

# Corporate Governance

The 2003 Annual Report discussed at length the Board's view on corporate governance, its importance, its role in your Company and how the Board expects to fulfil its obligations. I have not repeated that discussion in this year's report but have set out below our policies on corporate governance. There have been no substantive changes in the past year.

Since my last report there have been a number of changes in Board personnel. Stephen Thomas stepped down from the Board at the AGM in May 2006, and Tom Grace and Jack Massey were appointed to the Board in January and April 2006 respectively.

Our policy on corporate governance is as follows:

## Board Role and Responsibilities

Your Board has overall responsibility for the leadership and control of the Group. Responsibility for the management of the Group has been delegated by the Board to executive management. This delegation is effected through the Chief Executive, who is accountable to the Board for its exercise. The functions of Chairman and Chief Executive are not combined and both roles' responsibilities are clearly divided. A number of responsibilities of the Board are delegated to Committees of the Board.

Certain decisions of the Group are formally reserved to the Board. The Board has responsibility for approving Group strategy, annual budgets, major acquisitions and capital projects, and treasury policy. It sets governance policies and ensures implementation thereof. It defines the roles and responsibilities of the Chairman, Chief Executive, other directors and the Board sub-committees, appoints and removes directors from the boards of the Company and its subsidiary companies. In addition, the Board approves the interim and final financial statements, reviews the Group's systems of internal control and approves any significant changes in accounting policies. It approves all resolutions and related documentation put before shareholders at general meetings. The Board sets the Group's dividend policy, approves the interim dividend and recommends the final dividend.

## Board Composition

It will be at the discretion of the Board itself to decide on the appropriate number of directors for the business at any point. The majority of the Board should be independent non-executive directors. The Board should comprise a mix of the necessary business skills required to provide oversight of the management of the business and to contribute to the development and advancement of business strategy. Paddy Power is a specialist business and

should always retain the betting industry savvy that has been part of the fabric of its Board, both as a private and public company. The Board should also include high quality non-executives sourced from the different geographic markets in which the Group operates.

It is essential that all Board members have sufficient time to add real value to your Company. With this in mind and, reflecting the regulatory obligations and the wider demands of this Board, it has been agreed that our non-executive directors should not hold more than three directorships of publicly quoted companies. In addition the Chairman cannot be the chairman of any other publicly quoted company. We have also agreed that there should be no more than two Paddy Power directors on the Board of any one other listed company. Executive directors should hold non-executive directorships with no more than one other group.

## Tenure

The current Board comprises a mix of executive directors, founding directors and directors recruited for the particular skill and experience they would bring to Paddy Power. The Board is going through a period of change. Of the nine directors currently serving on the Board, just two have been members since the Company was launched on the Stock Exchange in December 2000. The Board is actively seeking to recruit at least one additional independent non-executive director for appointment in 2007. After this appointment the Board membership will increase to ten, five of whom will be independent non-executive directors, two of whom will be non-executive founder directors and three of whom will be executive directors.

In 2004, the Board decided that, effective from the date of flotation, all non-executive directors of Paddy Power would serve a maximum of two three year terms. It was agreed that the Nominations Committee would retain the right, in special circumstances, to extend the tenure of any non-executive director for a further term, up to an absolute maximum of nine years in total. David Power and Stewart Kenny, both founder members of the Company, have now completed two three year terms. The Board has performed a very rigorous review of the appropriateness of their serving for a third term and believes that their vast experience of the betting industry continues to be central to your Company's continued development and success and hence that their continuance in office for a further three year term is in the best interests of the Company. Accordingly, they offer themselves for re-election for a third and final term at the forthcoming Annual General Meeting in May 2007.

## Corporate Governance (continued)

Paddy Power plc  
Annual Report 2006

30

### The Non-Executive Directors' Responsibilities

In addition to their statutory responsibilities as outlined in the Statement of Directors' Responsibilities on page 28, it has been agreed by your Board that all directors will have three specific responsibilities:

- Attendance at Board meetings
- Membership of at least one Board sub-committee
- Role as a 'mentor' to a particular area of the business

Regular contact with each other, and availability to the Chairman and to the Chief Executive for advice and ideas, remain critical. Effective Paddy Power Board members are enthusiasts for the business. Mere attendance at meetings is not sufficient, what matters is the director's active participation and contribution in these meetings.

The non-executive directors also meet once a year without their executive director colleagues or your Chairman.

In addition to their 'standard' roles, the Board felt it would be very beneficial if individual non-executive directors were in a position to act as mentors to an individual or a team within the business, especially on strategic issues to which the director involved could contribute their relevant skills, experience and guidance. This is not about non-executives straying into operational affairs that are the business of management. It is about giving life to the Board's real desire to provide business counsel that can help grow the business and, with it, shareholder value. It is also a further check on the growing pressures on a Board to just supervise, dot i's and cross t's.

In that context, it is important too that non-executives do not feel either restricted by the corporate governance rules of engagement or feel that simple compliance with them will be sufficient to meet their obligations. That has never been the Paddy Power way and a commitment to corporate governance should not be interpreted as a change in our drive for innovation.

### The Chairman's Role

The Chairman is a non-executive director and carries the same responsibilities as all his non-executive colleagues. His, however, is a wider role. As well as conducting Board meetings and being a member of sub-committees, your Chairman is the one constant in the management of Board affairs.



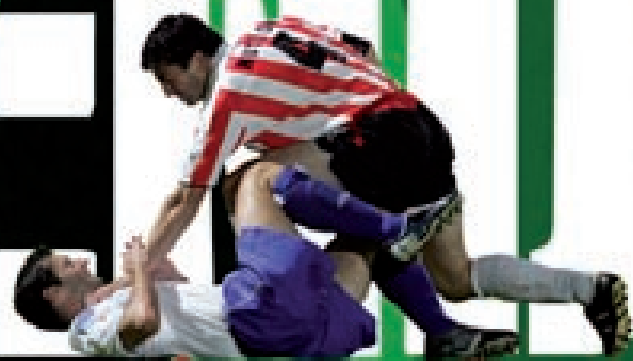
The World Cup started with 20 of the first 23 favourites winning – it wasn't pretty, just like ZZ's head butt!

Then came the knockout stages and the dreaded penalty shoot outs. The worst match of the tournament was Switzerland's draw with Ukraine, it went to penalties and both teams deserved to lose. Because Switzerland were beaten on penos, we refunded all losing outright bets on them to win the tournament so three of our customers were happy!

Then came the biggest betting match of the tournament so far. Hosts Germany against tournament favourites Argentina. Now both of these teams had been heavily backed before the tournament so the last thing we wanted was a massive refund...

The Argies were in front, but up popped Klose after 80 minutes and the writing was on the wall. The Argies went out on penos and the punters got their money back. At least it couldn't get any worse than that for the poor bookies.

Beckham's tears, Rooney's stamp, Carvalho's groin, Ronaldo's wink, Ronaldo's penalty. Enough said. Money back on England, we felt an awful lot sorer than Ricardo Carvalho!



**WORLD CUP  
EXCLUSIVE**

# Zidane defends Mother's honour





# WELL WICKET

**IT'S JUST NOT CRICKET**

## Bush reveals his weapon of Mass Destruction



**Cricket against Australia is never over until the fat boy spins**

**FREE WITH THIS ISSUE**



**YOUR VERY OWN COMMANDER IN CHIEF**



**Irish NO-HOPERS head to West Indies for World Cup in 2007**

**Paddy Power offer HUGE odds against getting into Super 8!**



I want to take you back to last year— yes 2006, the year when Irish people knew nothing about cricket! If ever there was an example of what Paddy Power is all about, it was during the controversial 4th England v Pakistan cricket test at the Oval.

It was all very confusing. The umpires accused Pakistan of ball tampering when the teams broke for tea, and then Pakistan refused to come back out to play.

Eventually when they did come out, the powers that be said it was all too late and awarded England a forfeit. So what about all of those poor punters who backed Pakistan? And even more importantly the vast majority who backed England?

The resounding vote from around the industry was "all bets void". The resounding vote from Paddy Power was "all bets void"- if you backed a loser, but "winner alright" if you backed England.

Rules are rules, but sometimes you've just got to think of it from the punters' point of view and do the right thing...Right George?

## Corporate Governance (continued)

The Chairman is responsible for the leadership of the Board, ensuring its continued effectiveness in carrying out its duties and setting its agenda. The Chairman is also responsible for ensuring that all directors receive accurate, timely and clear information. The Chairman facilitates the effective contribution of his non-executive colleagues and ensures constructive relationships exist between executive and non-executive directors. He is the guarantor of effective communications with shareholders.

A performance evaluation of the Board, its committees and its individual directors is undertaken annually. Your Chairman will act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the Board and, where appropriate, appointing new members to the Board or seeking the resignation of existing directors.

While there may be a perception that Board business revolves exclusively around meetings, this is not the case. Board counsel must be available to senior management at all times. Your Chairman is the normal source of such advice and encouragement, but by no means the only one. The need to source the most relevant expertise at short notice means that the Chairman must have regular contact with individual Board members to ensure that there is a seamless interaction between the senior executive team and the non-executive directors.

As Chairman, I also meet with the non-executive directors independently of the executive directors. I meet regularly with the Chief Executive to discuss all aspects of the business's performance and, on an occasional basis, we meet with other senior members of the management team together.

### Directors' Fees

As reported in the 2005 Annual Report the standard non-executive fee was set at €55,000 in 2006. It was also agreed that chairs of committees would be paid an additional fee of €10,000 and that the Chairman would receive an annual fee of €160,000. These fees were set for a two year period and, barring exceptional circumstances, will not be reviewed again until 2008.

Non-executive directors are not eligible to participate in the Group bonus schemes, option plans or long term incentive plans. None of the remuneration of the non-executive directors is performance related. The non-executive directors' fees are not pensionable and non-executive directors are not eligible to join any Group pension plans.

# Corporate Governance (continued)

## Board Effectiveness

Each director is expected to perform to the highest standards with regard to both their general contribution and their contribution through committees and mentoring.

As I have previously said, it is my responsibility to ensure that the performance of all directors is at the levels required. In addition to the formal Board meetings I have met with all directors individually to discuss their performance. The non-executive directors have also met without me and the executive directors. David Power has conducted a detailed review of my performance with all directors, the results of which have been discussed with me. In the absence of a senior independent director, David Power undertakes the review as it is felt he is in the best position to do so. David was not appointed during my tenure and has had the added benefit of serving under each of the chairmen of Paddy Power.

## Board Operations and Committees

The Board holds at least eight full Board meetings each year. Each non-executive member of the Board sits on at least one committee and each non-executive director mentors one part of the business where it is felt they can provide additional specialist advice to senior management. I expect all Board members to be available to me between meetings.

The composition of the Board committees as at 2 March 2007 is as follows:

### Remuneration

David Power (Chair); Fintan Drury.

### Nominations

Fintan Drury (Chair); Nigel Northridge; Patrick Kennedy; Stewart Kenny.

### Audit

Tom Grace (Chair); David Power; Brody Sweeney.

### Risk

David Power (Chair); Patrick Kennedy; Nigel Northridge; Breon Corcoran; David Power; Stewart Kenny.

## Audit Committee

The Audit Committee's responsibilities include:

- monitoring the integrity of the financial statements of the Company;
- reviewing the Group's internal controls;

- monitoring and reviewing the effectiveness of the Group's internal audit function;
- making recommendations to the Board in relation to the appointment and removal of the Group's external auditor;
- approving the remuneration and terms of engagement of the external auditor;
- evaluating the performance of the external auditor, including their independence and objectivity;
- approving non-audit services provided by the auditor in accordance with the Group's policy on non-audit services;
- developing and ensuring compliance with the Group's policy on the provision of non-audit services;
- reviewing arrangements by which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters; and
- ensuring that there are appropriate procedures in place to mentor and evaluate the general business risks to which the Group is exposed.

The Audit Committee has unrestricted access to the Group's external and internal auditors, with whom it meets at least twice a year, both with and without management. These meetings ensure that there are no restrictions on the scope of their audits, and allow discussion of any matters that the auditors did not wish to raise in the presence of management.

The Audit Committee is responsible for ensuring that auditor objectivity and independence is safeguarded where the auditor also provides non-audit services to the Group. The Audit Committee reviewed the letter from the Group's external auditor confirming their independence and objectivity. During the year the Committee also performed a review of the audit and non-audit services provided by the external auditor, and the fees charged for those services, to ensure there was no impairment of independence.

## Remuneration Committee

The Remuneration Committee is primarily responsible for making recommendations to the Board on remuneration policy for the Group's executive directors and selected senior management. The report of the Remuneration Committee is set out on pages 38 to 40.

## Corporate Governance (continued)

### Nominations Committee

The Nominations Committee is primarily responsible for recommending candidates to the Board for appointment as directors and ensuring that appropriate procedures are followed for all such appointments.

In appointing new non-executive directors the committee agrees the preferred profile of the director with the Board as a whole and receives written recommendations from existing directors. Given the industry knowledge of the Board and the committee members, as well as their general commercial experience, it is felt that this approach is more effective than using either advertised search or recruitment agencies. The quality of directors found using this approach has been excellent and the Board believes this is the best method for your Company.

### Attendance at Board and Committee Meetings

There were nine full meetings of the Board in 2006.

The attendance at Board and Committee meetings by the directors who held office in 2006 are set out below:

	Note	Board	Audit	Remuneration	Nominations	Risk
Number of meetings held in 2006:		9	5	6	3	2
Attended by:						
F Drury*		9		6	3	
N Northridge*		9			3	2
T Grace*		9	5			
S Thomas*	a)	2		1		
B Sweeney*		9	5			
D Power**		9	4	6		2
S Kenny**	b)	9			3	1
P Kennedy***		9			3	2
J Massey***	c)	6				
B Corcoran***		9				2

\* Independent Non-Executive Director

\*\* Non-Executive Director

\*\*\* Executive Director

- a) Stephen Thomas resigned on 16 May 2006, before which there were four Board meetings, two of which he attended.  
b) Stewart Kenny was appointed to the Risk Committee on 20 June 2006, after which there was one meeting.  
c) Jack Massey joined the Board on 25 April 2006, after which there were six Board meetings, all of which he attended.

As discussed, the Board is in a state of transition. The number of independent non-executive directors is now four (including the chairman) and there are five non-independent directors (including three executive directors).

No senior independent director has been appointed as the Board wishes to complete the appointment of new independent directors and give the new Board some time to consider this matter.

### Risk Committee

The Risk Committee is responsible for ensuring that policies in respect of betting risk are appropriate to a group of Paddy Power's size, for monitoring that such policies are being correctly applied and that the expertise and systems within the organisation are consistent with the level of risk undertaken. The Committee also sets overall policy for betting risk. Limits are agreed with the Committee and set annually but are subject to review by the Committee at any time. Compliance with these risk limits is reported daily to senior management and internal audit. Internal audit also carries out reviews of the risk function. The Group does not offer credit betting.

Due to the number of independent directors serving in 2006 it was not possible to populate the committees in accordance with the Combined Code at all times. The Group is committed to complying with corporate best practice and significant effort has and is being expended to identify and appoint at least one additional non-executive director. It is the Board's intention to complete this appointment in 2007.

# Corporate Governance (continued)

With regard to the Nominations Committee, which comprises four directors, two of whom are independent non-executive directors, the Board believes that the current balance of independence, industry knowledge and experience best suits the task at hand. The quality of their work is reflected in the excellent quality of the appointments and no changes to the composition of this committee are planned.

## Internal Control

The Combined Code annexed to the listing rules of the Irish Stock Exchange and the UK Listing Authority states that:

1. The Board should maintain a sound system of internal control to safeguard shareholders' investment and Group assets.
2. The directors should, at least annually, conduct a review of the effectiveness of the Group's system of internal control and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls and risk management. The directors have overall responsibility for the Group's system of internal control and have delegated responsibility for the implementation of this system to executive management.

The Board has established a process of compliance which addresses the Board's responsibility to maintain, review and report on all internal controls, including financial, operational and compliance risk management.

The principal processes comprising the system of internal control are:

- Budgets are prepared for approval by executive management and include a Group budget approved by the Board.
- Expenditure and income are regularly compared to previously approved budgets.
- The Board establishes appropriate treasury risk policies for implementation by executive management. Compliance with risk limits are reported on by the risk management department and reviewed by senior management and internal audit.
- All material commitments for expenditure and payments are compared to previously approved budgets and are subject to prior approval by personnel designated by the Board of Directors.
- Regular financial results are submitted to and reviewed by the Board of Directors.

- The directors, through the Audit Committee, review the effectiveness of the Group's system of internal control.
- An audit and security department, independent of operations, monitors the activities of the betting operations and the risk management division, including the verification of winning bets. They also undertake internal control reviews throughout the organisation. The head of this department meets regularly with the Audit Committee.

The Board, through the Audit Committee, is responsible for conducting a review of the effectiveness of the Group's systems of internal controls. This review has been performed in respect of the year ended 31 December 2006. The directors consider that the procedures necessary to implement the Turnbull guidelines on internal control in the Combined Code have been properly established.

## Relations with Shareholders

The Group is committed to ongoing communication with its shareholders. The Group operates an investor relations section on its corporate website ('www.paddypowerplc.com'). This contains copies of investor presentations and annual reports as well as providing access to Regulatory New Service ('RNS') statements and corporate press releases. All shareholders are encouraged to attend the Annual General Meeting where they are afforded the opportunity to question the Board.

There is regular discussion between Group management and analysts, brokers and institutional shareholders, ensuring that the market is appropriately informed on business activities. Visits to the Group headquarters are encouraged and tours of our retail outlets are undertaken regularly. Feedback from major shareholders and reports by analysts are communicated to directors so directors can monitor their views on the Group.

The short-term financial performance of Paddy Power can be significantly influenced throughout the financial year by the run of sporting results. This is normal in the sports betting industry. For example, a disproportionate number of favourites winning at a major horse racing festival will depress short-term profitability, whereas a disproportionate number of outsiders winning will have the opposite effect. The experience of the industry is that this typically balances out over a more extended period. Accordingly, the Board does not believe that the typical levels of short-term profit volatility intrinsic to our business should significantly influence the investment decisions of a reasonable investor or that it should be likely to have a significant effect on the Company's share price.

## Corporate Governance (continued)

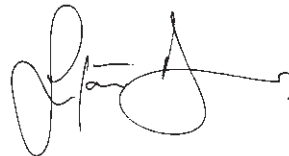
The Board and Management of Paddy Power carefully monitor any significant variances in financial performance to assess, based on the experience of the Company, whether such variances are attributable to the run of sporting results and therefore likely to be short-term in nature or reflect a trend which may impact on the overall performance of the Company going forward. The Board considers these two categories of variances to be fundamentally different as to their likely influence on the investment decisions of a reasonable investor and therefore on the Company's share price. The Board makes its judgments in respect of announcements to the market and its obligations under the disclosure rules to which the Company is subject against this background.

### Compliance

The directors confirm that the Company has complied throughout the accounting period with the provisions of the Combined Code, except as noted in this commentary.

### Conclusion

As in previous years, I would invite you all to consider the above carefully, and encourage any shareholders who have questions relating to this Corporate Governance Statement to contact me by email at [fdrury@paddypower.com](mailto:fdrury@paddypower.com).



**Fintan Drury**  
*Chairman*

2 March 2007