

Promoting online reporting

The Annual Report and Accounts is the principal means of communicating with shareholders. The group adopted e-communications after they were approved by shareholders as an alternative means of receiving company information at the 2007 annual general meeting. As at 31 March 2010, 42,449 shareholders receive company communications via electronic methods whilst 27,385 shareholders continue to receive communications by post. You can visit our website at www.severntrent.com



Governance

Directors' report

The directors present their report, together with the audited financial statements of the group for the year ended 31 March 2010.

Principal activity

The principal activity of the group is to provide and treat water and remove waste water in the UK and internationally.

Details of the principal joint ventures, associated and subsidiary undertakings of the group at 31 March 2010 appear in notes 19, 20 and 40 to the financial statements on pages 84 and 111.

Business review

The Chairman's statement, the Chief Executive's (CE) review, the report and performance reviews for the group's main businesses and the financial review on pages 9 to 27 provide detailed information relating to the group and its strategy, the operation of its businesses and the results and financial position for the year ended 31 March 2010.

Details of the principal risks and uncertainties facing the group are set out in the risk and assurance section on pages 58 to 60.

All of the above are incorporated by reference in (and are deemed to form part of) this report.

Directors and their interests

Biographies of the directors currently serving on the board are set out on pages 32 and 33.

Details of changes to the board during the year and of the directors offering themselves for reappointment at the Annual General Meeting (AGM) are set out in the Chairman's letter on pages 35 to 40.

Details of directors' service agreements are set out in the Directors' remuneration report on page 52. The interests of the directors in the shares of the company are shown on pages 55 to 57 of that report.

Directors' indemnities

The company's articles of association provide that directors of the company shall be indemnified by the company against any costs incurred by them in carrying out their duties including defending any proceedings brought against them arising out of their positions as directors in which they are acquitted or judgment is given in their favour or relief from any liability is granted to them by the court.

Employees

The average number of employees within the group is shown in note 9 to the financial statements on page 77.

Severn Trent believes that a diverse and inclusive culture is a key factor in being a successful business. Apart from ensuring an individual has the ability to do the job we do not discriminate in any way and make every effort to ensure that those with disabilities are able to be employed by us. We ensure that training, career development and promotion opportunities are available for all our employees irrespective of their gender, race, age or disability.

The group actively encourages employee involvement and consultation and places emphasis on keeping its employees informed of its activity and financial performance by way of briefings and publication to staff of all relevant information and corporate announcements. To help develop employees' interest in the company's performance, Severn Trent offers two employee share plans. The Severn Trent Sharesave Scheme, an HM Revenue and Customs approved SAYE plan, is offered to UK employees on an annual basis. The Severn Trent Share Incentive Plan, approved by HM Revenue and Customs, makes an annual award of shares to

Severn Trent Plc and Severn Trent Water Limited employees, based on performance against the KPIs.

Research and development

Expenditure on research and development is set out in note 7 to the accounts on page 76.

Treasury management

The disclosures required under the EU Fair Value Directive in relation to the use of financial instruments by the company are set out in note 21 to the accounts on pages 85 to 96. Further details on our treasury policy and management are set out in the financial review on page 26.

Post balance sheet events

Details of post balance sheet events are set out in note 38 to the group financial statements on page 110.

Dividends

An interim dividend of 26.71 pence per ordinary share was paid on 15 January 2010. The directors recommend a final dividend of 45.61 pence per ordinary share to be paid on 30 July 2010 to shareholders on the register on 18 June 2010. This would bring the total dividend for 2009/10 to 72.32 pence per ordinary share (2009: 67.34 pence). The payment of the final dividend is subject to shareholder approval at the AGM.

Capital structure

Details of the company's authorised issued share capital and of the movements during the year are shown in note 30 to the financial statements on page 103. The company has one class of ordinary shares which carries no right to fixed income. Each share carries the right to one vote at general meetings of the company. The issued nominal value of the ordinary shares is 100% of the total issued nominal value of all share capital.

There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the general provisions of the articles of association and prevailing legislation. The directors are not aware of any agreements between holders of the company's shares that may result in restrictions on the transfer of securities or on voting rights.

Details of employee share schemes are set out in note 33 to the financial statements on pages 104 to 107. For shares held by the Severn Trent Employee Share Ownership Trust, the trustee abstains from voting.

No person has any special rights of control over the company's share capital and all issued shares are fully paid.

With regard to the appointment and replacement of directors, the company is governed by its articles of association, the Combined Code on Corporate Governance, the Companies Act and related legislation. The articles may be amended by special resolution of the shareholders. The powers of directors are described in the Board Governance document, the articles and the Chairman's letter on pages 35 to 40.

Under its articles of association, the directors have authority to allot up to 197,166,322 ordinary shares, subject to the aggregate nominal amount limit set at the 2009 AGM.

There are a number of agreements that take effect after, or terminate upon, a change of control of the company, such as commercial contracts, bank loan agreements, property lease arrangements and employee share plans. None of these are considered to be significant in terms of their likely impact on the

business of the group as a whole. Furthermore, the directors are not aware of any agreements between the company and its directors or employees that provide for compensation for loss of office or employment that occurs because of a takeover bid.

Substantial shareholdings

As at 24 May 2010 the company had been notified in accordance with chapter 5 of the Disclosure and Transparency Rules of the following major shareholdings:

Name of holder	Percentage of voting rights and issued share capital	No. of ordinary shares of 97 ^{77/100} p each
Pictet Asset Management SA	7.6%	17,718,717
Invesco Limited	5.0%	11,980,630
Legal & General Group Plc	3.9%	9,403,273

Percentages rounded down to one decimal place

Authority to purchase shares

The company was given authority at its AGM in 2009 to make market purchases of ordinary shares up to a maximum number of 23,646,774 shares. Similar authority will again be sought from shareholders at this year's AGM. No market purchases were made by the company during the year ended 31 March 2010.

Supplier payment policy

Individual operating companies within the group are responsible for establishing appropriate policies with regard to the payment of their suppliers. The companies agree terms and conditions under which business transactions with suppliers are conducted. It is group policy that provided a supplier is complying with the relevant terms and conditions, including the prompt and complete submission of all specified documentation, payment will be made in accordance with agreed terms. It is also group policy to ensure that suppliers know the terms on which payment will take place when business is agreed. Details of supplier payment policies can be obtained from the individual companies at the addresses shown in note 40 to the financial statements on page 111. Trade creditors for the group at the year end are estimated as representing 44.1 days' purchases (2009: 39.3 days' purchases).

Contributions for political and charitable purposes

Donations to charitable organisations during the year amounted to £326,382 (2009: £352,201). Donations are given to charities whose projects align closely with our aim to promote the responsible use of water resources and waste water services which provide the opportunity for longer term partnerships. In addition we provide donations to employee nominated charities through a matched funding scheme and health and safety reward schemes. We are also committed to supporting WaterAid, the UK's only major charity dedicated to improving access to safe water, hygiene and sanitation in the world's poorest countries.

In 2008/09 a provision of £5 million was established for additional contributions to the Severn Trent Charitable Trust as agreed with Ofwat. Severn Trent Water paid £2 million additional contributions in that year and a further £2 million in 2009/10. The remaining £1 million is due to be paid in 2010/11.

Severn Trent's policy is not to make any donations for political purposes in the UK, or to donate to EU political parties or incur EU political expenditure. Accordingly neither Severn Trent Plc nor its subsidiaries made any political donations or incurred political expenditure in the financial year under review.

Under the provisions of the Political Parties Elections and Referendums Act 2000 (the relevant provisions of which are now contained in Part 14 of the Companies Act 2006), shareholder authority is required for political donations to be made or political expenditure to be incurred by the company or any of its subsidiaries in the EU and disclose any such payments in the annual report. The legislation gives a wide definition of what constitutes political donations and political expenditure including sponsorship, subscriptions, payment of expenses, paid leave for employees fulfilling public duties and support for bodies representing the business community in policy review or reform. The company has therefore obtained limited authority from shareholders as a precautionary measure to allow the company to continue supporting the community and such organisations without inadvertently breaching the legislation.

At the 2009 AGM, shareholders gave the company authorities to make political donations or to incur political expenditure in the EU (which would not ordinarily be regarded as political donations) up to an aggregate annual limit of £50,000 for the company and its subsidiaries. Pursuant to those authorities, during the year ended 31 March 2010 the group incurred costs of nil (2009: nil). Those authorities will expire at the 2010 AGM and, in line with market practice to renew the authorities on an annual basis, the board has decided to put forward a resolution to this year's AGM to renew the authorities to make donations to political organisations and to incur political expenditure up to a maximum of £50,000 per annum. As permitted under the Companies Act 2006, this resolution also covers any political donations made, or political expenditure incurred, by any subsidiaries of the company.

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

Analysis of shareholdings at 31 March 2010

Category	Number of shareholders	% of shareholders	Number of shares	% of shares
Individual and joint accounts	69,352	91.18	26,885,645	11.36
Other*	6,708	8.82	209,699,560	88.64
Total	76,060	100.00	236,585,205	100.00

Size of holding	Number of shareholders	% of shareholders	Number of shares	% of shares
1-499	55,834	73.41	10,910,098	4.61
500-999	13,203	17.36	9,280,858	3.92
1,000-4,999	5,995	7.88	10,257,090	4.34
5,000-9,999	313	0.41	2,080,100	0.88
10,000-49,999	341	0.45	8,179,494	3.46
50,000-99,999	104	0.14	7,440,826	3.15
Over 100,000	270	0.35	188,436,739	79.65
Total	76,060	100.00	236,585,205	100.00

* Includes insurance companies, nominee companies, banks, pension funds, other corporate bodies, limited and public limited companies

Governance – Directors' report (continued)

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 Audit Committee reviews the risk management process and the effectiveness of the system of internal control on behalf of the board. It 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 CE 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 financial 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 2010 and up to the date of approval of the Annual Report.

External auditors

In the case of each of the persons who are directors of the company at the date when this report was approved:

- so far as each of the directors is aware, there is no relevant audit information of which the company's auditors are unaware; and
- each of the directors has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Relevant audit information means information needed by the company's auditors in connection with preparing their report.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Deloitte LLP have indicated their willingness to continue as auditors. A resolution to reappoint Deloitte LLP will be proposed at this year's AGM.

The Audit Committee has recommended to the board the reappointment of Deloitte LLP and a resolution to that effect will be on the agenda at the AGM. The Audit Committee will also be responsible for determining the audit fee on behalf of the board.

Accounts of Severn Trent Water Limited

Regulatory accounts for Severn Trent Water Limited are prepared and sent to Ofwat. A copy of these accounts will be available from the website of Severn Trent Water Limited (www.stwater.co.uk) or on written request to the Company Secretary (at the address given on the back cover). There is no charge for this publication.

Going concern

The group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chief Executive's review on page 5 and the business reviews of Severn Trent Water and Severn Trent Services on pages 9 to 17 and 19 to 21. The financial position of the group, its cash flows, liquidity position and borrowing facilities are described in the Financial review on pages 23 to 26. The group's objectives, policies and processes for managing its capital and its financial risk management objectives are described in the Financial review and in the Governance report

on pages 28 to 60. Details of the group's financial instruments, hedging activities and exposure to credit risk and liquidity risk are described in note 21 to the group financial statements.

The group's principal operating subsidiary, Severn Trent Water, is a regulated long term business characterised by multi year investment programmes. The group's strategic funding objectives reflect this. The group therefore seeks to attain a balance of long term funding or commitment of funds across a range of funding at the best possible economic cost. Average debt maturity is 17 years and the effective average interest cost during the year was 5.6%. The group is in a strong liquidity position with £227.8 million in cash and liquid reserves and £650 million of undrawn committed bank facilities, which are expected to be sufficient to fund its investment and cash flow needs for at least the first year of the AMP5 period.

Severn Trent Water operates in an industry that is currently subject to economic regulation rather than market competition. Ofwat, the economic regulator, has a statutory obligation to set price limits that it believes will enable the water companies to finance their activities. As a consequence the directors believe that the group is well placed to manage its business risks successfully despite the current uncertain economic outlook.

The directors are proposing to increase the limit on the company's borrowing powers set out in its articles of association (articles) which are out of line with the company's current borrowing requirements and require the directors to restrict the borrowings of the group to two and a half times its adjusted capital and reserves. This amendment is part of a comprehensive update of the company's articles to be proposed at the AGM to reflect the final provisions of the Companies Act 2006 which came into effect last year. Whilst carrying out this update the directors became aware that the group's borrowings were in excess of this restriction. There was therefore a technical breach of article 102.

The directors have reviewed the implications of this technical breach and have plans in place to address it, including the above resolution. They consider that the resolution to be proposed to the AGM is in the best interests of shareholders and are therefore confident that the resolutions will be passed.

After making due enquiries of this situation and of all other relevant matters, the directors have a reasonable expectation that the company and the group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report and Accounts.

Annual general meeting

The AGM of the company will be held at the International Convention Centre, Broad Street, Birmingham B1 2EA at 11am on Tuesday 20 July 2010. The notice convening the meeting, together with details of the business to be considered and explanatory notes for each resolution, is distributed separately to shareholders. It is also available on the company's website: www.severntrent.com

By order of the board



Fiona Smith
General Counsel and Company Secretary
27 May 2010