We plan to extend this programme to communities with populations between 20,000 and 30,000 during AMP6.
	Effectively manage the supply chain particularly in view of the changing economic environment.	We are monitoring critical suppliers and developing contingency plans where risk of business failure is high. We have plans to reduce reliance on single sources of supply.
	Provide robust, resilient and secure IT services to ensure current day to day business operations can be carried out to an agreed level of service.	We continuously review our policies, standards and processes in order to improve performance. We also have disaster recovery arrangements, a service continuity team and third party disaster recovery capability.
<b>Corporate Responsibility</b> <i>F, B, R, O, E</i>	Operate the business in a responsible way, including changing customer and stakeholder behaviours towards water and waste water services to reduce water use and pollution events.	We have a corporate responsibility programme in place which is aligned to our business priorities. We undertake a variety of awareness raising activities designed to further educate customers and the wider public on responsible water use, including a leakage reduction and water efficiency awareness campaign and a campaign to reduce disposal of fats, oils and greases into the sewerage network.
	Effectively manage our processes to achieve or exceed relevant environmental standards.	We have resilience built into our treatment plants and networks, together with monitoring and alarms in place on our key processes.