

Corporate governance

We are committed to high standards of corporate governance and in this section set out how we comply with the principles in the Combined Code, and explain our reasons for any areas of non-compliance.

The Board

In 2006 the effectiveness of the Board was underpinned by a balance between Executive and Non-Executive Directors. The Board believes that it has the skills and experience necessary to provide effective leadership and control of the Company.

Jack Taylor retired from the Board on 17 May, 2006 and, on 18 May 2006, John Roberts was appointed a Non-Executive Director. There were no other changes during the year. At the end of the year the Board comprised of the Chairman (Sir Neville Simms), Executive Directors (Philip Cox, Mark Williamson, Tony Concannon, Steve Riley and Bruce Levy) and four Non-Executive Directors (Tony Isaac, Adri Baan, John Roberts and Struan Robertson). Sir Neville Simms was considered independent on his appointment as Chairman and the four Non-Executive Directors are considered to be independent. Tony Isaac is the Senior Independent Director.

The structure of the Board is not in strict compliance with the Combined Code in that the number of Non-Executive Directors is less than the number of Executive Directors. However, the Directors consider that the Board currently works effectively to carry out its duties and that the Non-Executive Directors have a strong independent presence at Board meetings to provide an effective counter balance to the Executive Directors. The size and structure of the Board is kept under review.

	Board (7 meetings)	Audit Committee (5 meetings) ⁽¹⁾	Remuneration Committee (4 meetings)	Appointments Committee (1 meeting)
Sir Neville Simms	7	n/a	4	1
Philip Cox	7	n/a	n/a	n/a
Adri Baan	7	5	4	1
Tony Concannon	7	n/a	n/a	n/a
Tony Isaac ⁽²⁾	6	5	3	1
Bruce Levy	7	n/a	n/a	n/a
Steve Riley	7	n/a	n/a	n/a
John Roberts ⁽³⁾	3	2	1	–
Struan Robertson	7	4	4	1
Jack Taylor ⁽⁴⁾	3	2	2	n/a
Mark Williamson	7	n/a	n/a	n/a

1. In 2006 the Audit Committee held three main meetings relating to the preliminary statement, the interim statement and audit planning. All members of the Committee attended these meetings. The remainder of the meetings related to quarterly reports and US reporting issues.
2. Tony Isaac missed one Board meeting and one Remuneration Committee meeting during 2006 due to an overriding business commitment. He passed comments on each of the relevant papers to each of the chairmen prior to the meetings.
3. John Roberts joined the Board on 18 May 2006. He has attended all Board and committee meetings since that date except one Board meeting and one meeting each of the Audit, Remuneration and Appointments Committees which was due to a pre-existing commitment at the time of his appointment. For all the meetings he missed, he passed his comments on the relevant papers to each of the chairmen, prior to the meetings.
4. Jack Taylor retired from the Board on 17 May 2006. He attended all Board and committee meetings up to the date of his retirement.



The full Board met seven times during 2006. Attendance by Directors at these and the Board committee meetings held during the year are detailed in the table on page 49.

In addition to the Board and committee meetings, a meeting of the Chairman and the Non-Executive Directors was held without the Executive Directors being present. The Non-Executive Directors also met without the Chairman being present. This meeting was chaired by Tony Isaac, the Senior Independent Director, and included a review of the Chairman's performance.

Board membership

In accordance with the Combined Code and the Company's Articles of Association, all Directors submit themselves for re-election every three years and newly appointed Directors are subject to election by shareholders at the first AGM after their appointment. In addition, the Board seeks to maintain a balance between continuity and new blood amongst the Non-Executive Directors.

In accordance with this policy, Jack Taylor stepped down as a Non-Executive Director at the 2006 AGM and, following a search carried out by an external agency, John Roberts was appointed in his place immediately following the AGM and will submit himself for re-election at the 2007 AGM.

In addition three Directors will submit themselves for re-election at the 2007 AGM in accordance with the three year re-election policy. They are Sir Neville Simms, Steve Riley and Tony Concannon.

Board training

Arrangements are in place to ensure that newly appointed Directors receive a comprehensive briefing on the Company, and training is provided for Directors on their roles and their legal obligations to ensure that they are fully conversant with their responsibilities as Directors. In accordance with this policy John Roberts met all the members of the Executive Management team individually, over a period of two days. In addition he has received guided visits to two power stations in the UK, so that he has a good understanding of the business of the company. A programme of continuous training is also provided for the Directors. Periodically the Board meets at the site of one of the

Group's assets and briefings are also given at Board meetings on particular parts of the business, including regional and functional reviews. In January 2007 the Board visited the Group's business in the Middle East where it met the regional management team and received a briefing about the local business operations. Directors are also kept informed of changes to the regulatory regime such as the revisions to the Combined Code, the new Companies Act and Transparency Directive and the US Sarbanes-Oxley Act. All of the Directors have access to the advice and services of the Company Secretary and also to external independent advice should they so wish.

Insurance

The Company has in place appropriate insurance cover in respect of legal action against its Directors.

Operation of the Board

The Board has responsibility for defining strategy, ensuring the successful implementation of approved projects/proposals and for the financial policies of the Group. It also reviews the risk policies and profile of the Group. It maintains a schedule of all matters requiring specific Board approval. Throughout 2006 this included all strategy decisions and significant capital investment proposals and acquisitions. The Board receives information on capital expenditure projects and investment proposals in advance of Board meetings, as well as management reports on the operational and financial performance of the business. Financial performance is monitored on a monthly basis and the overall performance of the Group is reviewed against approved budgets. At least once a year, the CEO presents a corporate strategy plan to the Board for review and approval. Each investment decision is made in the context of this plan.

The Board has established business values and standards for the Company, which provide a framework for the Company to balance the interests of all its stakeholders in the conduct of its business. The business values (FIRST) are set out in brief in the CEO's statement section of this *Annual Report*. The Company's Code of Business Conduct has been formally adopted by the Board and is set out on the Company's website. This code includes a whistle blowing procedure.



In respect of Board performance for 2006, the Board, following the assessment of Board performance in 2005 by an external facilitator, decided to carry out this assessment internally for 2006. A questionnaire was circulated to the Directors and was discussed in two separate meetings – one with Executive Directors and the other with Non-Executive Directors – chaired by the Chairman and minuted by the Company Secretary. The meetings discussed overall Board performance, the effectiveness of the Board's committees and the contributions of individual Directors. The results of the review demonstrated that the Board members were satisfied with the operation of the Board. The contribution by individual Directors to Board and committee meetings was considered to be high.

Chairman and Chief Executive Officer

There is a clear division of responsibilities at the head of the Company between the roles of the Chairman and the CEO. The Chairman is responsible for the leadership and effective operation of the Board, in terms of its agenda, decision making and the utilisation of the skills and experience of the Directors. He monitors, with the assistance of the Company Secretary, the information provided to the Board to ensure that it is sufficient, pertinent, timely and clear. The Chairman is also responsible for ensuring that there is effective engagement and communication with shareholders. The CEO is responsible for the running of the Company, and leading the executive and operational teams in implementing the strategies approved by the Board.

Philip Cox is also a Non-Executive Director of Wincanton plc. His remuneration from this role is retained by him. His remuneration for the year ended 31 March 2006 was £41,000.

Non-Executive Directors and their function

Through membership of the Board committees, the Non-Executive Directors have responsibilities for: overseeing that systems of internal control and risk management are appropriate and effective; managing the relationship with the external auditor; evaluating the performance of management in meeting targets and objectives; setting the remuneration of Executive Directors; appointing Executive Directors; and planning senior management succession.

Board committees

The Company has established the following committees: the Audit Committee; the Remuneration Committee; and the Appointments Committee. No person other than a committee member is entitled to attend the meetings of these Committees, except at the invitation of the Committee. The full terms of reference for each Committee are available on the Company's website.

Audit Committee

The Committee manages the relationship with the external auditor, including fixing the level of the auditor's remuneration and the scope and adequacy of the audit. The Committee also puts in place policies and procedures to ensure that the external auditor remains independent. The Committee reviews all financial reports (preliminary statement, *Annual Report*, Form 20-F, interim statement and quarterly reports) including consideration of the Group's accounting policies and major judgemental areas. The Committee reviews the effectiveness of the Group's systems of internal control, and reviews the scope (and the annual plan) of the internal audit function and satisfies itself of its adequacy, particularly in terms of resources and its performance against its annual plan. In addition it reviews the report prepared by the Risk Committee to ensure all relevant risks are addressed in these external and internal audit processes. The Committee has also reviewed the Company's Sarbanes-Oxley compliance programme to ensure that the Company's internal control system and safeguards are such that they comply with the requirements of the Sarbanes-Oxley Act.

During 2006 the Audit Committee was comprised of all the independent Non-Executive Directors of the Company. The Audit Committee Chairman is Tony Isaac, who is a Fellow of the Chartered Institute of Management Accountants and, before becoming Chief Executive of The BOC Group plc, was its Group Finance Director. The Company Secretary acts as secretary to the Committee.

Time was set aside for the Committee to meet the external auditor and the head of internal audit without executive management present. In addition to the members of the Committee, regular attendees at the Audit Committee meetings included representatives of the external auditor, the Chairman, the CEO, CFO, other Executive Directors, the group controller and the head of internal audit.

Remuneration Committee

The Remuneration Committee is responsible for ensuring that the remuneration package of Executive Directors is maintained on a sensible and comparative basis and enables the Company to compete effectively for good calibre executives. It monitors the performance of Executive Directors against targets, it sets the performance conditions for long-term incentive plan awards and reviews the remuneration levels and other conditions of service of senior managers, immediately below Board level.

The Committee comprises all of the independent Non-Executive Directors of the Company and the Chairman. The Chairman of the Committee is Adri Baan. The Company Secretary acts as secretary to the Committee and the head of global resources acts as adviser to the Committee. Towers Perrin acts as external adviser to the Committee.

Appointments Committee

The Appointments Committee is responsible for matters of management succession and the identification and appointment of Directors. It also reviews the Board structure, size and composition and makes recommendations to the Board with regard to changes that are deemed desirable. The Committee comprises of the Chairman and all of the independent Non-Executive Directors of the Company. The Chairman of the Committee is Sir Neville Simms. The Company Secretary acts as secretary to the Committee.

Relations with shareholders

The Board is accountable to shareholders for the performance and activities of the Group. International Power ensures that its AGM provides shareholders with an opportunity to receive comprehensive information on all aspects of the Group's business activities and to question senior management about business issues and prospects.

All proxy votes are counted and the level of proxy votes lodged for each resolution is reported at the AGM and on the Company's website. In line with best practice, the Company aims to ensure that the notice of AGM and the *Annual Report* are sent to shareholders at least 20 working days before the AGM.

International Power also runs, within the terms of the regulatory framework, frequent contact programmes with industry analysts and institutional investors to discuss matters of strategy and financial performance. Contact is made principally by the CEO and the CFO. On issues of major importance the Chairman communicates with major shareholders. The Senior Independent Non-Executive Director (Tony Isaac) is also available as an alternative point of contact if shareholders have concerns over the Chairman's performance or where contact with the Chairman or the use of other communication channels would be inappropriate. At each Board meeting, an update is given on movements in major shareholdings and on contact programmes between the Executive Directors and institutional shareholders. Reports issued by financial analysts on the Company are circulated to Board members. These summaries and reports enable the Directors to gain an understanding of the views and opinions of those with an interest in the Company. All results presentations and Stock Exchange announcements are available to shareholders on the Company's website.

Accountability and audit

The Board is mindful of its responsibility to present a balanced and understandable assessment of International Power's financial position and prospects, both to investors and regulatory authorities. The *Annual Report*, preliminary, interim and quarterly results announcements are the principal means of achieving this objective.

An explanation of the respective responsibilities of the Directors and external auditor in connection with the financial statements is set out in the Statement of Directors' responsibilities. The Directors confirm in the Directors' report their view that the Group is a going concern.

The Audit Committee has a process in place to approve all non-audit services provided by the external auditor to ensure that the objectivity and independence of the external auditor is not compromised. In line with the requirements of the Sarbanes-Oxley Act, our procedures specify the services from which the external auditor is excluded and the approval process for all other services.

Internal control

The Board has responsibility for the Group's system of internal control and for monitoring and reviewing its effectiveness.

Systems are in place to meet the requirements of the Combined Code and Turnbull Guidance and procedures and systems have been implemented to ensure compliance with the requirements of the Sarbanes-Oxley Act.

Any system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. The system can only provide reasonable, and not absolute, assurance against material financial misstatement or loss. The Board reviewed the internal control procedures during 2006. The principal features of the Group's systems of internal control are:

Control environment

The Board encourages a culture of integrity and openness. The Company has an organisation structure with clear lines of accountability and authority across its worldwide operations, supported by appropriate reporting procedures. Each of the regional businesses is accountable to the CEO and is managed within the strategic guidelines and delegated authorities adopted by the Board. An executive management team, chaired by the CEO and comprising the Executive Directors, regional directors and functional heads, meets regularly to discuss issues facing the Group.

Control procedures

Control procedures have been established in each of the Company's operations to safeguard the Group's assets from loss or misuse and to ensure appropriate authorisation and recording of financial transactions. All acquisition and investment decisions are subject to disciplined investment appraisal processes. Risk management procedures are in place for the Company's operations, including its energy marketing and trading activities, which are overseen by the Global Commodities Risk Committee, which comprises Executive Directors and senior management, and is chaired by the global risk manager. The Group treasury function operates under defined policies and the oversight of the Treasury Committee, chaired by the CFO.

Performance reporting and information

Corporate plan Executive management submits an annual corporate plan to the Board for approval. The plan for each business unit is the quantified assessment of its planned operating and financial performance for the next financial year, together with strategic reviews for the following four years. Group management reviews the plans with each operational team. The individual plans are based on key economic and financial assumptions and incorporate an assessment of the risk and sensitivities underlying the projections.

Performance monitoring Monthly performance and financial reports are produced for each business unit, with comparisons to budget. Reports are consolidated for overall review by executive management, together with forecasts for the income statement and cash flow. Detailed reports are presented to the Board on a regular basis.

Performance review Each business unit is subject to performance reviews with Group management regularly during the year. Actual results and forecasts for the year are compared to budget. Key operational and financial results are reviewed together with the risk profile and business environment of the reporting unit.

Investment projects These are subject to formal review and authorisation procedures with designated levels of authority, including a review by an Investment Committee chaired by the CEO and comprising the Executive Directors and senior managers. Major projects are subject to Board review and approval.

Corporate reporting The Company has a Disclosure Committee which is chaired by the Company Secretary and is comprised of members from the internal audit, corporate communications, human resources, operations and engineering, company secretariat and financial reporting departments. It reviews the *Annual Report*, the *Summary Annual Report* and Form 20-F, and also monitors compliance with disclosures required under UK and US reporting regulations.



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Risk identification and management

As outlined in the section 'Our approach to risk and risk management' there is a continuous process for identifying, evaluating and managing the key risks faced by the Company. Activities are co-ordinated by the Risk Committee, which is chaired by the CFO, and has responsibility, on behalf of the Board, for ensuring the adequacy of systems for identifying and assessing significant risks, that appropriate control systems and other mitigating actions are in place, and that residual exposures are consistent with the Company strategy and objectives.

Monitoring

The Board reviews the effectiveness of established internal controls through the Audit Committee which receives reports from management, the Risk Committee, the Group's internal audit function and the external auditor on the systems of internal control and risk management arrangements.

Internal audit reviews the effectiveness of internal controls and risk management through a work programme which is based on the Company's objectives and risk profile and is agreed with the Audit Committee. Findings are reported to operational and executive management, with periodic reporting to the Audit Committee.

Business unit managers provide annual self-certification statements of compliance with procedures. These statements give assurance that controls are in operation and confirm that programmes are in place to address any weaknesses in internal control. The certification process embraces all areas of material risk. Internal audit reviews the statements on behalf of the Disclosure Committee and reports any significant issues to the Audit Committee.

Compliance with the Combined Code

There were two areas where the Board was not fully compliant with the requirements of the revised Combined Code throughout 2006. Throughout 2006 there were more Executive Directors than Non-Executive Directors. The Board has reviewed the structure of the Board and has concluded there is no need at this time to appoint another Non-Executive Director.

The Senior Independent Director does not have a contact programme to communicate with institutional investors, primarily to avoid potential confusion over channels of communication. During 2006 no institutional shareholder has requested such communication.

In all other respects, the Company has complied with the provisions of the Combined Code throughout the period of the review.

US corporate governance compliance

There are no significant differences in corporate governance practices as undertaken by International Power as compared to those followed by US domestic companies under the NYSE listing standards.

The Company has securities registered in the US and, as a result, it is required to comply with those provisions of the Sarbanes-Oxley Act 2002 (the Act) as it applies to foreign private issuers. The Board continues to monitor the new rules arising from the Act and reviewed the arrangements that were developed to ensure that the Company can report on its systems of internal controls over financial reporting as required as at 31 December 2006.





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