

# Governance

## Chairman's letter



**Sir John Egan**  
Chairman

### Governance in Severn Trent

#### The way we are structured

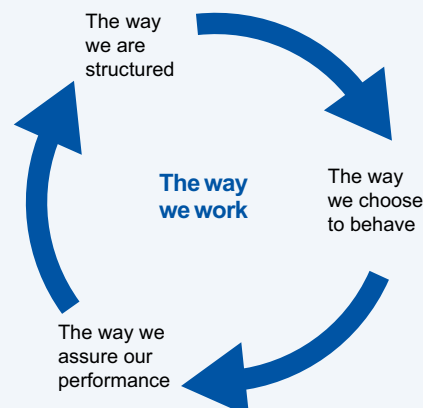
- Our organisation is structured to allow for effective and efficient decision making with clear accountabilities.

#### The way we choose to behave

- Our Code of Conduct sets out our approach to responsible business behaviours.
- The Code of Conduct is supported by 14 group policies and our behaviour model. Further details of the Code of Conduct can be found on our website [www.severntrent.com](http://www.severntrent.com)

#### The way we assure our performance

- Management assurance is provided by a combination of effective management processes and risk and compliance activities.
- Independent assurance is provided primarily by Internal Audit, by our external auditors and other external bodies.



### Dear Shareholder

#### Introduction

I want to set out in this letter how governance underpins our activities in Severn Trent and describe how we apply the principles of good corporate governance as set out in the Combined Code on Corporate Governance issued by the Financial Reporting Council (FRC) in 2008 (Combined Code).

#### 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 how we structure the board appropriately and develop its members, how we pay and reward our executive team, our accountability and audit, and our relationship with our shareholders.

From 1 July 2009 to the year ended 31 March 2010, Severn Trent was fully compliant in its application of the Combined Code. From 1 April 2009 to 30 June 2009, we did not comply with Code Provision A.3.2 which requires that at least half the board, excluding the chairman, should comprise independent non-executive directors.

Martin Houston's unplanned resignation as a non-executive director in January 2009, due to his other work commitments, meant that we needed to appoint another independent non-executive director to your board but it had to be the right director, able to demonstrate complementary skills and experience, to assist in our decision making. We appointed Gordon Fryett with effect from 1 July 2009.

Our compliance with the Combined Code demonstrates our commitment to the highest standards of governance and corporate behaviour. The Combined Code will be replaced next year with the UK Corporate Governance Code. The events in our corporate markets over the past two years necessitated a review of the Combined Code and your board encouraged and supported the changes that the new Code will bring to bear. Our response to the consultation on the review of the Combined Code is available for you to review on the website of the Financial Reporting Council, (FRC) [www.frc.org.uk](http://www.frc.org.uk)

#### Board membership

From 1 July 2009 the board has consisted of me, your non-executive Chairman, five executive directors and five independent non-executive directors. Together, as a unified board, I believe we bring an appropriate balance of innovation, experience, independence and challenge to ensure effective decision making.

Photographs of the members of the board, together with their biographies and a description of the skills that they bring to bear, can be found on pages 32 and 33.

#### Role of the Chairman

I joined the board in October 2004 and was appointed Chairman on 1 January 2005.

During my time as your Chairman, we have successfully established a strong and committed executive team who are driving continuous improvement throughout Severn Trent's activities.

With effect from the end of this year's AGM, on 20 July, I shall retire as your Chairman.

The board engaged Zygos, an independent executive search team, last year to lead the search for my successor and Richard Davey, your senior independent non-executive director chaired the Nominations Committee in the search and recommendation of a successor.

I am delighted that Andrew Duff has agreed to be your Chairman and, having been appointed to the board on 10 May 2010, will stand for reappointment at the AGM.

The role of the Chairman is to lead a unified board, facilitating its members at its meetings, and to be responsible for ensuring that the principles and processes of the board are maintained in line with the Board Governance document.

Agendas for our meetings are agreed in consultation with the Chief Executive (CE) and Company Secretary, although any director may request that an item be added to the agenda. I have authority to act and speak for the board between its meetings, including engaging with the CE. I report to the board and committee Chairmen as appropriate on

## Governance – Chairman’s letter (continued)

### 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 to the CE. In respect of certain issues, the delegated authority is subject to an obligation to work with specialist business services areas (such as Tax, Treasury, Finance and Company Secretariat) that provide additional expertise and a group wide perspective.

### Governance of subsidiaries

The board of the listed company, Severn Trent Plc, is the same as that of its regulated subsidiary, Severn Trent Water Limited. This structure was implemented 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. They are assisted through the management of separate agendas, meetings and minutes by the Company Secretariat and 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 businesses such as Severn Trent Services are monitored and controlled to ensure that we comply with our Ofwat obligations on arm’s length transactions.

decisions and actions taken between meetings of the board. I also meet with the non-executive directors without the executive directors present, to consider the performance of the executive directors and to 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 I am unable to do so for any reason.

During the year, Richard chaired the Nominations Committee, leading the search for my successor.

Due to my role on the steering group and advising the Institute of Chartered Secretaries and Administrators (ICSA) on the review of the Higgs guidance on board effectiveness, Richard also led our board’s response to this consultation. Our response can be found on the FRC website [www.frc.org.uk](http://www.frc.org.uk)

### Non-executive directors

Your non-executive directors are appointed to the board to contribute their external expertise and experience in areas of importance to the group such as corporate finance, general finance, corporate strategy, environmental matters, general management and supply chain management. They also provide independent challenge and rigour in the board’s deliberations and are encouraged to make independent assessments of the company’s competencies. The non-executive directors, led by Richard as the senior independent non-executive director, meet without me at least once a year, where there is an opportunity for them to appraise my performance.

Your 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.

### Chief Executive

The board has delegated all responsibility beyond its matters reserved to the CE to achieve the company’s strategy. The CE, 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 CE limits set out in the company’s Group Authorisation Arrangements (GAA).

### Executive directors

The executive directors support Tony in driving strategy forward in Severn Trent. They are committed to implementing strategy in a responsible way that takes account of our commitment to long term responsible stewardship of the business, the environment, our customers and the communities in which we live and work.

### Role of the 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.

In her role as the group’s General Counsel, Fiona is a part of the Severn Trent executive management team with responsibility for the Business Resilience and Security, Company Secretariat, Legal, Risk, Compliance and Insurance teams.

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

### Induction

On joining the board, directors are evaluated and then provided with a comprehensive and individualised induction pack that includes notes on the group structure, the regulatory framework of the operating businesses within the group, financial reports and business plans and information on our governance framework.

Meetings are arranged with members of the executive management team and external advisers who provide support to the relevant board committees the directors may serve on.

### 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.

### 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. 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.

The company's website ([www.severntrent.com](http://www.severntrent.com)) contains an archive of annual reports together with other information relevant to investors. This includes comprehensive share price information, financial results and financial calendars.

The company offers a Dividend Reinvestment Plan (DRIP). Details of the DRIP are available on the company website and the website of Equiniti, our registrar.

Further shareholder information can be found on pages 123 to 124.

Visits to operational and office 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. During this year, we had sessions to understand and examine the construction and delivery of our business plan for the next five years.

Moving forward, we will be creating individual programmes for learning and development. The programmes will be reviewed by your Chairman with each director as part of the annual performance and effectiveness reviews undertaken by the board.

### Performance and effectiveness reviews

In 2008/09, the board participated in a formal evaluation of its own performance and that of individual directors. To ensure independence and objectivity the review was externally facilitated by Praesta Partners LLP. We noted that although the board was effective across key aspects of its role and supporting processes, the directors felt that they needed to move the emphasis of the board's attention from detailed operational issues to long term strategic issues.

In 2009/10, working closely with Tony Wray, your CE, and Fiona Smith, the Company Secretary, we structured the content of the board and committee agendas to support that move in emphasis.

In April 2010, the board commenced a review of its effectiveness and the effectiveness of its key committees. That review is being led by me, your Chairman, assisted by Fiona Smith, and facilitated by Lintstock, an independent firm of corporate governance advisers. The review is in the form of an online questionnaire to be followed by a series of confidential interviews between each director, the Company Secretary and me. I shall present the results of the review to the board at its meeting in July and the results of that review will form part of my successor's induction pack.

### Board processes

We have processes in place regarding:

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

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

The board has reserved the following for its own consideration:

- the appointment of the CE, directors, the Company Secretary and the Director of Internal Audit;
- the strategy and budgets of the company;
- the GAA which set out the group's delegated approval limits;
- decisions regarding the company and its subsidiaries required to be made by the company's GAA, 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 GAA, constitutional documents, statute or external regulation.

### Financial calendar

16 June 2010	Ex-dividend date for 2009/10 final dividend
18 June 2010	Record date for 2009/10 final dividend
20 July 2010	AGM, International Convention Centre, Birmingham, B1 2EA
30 July 2010	Payment date for proposed 2009/10 final dividend
23 November 2010	Announcement date for 2010/11 interim results
14 January 2011	Payment date for proposed 2010/11 interim dividend

## Governance – Chairman’s letter (continued)

### Reporting obligations

As a publicly listed company, the company has a range of reporting obligations to meet that 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 the requirement to make interim management statements.

### Institutional shareholders and analysts

Presentations are made to shareholders and analysts following the release of the interim and year end results. The Chief Executive 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 and monitors shareholder activity on a quarterly basis at its meetings.

### Board meetings

We have regular scheduled meetings throughout the year.

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, I, as Chairman, will bring it to the attention of the board.

### Board attendance in 2009/10

Sir John Egan	8/8	Martin Lamb	8/8
Tony Ballance	8/8	Michael McKeon	8/8
Dr Bernard Bulkin	7/8	Baroness Noakes	8/8
Richard Davey	8/8	Andy Smith	8/8
Gordon Fryett	5/6	Tony Wray	8/8
Martin Kane	8/8		

Gordon Fryett was unable to attend one scheduled board meeting due to a family commitment arranged prior to his appointment to the board.

Bernard Bulkin was unable to attend one scheduled board meeting due to overseas business commitments.

In both cases, the directors reviewed the relevant agenda and papers and provided comments to me in advance of the meeting.

During the year, we finalised and submitted Severn Trent Water’s business plan for AMP5. In working through this process with the executive management team, we considered the impact of our plans on all of our stakeholders and used our risk management process to help us understand and assess that impact both for the five year period of our plan and our 25 year strategic direction statement.

In addition to the formal board meetings, your board attended one full day strategy session this year, where the board and executive management team together considered Severn Trent Water’s Draft and Final Determination and Severn Trent Services’ growth plan. During the financial year, nine ad hoc meetings of the board were convened to consider such matters as Severn Trent Water’s Draft Determination, Severn Trent Plc’s preliminary and interim results and interim management statements.

### Board committees

We have established committees of the board to deal with specific issues or approvals, as and when necessary.

The four permanent committees of the board assist in the execution of its responsibilities and the board 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 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.

Reports from the Chairmen of these committees are set out on pages 41 to 57 of this report.

### Terms and conditions of appointment

We have made the terms and conditions of appointment of the directors available for inspection by any person at the company's registered office during normal business hours. They will also be available at the AGM. The letters of appointment of the directors can also be seen at our website [www.severntrent.com](http://www.severntrent.com)

### Remuneration

The Directors' remuneration report is set out on pages 45 to 57.

### 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.

### 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 – update

Last year, the Governance report described in full the process that the board had put in place to authorise situational conflicts in accordance with the provisions of the Companies Act 2006.

For any actual or potential conflicts, 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.

### 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 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.

## Governance – Chairman’s letter (continued)

The company uses electronic voting at the AGM, allowing shareholders present at the meeting to register one vote per share held. 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.

At the 2009 AGM, over 75 shareholders registered for Severn Trent’s Shareholder Networking Programme. The aim of the programme is to offer retail shareholders the opportunity to learn more about the company, through a combination of site visits and talking to staff.

The 2009 event was hosted by Martin Kane, Director of Customer Relations and a member of the board, and Fiona Smith, the Company Secretary. Twenty-one participants were taken to Minworth, to our Sewage Treatment Works, for a tour and presentation on renewable energy. This was followed by a visit to Raynesway for a tour of our depot centre and customer contact centre.

Positive feedback was given on the organisation and content with strong support for the company continuing the programme, both from shareholders and employees who enjoyed the positive interest shown in their work and their part in explaining what work they did.

Your board encourages those shareholders attending the 2010 AGM to register for this year’s visit.

### Reappointment

At this year’s AGM, it is proposed that the directors listed below stand for reappointment:

Martin Kane	Baroness Noakes
Martin Lamb	Andy Smith

In accordance with the company’s articles of association, all directors are required to stand for reappointment at least every three years. This year, a total of four directors are retiring by rotation and standing for reappointment. Directors chosen for reappointment will vary and these directors have the longest service since their last reappointment.

In addition, Andrew Duff has been appointed to the board since the 2009 AGM. In accordance with the company’s articles of association he will also stand for reappointment at this year’s AGM.

### Conclusions

During my tenure as Chairman, I have presided over five years which have seen our business move from a position of offering poor service standards in 2005 to completing the delivery of our AMP4 programme successfully, after three years of continuous improvement in our operational, regulatory and customer service performance. Your board has worked effectively in ensuring that we have continued to deliver this marked improvement during 2009/10, together with a strong increase in our underlying profitability. The board has also been successful in starting to deliver a clear long term strategy for Severn Trent, so that we are well placed to take advantage of the opportunities that significant business, policy and regulatory changes may bring during the AMP5 period. In closing my last full year as your Chairman, I would like to thank board members, staff, our shareholders and all our other stakeholders for the support given to me during my tenure with Severn Trent. On behalf of you all, I wish my designated successor, Andy Duff, every success in the new role which he is due to take up on 20 July 2010.



**Sir John Egan**  
Chairman