

# 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 NEW COMBINED CODE, AND EXPLAIN OUR REASONS FOR ANY AREAS OF NON-COMPLIANCE.



Milford, Massachusetts

## The Board

The full Board met 13 times during 2004 – this included additional meetings, specifically to review the EME portfolio acquisition. Tony Isaac, Tony Concannon and Jack Taylor were each unable to attend one of these meetings. All other Directors were in attendance on the relevant meeting dates. 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 Non-Executive Director, and included a review of the Chairman's performance.

From 1 January to 30 September 2004, the Board comprised the Chairman (Sir Neville Simms); four Executive Directors (Philip Cox, Mark Williamson, Tony Concannon and Steve Riley) and

three Non-Executive Directors (Tony Isaac, Jack Taylor and Adri Baan). Tony Isaac is the Senior Independent Non-Executive Director. The three Non-Executive Directors are considered to be independent. On 1 October 2004 Struan Robertson joined the Board as a Non-Executive Director. He is considered to be independent.

In 2004 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.

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. 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 Struan Robertson visited Rugeley power station shortly after his appointment and he met with each of the functional heads who are members of the Company's management team. The newly appointed Executive Directors attended a two-day course on their role and responsibilities as Directors shortly after their appointment.



Marmara, Turkey

A programme of continuous training is 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. Directors are also kept informed of changes to the regulatory regime such as the revised Combined Code, new institutional investor guidelines 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.

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 2004 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 at the front 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 2004, a questionnaire on Board performance was circulated to each Director and was initially discussed by the Executive Directors with the Chairman and the

Company Secretary as a group and by the Non-Executive Directors with the Chairman and the Company Secretary as a separate group. The results of the discussions were then evaluated by the Board as a whole. Overall this evaluation confirmed that the Directors considered that the Board and its Committees worked effectively. As part of the review the Board agreed to increase the number of Remuneration Committee meetings for 2005. 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.

In addition to his role as Chairman of the Company, Sir Neville Simms was during 2004 Chairman of Carillion plc. The Board believes this does not compromise his role as Chairman of the Company.

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 2004 was £28,000.

### Non-Executive Directors and their function

Through membership of the Board Committees, the Non-Executive Directors have responsibilities for ensuring that systems of internal control and risk management are appropriate and effective; managing the relationship with the external auditors; 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 the Committee members 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: [www.ipplc.com](http://www.ipplc.com).

### Audit Committee

The Committee selects and fixes the remuneration of the external auditors and reviews the effectiveness of the external audit process. The Committee also ensures policies and procedures are in place to ensure that the external auditors remain independent. In addition to reviewing the Group's accounts, results announcements, risk management and accounting policies, the Committee monitors the effectiveness of internal control systems for the Board. The Committee monitors the work of the internal audit function and its progress against the Group's annual internal audit plan, and also reviews reports from the external auditors.

The Audit Committee is comprised of all the independent Non-Executive Directors of the Company and the Chairman. 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. During 2004 the Audit Committee met on six occasions, Tony Isaac attended each of these meetings, Sir Neville Simms attended five of these meetings, Adri Baan and Jack Taylor attended four meetings each and Struan Robertson attended two meetings.

Time is set aside for the Committee to meet the external auditors without executive management present and these sessions have been extended to include the Group's head of internal audit. In addition to the members of the Committee, regular attendees at the Audit Committee meetings included representatives of the external auditors, the CEO, the Chief Financial Officer (CFO), other Executive Directors, the head of financial reporting and the head of internal audit.

### Remuneration Committee

The Remuneration Committee is responsible for monitoring the performance of the Executive Directors of the Company against targets, and making recommendations to the Board on remuneration.

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 head of human resources at International Power acts as secretary to the Committee. During 2004 the Remuneration Committee met on two occasions. Sir Neville Simms, Adri Baan and Jack Taylor attended each of these meetings whilst Tony Isaac and Struan Robertson both attended one meeting.

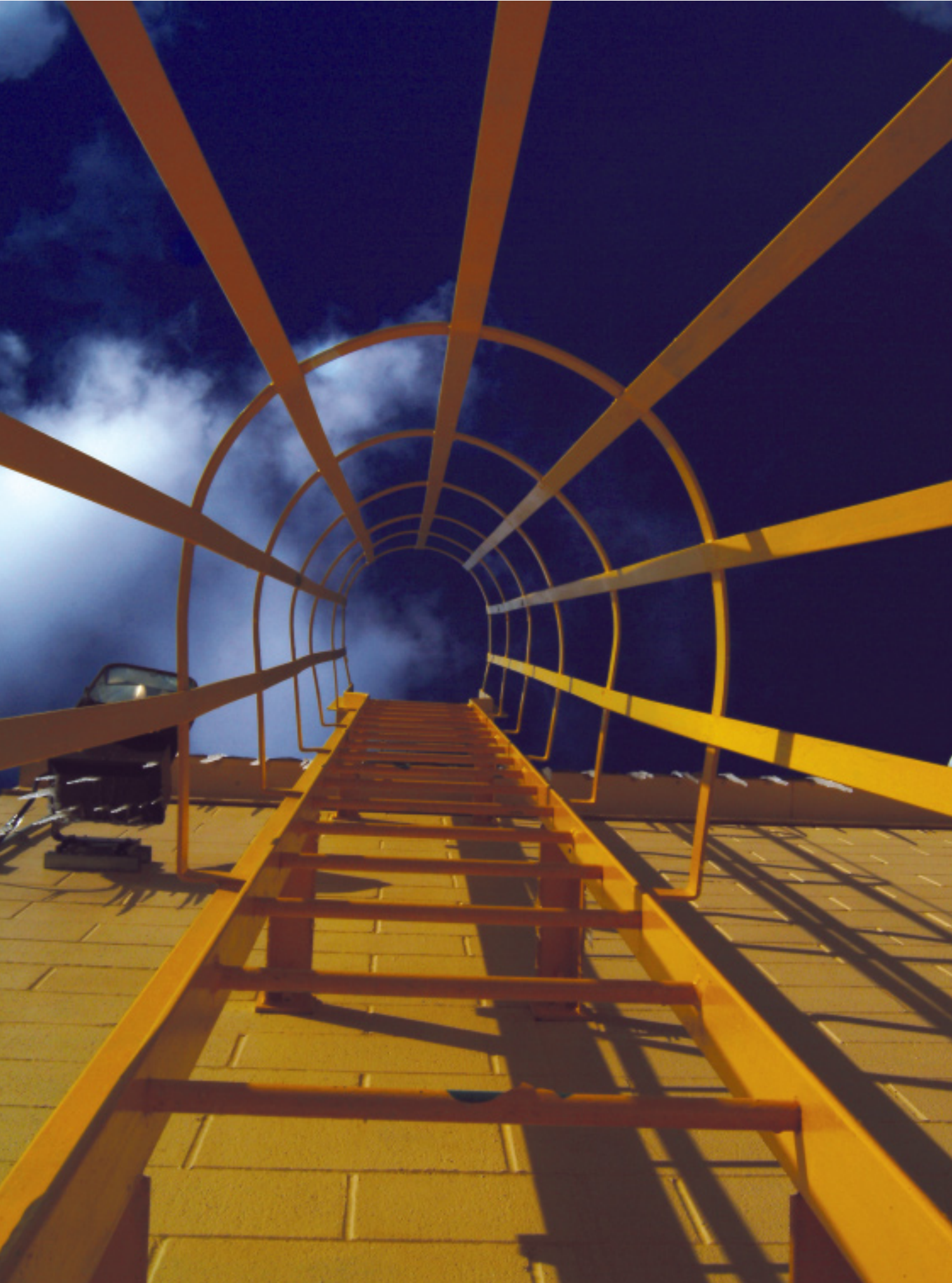
### Appointments Committee

The Appointments Committee is responsible for matters of management succession and the identification and appointment of Directors. The Committee is comprised of the Chairman and all of the independent Non-Executive Directors of the Company. The Chairman of the Committee is Sir Neville Simms. The head of human resources also acts as secretary to the Committee. During 2004, the Committee met on one occasion. Sir Neville Simms, Adri Baan, Tony Isaac and Jack Taylor attended this meeting.

When reviewing candidates for the appointment of the new Non-Executive Director, the Appointments Committee prepared a description of the role and capabilities required for the appointment and instructed Spencer Stuart, external search consultants. The appointment of Struan Robertson was made following full evaluation of available and suitable candidates, after taking into account their past experience, their personal achievements and other factors such as their knowledge and experience of the energy industry and the business environment of International Power.



Hazelwood, Australia



## 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. 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 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 [www.ipplc.com](http://www.ipplc.com).

## 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 auditors in connection with the financial statements is set out on page 69. The Directors confirm on page 68 their view that the Group is a going concern.

The Audit Committee approves 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 are being 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 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 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.

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



Hays, Texas

#### 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 profit and loss account 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 appraisal committee chaired by the CEO and comprising the Executive Directors and senior managers. Major projects are subject to Board review and approval.

#### Risk identification and 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's strategy and objectives. Assessments are conducted for all material entities.

As part of the annual business planning process, the key risks associated with achievement of the business' principal objectives are identified and their impact

quantified. During the year, significant changes in the risk profile are highlighted through the business performance reports. The principal risks are reviewed by the Risk Committee, which provides reports to the Board and the Audit Committee.

#### Energy marketing and trading

The objective of the Group's energy marketing and trading operations is to maximise the return from the purchase of fuel and the sale of the associated output.

For each of the businesses that operate in merchant energy markets, local risk committees have been established to oversee the management of the market, operational and credit risks arising from the marketing and trading activities. The committees are made up of the trading manager, global and local risk managers, Directors and senior managers.

The Group hedges its physical generating capacity by selling forward its electrical output, and purchasing its fuel input, as and when commercially appropriate and within approved control limits. This is accomplished through a range of financial and physical products. Our limited proprietary trading operations use similar methods.

Energy market risk on our asset and proprietary portfolios is measured using various techniques including Value-at-Risk (VaR). VaR is used where appropriate and provides a fair estimate of the net losses or gains which could be recognised on our portfolios over a certain period and given a certain probability; it does not provide an indication of actual results. Scenario analyses are used to estimate the economic impact of sudden market movements on the value of our portfolios. This supplements the other techniques and methodologies and captures additional market risks.

#### 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 auditors 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 and reports any significant issues to the Audit Committee.

### Compliance with the Combined Code

There were three areas where the Board was not fully compliant with the requirements of the revised Combined Code throughout 2004. Until 1 October 2004 there was a majority of Executive Directors over the Non-Executive Directors. This was due to the appointment of two new Executive Directors on 1 January 2004. At that time the Board considered it appropriate to strengthen the base of the executive team. In response to these appointments the Board sought the appointment of an additional independent Non-Executive Director and appointed Struan Robertson to the Board on 1 October 2004.

Throughout 2004, the Chairman of the Board, Sir Neville Simms, was a member of both the Audit and Remuneration Committees. The Chairman of each of these committees is an independent Non-Executive Director and there are at least two other independent Non-Executive Directors as members of each of the committees. Therefore Sir Neville Simms was not in a position to exert any control over the affairs of the respective committees. Due to Sir Neville Simms' role in communicating with institutional shareholders on remuneration matters

and the importance of the Audit Committee in reviewing the financial statements and the internal controls of the Company, the Board considered it appropriate for the Chairman to sit on each of the Remuneration Committee and the Audit Committee.

The Senior Independent Director did not have any direct communication with institutional investors, primarily to avoid potential confusion over channels of communication. To date, 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

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 arrangements are also being developed to ensure that the Company will be able to report on its systems of internal controls over financial reporting as required for the year ending 31 December 2006.

As recommended by the US Securities and Exchange Commission (SEC), the Company has established a Disclosure Committee comprising the Company Secretary, the head of internal audit and representatives of the investor relations, finance and company secretariat departments. The Committee meets regularly and is responsible for performing an oversight and advisory role in the disclosure process for the content and form of the annual report and Form 20-F.

The Committee makes recommendations to the CEO, the CFO and the executive management on the adequacy of processes to permit the signing of certifications required by the Act. The Committee also reviews the Group's compliance with the requirements of the Act.

In November 2003, the SEC approved changes to listing standards of the New York Stock Exchange (NYSE) related to the corporate governance practices of listed companies. Under these rules, listed foreign private issuers, such as International Power, must disclose any significant ways in which their corporate governance practices differ from those followed by US domestic companies under the NYSE listing standards. There are no significant differences in the corporate governance practices undertaken by International Power as compared to those followed by US domestic companies under the NYSE standards. Under the terms of the NYSE rules, Sir Neville Simms is deemed to be an independent Director as all the payments he receives from the Company are in respect of Directors' fees and therefore his membership of the Audit and Remuneration Committees is in accordance with the requirements of the NYSE corporate governance rules. The terms of reference of the Appointments Committee only relate to succession issues rather than corporate governance principles, which are currently reserved to the Board as a whole.

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 AS IT APPLIES  
TO FOREIGN PRIVATE ISSUERS