

Form

Unknown document format

this document shall not give rise to any implication that there has been no change in the facts set forth herein since such date. Nothing contained herein shall be deemed to be a forecast, projection or estimate of the future financial performance of ScottishPower or Iberdrola except where otherwise stated.

In the event of any ambiguity or conflict between this document and the Iberdrola Shareholder Circular in respect of the terms and conditions of the Offer, this document shall prevail.

### **CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS**

This document contains statements about Iberdrola and ScottishPower that are or may be forward looking statements, including for the purposes of the US Private Securities Litigation Reform Act of 1995. All statements other than statements of historical facts included in this document may be forward looking statements. Without limitation, any statements preceded or followed by or that include the words targets, plans, believes, expects, aims, intends, will, should, may, anticipates, estimates, synergies, cost savings, projects, strategy, substance or the negative thereof, are forward looking statements. Forward looking statements include statements relating to the following: (i) the expected timetable for completing this transaction, future capital expenditures, expenses, revenues, earnings, synergies, economic performance, indebtedness, financial condition, dividend policy, losses and future prospects of Iberdrola, ScottishPower or the Enlarged Iberdrola Group; (ii) business and management strategies and the expansion and growth of Iberdrola, ScottishPower or the Enlarged Iberdrola Group's operations and potential synergies resulting from the Offer; and (iii) the effects of government regulation on Iberdrola, ScottishPower or the Enlarged Iberdrola Group's business.

These forward looking statements are not guarantees of future performance. They have not been reviewed by the auditors of Iberdrola or ScottishPower. These forward looking statements involve known and unknown risks, uncertainties and other factors which may cause them to differ from the actual results, performance or achievements expressed or implied by such forward looking statements. These forward looking statements are based on numerous assumptions regarding the present and future business strategies of such persons and the environment in which each will operate in the future. Investors are cautioned not to place undue reliance on the forward looking statements, which speak only as of the date they were made. All subsequent oral or written forward looking statements attributable to Iberdrola or ScottishPower or the Enlarged Iberdrola Group or any of their respective members, directors, officers or employees or any persons acting on their behalf are expressly qualified in their entirety by the cautionary statement above. All forward looking statements included in this document are based on information available to Iberdrola and ScottishPower on the date hereof. Persons receiving this Offer should not place undue reliance on such forward looking statements, and neither Iberdrola nor ScottishPower undertake any obligation to publicly update or revise any forward looking statements.

**Table of Contents**

**INFORMATION FOR UNITED STATES SECURITY HOLDERS**

The New Iberdrola Shares to be issued to ScottishPower Shareholders and the Iberdrola ADSs to be issued to ScottishPower ADS Holders under the terms of the Scheme have not been, and will not be, registered under the US Securities Act, or under the securities laws of any state, district or other jurisdiction of the United States, or of Canada, Australia or Japan and no regulatory clearances in respect of the New Iberdrola Shares or the Iberdrola ADSs have been, or will be applied for in any jurisdiction. The New Iberdrola Shares and the Iberdrola ADSs will be issued in reliance upon the exemption from the registration requirements of the US Securities Act provided by Section 3(a)(10) thereof based on Court approval of the Scheme. For the purpose of qualifying for this exemption from the registration requirements of the US Securities Act, ScottishPower will advise the Court that its sanctioning of the Scheme will be relied upon by ScottishPower and Iberdrola as an approval of the Scheme, following a hearing on its fairness to ScottishPower Shareholders, at which hearing all such shareholders are entitled to attend in person or through counsel to support or oppose the sanctioning of the Scheme and with respect to which notification has been given to all such shareholders.

Shareholders who may be deemed to be affiliates of ScottishPower for the purposes of the US Securities Act before implementation of the Scheme or of Iberdrola before or after implementation of the Scheme will be subject to restrictions on the sale of New Iberdrola Shares and the Iberdrola ADSs received in connection with the Scheme under Rule 145(d) of the US Securities Act. ScottishPower Shareholders who are affiliates may, in addition to re-selling their New Iberdrola Shares or their Iberdrola ADSs in the manner permitted by Rule 145(d) under the US Securities Act, also sell their New Iberdrola Shares under any other available exemption under the US Securities Act, including Regulation S.

Shareholders who may be deemed to be affiliates of ScottishPower or Iberdrola include individuals who, or entities that, control directly or indirectly, or are controlled by or are under common control with, ScottishPower or Iberdrola and would include certain officers and directors of ScottishPower and Iberdrola and may include certain significant shareholders.

If Iberdrola determines to implement the Offer by way of a Takeover Offer rather than the Scheme, Iberdrola will, to the extent that the New Iberdrola Shares or the Iberdrola ADSs issued in connection with the Offer are required to be registered in the United States, file a registration statement on Form F-4, which will include a prospectus, with the SEC and ScottishPower will file a Solicitation/Recommendation Statement on Schedule 14D-9. Investors are strongly advised to read the documents that will be made available to them, including the registration statement, prospectus and Solicitation/Recommendation Statement on Schedule 14D-9, if and when available, and any other relevant documents made available to them and/or the SEC or other applicable regulatory authorities, as well as any amendments or supplements to those documents, because they will contain important information regarding Iberdrola, ScottishPower and the Offer. If and when filed, investors may obtain free copies of the registration statement, the prospectus as well as other relevant documents filed with the SEC, at the SEC's website at [www.sec.gov](http://www.sec.gov) and will receive information at an appropriate time on how to obtain these transaction-related documents for free from the parties involved or a duly appointed agent.

The Loan Notes to be issued pursuant to the Loan Note Alternative have not been, and will not be, listed on any stock exchange and have not been, and will not be registered under the US Securities Act or under the securities laws of any state or other jurisdiction of the United States.

No US federal or state Securities Commission has approved, disapproved, endorsed or recommended the offer of the New Iberdrola Shares or the Iberdrola ADSs, nor has it expressed a view on the adequacy of this document. Any representation to the contrary is a criminal offence in the United States.

## Edgar Filing: - Form

ScottishPower and Iberdrola are companies registered in Scotland and Spain respectively. Directors and officers of ScottishPower and Iberdrola may be located outside of the United States and, as a result, it may not be possible for ScottishPower Shareholders to effect service of process within the United States upon ScottishPower, Iberdrola, or their respective directors and officers. All or a substantial portion of the assets of ScottishPower, Iberdrola, or their respective directors and officers may be located outside of the United States and, as a result, it may not be possible to satisfy a

**Table of Contents**

judgment against ScottishPower, Iberdrola, or their respective directors and officers in the United States or to enforce a judgment obtained by United States courts against ScottishPower, Iberdrola, or their respective directors and officers outside the United States.

Iberdrola's financial statements are prepared in accordance with IFRS. Iberdrola has not at this time prepared US GAAP financial statements or a reconciliation of the differences between IFRS and US GAAP as applied to Iberdrola's financial statements. Investors should not assume that the historical IFRS financial statements in Part 7 of this document reflect what Iberdrola's financial position and results of operations would be if Iberdrola's financial statements were prepared in accordance with US GAAP.

**NOTICE TO NEW HAMPSHIRE RESIDENTS**

**Neither the fact that a registration statement or an application for a license has been filed under N.H. Rev. stat. ann. Chapter 421-B with the State of New Hampshire nor the fact that a security is effectively registered or a person is licensed in the State of New Hampshire constitutes a finding by the Secretary of State of New Hampshire that any document filed under N.H. Rev. stat. ann. Chapter 421-B is true, complete and not misleading. Neither any such fact nor the fact that an exemption or exception is available for a security or transaction means that the Secretary of State of New Hampshire has passed in any way upon the merits or qualifications of, or recommended or given approval to, any person, security or transaction. It is unlawful to make, or cause to be made, to any prospective purchaser, customer, or client any representation inconsistent with the provisions of this paragraph.**

**DEALING DISCLOSURE REQUIREMENTS**

Under the provisions of Rule 8.3 of the City Code, if any person is, or becomes, interested (directly or indirectly) in one per cent. or more of any class of relevant securities of Iberdrola or of ScottishPower, all dealings by that person in any relevant securities of that company (including by means of an option in respect of, or a derivative referenced to, any such relevant securities) must be publicly disclosed by no later than 3.30 p.m. (London time) on the Business Day following the date of the relevant transaction. This requirement will continue until the date on which the Offer becomes effective, lapses or is otherwise withdrawn or on which the offer period otherwise ends. If two or more persons act together pursuant to an agreement or understanding, whether formal or informal, to acquire an interest in relevant securities of Iberdrola or ScottishPower, they will be deemed to be a single person for the purpose of Rule 8.3.

Under the provisions of Rule 8.1 of the City Code, all dealings in relevant securities of Iberdrola or of ScottishPower by Iberdrola or ScottishPower, or by any of their respective associates, must be disclosed by no later than 12.00 noon (London time) on the Business Day following the date of the relevant transaction.

A disclosure table, giving details of the companies in whose relevant securities dealings should be disclosed, and the number of such securities in issue, can be found on the Panel's website at [www.thetakeoverpanel.org.uk](http://www.thetakeoverpanel.org.uk).

## Edgar Filing: - Form

Interests in securities arise, in summary, when a person has long economic exposure, whether conditional or absolute, to changes in the price of securities. In particular, a person will be treated as having an interest by virtue of the ownership or control of securities, or by virtue of any option in respect of, or derivative referenced to, securities.

**Terms in quotation marks are defined in the City Code, which can also be found on the Panel's website. If you are in any doubt as to whether or not you are required to disclose a dealing under Rule 8, you should consult the Panel's website at [www.thetakeoverpanel.org.uk](http://www.thetakeoverpanel.org.uk) or contact the Panel on telephone number +44 20 7382 9026; fax +44 20 7236 7005.**

**Table of Contents**

**Table of Contents**

<b><u>PART 1 LETTER FROM THE CHAIRMAN OF SCOTTISHPOWER</u></b>	10
1 <u>Introduction</u>	10
2 <u>The Offer</u>	11
3 <u>Reasons for Recommendation of the Offer</u>	12
4 <u>Action to be Taken</u>	13
5 <u>Further Information</u>	13
6 <u>Undertakings to Vote in Favour of the Scheme</u>	13
7 <u>Recommendation</u>	14
<b><u>PART 2 EXPECTED TIMETABLE OF PRINCIPAL EVENTS</u></b>	15
<b><u>PART 3 ACTION TO BE TAKEN</u></b>	17
<b><u>PART 4 EXPLANATORY STATEMENT</u></b>	21
1 <u>Introduction</u>	21
2 <u>Summary of the Offer</u>	21
3 <u>Financial Effects of the Offer</u>	24
4 <u>Mix and Match Facility</u>	25
5 <u>Loan Note Alternative</u>	26
6 <u>Information on the ScottishPower Group</u>	28
7 <u>Current Trading and Prospects for ScottishPower</u>	29
8 <u>Information on Iberdrola</u>	29
9 <u>Iberdrola's Reasons for the Offer</u>	32
10 <u>Iberdrola's Intentions for the ScottishPower Business</u>	33
11 <u>Financial Benefits of the Offer</u>	33
12 <u>Current Trading and Prospects for Iberdrola</u>	33
13 <u>Financing Arrangements</u>	34
14 <u>Implementation Agreement and Inducement Fee</u>	34
15 <u>Management and Employees</u>	35
16 <u>The ScottishPower Directors, the Effect of the Scheme on their Interests and Irrevocable Undertakings</u>	36
17 <u>ScottishPower Share Schemes</u>	36
18 <u>ScottishPower Convertible Bonds</u>	38
19 <u>Structure of the Offer</u>	42
20 <u>Listing, Settlement and Dealings</u>	48
21 <u>Holding of New Iberdrola Shares</u>	54
22 <u>ScottishPower ADSs</u>	54



**Table of Contents**

24	<u>Receipt of Iberdrola Dividends in Sterling</u>	59
25	<u>Receipt of Iberdrola Dividends in US Dollars</u>	59
26	<u>Taxation</u>	59
27	<u>Overseas Shareholders</u>	71
28	<u>Helplines</u>	72
29	<u>Action to be Taken</u>	72
30	<u>Further Information</u>	73
	APPENDIX A TO PART 4 SUBSCRIPTION AGREEMENT	74
	<u>PART 5 CONDITIONS TO THE SCHEME AND THE OFFER</u>	80
	<u>PART 6 FINANCIAL INFORMATION OF SCOTTISHPOWER</u>	87
	<u>SECTION A AUDITED CONSOLIDATED FINANCIAL STATEMENTS OF SCOTTISHPOWER FOR THE TWO YEARS ENDED 31 MARCH 2006</u>	88
	<u>SECTION B UNAUDITED INTERIM RESULTS OF SCOTTISHPOWER FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2006</u>	196
	<u>PART 7 FINANCIAL INFORMATION OF IBERDROLA</u>	210
	<u>SECTION A AUDITED CONSOLIDATED FINANCIAL STATEMENTS OF IBERDROLA FOR THE TWO YEARS ENDED 31 DECEMBER 2006</u>	211
	<u>SECTION B PRO FORMA FINANCIAL INFORMATION FOR THE ENLARGED IBERDROLA GROUP</u>	314
	<u>PART 8 DESCRIPTION OF IBERDROLA SHARES, IBERDROLA CDIs AND IBERDROLA ADSs</u>	322
	<u>PART 9 SUMMARY OF TERMS OF LOAN NOTES</u>	344
	<u>PART 10 ADDITIONAL INFORMATION</u>	348
	<u>PART 11 EMPLOYEE REPRESENTATIVE OPINION</u>	382
	<u>PART 12 NOTES FOR SCOTTISHPOWER SHAREHOLDERS ON COMPLETING THE FORM OF ELECTION</u>	383
	<u>PART 13 NOTES FOR SCOTTISHPOWER ADS HOLDERS ON COMPLETING THE ADS LETTER OF TRANSMITTAL AND ELECTION FORM</u>	389
	<u>PART 14 THE SCHEME OF ARRANGEMENT</u>	392
	<u>PART 15 DEFINITIONS</u>	408
	<u>PART 16 NOTICE OF COURT MEETING</u>	419
	<u>PART 17 NOTICE OF EXTRAORDINARY GENERAL MEETING</u>	422

Table of Contents

**PART 1**

**LETTER FROM THE CHAIRMAN OF SCOTTISHPOWER**

**Registered office:**

1 Atlantic Quay

Robertson Street

Glasgow, G2 8SP

(Registered in Scotland, No. SC193794)

**Directors:**

Charles Miller Smith, Chairman

Philip Bowman, Chief Executive

Simon Lowth, Finance Director

Euan Baird, Non-Executive Director

Donald Brydon, Non-Executive Director

Peter Hickson, Non-Executive Director

Nick Rose, Non-Executive Director

Nancy Wilgenbusch, Non-Executive Director

26 February 2007

*To ScottishPower Shareholders and ScottishPower ADS Holders and, for information only, to Convertible Bondholders, holders of ScottishPower B Shares and ScottishPower Deferred Shares, and participants in the ScottishPower Share Schemes*

Dear Shareholder,

**RECOMMENDED OFFER BY IBERDROLA, S.A. FOR SCOTTISH POWER PLC**

## 1 Introduction

On 28 November 2006, the boards of ScottishPower and Iberdrola announced the terms of a recommended Offer to be made by Iberdrola for the acquisition of ScottishPower.

The purpose of this document is to make sure that you are fully informed about the Offer and the reasons why your Board has decided that it represents a fair and reasonable price for ScottishPower and is unanimously recommending it to you after very careful and detailed consideration.

I draw your attention to the accompanying Question and Answer booklet, the letter from Morgan Stanley & Co. Limited set out in Part 4 of this document, which gives details about the Offer, to the additional information set out in Part 10 of this document and to the other information set out in this document.

In order to approve the terms of the Offer, ScottishPower Shareholders and ScottishPower ADS Holders will need to vote in favour of the resolutions to be proposed at the Court Meeting and the ScottishPower EGM, to be held on 30 March 2007. Details of the actions you should take, and the recommendation of the ScottishPower Directors, are set out in Part 3 of this document and paragraph 7 of this letter, respectively.

**Table of Contents**

**2 The Offer**

It is proposed that the Offer will be implemented by way of a Scheme, details of which are set out in Parts 4 and 14 of this document. If the Scheme becomes effective, the economic effect will be that ScottishPower Shareholders and ScottishPower ADS Holders will receive, subject to elections made by other ScottishPower Shareholders and ScottishPower ADS Holders under the Mix and Match Facility and the Loan Note Alternative:

<b>for each ScottishPower Share</b>	400 pence in cash; and 0.1646 of a New Iberdrola Share
<b>for each ScottishPower ADS</b>	1,600 pence in cash; and 0.6584 of an Iberdrola ADS

Subject to the approval of ScottishPower Shareholders, Court Sanction and receipt of approvals from Regulatory Authorities, the Scheme is expected to become effective on 23 April 2007.

Prior to the Effective Date, ScottishPower will declare a Special Dividend of 12 pence for every ScottishPower Share (48 pence per ScottishPower ADS) payable to ScottishPower Shareholders on the Register of Members and ScottishPower ADS Holders on the register of ScottishPower ADS Holders maintained by the ScottishPower Depository at the Special Dividend Record Time.

ScottishPower Shareholders and ScottishPower ADS Holders (other than ScottishPower Shareholders and ScottishPower ADS Holders in certain overseas jurisdictions) are also being offered the opportunity, under the Mix and Match Facility, to elect to vary the proportions of cash and New Iberdrola Shares or Iberdrola ADSs, as applicable, they receive in consideration for their ScottishPower Shares or ScottishPower ADSs, as applicable, subject to equal and opposite elections being made by other ScottishPower Shareholders and ScottishPower ADS Holders. To the extent that elections for New Iberdrola Shares (including New Iberdrola Shares underlying Iberdrola ADSs) and/or cash consideration cannot be satisfied in full, they will be scaled down on a pro rata basis. Further information about the Mix and Match Facility is provided in paragraphs 2 and 4 of Part 4 of this document.

ScottishPower Shareholders (other than Excluded Overseas Persons and ScottishPower ADS Holders) may elect to receive Loan Notes in respect of all or part of the cash consideration to which they would otherwise be entitled under the Offer, including any additional cash consideration to which they become entitled as a result of an election under the Mix and Match Facility. Further details regarding the Loan Note Alternative are set out in paragraph 5 of Part 4 of this document.

Based on the Closing Price of an Iberdrola Share on 22 February 2007 (the last practicable date prior to the publication of this document) of £23.31 per Iberdrola Share ( 34.72, based on the exchange rate on 22 February 2007 of £0.67125: 1), the Offer values each ScottishPower Share (inclusive of the Special Dividend) at 795.6 pence.

The terms of the Offer represent a premium of approximately:

## Edgar Filing: - Form

2.0 per cent. to the Closing Price of 780 pence per ScottishPower Share on 22 February 2007 (the latest practicable date prior to the publication of this document);

6.7 per cent. to the Closing Price of 746 pence for each ScottishPower Share on 27 November 2006 (the last Business Day prior to the date of the Announcement);

18.5 per cent. to the Closing Price of 671.50 pence for each ScottishPower Share on 7 November 2006 (the last Business Day prior to the commencement of the Offer Period); and

24.4 per cent. to the average daily Closing Price of 639.65 pence per ScottishPower Share for the three months ended 7 November 2006 (the last Business Day prior to the commencement of the Offer Period).

## **Table of Contents**

The holders of the ScottishPower B Shares and the ScottishPower Deferred Shares will not be able to participate in the Scheme and the rights attaching to the ScottishPower B Shares and the ScottishPower Deferred Shares will be unaffected by the Offer. Any dividend payable on the ScottishPower B Shares will continue to be payable annually in arrears on 28 May or such later date as the Directors of Iberdrola and/or ScottishPower may determine. The admission to listing on the Official List of the ScottishPower B Shares will be unaffected by the Offer and will continue after the Effective Date.

The Offer is subject to the Conditions set out in Part 5 of this document.

Iberdrola is offering a Dealing Facility to enable certain ScottishPower Shareholders who receive New Iberdrola Shares as a result of the Offer to sell their newly acquired shares. Further details regarding the Dealing Facility are set out in paragraph 23 of Part 4 of this document.

Options under the ScottishPower Share Option Schemes will become exercisable or will be exercised upon Court Sanction. Some options will be exercisable in full while others will only be exercisable on a pro-rated basis in accordance with the rules of the relevant schemes. Performance conditions, where applicable, will be treated as having been satisfied in full. Further information relating to the effect of the Scheme on participants in the ScottishPower Share Schemes is set out in paragraph 17 of Part 4 of this document.

The terms and conditions of the Convertible Bonds provide for enhanced Conversion Rights to be exercisable within the period of 60 days following the Effective Date or, if later, 60 days following the date on which notice of the Effective Date is given to Convertible Bondholders under the terms and conditions of the Convertible Bonds (the **Special Conversion Period** ). Further details of the proposal and the effect of the Scheme on Convertible Bondholders are set out in paragraph 18 of Part 4 of this document.

### **3 Reasons for Recommendation of the Offer**

Over the past 18 months, the newly restructured and refocused ScottishPower has demonstrated strong performance across all its businesses and has delivered significant improvements in profitability and cash flow. This has been achieved while continuing to invest heavily in the business. Over the same period, consolidation activity has resulted in significant changes in the European utilities landscape.

As a result, your Board believes that ScottishPower would benefit from widening its geographical presence, diversifying its operational risks, achieving greater economies of scale and developing the financial strength to invest in substantially larger infrastructure projects over the coming years. In the opinion of your Board, the Offer achieves these objectives and will enable ScottishPower to compete on a global scale in an increasingly competitive environment.

The Enlarged Iberdrola Group should be able to access significant economies of scale in commodity and capital goods procurement. It is also expected to benefit from broader complementary skills including power and gas distribution, coal-fired generation and nuclear technologies. Risk should be reduced by increased diversification in a number of areas, particularly business geography and regulation.

## Edgar Filing: - Form

The increased financial strength of the Enlarged Iberdrola Group will support the very significant levels of investment that are required in the large infrastructure projects that ScottishPower will have to undertake in the future. In addition, your Board believes that the Offer achieves the strategic objectives of both companies without the adverse social consequences for employees that could result in other merger situations.

The ScottishPower Board believes that the Offer represents an attractive blend of value for ScottishPower Shareholders and a clear future strategic rationale for the combined businesses which

## **Table of Contents**

can be implemented with minimal regulatory risk. In the opinion of the ScottishPower Board, the Offer provides ScottishPower Shareholders with the ability to crystallise the value that has been achieved and the possibility of continuing to participate in the future success of the Enlarged Iberdrola Group.

## **4 Action to be Taken**

Your attention is drawn to Part 3 of this document which details the actions required from ScottishPower Shareholders and ScottishPower ADS Holders. I also draw your attention to the Question and Answer Booklet which accompanies this document.

It is important that, for the Court Meeting in particular, as many votes as possible are cast so that the Court may be satisfied that there is a fair and reasonable representation of opinion of the ScottishPower Shareholders and ScottishPower ADS Holders. You are therefore strongly urged to sign and return both your Forms of Proxy (in the case of ScottishPower Shareholders) or ADS Voting Instruction Card (in the case of registered ScottishPower ADS Holders) or to take advantage of the voting procedures of the bank, broker, financial institution, share plan administrator or other nominee through which you hold your ScottishPower ADSs (in the case of indirect ScottishPower ADS Holders) as soon as possible.

**Whether or not you intend to attend the Court Meeting and/or the ScottishPower EGM, ScottishPower Shareholders are requested to complete and sign the enclosed Forms of Proxy in accordance with the instructions which accompany them and registered ScottishPower ADS Holders are requested to complete and sign the enclosed ADS Voting Instruction Card in accordance with the instructions printed thereon.**

## **5 Further Information**

**If you are a ScottishPower Shareholder and you have questions relating to this document or the completion and return of the Forms of Proxy, Forms of Election or the Upfront Dealing Facility Instruction Form, please call Lloyds TSB Registrars on Freephone 0800 023 2559 (or, from outside the United Kingdom, +44 1903 276326) between 8.30 a.m. and 5.30 p.m. (London time) Monday to Friday.**

**If you are a ScottishPower ADS Holder and have questions relating to ScottishPower ADSs, or the ADS Voting Instruction Card or the ADS Letter of Transmittal and Election Form, please call Georgeson Shareholder Communications on +1 212 440 9800 (if you hold ScottishPower ADSs in your capacity as a custodian or nominee) between 9.00 a.m. and 5.00 p.m. (New York time) Monday to Friday or on +1 800 657 4988 (for all other ScottishPower ADS Holders, including retail ScottishPower ADS Holders) between 9.00 a.m. and 11.00 p.m. (New York time) Monday to Friday. The second number is toll free if called within the United States. Please note that calls to these numbers may be monitored and recorded, and no advice on the merits of the Scheme or the Offer nor any financial or tax advice can be given.**

For further instructions on how to complete the Form of Election and the ADS Letter of Transmittal and Election Form, please see Parts 12 and 13 of this document.

## Edgar Filing: - Form

Your attention is drawn to the letter from Morgan Stanley & Co. Limited set out in Part 4 of this document (the explanatory statement pursuant to section 426 of the Companies Act), which gives further information on the Offer, the Scheme, ScottishPower, Iberdrola, the New Iberdrola Shares and the Iberdrola ADSs.

### **6 Undertakings to Vote in Favour of the Scheme**

Iberdrola has received irrevocable undertakings to vote in favour of the Offer and the resolutions to be proposed at the Court Meeting and the ScottishPower EGM from the ScottishPower Directors in respect of their entire beneficial holdings of 142,196 ScottishPower Shares, representing approximately

**Table of Contents**

0.1 per cent. of the existing issued share capital of ScottishPower. These undertakings are in respect of the ScottishPower Directors' entire beneficial holdings of ScottishPower Shares. These undertakings will cease to have any effect if the Implementation Agreement is terminated in accordance with its terms. For further details of the Implementation Agreement, please see paragraph 10 of Part 10 of this document.

The ScottishPower Directors did not obtain any additional financial benefit for the purpose of securing their irrevocable undertakings.

**7 Recommendation**

**The ScottishPower Board, which has been so advised by Morgan Stanley & Co. Limited, considers the terms of the Offer to be fair and reasonable. In providing advice to the ScottishPower Board, Morgan Stanley & Co. Limited has taken into account the commercial assessments of the ScottishPower Board.**

**Accordingly, the ScottishPower Board unanimously recommends that ScottishPower Shareholders and ScottishPower ADS Holders vote in favour of the Scheme at the Court Meeting and the ScottishPower EGM, as they have undertaken to do so in respect of their entire beneficial holdings of 142,196 ScottishPower Shares, representing approximately 0.1 per cent. of the existing ScottishPower Shares.**

**The ScottishPower Board unanimously recommends that all holders of Convertible Bonds exercise their Conversion Rights as soon as practicable after the Scheme becomes effective (but not before) in order to receive the Iberdrola Shares to which they are entitled on the Second Issue Date and in any event no later than before the end of the Special Conversion Period. The ScottishPower Board, which has been so advised by Morgan Stanley & Co. Limited, considers the proposals to Convertible Bondholders to be fair and reasonable.**

Yours faithfully

Charles Miller Smith

Chairman

Table of Contents**PART 2****EXPECTED TIMETABLE OF PRINCIPAL EVENTS<sup>(1)(5)</sup>**

ADS Record Time	4.00 p.m. (New York time) on 20 February 2007
<b>Latest time for receipt by the ScottishPower Depository of ADS Voting Instruction Cards</b>	<b>3.00 p.m. (New York time) on 26 March 2007</b>
Iberdrola Shareholders Meeting first call	11.00 a.m. (Madrid time) on 28 March 2007
<b>Latest time for lodging green Forms of Proxy for use at the Court Meeting<sup>(2)</sup></b>	<b>11.00 a.m. (London time) on 28 March 2007</b>
<b>Latest time for lodging purple Forms of Proxy for use at the ScottishPower EGM<sup>(2)</sup></b>	<b>11.10 a.m. (London time) on 28 March 2007</b>
Voting Record Time	6.00 p.m. (London time) on 28 March 2007
Iberdrola Shareholders Meeting second call	11.00 a.m. (Madrid time) on 29 March 2007
<b>Court Meeting</b>	<b>11.00 a.m. (London time) on 30 March 2007</b>
<b>ScottishPower EGM</b>	<b>11.10 a.m. (London time) on 30 March 2007<sup>(3)</sup></b>

**The following dates are subject to change:<sup>(5)</sup>**

Latest time for receipt of ADS Letters of Transmittal and Election Form	3.00 p.m. (New York time) on 4 April 2007
Last day of dealings in, and for registration of transfers of, ScottishPower ADSs	4 April 2007 <sup>(4)</sup>
Latest time for receipt of white Forms of Election and Electronic Elections to be settled	3.00 p.m. (London time) on 19 April 2007
Latest time for receipt of grey Upfront Dealing Facility Instruction Forms	3.00 p.m. (London time) on 19 April 2007
Sanction Court Hearing	19 April 2007
Last day for dealings in, and for registration of transfers of ScottishPower Shares	19 April 2007
Special Dividend Record Time	9.00 a.m. (London time) on 20 April 2007
Reorganisation Record Time	3.00 p.m. (London time) on 22 April 2007
Reduction Court Hearing	23 April 2007

## Edgar Filing: - Form

Effective Date of the Scheme

23 April 2007

15

---

**Table of Contents**

New Iberdrola Shares issued	23 April 2007
Cancellation of listing of ScottishPower Shares	24 April 2007
Admission to trading of the New Iberdrola Shares on the Bolsas de Valores expected to occur	effective 5.35 p.m. (Madrid time) on 24 April 2007
Commencement of dealings in New Iberdrola Shares on the Bolsas de Valores	25 April 2007
Settlement of New Iberdrola Shares to be issued through Iberclear (with settlement of New Iberdrola CDIs following shortly thereafter)	25 April 2007
Despatch of cheques in respect of cash consideration and settlement through CREST and statements of entitlements to New Iberdrola Shares	By 7 May 2007

---

Notes:

- (1) For the avoidance of doubt, unless otherwise stated, all references in this document to times are to London times.
- (2) A green Form of Proxy for the Court Meeting(s) not so lodged may be handed to representatives of Lloyds TSB Registrars on behalf of the chairman of the Court Meeting before the taking of the poll. However, the purple Form of Proxy for the ScottishPower EGM must be lodged before 11.10 a.m. (London time) on 28 March 2007 in order to be valid.
- (3) To commence at 11.10 a.m. (London time) or, if later, immediately after the conclusion or adjournment of the Court Meeting.
- (4) This date applies to ScottishPower ADS Holders who hold their ScottishPower ADSs through the Direct Registration System of DTC and make an election under the Mix and Match Facility. ScottishPower ADS Holders who do not hold their ScottishPower ADSs through the Direct Registration System of DTC but do make an election under the Mix and Match Facility will not be able to transfer their ScottishPower ADSs after they have returned their ADS Letters of Transmittal and Election Forms. ScottishPower ADS Holders who do not make an election under the Mix and Match Facility will be able to transfer their ScottishPower ADSs until the earlier of the date on which they return their ADS Letter of Transmittal and Election Form (or, if later, 4 April 2007 in the case of ScottishPower ADS Holders who hold their ScottishPower ADSs through the Direct Registration System of DTC) and 30 days after the termination of the ScottishPower Deposit Agreement.
- (5) These times and dates are indicative only and will depend, among other things, on the date on which the Conditions are either satisfied or waived; in particular, the timing of receipt of the approvals from the Regulatory Authorities is uncertain and outside the control of ScottishPower and Iberdrola. Furthermore, these times and dates may change depending on the dates on which the Court sanctions the Scheme and confirms the Capital Reduction associated with the Scheme and on which certified copies of the Court Orders and, in relation to the Reduction Order, a certified copy of the minute of such Capital Reduction attached thereto are delivered for registration to the Registrar of Companies and, in relation to the Capital Reduction, are so registered.

**Table of Contents**

**PART 3**

**ACTION TO BE TAKEN**

**Voting at the Court Meeting and the ScottishPower EGM**

The Scheme will require approval of ScottishPower Shareholders and ScottishPower ADS Holders at the Court Meeting to be held at the Crowne Plaza, Congress Road, Glasgow G3 8QT. The Court Meeting is to be held at 11.00 a.m. (London time) on 30 March 2007. Implementation of the Scheme will also require passing of a special resolution by ScottishPower Shareholders and ScottishPower ADS Holders at the ScottishPower EGM to be held at 11.10 a.m. (London time) on 30 March 2007 (or as soon thereafter as the Court Meeting has concluded or been adjourned).

**It is important that, for the Court Meeting in particular, as many votes as possible are cast so that the Court may be satisfied that there is a fair and reasonable representation of ScottishPower Shareholder and ScottishPower ADS Holder opinion.**

**ScottishPower Shareholders**

ScottishPower Shareholders will find enclosed a green Form of Proxy for the Court Meeting and a purple Form of Proxy for the ScottishPower EGM.

**You are strongly urged to sign and return your Forms of Proxy as soon as possible and in any event so as to be received by Lloyds TSB Registrars no later than:**

11.00 a.m. (London time) on 28 March 2007 in respect of the green Forms of Proxy for the Court Meeting; and

11.10 a.m. (London time) on 28 March 2007 in respect of the purple Forms of Proxy for the ScottishPower EGM.

If the green Form of Proxy for use at the Court Meeting is not lodged by 11.00 a.m. (London time) on 28 March 2007, it may be handed to representatives of Lloyds TSB Registrars on behalf of the chairman at the Court Meeting (or, if the Court Meeting is adjourned, at the adjourned Court Meeting) before the taking of the poll. This is not the case, however, for the purple Form of Proxy for use at the ScottishPower EGM. In the case of the ScottishPower EGM, unless the purple Form of Proxy is returned by 11.10 a.m. (London time) on 28 March 2007, it will be invalid. The completion and return of a Form of Proxy will not prevent you from attending and voting in person at either the Court Meeting or the ScottishPower EGM, or any adjournment thereof, if you are so entitled.

## Edgar Filing: - Form

CREST members who wish to appoint a proxy or proxies through the CREST Electronic Proxy Appointment Service may do so for the Meetings and any adjournment(s) thereof by using the procedures described in the CREST Manual. CREST personal members or other CREST sponsored members, and those CREST members who have appointed a voting service provider(s) should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.

ScottishPower Shareholders who hold their ScottishPower Shares in certificated or uncertificated form may also register proxy appointments and instructions electronically by logging on to the website of Lloyds TSB Registrars, [www.sharevote.co.uk](http://www.sharevote.co.uk), where details of the procedure are set out, provided that they do so before 11.00 a.m. on 28 March 2007 or, if the Court Meeting is adjourned, 48 hours before the time set for the adjourned Court Meeting.

### **ScottishPower ADS Holders**

If you are a registered ScottishPower ADS Holder, please complete and sign the enclosed ADS Voting Instruction Card in accordance with the instructions thereon and return it in the white postage-paid business reply envelope provided (for use in the US only) as soon as possible, but in any event so as to be received by JPMorgan Chase Bank, N.A., no later than 3.00 p.m. (New York time) on 26 March 2007. You may indicate on the ADS Voting Instruction Card whether you wish to attend and vote at the

## **Table of Contents**

Meetings yourself or whether you wish to appoint the nominee of the ScottishPower Depository or another person as your proxy. If you wish to attend and vote at the Meetings yourself, you are requested to indicate this on the ADS Voting Instruction Card (you will be required to present a valid passport or other government-issued photo identification in order to be admitted to the Meetings). If you appoint the nominee of the ScottishPower Depository as your proxy, the nominee will vote in accordance with your instructions. If you appoint a person other than the nominee of the ScottishPower Depository, you should instruct your proxy how you wish your ScottishPower ADSs to be voted.

In lieu of completing and returning the ADS Voting Instruction Card, you may cast your vote by telephone, by calling +1-866-540-5760, or electronically by logging on to [www.proxyvoting.com/spi](http://www.proxyvoting.com/spi), where details of the procedure to be followed are set out. Please refer to the ADS Voting Instruction Card for further information.

If you hold your ScottishPower ADSs indirectly, you must rely on the procedures of the bank, broker, financial institution, share plan administrator or other nominee through which you hold your ScottishPower ADSs if you wish to vote on the Scheme. Indirect ScottishPower ADS Holders who wish to attend and vote at the Meetings may alternatively present their ScottishPower ADSs to the ScottishPower Depository for cancellation and receive (upon compliance with the terms of the ScottishPower Deposit Agreement, including payment of the ScottishPower Depository's fees and any applicable taxes and governmental charges) delivery of their ScottishPower Shares so as to become registered holders of ScottishPower Shares prior to the Voting Record Time.

## **Elections**

### **Form of Election for ScottishPower Shareholders**

ScottishPower Shareholders who hold their ScottishPower Shares in certificated form will find a white Form of Election enclosed with this document, which relates to the Mix and Match Facility and the Loan Note Alternative. There is an explanation of the Form of Election, the procedure to make an election under the Mix and Match Facility and the procedure to make an election under the Loan Note Alternative in Part 12 of this document.

Your completed Form of Election should be signed, witnessed and returned in accordance with the instructions printed thereon, by post or by hand (during normal business hours) to Lloyds TSB Registrars at 3rd Floor, Princess House, 1 Suffolk Lane, London EC4R 0AX as soon as possible, but in any event so as to be received by no later than 3.00 p.m. (London time) on 19 April 2007 or such later time (if any) until which the right to make the relevant election may be extended. A reply-paid envelope, for use in the UK only, is enclosed for your convenience.

If you hold your ScottishPower Shares in uncertificated form (i.e. in CREST), to make an election under the Mix and Match Facility and/or the Loan Note Alternative, you should comply with the procedure for election set out in Part 12 of this document and ensure that an Electronic Election is made which settles no later than 3.00 p.m. (London time) on 19 April 2007 or such later time (if any) that the right to make the relevant election may be extended.

ScottishPower Shareholders who do not wish to make an election for the Mix and Match Facility or the Loan Note Alternative are not required to return the white Form of Election or to make an Electronic Election.

**Dealing Facility**

ScottishPower Shareholders will also find enclosed with this document a Dealing Facility Documentation Pack and a grey Upfront Dealing Facility Instruction Form, relating to election for the Dealing Facility. There is an explanation of the Upfront Dealing Facility Instruction Form and the procedure to make an election for the Dealing Facility in the Dealing Facility Documentation Pack.

## **Table of Contents**

Your completed Upfront Dealing Facility Instruction Form should be signed and returned in accordance with the instructions thereon, by post or by hand (during normal business hours) to Lloyds TSB Registrars at 3rd Floor, Princess House, 1 Suffolk Lane, London EC4R 0AX, so as to be received by 3.00 p.m. (London time) 19 April 2007 or such later time (if any) to which the right to make the relevant election may be extended. A reply-paid envelope, for use in the UK only, is enclosed for your convenience.

**SCOTTISHPOWER SHAREHOLDERS WHO HOLD THEIR SCOTTISHPOWER SHARES IN UNCERTIFICATED FORM (BUT WHO ARE OTHERWISE ELIGIBLE TO MAKE USE OF THE DEALING FACILITY) AND WHO WISH TO MAKE USE OF THE DEALING FACILITY (WHETHER IMMEDIATELY AFTER THE EFFECTIVE DATE OR AT SUCH OTHER DATE AS PERMITTED BY THE TERMS OF THE DEALING FACILITY) MUST CONVERT, AT THEIR OWN COST, THEIR HOLDINGS OF SCOTTISHPOWER SHARES INTO CERTIFICATED FORM PRIOR TO THE EFFECTIVE DATE IN ORDER TO PARTICIPATE IN THE DEALING FACILITY.**

ScottishPower Shareholders who do not wish to participate in the Dealing Facility are not required to return the Upfront Dealing Facility Instruction Form.

If you wish to participate in the Dealing Facility after the Effective Date, you must complete an Ongoing Dealing Facility Instruction Form, which will be sent to you after the Effective Date with your Statement of Ownership.

## **ADS Letter of Transmittal and Election Form for ScottishPower ADS Holders**

Registered ScottishPower ADS Holders will find an ADS Letter of Transmittal and Election Form enclosed with this document. All registered ScottishPower ADS Holders must complete and return the ADS Letter of Transmittal and Election Form, along with any ScottishPower ADSs they hold in certificated form, in the brown non-postage-paid envelope provided in order to receive any consideration for their ScottishPower ADSs. Notes on completing and returning the ADS Letter of Transmittal and Election Form are set out in Part 13 of this document. Completed ADS Letters of Transmittal and Election Forms, along with any ScottishPower ADSs held in certificated form, should be returned by post (properly insured) or by hand (during normal business hours) to JPMorgan Chase Bank, N.A., at the address set forth on the ADS Letter of Transmittal and Election Form.

If you wish to instruct the ScottishPower Depository to make an election in respect of your holding of ScottishPower ADSs for the Mix and Match Facility, you must complete and return the ADS Letter of Transmittal and Election Form (including Box C thereof), along with any ScottishPower ADSs you hold in certificated form, as soon as possible and in any event so as to be received not later than 3.00 p.m. (New York time) on 4 April 2007.

If you hold your ScottishPower ADSs indirectly, you must rely on the procedures of the bank, broker, financial institution, share plan administrator or other nominee through which you hold your ScottishPower ADSs in order to receive any consideration for your ScottishPower ADSs or to make an election under the Mix and Match Facility.

## **Helplines**

## Edgar Filing: - Form

**If you are a ScottishPower Shareholder and have any questions relating to this document or the completion and return of the Forms of Proxy, the Form of Election or the Dealing Facility Instruction Forms, please call Lloyds TSB Registrars on Freefone 0800 023 2559 (or, from outside the United Kingdom, +44 1903 276326) between 8.30 a.m. and 5.30 p.m. (London time) Monday to Friday.**

**If you are a ScottishPower ADS Holder and have questions relating to ScottishPower ADSs, the ADS Voting Instruction Card or the ADS Letter of Transmittal and Election Form, please call Georgeson Shareholder Communications on +1 212 440 9800 (if you hold ScottishPower ADSs in**

**Table of Contents**

**your capacity as a custodian or nominee) between 9.00 a.m. and 5.00 p.m. (New York time) Monday to Friday or on +1 800 657 4988 (for all other ScottishPower ADS Holders, including retail ScottishPower ADS Holders) between 9.00 a.m. and 11.00 p.m. (New York time) Monday to Friday. The second number is toll free if called within the United States.**

**These helplines cannot provide advice on the merits of the Scheme or the Offer or give any financial or tax advice.**

Table of Contents

**PART 4**

**EXPLANATORY STATEMENT**

*(in compliance with section 426 of the Companies Act 1985)*

Morgan Stanley & Co. Limited

25 Cabot Square

Canary Wharf

London E14 4QA

26 February 2007

*To ScottishPower Shareholders and ScottishPower ADS Holders and, for information only, to Convertible Bondholders, holders of ScottishPower B Shares and ScottishPower Deferred Shares, and participants in the ScottishPower Share Schemes*

Dear Sir or Madam,

**RECOMMENDED OFFER BY IBERDROLA, S.A. FOR SCOTTISH POWER PLC**

**1 Introduction**

On 28 November 2006, the Boards of ScottishPower and Iberdrola announced that they had reached agreement on the terms of a recommended offer by Iberdrola to acquire the entire issued and to be issued ordinary share capital of ScottishPower. The Offer is to be effected by means of a scheme of arrangement under section 425 of the Act, which requires the approval of ScottishPower Shareholders and the sanction of the Court.

**Your attention is drawn to the letter from the chairman of ScottishPower, Charles Miller Smith, set out in Part 1 of this document, which forms part of this Explanatory Statement. That letter contains, among other things, information on the background to and reasons for the unanimous recommendation by the ScottishPower Directors to ScottishPower Shareholders and ScottishPower ADS Holders to vote in favour of the resolutions to approve and implement the Scheme to be proposed at the Court Meeting and the ScottishPower EGM.**

## Edgar Filing: - Form

The ScottishPower Board has been advised by Morgan Stanley & Co. Limited in connection with the Offer. Morgan Stanley & Co. Limited has been authorised by the ScottishPower Board to write to you to explain the terms of the Offer and the Scheme and to provide you with other relevant information.

The terms of the Scheme are set out in full in Part 14 of this document. Your attention is also drawn to the additional information set out in Part 10 of this document and the other information set out in this document.

### 2 Summary of the Offer

In accordance with the terms of the Scheme, the economic effect of the Offer will be that, subject to the elections made under the Mix and Match Facility and the Loan Note Alternative (which are described in paragraphs 4 and 5 respectively of this Part 4), ScottishPower Shareholders on the Register of Members and ScottishPower ADS Holders on the register of ScottishPower ADS Holders maintained by the ScottishPower Depository at the Reorganisation Record Time will receive:

<b>for each ScottishPower Share</b>	400 pence in cash; and 0.1646 of a New Iberdrola Share
<b>for each ScottishPower ADS</b>	1,600 pence in cash; and 0.6584 of an Iberdrola ADS

Registered in England and Wales, No. 2164628

Registered office: 25 Cabot Square, Canary Wharf, London E14 4QA

Authorised and Regulated by the Financial Services Authority.

---

**Table of Contents**

Prior to the Effective Date, ScottishPower will declare a Special Dividend of 12 pence for every ScottishPower Share (48 pence per ScottishPower ADS) payable to ScottishPower Shareholders on the Register of Members and ScottishPower ADS Holders on the register of ScottishPower ADS Holders maintained by the ScottishPower Depository at the Special Dividend Record Time.

The Offer values each ScottishPower Share at 795.6 pence and the entire issued ordinary share capital of ScottishPower at approximately £11.85 billion (inclusive of the Special Dividend) based on the Closing Price of an Iberdrola Share on 22 February 2007 (the last practicable date prior to the publication of this document) of £23.31 per Iberdrola Share ( 34.72, based on the exchange rate on 22 February 2007 of £0.67125: 1).

Under the Offer, 52.3 per cent. of the ScottishPower Shares (including ScottishPower Shares underlying ScottishPower ADSs) will be acquired by Iberdrola in consideration for cash (and/or Loan Notes). The remaining ScottishPower Shares will be acquired in consideration for New Iberdrola Shares (or, in the case of ScottishPower Shares underlying ScottishPower ADSs, for Iberdrola ADSs).

The consideration payable by Iberdrola represents a premium of approximately:

2.0 per cent. to the Closing Price of 780 pence per ScottishPower Share on 22 February 2007 (the last practicable date prior to the publication of this document);

6.7 per cent. to the Closing Price of 746 pence for each ScottishPower Share on 27 November 2006 (the last Business Day prior to the date of Announcement);

18.5 per cent. to the Closing Price of 671.50 pence for each ScottishPower Share on 7 November 2006 (the last Business Day prior to the commencement of the Offer Period); and

24.4 per cent. to the average daily Closing Price of 639.65 pence per ScottishPower Share for the three months ended 7 November 2006 (the last Business Day prior to the commencement of the Offer Period).

The Offer is subject to the Conditions set out in Part 5 of this document.

The holders of ScottishPower B Shares and the ScottishPower Deferred Shares will not be able to participate in the Scheme and the rights attaching to the ScottishPower B Shares and the ScottishPower Deferred Shares will be unaffected by the Offer. Any dividend payable on the ScottishPower B Shares will continue to be payable annually in arrears on 28 May or such later date as the Directors of Iberdrola and/or ScottishPower may determine. The admission to listing on the Official List of the ScottishPower B Shares will be unaffected by the Offer and will continue after the Effective Date.

The economic effect of the Offer for each ScottishPower ADS (which represents four ScottishPower Shares) will be as if each ScottishPower ADS Holder receives 1,600 pence and 0.6584 of an Iberdrola ADS. Each Iberdrola ADS will represent one New Iberdrola Share. The ScottishPower Depository will convert at the then prevailing exchange rate the cash consideration into US Dollars in accordance with the ScottishPower Deposit Agreement and distribute the cash proceeds to registered ScottishPower ADS Holders, together with any Iberdrola ADSs to which they become entitled, upon surrender of their ScottishPower ADSs. ScottishPower ADS Holders who hold their ScottishPower ADSs indirectly must rely on the procedures of the bank, broker, financial institution, share plan administrator or other nominee through which they

## Edgar Filing: - Form

hold their ScottishPower ADSs in order to receive the consideration for their ScottishPower ADSs.

Iberdrola will establish the Iberdrola ADR Facility in connection with the acquisition of ScottishPower upon the Scheme becoming effective. Iberdrola currently intends to maintain the Iberdrola ADR Facility on an ongoing basis.

---

**Table of Contents**

Since the Iberdrola ADSs will not be listed or traded on any exchange in the United States, the Iberdrola ADSs will only be eligible for trading over-the-counter. ScottishPower ADS Holders are therefore cautioned that the Iberdrola ADSs may be illiquid. The lack of an active and liquid trading market in the Iberdrola ADSs could therefore make it more difficult to trade such Iberdrola ADSs. In the event that Iberdrola terminates the Iberdrola ADR Facility, former holders of Iberdrola ADSs who receive New Iberdrola Shares following such termination may face administrative burdens and costs in holding New Iberdrola Shares directly. As a result of the decision not to list the New Iberdrola Shares on the New York Stock Exchange or any other US exchange, US resident holders of New Iberdrola Shares, including New Iberdrola Shares received as a result of any termination of the Iberdrola ADR Facility, may be required to sell such underlying shares on the Bolsas de Valores, which could be more time consuming and costly for such holders than settling trades in Iberdrola ADSs.

ScottishPower Shareholders (other than ScottishPower Shareholders in certain overseas jurisdictions) are being offered the opportunity, under the Mix and Match Facility, to elect to vary the proportions in which they receive cash consideration and New Iberdrola Shares in respect of their holdings of ScottishPower Shares. ScottishPower ADS Holders (other than ScottishPower ADS Holders in certain overseas jurisdictions) are also being offered the opportunity, under the Mix and Match Facility, to elect to vary the proportions in which they receive cash consideration and Iberdrola ADSs in respect of their ScottishPower ADSs. Satisfaction of such elections will be subject to elections made by other ScottishPower Shareholders and other ScottishPower ADS Holders. To the extent that elections for cash and/or New Iberdrola Shares, including New Iberdrola Shares underlying Iberdrola ADSs, cannot be satisfied in full, they will be scaled down on a pro rata basis. Further information about the Mix and Match Facility is provided in paragraph 4 below.

A Loan Note Alternative is also being offered to ScottishPower Shareholders (other than Excluded Overseas Persons and ScottishPower ADS Holders) who may elect to receive Loan Notes instead of all or part of the cash consideration to which they would otherwise be entitled under the Offer, including any additional cash consideration to which they become entitled under the Mix and Match Facility. Further information about the Loan Note Alternative is provided in paragraph 5 below. The attention of ScottishPower Shareholders resident in, or who are citizens of, jurisdictions outside the United Kingdom is drawn to paragraph 27 below.

Iberdrola is offering a Dealing Facility to enable certain ScottishPower Shareholders who receive New Iberdrola Shares as a result of the Offer to sell their newly acquired shares.

For the six-month period from the Effective Date, Iberdrola is offering certain qualifying ScottishPower Shareholders use of the Ongoing Dealing Facility for free, without incurring any charges (including any dealing charges, settlement charges or foreign exchange commission). Further details are set out in paragraph 23 of this Part 4.

**SCOTTISHPOWER SHAREHOLDERS WHO HOLD THEIR SCOTTISHPOWER SHARES IN UNCERTIFICATED FORM (BUT WHO ARE OTHERWISE ELIGIBLE TO MAKE USE OF THE DEALING FACILITY) AND WHO WISH TO MAKE USE OF THE DEALING FACILITY (WHETHER IMMEDIATELY AFTER THE EFFECTIVE DATE OR AT SUCH OTHER DATE AS PERMITTED BY THE TERMS OF THE DEALING FACILITY) MUST CONVERT, AT THEIR OWN COST, THEIR HOLDINGS OF SCOTTISHPOWER SHARES INTO CERTIFICATED FORM PRIOR TO THE EFFECTIVE DATE IN ORDER TO PARTICIPATE IN THE DEALING FACILITY.**

ScottishPower ADS Holders will not be entitled to participate in the Dealing Facility with respect to the Iberdrola ADSs received in exchange for their ScottishPower ADSs.

## Edgar Filing: - Form

Eligible Holders wishing to make use of the Dealing Facility should note that Iberdrola anticipates announcing its 2007 first quarter results in the last week of April 2007, after the expected Effective Date of 23 April 2007.

Further details regarding the Dealing Facility can be found in paragraph 23 below.

## Table of Contents

Fractions of New Iberdrola Shares will not be allotted, but will be aggregated and sold in the market after the Effective Date and the net proceeds of such sale will be paid in cash to the ScottishPower Shareholders entitled thereto in accordance with their fractional entitlements. No assurance can be given as to the price that will be received for such New Iberdrola Shares sold as described in this paragraph.

Fractions of Iberdrola ADSs will not be allotted, but will be aggregated and sold in the market after the Effective Date. The net proceeds of such sale shall be converted, if necessary, into US Dollars by the ScottishPower Depository and made available to ScottishPower ADS Holders entitled thereto in accordance with their fractional entitlements. No assurance can be given as to the price that will be received for such Iberdrola ADSs sold as described in this paragraph.

The New Iberdrola Shares will be issued credited as fully paid and free from all liens, charges, encumbrances, and, subject to the Iberdrola By-laws, rights of pre-emption and any other third party rights of any nature whatsoever (save that under the CREST Deed Poll, CREST has certain rights of sale and deduction for expenses and liabilities it may incur in relation to acting as depository in relation to the Iberdrola CDIs) and will rank *pari passu* in all respects with the existing Iberdrola Shares, including the right to receive all dividends, distributions and other entitlements declared, made or paid by Iberdrola on Iberdrola Shares after the Effective Date. Further details of the rights attaching to the New Iberdrola Shares are set out in Part 8 of this document. Immediately following completion of the Offer, but before any dealings take place under the Dealing Facility, former ScottishPower Shareholders and ScottishPower ADS Holders are expected to own approximately 21 per cent. of the issued share capital of Iberdrola.

An application will be made by Iberdrola for the New Iberdrola Shares to be admitted to trading on the Bolsas de Valores. It is expected that admission of the New Iberdrola Shares to trading on the Bolsas de Valores will become effective and that dealings for normal settlement will commence by the second Business Day following the Effective Date. Further details regarding the issue of the New Iberdrola Shares are set out in paragraph 20 below.

### **3 Financial Effects of the Offer**

The following table sets out, for illustrative purposes only, and on the bases and assumptions set out in the notes below, the financial effects on the capital value and income for a holder of 100 ScottishPower Shares assuming the Scheme becomes effective. It compares the value of the number of New Iberdrola Shares and the amount of cash consideration to be issued or paid (respectively) under the Scheme in respect of 100 ScottishPower Shares with the value of 100 ScottishPower Shares on 7 November 2006 (the last Business Day prior to the commencement of the Offer Period). It assumes no election is made under the Mix and Match Facility or Loan Note Alternative and no use is made of the Dealing Facility. In assessing the financial effects of the Offer, no account has been taken of any potential liability to taxation of a ScottishPower Shareholder.

#### **(a) Capital Value**

	Note	Pounds
Value of 16 New Iberdrola Shares	(1)	372.89
Cash consideration (plus the Special Dividend and fractional entitlements)		422.72
Total value of consideration in respect of 100 ScottishPower Shares		795.61
Less: market value of 100 ScottishPower Shares on 7 November 2006	(2)	671.50
Increase in capital value		124.11
Percentage increase in capital value		18.48%



**Table of Contents****(b) Income**

	Note	For the period of last 12 months dividend cycle (Pence)
Dividend income from 16 New Iberdrola Shares	(3)	886.56
Income from cash consideration (plus the Special Dividend and fractional entitlements)	(4)	2,181.24
<b>Total income in respect of consideration for 100 ScottishPower Shares</b>		<b>3,067.80</b>
Dividend income from 100 ScottishPower Shares	(5)	2,735.00
<b>Increase in income</b>		<b>332.80</b>
Percentage increase in income		12.17%

Notes:

- (1) Based on the value of an Iberdrola Share of 34.72 on 22 February 2007, being the last practicable date prior to publication of this document, and an exchange rate of £0.67125: 1.
- (2) Based on the Closing Price of £6.72 per ScottishPower Share on 7 November 2006, being the last Business Day before the commencement of the Offer Period.
- (3) The dividend income from one New Iberdrola Share is based on the aggregate dividends of 55.41 pence ( 0.8094) (net) per Iberdrola Share, being the total of the 30.57 pence ( 0.4404) (net) final dividend for the year ended 31 December 2005 and the 24.84 pence ( 0.3690) (net) interim dividend for the six months ended 30 June 2006, excluding any associated tax credit in respect of the final dividend and interim dividend at exchange rates of £0.6942: 1 and £0.6731: 1 respectively, the prevailing exchange rates at the dividend payment dates of 3 July 2006 and 2 January 2007 respectively.
- (4) The income from the cash consideration has been calculated on the assumption that the cash component (plus the Special Dividend and fractional entitlements) is reinvested for the period of 12 months to yield approximately 5.16 per cent. per annum, being the yield shown by the FTSE Actuaries Government Securities of up to five-year maturities, as published in the *Financial Times* on 22 February 2007 (the last practicable date before the publication of this document).
- (5) The dividend income from one ScottishPower Share is based on aggregate dividends of 27.35 pence (net) per ScottishPower Share, being the total of the 6.55 pence (net dividend for the third quarter of the financial year ending 31 March 2006 and adjusted for the 0.7937:1 share consolidation which took place on 15 May 2006) and the 9.40 pence (net interim dividend for the fourth quarter of the financial year ending 31 March 2006 and the 11.40 pence (net interim dividend for the six-month period ended 30 September 2006, excluding any associated tax credit in respect of the final dividend and interim dividend).

**4 Mix and Match Facility**

Under the terms of the Offer, ScottishPower Shareholders and ScottishPower ADS Holders (other than those in certain overseas jurisdictions) are entitled to elect to vary the proportion of cash consideration and New Iberdrola Shares or Iberdrola ADSs, as applicable, subject to elections made by other ScottishPower Shareholders and ScottishPower ADS Holders. The economic ratio in which ScottishPower Shareholders and ScottishPower ADS Holders may elect to receive New Iberdrola Shares or Iberdrola ADSs, as applicable, instead of cash or elect to receive cash instead of New Iberdrola Shares or Iberdrola ADSs, as applicable, under the Mix and Match Facility will be:

**for every 380 pence in cash  
for every 1,520 pence in cash**

**0.1646 of a New Iberdrola Share  
0.6584 of an Iberdrola ADS**

Elections made under the Mix and Match Facility may only be made in respect of whole numbers of ScottishPower Shares or ScottishPower ADSs. Irrespective of the number of ScottishPower Shareholders and ScottishPower ADS Holders who elect for cash consideration or New Iberdrola Shares or Iberdrola ADSs, as applicable, under the Mix and Match Facility, the total cash consideration to be paid by Iberdrola and the total number of New Iberdrola Shares (including New Iberdrola Shares underlying Iberdrola ADSs) to be issued pursuant to the Offer will not be varied as a result of elections made under the Mix and Match Facility. Accordingly, Iberdrola's ability to satisfy elections for New Iberdrola Shares or Iberdrola ADSs, as applicable, or cash consideration made by ScottishPower Shareholders and ScottishPower ADS Holders will depend on the elections of other ScottishPower Shareholders and ScottishPower ADS Holders. To the extent that elections for New Iberdrola Shares or Iberdrola ADSs, as applicable, and/or cash consideration cannot be satisfied in full, they will be scaled down on a pro rata basis. As a result, ScottishPower Shareholders and ScottishPower ADS Holders

## **Table of Contents**

who elect to receive additional New Iberdrola Shares or Iberdrola ADSs, as applicable, or cash consideration under the Mix and Match Facility will not necessarily know the exact number of New Iberdrola Shares or Iberdrola ADSs, as applicable, or cash consideration they are entitled to receive until settlement of the consideration under the Offer.

An announcement will be made of the extent to which elections under the Mix and Match Facility have been satisfied before the Reduction Court Hearing.

**Elections made under the Mix and Match Facility will not affect the entitlements of those ScottishPower Shareholders and ScottishPower ADS Holders who do not make an election under the Mix and Match Facility.**

### *Elections by ScottishPower Shareholders*

The Mix and Match Facility will remain open until 3.00 p.m. (London time) on 19 April 2007 or such later time (if any) until which the right to make the relevant election may be extended.

Details on how ScottishPower Shareholders can make an election under the Mix and Match Facility are set out in Part 12 of this document and, in the case of Certificated Holders, the white Form of Election. Overseas Shareholders should also read paragraph 27 of this Part 4 in relation to their ability to make an election under the Mix and Match Facility.

### *Elections by ScottishPower ADS Holders*

Registered ScottishPower ADS Holders will find enclosed with this document an ADS Letter of Transmittal and Election Form which includes a section relating to elections for the Mix and Match Facility. All registered ScottishPower ADS Holders must complete and return the ADS Letter of Transmittal and Election Form, along with any ScottishPower ADSs they hold in certificated form, in the brown non-postage-paid envelope provided in order to receive any consideration for their ScottishPower ADSs. Notes on completing and returning the ADS Letter of Transmittal and Election Form are set out in Part 13 of this document. If you wish to instruct the ScottishPower Depository to make an election in respect of your holding of ScottishPower ADSs for the Mix and Match Facility, you must complete and return the ADS Letter of Transmittal and Election Form (including Box C thereof), along with any ScottishPower ADSs you hold in certificated form, as soon as possible and in any event so as to be received not later than 3.00 p.m. (New York time) on 4 April 2007.

If you hold your ScottishPower ADSs indirectly, you must rely on the procedures of the bank, broker, financial institution, share plan administrator or other nominee through which you hold your ScottishPower ADSs in order to make an election under the Mix and Match Facility.

## **5 Loan Note Alternative**

## Edgar Filing: - Form

As an alternative to some or all of the cash consideration which would otherwise be receivable under the Scheme, ScottishPower Shareholders (other than Excluded Overseas Persons and ScottishPower ADS Holders) may be able to elect to receive Loan Notes to be issued by Iberdrola on the following basis:

**For every £1 of cash consideration**

**£1 nominal value of Loan Notes**

Up to a maximum amount of £750 million of Loan Notes in aggregate nominal value will be available under the Loan Note Alternative. To the extent that ScottishPower Shareholders validly elect to receive

---

**Table of Contents**

Loan Notes pursuant to the Loan Note Alternative which in aggregate nominal value exceed £750 million, the entitlement of each ScottishPower Shareholder who so validly elects will be scaled down pro rata.

The Loan Notes will be issued by Iberdrola, credited as fully paid, in amounts and integral multiples of £1 and the balance of any entitlement that is not a whole multiple of £1 will not be issued but will instead be settled in cash. The Loan Notes will constitute direct, unsecured and unsubordinated obligations of Iberdrola. The Loan Notes will bear interest at a rate of 0.50 per cent. below six-month Sterling LIBOR to be determined on the first Business Day of each interest period. Interest will be payable by half-yearly instalments in arrears (less any tax) on 30 June and 30 December in each year. The first payment of interest will be made on 30 December 2007 (the **First Payment Date**). On the First Payment Date, interest will be paid in respect of the period from (and including) the date after that on which the relevant Loan Notes are issued, up to (but excluding) the First Payment Date and the interest for this period will be calculated by reference to the six-months Sterling LIBOR prevailing at the date of issue of the Loan Notes.

Unless Iberdrola decides otherwise, no Loan Notes will be issued by Iberdrola unless, on or before the Effective Date, the aggregate nominal value of all Loan Notes to be issued as a result of valid elections for the Loan Note Alternative exceeds £20 million. If such aggregate nominal value is less than £20 million, any such election shall, unless Iberdrola decides otherwise, be void and the relevant ScottishPower Shareholders will be deemed not to have made an election under the Loan Note Alternative.

Iberdrola may redeem all (but not some only) of the Loan Notes (so long as they have been in issue for at least six months) if the aggregate nominal value of the outstanding Loan Notes falls below £2 million. Iberdrola may purchase any Loan Notes which have been in issue for at least six months at a price by tender available to all holders of Loan Notes alike, or otherwise by agreement with any holders of Loan Notes. The Loan Notes may be redeemed at the option of a Loan Note Holder on not more than 60 days and not less than 14 days notice, in minimum denominations of £1,000, unless the holder of Loan Notes has a total holding of less than £1,000, in which case the total Loan Note holding, but not part thereof, may be redeemed. The Loan Notes are redeemable at the option of the holder for cash at par on any interest payment date between the First Payment Date and five years from the Effective Date (the **Final Redemption Date**) (both dates inclusive). Any Loan Notes outstanding on the Final Redemption Date will be redeemed at par together with any accrued interest (less any tax) due at that date.

The Loan Notes will not be transferable without the prior consent of Iberdrola, and no application will be made for them to be listed on, or dealt on, any stock exchange or other trading facility.

The Loan Notes to be issued pursuant to the Loan Note Alternative have not been, and will not be, listed on any stock exchange and have not been, and will not be registered under the US Securities Act or under the securities laws of any state or other jurisdiction of the United States (or under the securities laws of any other jurisdiction which Iberdrola is advised to treat as a Loan Note Restricted Jurisdiction); the relevant clearances have not been, and will not be, obtained from the securities commission of any province, territory or jurisdiction of Canada; nor has any prospectus been lodged with, or registered by, the Australian Securities and Investments Commission, nor have any steps been taken, nor will any steps be taken, to enable the Loan Notes to be offered in compliance with the applicable securities laws of Japan. Accordingly, unless an exemption under relevant securities law is available, the Loan Notes may not be offered, sold, resold, delivered or transferred, directly or indirectly, in or into a Loan Note Restricted Jurisdiction in which an offer of Loan Notes would constitute a violation of the relevant laws of, or require registration of the Loan Notes in, such jurisdiction or to, or for the account or benefit of, a person located in a Loan Note Restricted Jurisdiction.

## **Table of Contents**

Shareholders electing to receive Loan Notes will be required to certify that they are not US persons (as defined in Regulation S under the US Securities Act) and are not located in the United States.

Documents of title in respect of the Loan Notes will not be sent to addresses in the United States, Canada, Australia or Japan or any other Loan Note Restricted Jurisdictions.

The Loan Notes and the Loan Note Instrument will be governed by, and construed in accordance with, English law and will be unsecured obligations of Iberdrola. The issue of the Loan Notes, the ranking of the Loan Notes and the regulations governing the syndicate of the holders of the Loan Notes (*sindicato de obligacionistas*) will be governed by Spanish law.

The terms of the Loan Notes will be such that the Loan Notes should not constitute qualifying corporate bonds for individuals for the purposes of UK taxation.

An announcement will be made of the extent to which elections under the Loan Note Alternative have been satisfied before the Reduction Court Hearing.

Further details on the terms of the Loan Notes are set out in Part 9 of this document and details on how to make an election under the Loan Note Alternative are set out in Part 12 of this document and, in the case of Certificated Holders, the white Form of Election.

ABN AMRO has advised Iberdrola that, in its opinion, based on market conditions on 22 February 2007 (the last practicable date prior to the publication of this document), the value of the Loan Notes (had they been in issue on that day) would have been not less than 99 pence per £1 in nominal value.

## **6 Information on the ScottishPower Group**

ScottishPower is an international energy company with businesses in the UK and US, and is listed on the London and New York Stock Exchanges. ScottishPower provides electricity transmission and distribution services in the UK, supplies electricity and gas services to homes and businesses across the UK and has electricity generation, gas storage facilities and associated energy management activities in the UK, Ireland and North America. ScottishPower was created upon privatisation in 1991, was incorporated as a public limited company in 1999 and has subsequently developed through organic growth and strategic acquisitions. In the financial year ended 31 March 2006, the ScottishPower Group reported total revenues of £5,446 million and an operating profit of £870 million from continuing operations. As at 31 March 2006, ScottishPower employed 9,793 people.

It has three divisions: Energy Networks, Energy Wholesale & Retail and PPM Energy.

**(a) Energy Networks**

The Energy Networks business owns and operates ScottishPower's electricity transmission and distribution network in the UK. It operates primarily in a regulated environment with targets set by the UK regulator, OFGEM, and has a regulated asset base of £2.9 billion with approximately 3.3 million customers (as at 31 March 2006). The network extends to almost 112,000 km, with some 65,000 km of underground cables and 47,000 km of overhead lines (as at 31 March 2006).

The management focus of the transmission and distribution business is to provide an efficient, safe and reliable network while outperforming allowed regulatory returns. Investment is planned to grow the regulated asset base, to improve the security of supply and network performance and facilitate connection of renewable generation.

## **Table of Contents**

### **(b) Energy Retail & Wholesale**

Energy Wholesale operates over 6,300 MW of generating capacity in the British Isles and manages ScottishPower's exposure to the UK wholesale electricity and gas markets. Energy Retail supplies gas and electricity to about 5.2 million customers across the UK (as at 31 March 2006). It manages pricing, selling, metering, billing, customer service and cash collection for gas and electricity supply to both business and domestic customers.

The Energy Retail & Wholesale management oversee activities across the energy value chain, maximising value from a diverse generation portfolio through to its national customer base, via an integrated commercial and energy management activity that balances and hedges energy needs. Energy Retail & Wholesale has a strong track record as the UK's leading developer of onshore wind energy. As at 30 September 2006, operational capacity was 344 MW with a further 464 MW under construction or with planning consents. This represents over 80 per cent. of ScottishPower's 2010 target of 1,000 MW.

### **(c) PPM Energy**

In North America, ScottishPower owns PPM Energy, which is based in Portland, Oregon. PPM Energy is a growing energy provider operating in the areas of renewable energy, gas storage and hub services, gas-fired generation and energy management activities. PPM Energy's principal assets are renewable and thermal generation resources and natural gas storage facilities in 12 US states and in Canada (as at 31 March 2006). As at 30 September 2006, PPM Energy owned or controlled 1,620 MW of wind generation and 806 MW of thermal generation. PPM Energy is the second largest developer of wind energy in the US (as at 31 March 2006) and ranks as the third largest independent owner of gas storage (as at 31 March 2006).

PPM Energy is building on its leading positions in wind generation and independent gas storage, while expanding its energy management and origination activities. For example, PPM Energy is aiming to develop at least 3,500 MW of wind capacity by 2010 and the energy management and origination business continues to build a portfolio of rights and marketing alliances to complement its gas storage activities.

## **7 Current Trading and Prospects for ScottishPower**

In the financial year ended 31 March 2006, the ScottishPower Group reported total revenues of £5,446 million and an operating profit of £870 million from continuing operations.

On 14 November 2006, ScottishPower announced its half-year results for the six months ended 30 September 2006. The half-year results demonstrated a strong performance with adjusted operating profit up by 59 per cent. to £517 million for the six-month period, adjusted profit before tax up by 77 per cent. to £483 million and adjusted profit from continuing operations up 39 per cent. to £330 million. On a reported basis, operating profit was £396 million, profit before tax was £271 million and profit from continuing operations was £181 million. Extracts from the half-year results statement are set out in section B of Part 6 of this document.

## Edgar Filing: - Form

Since the half-year results for the six months ended 30 September 2006, ScottishPower has continued to trade in line with expectations. During this period, UK wholesale commodity prices have declined, which has resulted in a redistribution of profits across the ScottishPower Group's integrated energy value chain, with reduced profits from the Energy Wholesale activities offset by improved profitability in the Energy Retail business. Potential domestic supply tariff reductions could impact the near-term performance of the Energy Retail business, given ScottishPower's hedge position.

### **8 Information on Iberdrola**

Iberdrola was founded in 1901 and is listed on the Bolsas de Valores, through the Spanish Continuous Market (ticker: IBE.SM). Iberdrola's share performance is included in the computation of the Spanish

## **Table of Contents**

IBEX 35 index and the Euro Stoxx 50, Dow Jones Sustainability World Index and DJSI Stoxx indexes. Iberdrola is a vertically integrated energy company with a solid position in the Spanish market and an international footprint focused in Mexico and Brazil. As at 31 December 2006, Iberdrola accounted for 30,384 MW and 18.4 million electricity points of supply worldwide. As at 31 December 2006, Iberdrola, the leading wind generator worldwide, had a wind generating capacity of 4,102 MW.

As at 31 December 2006, Iberdrola employed 16,155 people.

A general description of each of Iberdrola's major businesses is set out below:

### **(a) Traditional Generation (Spain)**

In Spain, Iberdrola's generation capacity as at 31 December 2006 amounted to 21,532 MW, including 4,800 MW of CCGTs.

In Spain, for the full year ending 31 December 2006, Iberdrola produced 60.5 TWh with a diversified portfolio of power plants (nuclear, hydro, coal, CCGT and fuel-oil). In addition, Iberdrola also has a small presence in Portugal, France, Belgium, the Netherlands, Austria, Switzerland, Italy and Germany focused around electricity trading.

### **(b) Supply and Gas**

Iberdrola sold 6,518 GWh in the liberalised electricity supply segment in Spain in 2006, a decline of 77 per cent. from 2005, as a consequence of the profit and loss optimisation policy.

Iberdrola has consolidated its position as the second largest gas player in the wholesale procurement and supply businesses in Spain. In the procurement business, in 2006 Iberdrola supplied 4.3 bcm of gas into the Spanish deregulated market, with a market share of 15 per cent.

Iberdrola has signed long-term supply contracts that amount to 16 bcm of gas annually (7 bcm in Spain and 9 bcm in Mexico and Brazil). These supply contracts have been entered into with a range of counterparties and each has different commercial terms. This contractual structure, in part, allows Iberdrola to reduce its exposure to currency risks and oil price fluctuations.

Pursuant to the agreements with Sonatrach, Nigeria LNG, GNA, ENI and Snohvit, supplies which originate in Algeria, Nigeria, the Persian Gulf and Trinidad and Tobago are to be delivered to the re-gasification plants of Bilbao, Huelva and Sagunto. Iberdrola also has a long-term supply contract via the direct gas pipeline between Algeria and Spain, MEDGAZ, for 1.6 bcm annually.

## Edgar Filing: - Form

In addition, Iberdrola has become a main developer of new gas infrastructure in Spain. As at 31 December 2006, Iberdrola owned 25 per cent. and 30 per cent. of the re-gasification plants of BBG (Bilbao) and SAGGAS (Sagunto), respectively. During January 2007, Iberdrola increased its stake in the MEDGAZ gas pipeline to 20 per cent.

### **(c) Renewables**

At 31 December 2006, Iberdrola had renewable installed capacity of 4,434 MW (4,102 MW of wind energy and 332 MW of mini-hydroelectric energy), positioning Iberdrola as a world leader in renewables. At 31 December 2006, 440 MW of installed capacity related to countries outside Spain, including Portugal, France, Italy, the UK, Greece, Germany and Poland.

In 2006, 624 MW of capacity became operational (607 MW of wind energy and 17 MW of mini-hydroelectric). Of the total new capacity, 420 MW related to Spain and 204 MW to other countries. Installed capacity at 31 December 2006 was 16.4 per cent. higher than at 31 December 2005. Globally, Iberdrola has a portfolio of projects that is approaching 18,500 MW.

## **Table of Contents**

Iberdrola's strong focus on renewable energy is part of its commitment to the environment, sustainable development and the objectives of the Kyoto Protocol. Iberdrola has become the only Spanish electricity company included in the Climate Leadership Index, international recognition that demonstrates its firm strategy to combat climate change.

### **(d) Distribution in Spain**

In the distribution business in Spain, Iberdrola accounted for 9.9 million electricity points of supply as at 31 December 2006. In Spain, for the full year ending 31 December 2006, Iberdrola distributed 99.5 TWh of electricity.

### **(e) International**

In Latin America, Iberdrola is present in the generation business in Mexico, Chile and Brazil and the distribution business in Brazil, Guatemala and Bolivia. As at 31 December 2006, Iberdrola accounted for 8.5 million connected customers and 4,418 MW of total installed generation capacity in Latin America. Iberdrola's main activities in Latin America are the generation business in Mexico (where Iberdrola accounts for approximately 3,815 MW of installed capacity) and the electricity distribution in Brazil (where Iberdrola controls 7.7 million connected customers).

### **(f) Non-Energy**

Iberdrola Ingeniería, the engineering and construction company of the Iberdrola Group, has wide experience in electric power generation, distribution and control facilities services worldwide and employs more than 1,000 people. At present, Iberdrola Ingeniería has projects underway in more than 25 countries and has subsidiaries in Mexico, Brazil, Russia, Qatar, Greece, Poland, the UK, the US, Venezuela, Tunisia, Latvia, Germany, Bulgaria, India, Kenya and Slovakia. As at the date of this document, Iberdrola Ingeniería is Spain's leading electrical engineering company by sales.

Iberdrola Inmobiliaria is a nationally based company offering an extensive portfolio of products, including first homes, holiday homes, offices, industrial buildings and shopping centres. In 2006, Iberdrola Inmobiliaria generated a net profit of £74.3 million (€110.3 million), an increase of 15.4 per cent. on the previous year (based on the exchange rate of 1.4842: £1 as of 31 December 2006). Iberdrola Inmobiliaria had a portfolio of developable land of 2.2 million sqm (1.6 million sqm for residential use and 0.6 million sqm for commercial use).

On 4 October 2006, Iberdrola outlined a new Strategic Plan 2007-2009 (the **Strategic Plan 2007-2009**), setting a range of operational and financial targets for the Iberdrola Group as a whole and for its constituent business. The Strategic Plan 2007-2009 also includes certain projections up to 2011. The Strategic Plan 2007-2009 sets out, among other things, targets for compound annual growth in EBITDA between 2005 and 2009, and target net profit for 2009 for Iberdrola.

These long-term 2009 targets were not expressly made to place a floor under, or a ceiling on, the likely outcome for the relevant period, and so should not be interpreted as a profit forecast.

## Edgar Filing: - Form

The stated targets form part of an established pattern of investor relations communication dating back to October 2001, when Iberdrola announced its Strategic Plan 2001-2006, that marked a new strategic direction for the Iberdrola Group (by focusing on the core energy business) and set five-year targets for a range of operational and financial metrics. This plan formed the basis for the market's assessment of the progress made by Iberdrola between 2000 (the reference year) and 2006.

Such long-term targets remain subject to a significant number of uncertainties and necessarily can only be based on information available to the management of Iberdrola at the time the targets were provided and do not take into account the proposed acquisition of ScottishPower. Management plans, by their nature, can change based on information that becomes available subsequently and in response to market and other external factors.

---

## Table of Contents

ScottishPower Shareholders are further cautioned that the long-term targets provided in the Strategic Plan 2007-2009 were necessarily based upon a variety of assumptions relating to the business of Iberdrola including general business and economic conditions, all of which are subject to significant uncertainties and many of which are beyond Iberdrola's control. Given the nature of such long-term targets, there can be no assurance that any such long-term targets will be realised.

None of Iberdrola, ScottishPower, or their respective directors, officers, affiliates or any of such parties' respective financial advisers accepts any responsibility for such long-term targets, or the basis or assumptions on which they were prepared or the context in which they appear. The long-term targets prepared by Iberdrola's management were not intended to be a profit forecast as defined by the City Code and were not prepared to the standards that can be reported on in accordance with the requirements of the City Code. No reliance should be placed upon any such long-term targets in making any investment decisions in connection with ScottishPower or Iberdrola securities.

Further to the Announcement of the Offer on 28 November 2006, which referred to the agreement entered into between Iberdrola and Gas Natural SDG, S.A. ( "**Gas Natural** ") whereby Iberdrola would acquire certain assets from the combined Company resulting from Gas Natural's proposed acquisition of the entire share capital of Endesa, S.A. ( "**Endesa** "), which was filed on 5 September 2005 and approved by the CNMV on 27 February 2006, the board of directors of Gas Natural decided to withdraw its takeover bid for Endesa. The withdrawal was communicated to the CNMV and the Bolsas de Valores on 1 February 2007.

## **9 Iberdrola's Reasons for the Offer**

Iberdrola believes that the Offer will accelerate the achievement of a number of Iberdrola's objectives, outlined in its 2007-2009 strategic plan. Iberdrola anticipates that the combination of Iberdrola and ScottishPower will create one of the leading European integrated utility companies and the leading wind generator. Based on pro forma enterprise value, the Enlarged Iberdrola Group will be valued at £43.9 billion ( \$65.4 billion). As a result of the transaction, the Enlarged Iberdrola Group will also have:

a leading position in the rapidly growing UK and North America renewables markets;

a reinforced market presence in Europe and North America which will provide enhanced opportunities for gas trading and procurement in the increasingly global and LNG-driven gas marketplace;

an installed generation capacity base of 38,922 MW including 6,066 MW of wind generation capacity and 332 MW of small hydro generation capacity; and

a regulated networks business with approximately 21.7 million electricity points of supply.

The Offer affords Iberdrola an exceptional opportunity to acquire a vertically integrated utility company, with complementary skills in the attractive liberalised UK market with scope for significant ongoing investment in new generation capacity and networks. The Enlarged Iberdrola Group will be well diversified in terms of:

geographical spread (Spain, United Kingdom, Latin America and North America);

## Edgar Filing: - Form

generation mix (nuclear, coal, wind, hydro and gas); and

business mix (regulated and non-regulated).

Iberdrola will be able to draw on ScottishPower's considerable experience in deregulated markets and its strong skill sets in retailing and trading. In return, Iberdrola believes that ScottishPower will also benefit from Iberdrola's best-in-class standards in generation and distribution activities.

## **Table of Contents**

### **10 Iberdrola's Intentions for the ScottishPower Business**

The combination of Iberdrola and ScottishPower will be driven by Iberdrola's strategy of enhancing growth, efficiency and internationalisation with the vision of being at the forefront of the utility industry in Europe, as well as globally. Iberdrola's current intentions are in line with ScottishPower's plans to maintain its asset base in the UK, to improve the performance of its energy networks business and to expand wind energy generation capacity in the UK and the US.

Iberdrola has no current intention to redeploy any material part of the fixed assets of ScottishPower as a consequence of the transaction.

The combination of both Iberdrola and ScottishPower is not only strategically complementary, but also establishes a firm foundation for continued growth in the future.

### **11 Financial Benefits of the Offer**

The Iberdrola Directors believe that the Enlarged Iberdrola Group can achieve annual pre-tax operating cost savings of at least £88 million ( 130 million) based on the existing cost and operating structures and plans of Iberdrola and ScottishPower. The full annual run rate of these savings will be achieved by the end of the third year after the Effective Date. Annual capital expenditure savings are anticipated to average at least £30 million ( 44 million<sup>b</sup>) over the first five years following completion of the Offer.

Annual operating and capital expenditure savings will result from:

reduction in corporate overheads;

optimisation of operations and maintenance;

transfer of best practice in the generation, supply and distribution businesses; and

scale efficiencies in the procurement of gas, and of renewable and other generation capital equipment.

The balance sheet, profitability and cash flow strength of the Enlarged Iberdrola Group is expected to enable it to capitalise upon and accelerate investment in a number of attractive growth opportunities in existing as well as new markets in both Europe and the Americas. This statement does not constitute a profit forecast and should not be interpreted to mean that profits for the year to 31 December 2007 or any subsequent financial period would necessarily be greater than those for any preceding financial year.

## 12 Current Trading and Prospects for Iberdrola

On 21 February 2007, Iberdrola announced total revenues of 11,017 million (£7,423 million) for the financial year ended 31 December 2006. Operating profit for the same period increased 17.3 per cent. to 2,654 million (£1,789 million) and EBITDA increased 15.2 per cent. to 3,890 million (£2,621 million). Net profit after minority interests for the financial year ended 31 December 2006 was 1,660 million (£1,119 million), 20.1 per cent. higher compared to 2005 and 3.8 per cent. higher than the 1,600 million (£1,078 million) net profit target contained in the Strategic Plan 2001-2006 (based on the exchange rate of 1.4842:£1 as of 31 December 2006).

Trading in 2007 has to date continued in line with Iberdrola's expectations.

33

- 
- (1) The expected cost savings have been calculated on the basis of the existing cost and operating structures of the current Iberdrola Group and ScottishPower Group. These statements of estimated cost savings relate to future actions and circumstances which by their nature involve risks, uncertainties, contingencies and other factors. As a result, the cost savings referred to may not be achieved, or those achieved may be materially different from those estimated. Please see the Cautionary Note regarding Forward-Looking Statements on page 5 of this document.

## **Table of Contents**

### **13 Financing Arrangements**

The consideration payable to ScottishPower Shareholders and ScottishPower ADS Holders under the terms of the Offer will be in cash (or, at the option of certain eligible individual ScottishPower Shareholders, Loan Notes) and New Iberdrola Shares (including Iberdrola ADSs) and will be provided through a combination of new committed credit facilities and the issue of New Iberdrola Shares.

Iberdrola has obtained committed debt financing arranged by ABN AMRO Bank N.V., Barclays Capital and The Royal Bank of Scotland plc in the sum of £7,955,000,000. To satisfy acceptances of the share element of the consideration, Iberdrola will also issue approximately 245 million New Iberdrola Shares to ScottishPower Shareholders (including Iberdrola ADSs issued to ScottishPower ADS Holders). As a result, on completion of the Offer and prior to any dealings made through the Dealing Facility, former ScottishPower Shareholders and ScottishPower ADS Holders will own approximately 21 per cent. of the issued share capital of Iberdrola as enlarged by the Offer.

Iberdrola will use the operating cash flows of the Enlarged Iberdrola Group to service the acquisition debt financing within the restrictions placed on the businesses by regulators.

ABN AMRO, the financial adviser to Iberdrola, is satisfied that Iberdrola has sufficient resources available to satisfy in full the cash consideration payable to ScottishPower Shareholders under the terms of the Scheme.

Further details of the financing arrangements are set out in paragraph 11(b) of Part 10 of this document.

### **14 Implementation Agreement and Inducement Fee**

ScottishPower and Iberdrola have entered into the Implementation Agreement which provides, among other things, for the implementation of the Scheme and contains certain assurances and confirmations between the parties, including to implement the Scheme in accordance with an agreed timetable, regarding the satisfaction of certain conditions to the Offer and regarding the conduct of the respective businesses of both parties pending completion of the Offer. Under the terms of the Implementation Agreement, Iberdrola has retained the right, subject to ScottishPower's prior written consent, to effect the Offer by way of a Takeover Offer for ScottishPower.

In the Implementation Agreement, ScottishPower has agreed to pay an Inducement Fee of £50 million to Iberdrola if, among other things, after the date of the Announcement:

- (a) the ScottishPower Directors (or any committee of the ScottishPower Directors) fail unanimously to recommend the Offer or withdraw or adversely modify or qualify their unanimous recommendation of the Offer; or

## Edgar Filing: - Form

- (b) the ScottishPower Directors determine not to implement the Offer by refusing to put forward the Scheme; or
- (c) where the Offer is being made by way of a Scheme, it is not approved by the ScottishPower Shareholders at the Court Meeting or the ScottishPower EGM Resolution is not approved at the ScottishPower EGM; or
- (d) where the Offer is being made by way of a Scheme, following the resolutions proposed at the Court Meeting and the ScottishPower EGM having been passed by the requisite majorities, the ScottishPower Directors do not, in breach of the Implementation Agreement or because (acting in good faith) their fiduciary duties require it, seek the Court Orders at the Court Hearings; or
- (e) an Alternative Proposal is made and:
  - (i) such Alternative Proposal (whether or not recommended by the ScottishPower Directors) is declared unconditional in all respects, becomes effective or otherwise completes;

**Table of Contents**

- (ii) that Alternative Proposal is referred to the competition authorities, lapses, and the relevant third party makes another offer for ScottishPower which completes, or becomes effective or becomes or is declared unconditional in all respects; and
- (iii) for the avoidance of doubt, if an Alternative Proposal made before the Offer is withdrawn or lapses is declared unconditional in all respects, becomes effective or otherwise completes following the withdrawal or lapse of the Offer and Iberdrola is not in a material breach of any of its obligations under the Implementation Agreement, ScottishPower shall remain liable to pay Iberdrola the Inducement Fee; or
- (f) ScottishPower is in material breach of certain of its obligations under the Implementation Agreement (for further details see paragraph 10(a) of Part 10 of this document) and Iberdrola has exercised its right to terminate the Implementation Agreement as a consequence thereof,

provided that Iberdrola is not in material breach of its obligations under the Implementation Agreement.

ScottishPower has undertaken in the Implementation Agreement not to solicit, or otherwise seek to procure, any Alternative Proposal, save that ScottishPower shall not be prohibited from complying with its obligations under the provisions of the City Code or required by law or any applicable regulatory body nor shall ScottishPower's Directors be prohibited from fulfilling their fiduciary duties.

Iberdrola also agreed to pay ScottishPower an Inducement Fee of £50 million if, among other things:

- (a) the resolution in respect of the Offer is not passed by the requisite majority of Iberdrola shareholders at the Iberdrola Shareholders Meeting;
- (b) Iberdrola fails to convene or adjourns and fails to reconvene the Iberdrola Shareholders Meeting (other than with the prior written consent of ScottishPower); or
- (c) Iberdrola is in material breach of certain of its obligations under the Implementation Agreement (for further details see paragraph 10(a) of Part 10 of this document), provided ScottishPower is not in material breach of its obligations under the Implementation Agreement.

**15 Management and Employees**

Iberdrola attaches great value to the skills and experience of the business management and employees of ScottishPower. They will be critical to the success of the Enlarged Iberdrola Group and Iberdrola fully expects that they will continue to play a vital role in the business going forward.

Iberdrola has given assurances to ScottishPower that, on completion of the Offer, it will honour the contractual terms and conditions, benefits and existing severance policy of ScottishPower's employees (including pension rights) for at least two years.

## Edgar Filing: - Form

Iberdrola also intends to continue funding the current pension arrangements for all participants in such arrangements at the time of completion of the Offer in line with the principles in operation at the time of the transaction, including commissioning regular valuations and updating the principles accordingly, and in full compliance with all applicable legal requirements. If Iberdrola proposes to implement any new arrangements for new employees following completion of the Offer, these will be subject to the normal consultation and agreement arrangements currently in place with employee representatives.

Iberdrola currently has no plans to change the principal locations of Iberdrola's business after the completion of the Offer. Iberdrola will continue to be headquartered in Madrid, Spain and its corporate legal domicile will remain in Bilbao, Spain. While Iberdrola will continue to be headquartered in Spain, it has provided assurances to ScottishPower that ScottishPower will maintain its identity and a corporate headquarters in Glasgow and does not envisage changing the principal locations of ScottishPower's business in the UK and in the US.

**Table of Contents**

Iberdrola has also confirmed that it will honour the contractual terms and conditions, benefits and existing severance policy of Iberdrola's employees (including pension rights) for at least two years from the Effective Date.

**16 The ScottishPower Directors, the Effect of the Scheme on their Interests and Irrevocable Undertakings**

Details of the interests of the ScottishPower Directors in the share capital of ScottishPower and options over its share capital are set out in paragraph 4 of Part 10 of this document. ScottishPower Shares held by the ScottishPower Directors will be subject to the Offer.

In letters dated 28 November 2006, addressed to Philip Bowman and Simon Lowth as employees and/or ScottishPower Directors, Iberdrola has agreed, among other things:

- (a) to honour in full the terms of Philip Bowman's and Simon Lowth's respective service agreements;
- (b) to honour in full the bonus provisions set out in Philip Bowman's and Simon Lowth's respective service agreements and to procure the exercise of any and all discretions to the maximum amount permitted in accordance with the terms thereof; and
- (c) that, unless Philip Bowman and/or Simon Lowth provide prior notification to the contrary to Iberdrola, if the Scheme becomes effective, their respective employment and/or appointment as directors will terminate on the day on which the Scheme becomes effective and Iberdrola will procure the payments and the provision of the benefits and the exercise of any discretions as provided for in the letters.

Particulars of the service contracts (including termination provisions) and letters of appointment of the ScottishPower Directors are set out in paragraph 9 of Part 10 of this document.

Save as set out above, the total emoluments receivable by the ScottishPower Directors will not be varied as a consequence of the Scheme becoming effective.

The ScottishPower Directors have irrevocably undertaken to vote in favour of the Scheme in respect of their aggregate beneficial holdings of 142,196 ScottishPower Shares, representing approximately 0.1 per cent. of the existing issued share capital of ScottishPower. These undertakings will cease to have any effect if the Implementation Agreement is terminated in accordance with its terms.

The ScottishPower Directors did not obtain any additional financial benefit for the purpose of securing their irrevocable undertakings.

Save as set out in this paragraph 16, paragraph 15 above and paragraph 17 below, the effect of the Scheme on the interests of the ScottishPower Directors does not differ from its effect on the like interests of any other holder of ScottishPower Shares.

**17 ScottishPower Share Schemes**

**(a) The ScottishPower Share Option Schemes**

Options under the ScottishPower Share Option Schemes will become exercisable upon Court Sanction. Performance conditions, where applicable, will be treated as having been satisfied in full.

Options awarded in 2005 under the ScottishPower 2000 Long Term Incentive Plan and options awarded under the ScottishPower 2006 Long Term Incentive Plan will only be exercisable on a pro-rated basis, to reflect the early exercise. To the extent unexercisable, options will lapse on or shortly after the Effective Date as described below. As a result, Iberdrola has agreed to compensate those participants in these plans who are employed by the ScottishPower Group immediately prior to the Effective Date in respect of any part of their options that lapse as a result of the pro-rating referred to above and has agreed to pay to and award such participants, on the Effective Date, cash and New Iberdrola Shares equal to the consideration they would have received under the Offer in respect of the ScottishPower Shares which they would have obtained in respect of those lapsed options.

---

**Table of Contents**

Options under the ScottishPower Executive Share Option Plan 2001 will be exercisable in full. Options under the PacifiCorp Stock Incentive Plan are already exercisable in full.

Options under the ScottishPower Sharesave Scheme will only be exercisable to the extent of the savings and interest in the associated savings contract at the date of exercise. Iberdrola has agreed to pay to participants in the ScottishPower Sharesave Scheme an amount equal to the profit they would have made if they had been able to exercise those options in full (less the profit they make from actual exercise and on the assumption that they exercise at the latest permitted time) on a grossed up basis. The profit will be calculated by reference to 412 pence plus a cash amount equal to 0.1646 of an Iberdrola Share at the Effective Date per ScottishPower Share.

In order to encourage participants in the ScottishPower Share Schemes to remain within the Enlarged Iberdrola Group after the completion of the Offer, Iberdrola has agreed to compensate them for any additional income tax or social security contributions they have to pay as a consequence of any option being exercised or shares being released early due to the completion of the Offer.

The periods during which options can be exercised vary from scheme to scheme. The periods start on the date of the Court Sanction and end up to six months later. Options under the ScottishPower Executive Share Option Plan 2001 lapse on the date of the Court Sanction. Options under the ScottishPower 2006 Long Term Incentive Plan lapse on the day after the Court Sanction. Options under the ScottishPower 2000 Long Term Incentive Plan lapse one month after notification of the Court Sanction. Options under the ScottishPower Sharesave Scheme lapse six months after the Court Sanction. Participants will be given the opportunity to exercise their options conditionally upon the Court Sanction. Options under the PacifiCorp Stock Incentive Plan do not lapse as a result of the Scheme.

Where ScottishPower Shares are issued to participants under the ScottishPower Share Option Schemes after the Court Sanction but before the Reorganisation Record Time, they will be subject to the Scheme and participants will be able to participate in the Scheme on the same basis as other ScottishPower Shareholders. It is intended that any ScottishPower Shares which are issued to participants on exercise of options after the Effective Date will be transferred automatically to Iberdrola under the proposed changes to the ScottishPower Articles outlined in paragraph 4(C) of the ScottishPower EGM Resolution, in consideration of the payment of 400 pence in cash and the issue of 0.1646 of an Iberdrola Share for each such ScottishPower Share rounded down to the nearest whole number of an Iberdrola Share, save that in the event that the law or regulation of a country or territory or its internal states or other governmental sub- divisions outside the United Kingdom may preclude the allotment or issue to the holder of the ScottishPower Shares or Iberdrola Shares or may preclude the same except after compliance by ScottishPower or Iberdrola (as the case may be) with any governmental or other consent or any registration, filing or other formality with which ScottishPower or Iberdrola (as the case may be) is unable to comply or which Iberdrola regards as onerous or in the event that Iberdrola is unable to confirm the availability of an exemption from any such formalities or whether a consent or other relief may be required without undertaking further administrative or other steps or making a request for relief or otherwise, then Iberdrola may in its sole discretion elect to allot or sell such Iberdrola Shares to a third party and remit the proceeds (net of expenses) to the holder of such ScottishPower Shares in lieu of 0.1646 of an Iberdrola Share for each ScottishPower Share. No assurance can be given as to the price that will be received for such New Iberdrola Shares and Iberdrola ADSs sold, as described in this paragraph. Due to the impracticality of issuing shares under Spanish law, Iberdrola Shares issued on or after the Effective Date, as a consequence of the exercise of options (within the Special Conversion Period as further described in paragraph 18 of this Part 4), will be delivered on the Second Issue Date and the Third Issue Date (as applicable). Thereafter, participants will receive treasury shares held by Iberdrola as reasonably practicable. In addition, ScottishPower will make a payment to such holders of 12 pence for each ScottishPower Share so transferred under the ScottishPower Articles.

ScottishPower will not be able to issue any ScottishPower Shares in the period between the Reorganisation Record Time and the Effective Date, as transfers of and dealings in ScottishPower Shares will be suspended and the Register of Members will be closed. If any participants in the ScottishPower Share Schemes choose to exercise options during this period, ScottishPower will issue them with ScottishPower Shares after the Effective Date and such shares will be automatically acquired by Iberdrola in the manner described above.



**Table of Contents**

**(b) ScottishPower Employee Trust 2001**

ScottishPower Shares held in the ScottishPower Employee Trust 2001 will be available to satisfy the exercise of options under the ScottishPower Executive Share Option Plan 2001, the ScottishPower 2000 Long Term Incentive Plan and the ScottishPower 2006 Long Term Incentive Plan.

**(c) The ScottishPower Employee Share Ownership Plan**

The trustee of the ScottishPower Employee Share Ownership Plan already holds ScottishPower Shares for participants in that plan. Accordingly, participants in that plan (through the trustee) will participate in the Scheme in the same way as other ScottishPower Shareholders. Cash consideration for these ScottishPower Shares under the Offer will be paid directly to such participants. Any New Iberdrola Shares and/or Loan Notes received under the Offer will continue to be held by the trustee on the terms of the plan.

**(d) The Annual Incentive Plan Deferred Share Programme**

Participants in the Annual Incentive Plan Deferred Share Programme are ScottishPower Shareholders and will participate in the Scheme in the same way as other ScottishPower Shareholders.

**(e) Future Share Schemes**

Going forward, Iberdrola has agreed to explore alternatives that will provide ScottishPower employees with benefits which are broadly comparable to the benefits provided under the ScottishPower Share Schemes in the two years before the Effective Date. Iberdrola will decide on and procure the implementation of one of those alternatives which will take into account the economic consequences for employees resulting from the implementation date being different from the date of termination of the ScottishPower Share Schemes.

**(f) Dealing Facility**

The Dealing Facility will be made available to participants in the other ScottishPower Share Schemes in relation to the New Iberdrola Shares they receive or have received under those schemes (on the same terms as set out in paragraph 23 of this Part 4).

**(g) Communications**

## Edgar Filing: - Form

ScottishPower is writing separately to participants in the ScottishPower Share Schemes outlining the choices open to them and, where appropriate, providing forms to enable them to make their choices.

### (h) Directors Arrangements

Directors will participate in the arrangements set out above on the same terms as other participants in the ScottishPower Share Schemes.

## 18 ScottishPower Convertible Bonds

### (a) Conversion Rights

Convertible Bondholders currently have the right to convert the Convertible Bonds into fully paid four per cent. exchangeable redeemable preference shares in Scottish Power Finance (Jersey) Limited ( **Conversion Rights** ). Upon conversion, the preference shares will be immediately exchanged for ScottishPower Shares at the applicable exchange price under the terms and conditions of the Convertible Bonds.

Convertible Bondholders may elect to exercise Conversion Rights either before or after the Scheme becomes effective. Note that the applicable exchange price will vary depending on when Conversion Rights are exercised.

**Table of Contents**

(i) Conversion before the Reorganisation Record Time

Where ScottishPower Shares are issued to Convertible Bondholders upon exercise of Conversion Rights before the Reorganisation Record Time, they will be subject to the Scheme and the relevant Convertible Bondholders will be able (provided they exercise their Conversion Rights sufficiently in advance of the relevant deadline for receipt of Forms of Election and in any event submit the completed Forms of Election by 19 April 2007) to take advantage of the Mix and Match Facility and the Loan Note Alternative on the same basis as other ScottishPower Shareholders.

Convertible Bondholders should note that any such conversion outside the Special Conversion Period would not be at the enhanced exchange price.

(ii) Conversion after the Reorganisation Record Time but before the start of the Special Conversion Period

Convertible Bondholders who exercise their Conversion Rights in the period between the Reorganisation Record Time and the Effective Date will receive those ScottishPower Shares to which they are entitled on the Second Issue Date, provided the Scheme becomes effective (as transfers and dealings of ScottishPower Shares are suspended and the Register of Members is closed during this period). They will therefore be treated as if they had exercised their Conversion Rights during the Special Conversion Period, provided the Scheme becomes effective.

(iii) Conversion during the Special Conversion Period

The terms and conditions of the Convertible Bonds contain provisions whereby the exchange price may be adjusted downwards in certain circumstances, including: (a) upon payment of a special dividend by Scottish Power; (b) upon payment of an ordinary dividend to shareholders in excess of certain specified levels in respect of a financial year; and (c) for a limited period only, following a change of control event. Scottish Power Finance (Jersey) Limited is obliged to give Convertible Bondholders written notice of the commencement of the Special Conversion Period in accordance with the terms and conditions of the Convertible Bonds.

Convertible Bondholders who exercise their Conversion Rights such that the conversion date falls within the Special Conversion Period will receive an enhanced number of ScottishPower Shares reflecting: (i) an adjustment to the exchange price made in respect of the payment of the Special Dividend; (ii) an adjustment to the exchange price made in respect of the payment of the total dividend declared for the financial year ending 31 March 2006 ( **2005 Dividend** ) (such adjustment in itself was less than one per cent. of the exchange price in effect at the time of payment of the 2005 Dividend and therefore was not previously effective under the terms and conditions of the Convertible Bonds, but was carried forward to be taken into account in any subsequent adjustment on a cumulative basis); and (iii) an adjustment to the exchange price made in respect of the change of control upon the Scheme becoming effective.

The quantum of the adjustment in respect of the Special Dividend will depend upon the average of the bid and offer quotations for a ScottishPower Share as derived from the Daily Official List of the London Stock Exchange in the five consecutive dealing days ending on the second dealing day prior to the first date on which the ScottishPower Shares are traded ex-the Special Dividend.

## Edgar Filing: - Form

Convertible Bondholders will be notified of the applicable exchange price in accordance with the terms and conditions of the Convertible Bonds.

### (iv) Conversion after the Special Conversion Period

Convertible Bondholders who exercise Conversion Rights such that the conversion date falls after the Special Conversion Period will receive an enhanced number of ScottishPower Shares reflecting an adjustment to the exchange price made in respect of the payment of the 2005 Dividend and the Special Dividend only. No adjustment will be made in respect of the change of control upon the Scheme becoming effective.

Convertible Bondholders will be notified of the applicable exchange price in accordance with the terms and conditions of the Convertible Bonds.

---

**Table of Contents**

**(b) Receipt of Iberdrola Shares**

From an economic point of view, it is intended that any ScottishPower Shares which are issued to Convertible Bondholders upon exercise of Conversion Rights after the Effective Date (the **Bondholder Shares** ) will be transferred automatically to Iberdrola under the proposed changes to the ScottishPower Articles outlined in paragraph 4(E) of the ScottishPower EGM Resolution, in consideration of the payment by Iberdrola to the holder of such Bondholder Shares of 400 pence in cash and the issue of 0.1646 of an Iberdrola Share save that in the event that the law or regulation of a country or territory or its internal states or other governmental subdivisions outside the United Kingdom may preclude the allotment or issue to the holder of the Bondholder Shares of ScottishPower Shares or Iberdrola Shares or may preclude the same except after compliance by ScottishPower or Iberdrola (as the case may be) with any governmental or other consent or any registration, filing or other formality with which ScottishPower or Iberdrola (as the case may be) is unable to comply or which Iberdrola regards as onerous or, in the event that Iberdrola is unable to confirm the availability of an exemption from such formalities or whether a consent or other relief may be required without undertaking further administrative or other steps or making a request for relief or otherwise, then Iberdrola may in its sole discretion elect to allot or sell such Iberdrola Shares to a third party and remit the proceeds (net of expenses) to the holder of such Bondholder Shares in lieu of 0.1646 of an Iberdrola Share for each such Bondholder Share. No assurance can be given as to the price that will be received for such New Iberdrola Shares and Iberdrola ADSs sold as described in this paragraph.

Fractions of Iberdrola Shares will not be allotted and the number of Iberdrola Shares to be allotted to each Convertible Bondholder who exercises Conversion Rights will be rounded down to the nearest whole number. Fractions of Iberdrola Shares not allotted to Convertible Bondholders will, wherever practicable, be aggregated and sold in the market and the net proceeds of such sale shall be paid in cash to Convertible Bondholders entitled thereto in accordance with their fractional entitlements. No assurance can be given as to the price that will be received for such Iberdrola Shares as described in this paragraph.

Due to the impracticality of regularly issuing shares under Spanish law, the Iberdrola Shares issued in exchange for the ScottishPower Shares will only be issued: (i) on the twelfth Business Day following the Effective Date, in respect of conversion notices received from Convertible Bondholders at any time before 6.00 p.m. (London time) on the eighth Business Day following the Effective Date (the **Second Issue Date** ); (ii) thereafter, in respect of conversion notices received from Convertible Bondholders at any time before the end of the Special Conversion Period, on the fourth Business Day following the expiry of the Special Conversion Period (the **Third Issue Date** ).

Convertible Bondholders exercising their Conversion Rights thereafter will (subject to the aforementioned restrictions) receive Iberdrola Shares held as treasury stock by Iberdrola as soon as reasonably practicable after conversion.

**(c) Eligibility to exercise Conversion Rights and receive Iberdrola Shares**

The Iberdrola Shares to be issued to Convertible Bondholders upon exercise of Conversion Rights have not been, and will not be, registered under the US Securities Act, or under the securities laws of any state, district or other jurisdiction of the United States. Accordingly, the Iberdrola Shares issuable upon exercise of Conversion Rights are not being, and will not be, offered or sold in the United States except in reliance on an exemption from the registration requirements of the US Securities Act. Convertible Bondholders will therefore be required to make certain representations in the Conversion Notice pursuant to the Paying, Transfer, Conversion and Exchange Agency Agreement in order to be able to exercise Conversion Rights.

The Iberdrola Shares issuable upon exercise of Conversion Rights may not be reoffered or sold without registration under the US Securities Act except pursuant to an exemption therefrom. In addition, such Iberdrola Shares issuable upon exercise of Conversion Rights may not for so long

## Edgar Filing: - Form

as and in the event that they are restricted securities within the meaning of Rule 144(a)(3) of the US Securities Act be deposited into any unrestricted depositary facility, including the Iberdrola ADR Facility.

---

**Table of Contents**

**(d) Interest and dividends**

The next interest payment on the Convertible Bonds is due to be made on 10 July 2007. This payment will be made on all Convertible Bonds not converted into ScottishPower Shares on or before that date. No part of the interest payable for the period from 10 January 2007 to the date of voluntary conversion will be paid on Convertible Bonds converted on or before 9 July 2007.

A final dividend for the year 2006 is expected to be distributed to Iberdrola Shareholders in July 2007. Although the record date (which is currently expected to be, subject to shareholder approval, 29 June 2007) for this dividend has not yet been fixed, Convertible Bondholders who exercise their Conversion Rights and are registered holders of New Iberdrola Shares by the record date will be eligible to receive this dividend on the Iberdrola Shares they receive.

**(e) Redemption**

If Convertible Bondholders holding more than 85 per cent. of the principal amount of the Convertible Bonds exercise their Conversion Rights, the ScottishPower Board proposes to procure that Scottish Power Finance (Jersey) Limited takes advantage of its right to redeem the remaining ScottishPower Convertible Bonds at their principal amount (together with interest accrued to the relevant redemption date) by giving not less than 30 but not more than 90 days notice in accordance with the conditions of the Convertible Bonds. In the event that Scottish Power Finance (Jersey) Limited exercises its rights to redeem the remaining ScottishPower Convertible Bonds, Convertible Bondholders may exercise their Conversion Rights until the seventh calendar day prior to the date fixed for the redemption of the Convertible Bonds ( **Redemption Date** ).

Under the proposed changes to the ScottishPower Articles outlined in paragraph 4(E) of the ScottishPower EGM Resolution, ScottishPower Shares issued upon conversion shall be issued on economic terms that they shall (on the Effective Date or, if later, on issue) be immediately transferred to Iberdrola or its nominee(s) in consideration (subject as hereinafter provided) of and conditional on the payment by Iberdrola to the holder of such ScottishPower Shares of 400 pence in cash and the issue of 0.1646 of an Iberdrola Share for each such ScottishPower Share (or in the event that Iberdrola undertakes any subdivision, alteration or consolidation of its share capital, such number of shares as adjusted to reflect such subdivision, alteration or consolidation) rounded down to the nearest whole number of an Iberdrola Share (or such other proportion of cash and Iberdrola Shares, the economic effect of which is equivalent to the payment of 400 pence in cash and the issue of 0.1646 of an Iberdrola Share) save that Iberdrola may in its sole discretion elect to allot or sell such Iberdrola Shares to a third party and remit the proceeds (net of expenses) to the holder of such ScottishPower Shares in lieu of 0.1646 of an Iberdrola Share for each such ScottishPower Share. No assurance can be given as to the price that will be received for such new Iberdrola Shares and Iberdrola ADSs sold as described in this paragraph.

Subject to compliance with the applicable Spanish law requirements, the Iberdrola Shares to be issued upon conversion by the Convertible Bondholders as set out above shall be issued on the Third Issue Date, unless (i) the Redemption Date occurs prior to the end of the Special Conversion Period, in which case the Iberdrola Shares shall be issued on or before the fourth Business Day after the Redemption Date or (ii) the Redemption Date occurs after the end of the Special Conversion Period, in which case Convertible Bondholders will receive Iberdrola Shares from treasury as soon as practicable thereafter.

**(f) Recommendation and Action to be Taken**

## Edgar Filing: - Form

**The ScottishPower Board unanimously recommends that all holders of Convertible Bonds exercise their Conversion Rights as soon as practicable after the Scheme becomes effective (but not before) in order to receive the Iberdrola Shares to which they are entitled on the Second Issue Date and in any event no later than before the end of the Special Conversion Period. For this purpose, a form of conversion notice will be available from the offices of the Exchange, Transfer, Conversion and Paying Agent, Citigroup Agency and Trust, Citibank, N.A., London Branch, for the Convertible Bonds from time to time. The ScottishPower Board, which has been so advised by Morgan Stanley & Co. Limited, considers this proposal to Convertible Bondholders to be fair and reasonable.**

**Table of Contents**

**19 Structure of the Offer**

**(a) Introduction**

The Offer is to be effected by way of a scheme of arrangement of ScottishPower under section 425 of the Act, the provisions of which are set out in full in Part 14 of this document.

The purpose of the Scheme is to provide for Iberdrola to become the owner of the whole of the issued ordinary share capital of ScottishPower, which is to be achieved by the reorganisation of the share capital of ScottishPower (as set out in paragraph 19(c) below) and the subsequent cancellation of the shares resulting from such reorganisation. ScottishPower Shareholders on the Register of Members at the Reorganisation Record Time will then receive New Iberdrola Shares, cash and/or Loan Notes on the basis set out in paragraph 2 of this Part 4 and ScottishPower ADS Holders on the register of ScottishPower ADS Holders maintained by the ScottishPower Depositary at the Reorganisation Record Time will receive Iberdrola ADSs and cash on the basis set out in paragraph 2 of this Part 4.

**(b) The Meetings**

The Scheme involves an application by ScottishPower to the Court to sanction the Scheme. Before the Court's approval can be sought, the Scheme will require approval at the Court Meeting and the passing of a special resolution at the ScottishPower EGM.

Notices of the Court Meeting and the ScottishPower EGM are set out in Parts 16 and 17 of this document, respectively. All ScottishPower Shareholders (excluding members of the Iberdrola Group) whose names appear on the Register of Members at 6.00 p.m. (London time) on 28 March 2007 or, if either of the Meetings is adjourned, on the Register of Members at 6.00 p.m. on the second day before the day set for such adjourned Meeting, shall be entitled to attend and vote at the relevant Meeting in respect of the number of ScottishPower Shares registered in their name at the relevant time.

Each registered ScottishPower ADS Holder may choose either to attend the Meetings and vote in person on the Scheme or else to appoint the nominee of the ScottishPower Depositary or another person as their proxy to vote on the Scheme. If a ScottishPower ADS Holder appoints the nominee of the ScottishPower Depositary as proxy, the nominee will vote in accordance with their instructions.

ScottishPower ADS Holders who hold their ScottishPower ADSs indirectly must rely on the procedures of the bank, broker, financial institution, share plan administrator or other nominee through which they hold their ScottishPower ADSs if they wish to vote on the Scheme. Indirect ScottishPower ADS Holders who wish to attend and vote at the Meetings may alternatively present their ScottishPower ADSs to the ScottishPower Depositary for cancellation and receive (upon compliance with the terms of the ScottishPower Deposit Agreement, including payment of the ScottishPower Depositary's fees and any applicable taxes and governmental charges) delivery of their ScottishPower Shares so as to become registered holders of ScottishPower Shares prior to the Voting Record Time.

## Edgar Filing: - Form

**It is important that for the Court Meeting in particular, as many votes as possible are cast so that the Court may be satisfied that there is a fair and reasonable representation of opinion of the ScottishPower Shareholders and ScottishPower ADS Holders. You are therefore strongly urged to sign and return both your Forms of Proxy (in the case of ScottishPower Shareholders) or ADS Voting Instruction Card (in the case of registered ScottishPower ADS Holders) or to take advantage of the voting procedures of the bank, broker, financial institution, share plan administrator or other nominee through which you hold your ScottishPower ADSs (in the case of indirect ScottishPower ADS Holders) as soon as possible.**

Whether or not you vote in favour of the Scheme at the Court Meeting and/or the ScottishPower EGM if the Scheme becomes effective, your ScottishPower Shares and ScottishPower ADSs will be cancelled, and, unless you have made an election under the Mix and Match Facility and/or the Loan Note

---

## **Table of Contents**

Alternative, you will receive, in economic terms, 400 pence in cash and 0.1646 of a New Iberdrola Share for each ScottishPower Share that you hold (or 1,600 pence and 0.6584 of an Iberdrola ADS for each ScottishPower ADS that you hold) immediately prior to the Reorganisation Record Time (save that fractions of New Iberdrola Shares or Iberdrola ADSs will not be allotted, but will be aggregated and sold in the market after the Effective Date and the net proceeds of such sale will be paid in cash to ScottishPower Shareholders and ScottishPower ADS Holders entitled thereto in accordance with their fractional entitlements.) No assurance can be given as to the price that will be received for fractional New Iberdrola Shares and Iberdrola ADSs sold. Prior to the Effective Date, ScottishPower will declare the Special Dividend of 12 pence for every ScottishPower Share (which will amount to 48 pence per ScottishPower ADS) payable to ScottishPower Shareholders on the Register of Members and ScottishPower ADS Holders on the register of ScottishPower ADS Holders maintained by the ScottishPower Depository at the Special Dividend Record Time.

If you are a ScottishPower Shareholder, you are encouraged to complete and return the white Form of Election (or make an Electronic Election, if you hold your ScottishPower Shares in uncertificated form) if you wish to elect to vary the proportions in which you will receive cash and/or New Iberdrola Shares in respect of your ScottishPower Shares under the Scheme if the Scheme becomes effective or wish to elect for the Loan Note Alternative. If you are a registered ScottishPower ADS Holder, you must complete and return the ADS Letter of Transmittal and Election Form, along with any ScottishPower ADSs you hold in certificated form, and if you wish to elect to vary the proportions in which you will receive cash and/or Iberdrola ADSs in respect of your ScottishPower ADSs under the Scheme if the Scheme becomes effective, your ADS Letter of Transmittal and Election Form must be received by 3.00 p.m. (New York time) on 4 April 2007. If you hold your ScottishPower ADSs indirectly, you must rely on the procedures of the bank, broker, financial institution, share plan administrator or other nominee through which you hold your ScottishPower ADSs if you wish to vary the proportions in which you receive cash and/or Iberdrola ADSs.

### ***The Court Meeting***

The Court Meeting, which has been convened for 11.00 a.m. (London time) on 30 March 2007, is being held at the direction of the Court to seek the approval of ScottishPower Shareholders and ScottishPower ADS Holders for the Scheme. At the Court Meeting, voting will be by way of poll and each member present and able to vote, either in person or by proxy, will be entitled to one vote for each ScottishPower Share held. The approval required at the Court Meeting (or any adjournment thereof) is a majority in number representing three-fourths in value of the holders of ScottishPower Shares present and voting, either in person or by proxy. In other words, the Scheme will only be approved at the Court Meeting if (a) a majority in number of the ScottishPower Shareholders present and voting at the Court Meeting (in person or by proxy) vote in favour and (b) such majority holds 75 per cent. or more in value of the ScottishPower Shares present and voting at the Court Meeting (in person or by proxy).

In determining (a), all ScottishPower Shareholders count equally, regardless of how many shares they hold. Therefore, as the ScottishPower Depository is the registered holder of all ScottishPower Shares which underlie the ScottishPower ADSs, votes cast in favour of the Scheme by the ScottishPower Depository (or by any ScottishPower ADS Holder or other person acting as the proxy of the ScottishPower Depository) will represent one vote in number, and votes cast against the Scheme by the ScottishPower Depository (or by any ScottishPower ADS Holder or other person acting as the proxy of the ScottishPower Depository) will represent one vote in number. The number of ScottishPower ADS Holders who vote does not count in determining (a). In determining (b), however, every vote cast by the ScottishPower Depository (or by any ScottishPower ADS Holder or other person acting as the proxy of the ScottishPower Depository) in respect of a ScottishPower Share will count in value.

### ***The ScottishPower EGM***

In addition to the Court Meeting, the ScottishPower EGM has been convened for 11.10 a.m. (London time) on 30 March 2007, or as soon thereafter as the Court Meeting has concluded or been adjourned, to consider and, if thought fit, pass a special resolution (which requires votes

## Edgar Filing: - Form

in favour representing at least 75 per cent. of the votes cast) to approve:

43

---

**Table of Contents**

- (i) the reorganisation of the Company's share capital referred to in paragraph 19(c) below;
- (ii) the Capital Reduction and the issue of New ScottishPower Shares to Iberdrola provided for in the Scheme; and
- (iii) amendments to the ScottishPower Articles in accordance with the Scheme and in the manner described in paragraph 19(h) below.

***Voting by ScottishPower Shareholders***

The green Form of Proxy for use at the Court Meeting should be lodged with Lloyds TSB Registrars at The Causeway, Worthing, West Sussex, BN99 6AZ as soon as possible and, in any event, so as to be received by no later than 11.00 a.m. (London time) on 28 March 2007. The purple Form of Proxy for use at the ScottishPower EGM should be lodged with Lloyds TSB Registrars at The Causeway, Worthing, West Sussex, BN99 6AX as soon as possible and, in any event, so as to be received by no later than 11.10 a.m. (London time) on 28 March 2007. If the green Form of Proxy for use at the Court Meeting is not returned by the above time, it may be handed to representatives of Lloyds TSB Registrars on behalf of the chairman of the Court Meeting (or, if the Court Meeting is adjourned, at the adjourned Court Meeting) before the taking of the poll. However, in the case of the ScottishPower EGM, unless the purple Form of Proxy is lodged by the above time, it will be invalid. The completion and return of a Form of Proxy will not prevent you from attending and voting in person at either the Court Meeting or the ScottishPower EGM, or at any adjournment thereof, if you so wish and are so entitled.

CREST members who wish to appoint a proxy or proxies through the CREST Electronic Proxy Appointment Service may do so for the Meetings and any adjournment(s) thereof by using the procedures described in the CREST Manual. CREST personal members or other CREST sponsored members, and those CREST members who have appointed a voting service provider(s) should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.

ScottishPower Shareholders who hold their ScottishPower Shares in certificated or uncertificated form may also register proxy appointments and instructions electronically by logging on to the website of Lloyds TSB Registrars, [www.sharevote.co.uk](http://www.sharevote.co.uk), where details of the procedure are set out, provided that they do so before 11.00 a.m. on 28 March 2007 or, if the Court Meeting is adjourned, 48 hours before the time set for the adjourned Court Meeting.

***Voting by ScottishPower ADS Holders***

If you are a registered holder of ScottishPower ADSs, please complete and sign the enclosed ADS Voting Instruction Card in accordance with the instructions printed thereon and return it in the white postage-paid envelope provided (for use in the US only) to JPMorgan Chase Bank, N.A., at the appropriate address set forth on the ADS Voting Instruction Card as soon as possible and, in any event, so as to be received no later than 3.00 p.m. (New York time) on 26 March 2007. You may indicate on the ADS Voting Instruction Card whether you wish to attend and vote at the Meetings yourself or whether you wish to appoint the nominee of the ScottishPower Depositary or another person as your proxy. If you wish to attend and vote at the Meetings yourself, you are requested to indicate this on the ADS Voting Instruction Card (you will be required to present a valid passport or other government-issued photo identification in order to be admitted to the Meetings). If you appoint the nominee of the ScottishPower Depositary as your proxy, the nominee will vote in accordance with your instructions. If you appoint a person other than the nominee of the ScottishPower Depositary, you should instruct your proxy how you wish your ScottishPower ADSs to be voted.

## Edgar Filing: - Form

In lieu of completing and returning the ADS Voting Instruction Card, you may cast your vote by telephone, by calling +1-866-540-5760, or electronically by logging on to [www.proxyvoting.com/spi](http://www.proxyvoting.com/spi), where details of the procedure to be followed are set out. Please refer to the ADS Voting Instruction Card for further information.

---

## **Table of Contents**

If you hold your ScottishPower ADSs indirectly, you must rely on the procedures of the bank, broker, financial institution, share plan administrator or other nominee through which you hold your ScottishPower ADSs if you wish to vote on the Scheme. Indirect ScottishPower ADS Holders who wish to attend and vote at the Meetings may alternatively present their ScottishPower ADSs to the ScottishPower Depository for cancellation and receive (upon compliance with the terms of the ScottishPower Deposit Agreement, including payment of the ScottishPower Depository's fees and any applicable taxes and governmental charges) delivery of their ScottishPower Shares so as to become registered holders of ScottishPower Shares prior to the Voting Record Time.

Members of the Iberdrola Group will not be entitled to attend and vote at meetings in respect of any ScottishPower Shares held by them. As at the date of this document, no member of the Iberdrola Group holds any ScottishPower Shares.

### **(c) Share Capital Reorganisation**

In order to allow the most favourable treatment of the Capital Reduction for UK tax purposes, the Scheme will include a reorganisation of the share capital of ScottishPower whereby the Scheme Shares will, in accordance with the terms of the Scheme, be subdivided and reclassified into A1 Shares, A2 Shares and A3 Shares. The share capital reorganisation will take effect at the Reorganisation Record Time, at which point the A1 Shares will carry the right to receive the cash consideration, the A2 Shares will carry the right to receive New Iberdrola Shares and the A3 Shares will carry the right to receive Loan Notes upon the Scheme becoming effective in each case. To the extent that Scheme Shareholders validly elect for Loan Notes under the Loan Note Alternative, the number of A1 Shares to which they would otherwise be entitled will be reduced and they will instead become entitled to an equivalent number of A3 Shares. Once the Capital Reduction that forms part of the Scheme becomes effective, the A1 Shares, A2 Shares and A3 Shares will be cancelled and Scheme Shareholders will be paid cash, issued with New Iberdrola Shares and issued with Loan Notes in proportion to their holdings of A1 Shares, A2 Shares and A3 Shares, respectively.

No temporary documents of title will be issued to Scheme Shareholders in respect of the A1 Shares, A2 Shares or A3 Shares. If for any reason the Capital Reduction comprised in the Scheme does not become effective within five Business Days of the Reorganisation Record Time, or such later date as Iberdrola and ScottishPower may agree and the Court may allow, the share capital reorganisation described above will be reversed and Scheme Shareholders will hold such number of Scheme Shares as they held immediately prior to the Reorganisation Record Time.

The terms of the reorganisation of the share capital of ScottishPower are set out in paragraph 1 of the Scheme contained in Part 14 of this document and the special resolution set out in Part 17 of this document.

### **(d) Subscription Agreement**

Conditional on the Scheme becoming effective, the ScottishPower Board will appoint a person to execute the Subscription Agreement for the New Iberdrola Shares on behalf of the holders of the A2 Shares immediately and the person so authorised by the ScottishPower Board will execute the Subscription Agreement after the Scheme becomes effective. The Subscription Agreement, which will be in English and governed by Spanish law but subject to the jurisdiction of the English courts, will be in the form set out in Appendix A to this Part 4 (subject to any modifications agreed between the parties thereto before the Sanction Court Hearing) and will provide that: (i) Euroclear Nominees will subscribe for the New Iberdrola Shares on behalf of the holders of the A2 Shares; and (ii) the holders of the A2 Shares, Euroclear Nominees and Iberdrola agree that the cancellation of the A2 Shares, on terms that the reserve arising on the cancellation of such shares is applied in paying up the New ScottishPower Shares to be issued to Iberdrola, will satisfy the consideration for the New Iberdrola Shares. The Subscription Agreement will also provide that Iberdrola will issue New Iberdrola Shares as soon as legally and practically possible after signing the Subscription Agreement.



**Table of Contents**

**(e) Conditions to the Offer**

The Conditions to the Offer are set out in full in Part 5 of this document. In summary, the implementation of the Scheme is conditional upon:

- (i) approval of the Scheme by a majority in number representing three-fourths in value of the holders of ScottishPower Shares who are present and voting, either in person or by proxy, at the Court Meeting (or any adjournment thereof);
- (ii) the special resolution to approve and implement the Scheme and related matters being duly passed by the requisite majority at the ScottishPower EGM (or any adjournment thereof);
- (iii) the passing at the Iberdrola Shareholders Meeting (or any adjournment of such meeting) of such resolutions as may be necessary to implement the Offer (including resolutions to increase the share capital of Iberdrola);
- (iv) the negotiation and filing with the CNMV of the applicable documentation in relation to the issue of the New Iberdrola Shares;
- (v) the sanction of the Scheme and confirmation of the Capital Reduction by the Court and the delivery of certified copies of the Court Orders and a certified copy of the minute of such Capital Reduction in relation thereto for registration to the Registrar of Companies and in relation to the Capital Reduction, the registration of the minute of the Capital Reduction by the Registrar of Companies;
- (vi) receipt of the regulatory approvals; and
- (vii) the other Conditions (set out in paragraph 2 of Part 5 of this document), which are not otherwise summarised above, being satisfied or waived.

**(f) Sanction of the Scheme by the Court**

Under the Act, the Scheme also requires the sanction of the Court. The Sanction Court Hearing and the Reduction Court Hearing are expected to be held on 19 April 2007 and 23 April 2007, respectively. The time between the two Court Hearings is required in order to permit ScottishPower Shares released, transferred or issued under the terms of the ScottishPower Share Schemes to be registered prior to the Capital Reduction being confirmed by the Court and for the share capital reorganisation described in paragraph (c) above to take place.

Iberdrola has confirmed that it will be represented by counsel at the Court Hearings so as to consent to the Scheme and to undertake to the Court to be bound thereby.

The Scheme will become effective in accordance with its terms on delivery of certified copies of the Court Orders and the minute of the Capital Reduction attached thereto for registration to the Registrar of Companies and, in relation to the Capital Reduction the registration by the Registrar of Companies of the minute of the Capital Reduction.

## Edgar Filing: - Form

If the Scheme becomes effective, it will be binding on all ScottishPower Shareholders and ScottishPower ADS Holders irrespective of whether or not, being entitled to do so, they attended or voted in favour of the Scheme at the Court Meeting or in favour of the special resolution at the ScottishPower EGM. If the Scheme does not become effective by 31 July 2007 (or such later date (if any) as ScottishPower and Iberdrola may agree and the Court may allow), the Scheme will not become effective, the Capital Reduction will not occur and the Offer will not proceed and will lapse.

## **Table of Contents**

### **(g) Objections**

Any ScottishPower Shareholder, ScottishPower ADS Holder or other person who considers that he or she has an interest in the Scheme (each an **Interested Party** ) and who is concerned that the Scheme may adversely affect them is entitled to be heard by the Court, as explained below.

If an Interested Party wishes to raise concerns in relation to the Scheme with the Court or appear at the Sanction Court Hearing, he or she should seek independent legal advice and lodge written answers to the petition with the Court at Parliament House, Parliament Square, Edinburgh EH1 1RQ within 14 days of the publication of the advertisement of the petition (which is currently expected to be 3 April 2007) and pay the required fee. Written answers are a formal court document which must comply with the rules of the Court and are normally prepared by Scottish counsel or a Scottish solicitor.

The Court may consider written objections which are not in the form of written answers and/or allow an Interested Party who has not lodged written answers to appear at the Sanction Court Hearing, but each Interested Party should note that the decision to do so is entirely at the discretion of the Court, and that the Court may require an Interested Party to lodge written answers in order to raise objections to the Scheme and/or appear at the Sanction Court Hearing.

### **(h) Articles of Association**

The resolution to be proposed at the ScottishPower EGM will contain provisions to amend the ScottishPower Articles to ensure that any ScottishPower Shares issued between the adoption of the ScottishPower EGM Resolution and on or before the Reorganisation Record Time will be subject to the Scheme and that any ScottishPower Shares issued after the Reorganisation Record Time will (subject to the Scheme becoming effective) automatically be acquired by Iberdrola for the consideration, the economic effect of which shall be 400 pence and 0.1646 of a New Iberdrola Share per ScottishPower Share.

The resolution to be proposed at the ScottishPower EGM will also contain provisions pursuant to which ScottishPower will pay 12 pence per ScottishPower Share to each ScottishPower Shareholder for each ScottishPower Share issued after the Effective Date and subsequently transferred to Iberdrola, other than those who receive such ScottishPower Shares following conversion of Convertible Bonds. In the latter case, the conversion ratio, and therefore the number of ScottishPower Shares received on conversion of the Convertible Bonds, will be adjusted to take into account the payment of the Special Dividend.

ScottishPower will not be able to issue any ScottishPower Shares in the period between the Reorganisation Record Time and the Effective Date, as transfers of and dealings in ScottishPower Shares will be suspended and the Register of Members will be closed. If any participants in the ScottishPower Share Schemes choose to exercise options during this period, ScottishPower will issue them with ScottishPower Shares immediately after the Effective Date and such shares will be automatically acquired by Iberdrola in the manner described above.

These provisions will avoid any person being left with ScottishPower Shares after dealings in such shares have ceased on the London Stock Exchange.

**(i) Alternative means of implementing the Offer**

Iberdrola has reserved the right to implement the Offer, with the written consent of ScottishPower, by way of a Takeover Offer, in which case additional documents will be despatched to ScottishPower Shareholders. In such event, such a Takeover Offer will (unless otherwise agreed) be implemented on the same terms (subject to appropriate amendments) as those which would apply to the Scheme.

---

**Table of Contents**

**20 Listing, Settlement and Dealings**

**(a) Delisting of ScottishPower Shares and ScottishPower ADSs; Deregistration of the ScottishPower Shares and ADSs under the Exchange Act**

- (i) The last day for dealings in, and for registration of, transfers of ScottishPower Shares will be 19 April 2007. The last day of dealings in, and for registration of transfers of, ScottishPower ADSs by ScottishPower ADS Holders who make an election under the Mix and Match Facility will be 4 April 2007 (please note that any ScottishPower ADS Holder who does not hold his or her ScottishPower ADSs through the Direct Registration System of DTC will not be allowed to transfer such ScottishPower ADSs after completing and returning the ADS Letter of Transmittal and Election Form, even if prior to 4 April 2007. In the case of any ScottishPower ADS Holder who does not make an election under the Mix and Match Facility, the last day of dealings in, and for registration of transfers of, ScottishPower ADSs will be the earlier of the date on which the ScottishPower ADS Holder returns his or her ADS Letter of Transmittal and Election Form (or, if later, 4 April 2007 in the case of ScottishPower ADS Holders who hold their ScottishPower ADSs through the Direct Registration System of DTC) and 30 days after the termination of the ScottishPower Deposit Agreement. No transfers of ScottishPower Shares will be received after 19 April 2007 and no transfers of ScottishPower ADSs will be received after the date which is 30 days after the termination of the ScottishPower Deposit Agreement. Following 19 April 2007, ScottishPower will be temporarily suspended from the Official List and from trading on the London Stock Exchange's market for listed securities.
- (ii) Prior to the Scheme becoming effective, applications will be made to the FSA for the listing of the ScottishPower Shares on the Official List to be cancelled and to the London Stock Exchange for such shares to cease to be admitted to trading on its market for listed securities. It is expected that the cancellation of the listing and the cancellation of the admittance to trading will both take place on the Effective Date.
- (iii) Promptly upon the Scheme becoming effective, the ScottishPower ADSs will be delisted.
- (iv) Iberdrola intends to terminate the ScottishPower Deposit Agreement and de-register the ScottishPower Shares and ScottishPower ADSs under the Exchange Act at the earliest practicable date following the Effective Date.
- (v) The admission to listing on the Official List of the ScottishPower B Shares will be unaffected by the Offer and will continue after the Effective Date.

**(b) Listing of New Iberdrola Shares**

- (i) An application will be made by Iberdrola for the New Iberdrola Shares to be admitted to trading on the Bolsas de Valores. Admission of the New Iberdrola Shares to trading on the Bolsas de Valores is expected to occur at 5.35 p.m. (Madrid time) on 24 April 2007 and that dealings for normal settlement will commence on 25 April 2007. During the period from the Effective Date until the date on which dealings in the New Iberdrola Shares on the Bolsas de Valores commence, the New Iberdrola Shares will not be listed, nor can they be traded on any stock exchange.
- (ii) Iberdrola does not intend to apply for a listing of the New Iberdrola Shares on the London Stock Exchange or the New York Stock Exchange and does not intend to apply for a listing of the Iberdrola ADSs on any stock exchange.

**(c) Registration of Iberdrola Shares and Iberdrola ADSs under the Exchange Act**

## Edgar Filing: - Form

In accordance with the successor registration provisions of Rule 12g-3 of the Exchange Act, on the Effective Date, the Iberdrola Shares and Iberdrola ADSs will be deemed to be registered with the SEC under the Exchange Act. Accordingly, Iberdrola will succeed to ScottishPower's status as a registrant under the Exchange Act and will therefore become subject to the ongoing reporting obligations of the Exchange Act for so long as Iberdrola remains a registrant. Such reporting obligations include the

---

**Table of Contents**

requirement to file with the SEC annual reports on Form 20-F and to submit to the SEC periodic and other reports on Form 6-K. Iberdrola intends to seek to de-register the Iberdrola Shares and Iberdrola ADSs under the Exchange Act at the earliest practicable date following the Effective Date.

**(d) Issue of Iberdrola CDIs representing entitlements to New Iberdrola Shares**

- (i) Iberdrola Shares are traded, cleared and settled through Iberclear and, unlike ScottishPower Shares, are not capable of being admitted and settled directly in the usual UK settlement systems. In addition, Iberdrola Shares may only be held in uncertificated form with the ownership rights of shareholders being represented by book entries rather than share certificates. As a result, holding and trading the New Iberdrola Shares directly may therefore involve a number of unfamiliar formalities for certain UK and other investors.
- (ii) In order to facilitate trading of the New Iberdrola Shares in the UK, Iberdrola intends that the New Iberdrola Shares will initially be delivered, held and settled in CREST by means of the CREST International Settlement Links Services, and in particular through CREST's link with Euroclear and Euroclear's link with Iberclear through an account with Santander. Iberclear is the Spanish clearance and settlement system, which is in charge of the clearing and settlement of all trades from the Bolsas de Valores. CREST's link operates via the services of Euroclear, which, in turn, operates via the services of Santander, which acts as a participant in Iberclear. By virtue of these links CREST may issue CREST Depository Interests representing New Iberdrola Shares to investors (as explained in more detail below).
- (iii) Under the CREST International Settlement Links Services, CREST Depository Limited, a subsidiary of CRESTCo, issues dematerialised depository interests representing entitlements to non-UK securities (in this case the New Iberdrola Shares) known as CREST Depository Interests or CDIs. CDIs may be held, transferred and settled solely within CREST. However, CDI holders, provided they cancel their CDIs, are able to deliver their underlying shares to a participant in the relevant settlement system (e.g. Iberclear). Upon receipt of Iberdrola CDIs, ScottishPower Shareholders will therefore not be the registered holders of the New Iberdrola Shares to which they are entitled as a result of the implementation of the Scheme. The registered holder of such shares will be Euroclear Nominees, who will hold them on trust (as bare trustee under English law) for Euroclear as operator of the Euroclear system, which shall credit that interest for the account of CREST Depository Limited's nominee, CREST Nominees, in Euroclear, pursuant to which CREST Depository Limited will issue the Iberdrola CDIs. However, ownership of Iberdrola CDIs will represent each ScottishPower Shareholder's entitlement to such New Iberdrola Shares.
- (iv) Following issue of the Iberdrola CDIs, holders of the Iberdrola CDIs will, at their option, be able to effect the cancellation of their Iberdrola CDIs in CREST in order to hold their underlying New Iberdrola Shares by sending an instruction to CREST to that effect (via the Corporate Nominee in the case of holders of Iberdrola CDIs holding through the Corporate Nominee Facility described in paragraph 20(e) below) and will be entitled to arrange for the transfer of their New Iberdrola Shares (as represented by their holding of Iberdrola CDIs) into a shareholding account with a depository financial institution which is a participant in Iberclear. Certain transfer fees will be payable by a holder of Iberdrola CDIs (including those holding through the Corporate Nominee Facility (described in paragraph 20(e) below) who makes such a transfer. However, any former Certificated Holder who is issued with Iberdrola CDIs pursuant to the Scheme will not be charged any such transfer fees for the first such transfer, provided such transfer is effected within six weeks of the Effective Date. The terms and conditions upon which CDIs are issued and held in CREST are set out in the CREST Deed Poll and other related documents in the CREST Manual including, in particular, in the CREST International Manual.
- (v) Iberdrola will arrange for the Corporate Nominee to hold Iberdrola CDIs in CREST on behalf of all Certificated Holders. The terms and conditions of these arrangements will be sent to all Certificated Holders together with a letter setting out their entitlement shortly after the Effective Date.

---

**Table of Contents**

- (vi) A custody fee, as determined by CREST from time to time is charged at user level for the use of Iberdrola CDIs. Iberdrola will procure that this fee will not be charged to Certificated Holders, whose Iberdrola CDIs are held on their behalf through the Corporate Nominee Facility.
- (vii) Normal CREST procedures (including timings) apply in relation to any ScottishPower Shares that are, or are to be, converted from uncertificated to certificated form, or from certificated to uncertificated form, prior to the Effective Date (whether any such conversion arises as a result of a transfer of ScottishPower Shares or otherwise). ScottishPower Shareholders who are proposing to convert any such ScottishPower Shares are recommended to ensure that such conversions have been completed prior to the Reorganisation Record Time.
- (viii) For the avoidance of doubt, the provisions of this paragraph (d) do not apply to the Iberdrola ADSs. Euroclear Nominees shall, at the direction of the ScottishPower Depository, direct Santander that the Iberdrola Depository be registered with Santander as the holder of the number of New Iberdrola Shares to which the ScottishPower Depository is entitled under the Scheme in order for the Iberdrola Depository to issue such number of Iberdrola ADSs to which holders of ScottishPower ADSs are entitled. The Iberdrola Depository will not receive Iberdrola CDIs.

**(e) Settlement**

As soon as reasonably practicable after the Effective Date, Iberdrola shall deliver such New Iberdrola Shares, cash and Loan Notes as are required to be delivered to give effect to the Scheme, such consideration to be settled as set out below:

(i) Settlement of the New Iberdrola Shares

Iberdrola shall instruct Iberclear to credit the New Iberdrola Shares to which the relevant ScottishPower Shareholders are entitled to the securities deposit account of Euroclear Nominees. Iberdrola shall procure that Euroclear Nominees through its link with Santander, as participating entity in Iberclear, shall hold such shares on trust (as bare trustee under English law) for Euroclear and that Euroclear shall in turn credit such New Iberdrola Shares to an account in the name of CREST Nominees. The interest in such New Iberdrola Shares shall be held by CREST Nominees as nominee for CREST Depository Limited. Shortly following the aforementioned steps having been taken, CREST Depository Limited shall:

- (a) in the case of Certificated Holders, issue Iberdrola CDIs to the Corporate Nominee, Lloyds TSB Registrars Corporate Nominee Limited, and the Corporate Nominee shall thereupon deliver a Statement of Ownership detailing the relevant Certificated Holders' entitlement to Iberdrola CDIs; and
- (b) in the case of Uncertificated Holders, issue Iberdrola CDIs, in CREST, to the Receiving Agent and Iberdrola shall procure that the Receiving Agent shall thereupon deliver, through CREST to the stock account in CREST in which each such Uncertificated Holder held ScottishPower Shares, such Uncertificated Holders' entitlement to Iberdrola CDIs as soon as reasonably practicable after the Effective Date, and in any event within 14 days of the Effective Date.

(ii) Settlement of the cash consideration

- (a)

## Edgar Filing: - Form

Settlement of any cash consideration to which any Certificated Holder is entitled, including any cash to which they become entitled as a result of the sale of their fractional entitlements to New Iberdrola Shares, shall be settled by cheque drawn on a branch of a clearing bank in the United Kingdom and Iberdrola shall deliver or procure delivery to persons entitled thereto in accordance with the provisions of this paragraph 20(e)(ii)(a). Cheques shall be despatched as soon as reasonably practicable after the Effective Date and in any event within 14 days of the Effective Date; and

---

**Table of Contents**

- (b) Settlement of any cash consideration to which any Uncertificated Holder is entitled, including any cash to which they become entitled as a result of the sale of their fractional entitlements to New Iberdrola Shares, shall be paid by means of CREST by Iberdrola procuring a CREST payment obligation in favour of such Uncertificated Holder's payment bank in respect of the cash consideration due as soon as reasonably practicable after the Effective Date and in any event within 14 days of the Effective Date, in accordance with the CREST payment arrangements. Iberdrola reserves the right to settle all or any part of the cash consideration in the manner referred to in paragraph 20(e)(ii)(a) above if, for reasons outside its reasonable control, it is not able to effect settlement through CREST in accordance with this paragraph (20)(e)(ii)(b).

- (iii) Settlement of any Loan Note Consideration

Loan Notes will be issued by Iberdrola, credited as fully paid, in amounts and integral multiples of £1 and the balance of any entitlement that is not a whole multiple of £1 will be disregarded and not issued and will instead be settled in cash. Loan Note certificates shall be despatched by first class post (or by such other method as may be approved by the Panel) addressed to the person entitled thereto to the address appearing on the Register of Members or, in the case of joint holders, to the address of the holder whose name stands first in such register in respect of the joint holding concerned at such time. Loan Note certificates shall be despatched as soon as reasonably practicable after the Effective Date and in any event within 14 days of the Effective Date.

- (iv) Settlement of ADSs

On the Effective Date, the ScottishPower Shares held by the ScottishPower Depositary in respect of the ScottishPower ADSs will be cancelled and the cash consideration for, and the Iberdrola ADSs to be issued in respect of, such ScottishPower Shares will be delivered to the ScottishPower Depositary, as a ScottishPower Shareholder, within 14 days of the Effective Date. The ScottishPower Depositary will then promptly convert the cash consideration into US Dollars in accordance with the ScottishPower Deposit Agreement and distribute the cash proceeds to each registered holder of ScottishPower ADSs, together with any Iberdrola ADSs to which such holder becomes entitled, upon receipt of the holder's completed ADS Letter of Transmittal and Election Form along with any ScottishPower ADSs held in certificated form.

Please also refer to paragraph 22 of this Part 4 below and to Part 13 of this document for further information.

- (v) General

All documents and remittances sent by or to holders of ScottishPower Shares or ScottishPower ADSs will be sent at their own risk.

New Iberdrola Shares, including such shares underlying Iberdrola ADSs, to be issued as consideration under the Scheme will be issued credited as fully paid and free from all liens, charges, encumbrances, and, subject to the Iberdrola By-laws, rights of pre-emption and any other third party rights of any nature whatsoever (save that under the CREST Deed Poll, CREST has certain rights of sale and deduction for expenses and liabilities it may incur in relation to acting as depositary in relation to the Iberdrola CDIs) and will rank *pari passu* in all respects with the existing Iberdrola Shares, including the right to receive all dividends, distributions and other entitlements declared, made or paid by Iberdrola on Iberdrola Shares after the Effective Date. Further details of the rights attaching to the New Iberdrola Shares are set out in Part 8 of this document. Immediately following the Offer becoming effective, but before any dealings take place under the Dealing Facility, former ScottishPower Shareholders and ScottishPower ADS Holders are expected to own approximately 21 per cent. of the issued share capital of Iberdrola.



---

**Table of Contents**

**(f) Rights Attaching to Iberdrola CDIs**

The holders of Iberdrola CDIs will have an entitlement to the New Iberdrola Shares to which they are entitled under the Scheme but will not be the registered holders thereof. Accordingly, the holders of Iberdrola CDIs will only be able to enforce and exercise the rights relating to the New Iberdrola Shares described in Part 8 of this document in accordance with the arrangements described below.

- (i) In order to allow the holders of Iberdrola CDIs to exercise rights relating to the New Iberdrola Shares, Iberdrola will, prior to the Effective Date, enter into arrangements pursuant to which it will procure that, with effect from the Effective Date, all holders of Iberdrola CDIs (including all former Certificated Holders whose Iberdrola CDIs are held through the Corporate Nominee Facility described in paragraph 20(e) above):
  - (a) will receive notices, in English, of all general shareholders meetings of Iberdrola;
  - (b) will be able to give directions as to voting at all general shareholders meetings of Iberdrola;
  - (c) will have made available to them and will be sent, at their request, copies of the annual report and accounts of Iberdrola and all of the documents issued by Iberdrola to Iberdrola shareholders (in each case, in English); and
  - (d) will be treated in the same manner as registered Iberdrola shareholders in respect of all other rights attaching to New Iberdrola Shares,

in each case, insofar as reasonably practicable and possible in accordance with applicable CREST Regulations and CREST Requirements, and applicable law, and subject to the provisions of paragraphs 2(c) to 2(f) of Part 8 of this document.

- (ii) Holders of Iberdrola CDIs (including former Certificated Holders whose Iberdrola CDIs are held through the Corporate Nominee Facility described in paragraph 20(e) above) are not entitled to attend and vote at general shareholders meetings of Iberdrola. In order to do so, whether in person or through the appointment of a proxy (who must also be an Iberdrola Shareholder), they must first effect the cancellation of their Iberdrola CDIs for their underlying Iberdrola Shares which must then be held with a depositary financial institution which is a participant in Iberclear at least five days before the relevant general shareholders meeting. On so doing, they will, subject to and in accordance with Iberdrola's By-laws, be able to attend and vote in person at the relevant general shareholders meeting of Iberdrola. Details of how such cancellation can be effected are set out in paragraph 20(d)(iv) above. As mentioned in paragraph 20(d)(iv) above, the first transfer will, for former Certificated Holders, be free of transfer fees provided it is effected within six weeks of the Effective Date.
- (iii) Under the Iberdrola By-laws, the chairman of Iberdrola has the right to invite any person to be present at a general shareholders meeting of Iberdrola, subject to the right of Iberdrola shareholders to revoke such authorisation. The chairman may, at his discretion, extend such invitation to holders of Iberdrola CDIs (including former Certificated Holders whose Iberdrola CDIs are held through the Corporate Nominee Facility described in paragraph 20(e) above) who wish to be present at a general shareholders meeting of Iberdrola without effecting the cancellation of their Iberdrola CDIs for their underlying New Iberdrola Shares. It should be noted that any person present at a general shareholders meeting of Iberdrola by invitation of the chairman is not entitled to speak, vote or exercise other shareholder rights in person at such meeting. Such holders of Iberdrola CDIs will, however, be entitled to give directions for voting their underlying New Iberdrola Shares pursuant to the arrangements which Iberdrola has put in place as referred to above.

---

**Table of Contents**

- (iv) In addition, the arrangements referred to in paragraph 20(f)(i) above will also include provisions dealing with the payment of amounts in respect of dividends (including a provision to the effect that the Corporate Nominee referred to in paragraph 20(e) will, for so long as CREST continues to provide such service, elect to receive any amounts in respect of dividends paid on the New Iberdrola Shares represented by the Iberdrola CDIs held through the Corporate Nominee Facility, in Sterling) and facilitating, so far as practicable and to the extent permitted by applicable law, the participation of Iberdrola CDI holders in capital events in the same manner as Iberdrola shareholders.

Holders of Iberdrola CDIs will not be able to participate in the Dividend Reinvestment Plan ( **DRiP** ), which Iberdrola offers to its shareholders. Holders of Iberdrola CDIs who wish to participate in the DRiP must first effect the cancellation of their Iberdrola CDIs for their underlying New Iberdrola Shares which must then be held with a depository financial institution which is a participant in Iberclear. Details of how such cancellation can be effected are set out in paragraph 20(d)(iv) above.

Iberdrola will investigate the possibility of Iberdrola CDI holders whose Iberdrola CDIs are held through the Corporate Nominee Facility described in paragraph 20(e) above participating in the DRiP in respect of future dividends. Further details of the DRiP are set out in paragraph 1(b) of Part 8 of this document.

- (v) Iberdrola will procure that the provider of the Corporate Nominee Facility described in paragraph 20(e) above will send to former Certificated Holders on whose behalf the Corporate Nominee holds Iberdrola CDIs pursuant to the arrangement described in paragraph 20(e) above a statement of their holdings in Iberdrola CDIs on joining the Corporate Nominee Facility and at least once a year afterwards, for so long as such holder retains some Iberdrola CDIs in the account of the Corporate Nominee.
- (vi) All former Certificated Holders will be sent, together with their initial Statement of Ownership detailing the number of Iberdrola CDIs held on their behalf in the Corporate Nominee Facility, a booklet containing the terms and conditions of the Corporate Nominee arrangements which will include a description of the procedure to be followed for cancelling Iberdrola CDIs and effecting the transfer of the underlying New Iberdrola Shares and provisions relating to exclusion of liability on the part of the relevant Corporate Nominee from Iberdrola CDI holders.
- (vii) Former Certificated Holders who wish to hold their New Iberdrola Shares through an intermediary of their own choice which is a participating entity in Iberclear will be able to instruct the Corporate Nominee to transfer the New Iberdrola Shares accordingly. Details of the manner in which instructions may be given to the Corporate Nominee will be sent to ScottishPower Shareholders following the Meetings.

**(g) Transfers of New Iberdrola Shares Underlying Iberdrola CDIs**

- (i) A description of the procedure to be followed by a former Certificated Holder who wishes to cancel the Iberdrola CDIs held on his behalf pursuant to the Corporate Nominee Facility described in paragraph 20(e) above and effect the transfer of his underlying New Iberdrola Shares will be set out in the booklet to be sent to all former Certificated Holders together with their initial Statement of Ownership as referred to in paragraph 20(e) above. Former Uncertificated Holders will be able to cancel their Iberdrola CDIs and effect the transfer of their underlying New Iberdrola Shares in accordance with the relevant rules and practices of CREST (subject to any legal restrictions on transfer in any jurisdiction).
- (ii) Any cancellation of Iberdrola CDIs will involve the disposal of the underlying interest in the New Iberdrola Shares. If former ScottishPower Shareholders dispose of their underlying New Iberdrola Shares by way of sale, gift or on death, then Spanish tax requirements, which are described in paragraph 26 of this Part 4, apply. For UK tax residents, these requirements are described in paragraph 26 of this Part 4 of this document. For US tax residents, there are additional requirements which are described in paragraph 26 of this Part 4. Former ScottishPower Shareholders who are in any doubt, and in particular those who are tax resident other than in the UK or US, should take appropriate professional advice.



---

**Table of Contents****21 Holding of New Iberdrola Shares**

The New Iberdrola Shares to be issued and delivered as consideration under the Offer will be fully paid, will rank *pari passu* for any dividend declared or paid by Iberdrola by reference to a record date on or after the Effective Date and will otherwise rank *pari passu* in all respects with Iberdrola Shares in issue at the time the New Iberdrola Shares are delivered under the Offer. The New Iberdrola Shares will be issued free from all liens, charges, equitable interests, encumbrances and other third party rights and interests of any nature whatsoever and, subject to the Iberdrola By-laws, rights of pre-emption and any other third party rights of any nature whatsoever (save that, under the CREST Deed Poll, CREST has certain rights of sale and deduction for expenses and liabilities it may incur in relation to acting as Depository in relation to the Iberdrola CDIs).

Applications will be made for the New Iberdrola Shares to be listed on the Bolsas de Valores, quoted through the Automated Quotation System of the Bolsas de Valores and cleared and settled through Iberclear, the Spanish clearing and settlement system. Iberclear and its member entities maintain a book-entry system on which details of shareholders' holdings of, and trades in, Iberdrola Shares will be recorded. The New Iberdrola Shares, like all shares in Spanish public companies, will be dematerialised and will not be capable of being represented by share certificates. In the event that the registered holder of a New Iberdrola Share desires a document evidencing his or her title to such share, a Statement of Ownership (*certificado de inmovilización*) can be requested from the Iberclear member through which the share is held. A statement of ownership of the New Iberdrola Shares will not be issued by the Iberclear member unless one is requested by the Iberdrola shareholder, in which case, according to Spanish law, the securities in respect of which the statement of ownership has been issued will be, and remain, blocked (and, therefore, among other things, cannot be traded) other than in relation to enforcement procedures until such statement of ownership is returned. Such statement of ownership is not a definitive certificate of title.

However, please note that without prejudice to the option of requesting a statement of ownership to the Iberclear member, the registered holder of New Iberdrola Shares will also be entitled to request from the Iberclear member, where the registered holder has deposited the New Iberdrola Shares, an informative excerpt (*extracto*) detailing, in accordance with the Iberclear member records, the number of New Iberdrola Shares owned by such registered holder. Such informative excerpt is not a definitive certificate of title. It is expected that admission of the New Iberdrola Shares to trading on the Bolsas de Valores will become effective and that dealings for normal settlement will commence on 25 April 2007. During the period from the Effective Date until the date on which dealings in the New Iberdrola Shares on the Bolsas de Valores commence, the New Iberdrola Shares will not be listed, nor can they be traded on any stock exchange.

Further information about the manner of holding and trading New Iberdrola Shares is set out in paragraph 1(f) of Part 8 of this document.

**22 ScottishPower ADSs**

Each outstanding ScottishPower ADS represents four ScottishPower Shares deposited pursuant to the ScottishPower Deposit Agreement. Each registered ScottishPower ADS Holder as at the ADS Record Time is entitled, under the terms of the ScottishPower Deposit Agreement, to attend and vote at the Meetings or to appoint a proxy to do so. Indirect holders of ScottishPower ADSs should consult the procedures of the bank, broker, financial institution, share plan administrator or other nominee through which they hold their ScottishPower ADSs in order to vote their ScottishPower ADSs. Indirect ScottishPower ADS Holders who wish to attend and vote at the Meetings may alternatively present their ScottishPower ADSs to the ScottishPower Depository for cancellation and receive (upon compliance with the terms of the ScottishPower Deposit Agreement, including payment of the ScottishPower Depository's fees and any applicable taxes and governmental charges) delivery of their ScottishPower Shares so as to become registered holders of ScottishPower Shares prior to the Voting Record Time.



---

**Table of Contents**

If you are a registered ScottishPower ADS Holder, please complete and sign the enclosed ADS Voting Instruction Card in accordance with the instructions printed thereon and return it in the white postage-paid business reply envelope provided (for use in the US only) to JPMorgan Chase Bank, N.A., at the address set forth on the ADS Voting Instruction Card, as soon as possible and, in any event, so as to be received no later than 3.00 p.m. (New York time) on 26 March 2007. You may indicate on the ADS Voting Instruction Card whether you wish to attend and vote at the Meetings yourself or whether you wish to appoint the nominee of the ScottishPower Depositary or another person as your proxy. If you wish to attend and vote at the Meetings yourself, you are requested to indicate this on the ADS Voting Instruction Card. If you appoint the nominee of the ScottishPower Depositary as your proxy, the nominee will vote in accordance with your instructions on the ADS Voting Instruction Card. If you appoint a person other than the nominee of the ScottishPower Depositary, you should instruct your proxy how you wish your ScottishPower ADSs to be voted.

Please note that if you appoint the nominee of the ScottishPower Depositary as your proxy (but not if you appoint another person as your proxy), you may nonetheless attend the Meetings, in which case the proxy you granted will be revoked, and you will be asked to vote in person. You will also be allowed to attend and vote in person if you have not returned your ADS Voting Instruction Card.

If you wish to attend the Meetings in person, you will be required to present a valid passport or other government-issued photo identification in order to gain admittance.

In lieu of completing and returning the ADS Voting Instruction Card, you may cast your vote by telephone, by calling +1-866-540-5760, or electronically by logging on to [www.proxyvoting.com/spi](http://www.proxyvoting.com/spi), where details of the procedure are set out. Please refer to the ADS Voting Instruction Card for further information.

In the case of joint registered holders of ScottishPower ADSs, the ScottishPower Depositary has indicated that it will recognise as valid an ADS Voting Instruction Card signed by less than all of the joint holders (but the legal right of individual holders of jointly-held ScottishPower ADSs to appoint and instruct a proxy may depend on applicable US or state laws).

As soon as reasonably practicable after the Effective Date but in any event within 14 days of the Effective Date, and subject to any election made under the Mix and Match Facility, the ScottishPower Depositary will receive the economic equivalent of 1,600 pence and 0.6584 of an Iberdrola ADS for every ScottishPower ADS.

Upon the exchange of their ScottishPower ADSs, after receipt of the above by the ScottishPower Depositary and conversion of the cash portion thereof into US Dollars at the then prevailing exchange rate, each holder of such ScottishPower ADSs will be entitled to receive:

- (i) a cheque in US Dollars from the ScottishPower Depositary for the amount obtained by the ScottishPower Depositary with respect to such ScottishPower ADS Holder's ScottishPower ADSs upon conversion of the cash consideration received by it pursuant to the Scheme into US Dollars in accordance with the ScottishPower Deposit Agreement (and upon the sale of that ScottishPower ADS Holder's fractional entitlements to Iberdrola ADSs (if any) as described below); and
- (ii) any Iberdrola ADSs to which they become entitled.

## Edgar Filing: - Form

There will be no cancellation or issuance charges in connection with the surrender of any ScottishPower ADS in exchange for Iberdrola ADSs pursuant to the Scheme.

Fractions of Iberdrola ADSs will not be issued, but will be aggregated and sold after the Effective Date. The net proceeds of such sale shall be converted into US Dollars by the ScottishPower Depositary and made available to ScottishPower ADS Holders entitled thereto in accordance with their fractional entitlements. No assurance can be given as to the price that will be received for Iberdrola ADSs sold pursuant to this paragraph.

## **Table of Contents**

The Iberdrola Deposit Agreement will set forth the charges and fees that will be payable by Iberdrola ADS Holders to the Iberdrola Depositary. Certain fees, including in connection with the payment of dividends and the administration of the Iberdrola ADR Facility, to which Scottish Power ADS Holders were not previously subject will be charged by the Iberdrola Depositary in respect of the Iberdrola ADSs. See Part 8 of this document for further information with respect to such charges and fees.

### ***No Listing of Iberdrola ADSs***

Subject to any election made under the Mix and Match Facility, holders of ScottishPower ADSs will receive Iberdrola ADSs representing the New Iberdrola Shares issued in respect of the underlying ScottishPower Shares upon surrender of the ScottishPower ADSs in accordance with the terms of the ScottishPower Deposit Agreement.

Iberdrola will establish the Iberdrola ADR Facility in connection with the acquisition of Scottish Power upon the Scheme becoming effective. Iberdrola currently intends to maintain the Iberdrola ADR Facility on an ongoing basis.

Since the Iberdrola ADSs representing New Iberdrola Shares will not be listed or traded on any exchange in the United States or elsewhere, the Iberdrola ADSs will only be eligible for trading over-the-counter. Thus, ScottishPower ADS Holders are cautioned that the Iberdrola ADSs may be illiquid. The lack of an active and liquid trading market in the Iberdrola ADSs could make it more difficult to trade such Iberdrola ADSs. In the event that Iberdrola terminates the Iberdrola ADR Facility, former holders of Iberdrola ADSs who receive New Iberdrola Shares following such termination of the Iberdrola ADR Facility may face administrative burdens and costs in holding New Iberdrola Shares directly. As a result of the decision not to list the New Iberdrola Shares on the New York Stock Exchange or any other US exchange, US resident holders of the New Iberdrola Shares, including New Iberdrola Shares received as a result of any termination of the Iberdrola ADR Facility, may be required to sell such underlying shares on the Bolsas de Valores, which could be more time consuming and costly for such holders than settling trades in Iberdrola ADSs.

### ***Conversion of Iberdrola ADSs into New Iberdrola Shares***

Holders of the Iberdrola ADSs who wish to convert their Iberdrola ADSs into the underlying New Iberdrola Shares will have the option to present their Iberdrola ADSs to the Iberdrola Depositary for cancellation and (upon compliance with the Iberdrola Deposit Agreement, including payment of the fees of the Iberdrola Depositary and any applicable taxes and governmental charges) for delivery of the New Iberdrola Shares represented thereby so as to become registered holders of New Iberdrola Shares.

Further details about the rights attaching to the Iberdrola ADSs are set out in Part 8 of this document.

## **23 Dealing Facility**

Iberdrola is offering a Dealing Facility to enable certain ScottishPower Shareholders who receive New Iberdrola Shares as a result of the Offer to sell their newly acquired shares.

## Edgar Filing: - Form

For the six-month period from the Effective Date, Iberdrola is offering certain qualifying ScottishPower Shareholders use of the Ongoing Dealing Facility for free, without incurring any charges (including any dealing charges, settlement charges or foreign exchange commission). The free Dealing Facility will be available to persons who:

- (i) hold 5,000 or fewer ScottishPower Shares immediately prior to the Reorganisation Record Time or, if they are a participant under the ScottishPower Sharesave Scheme, would have held 5,000 or fewer ScottishPower Shares at the Reorganisation Record Time if they had exercised their options before that time, and they subsequently exercise their options within six months of the Court Sanction;

---

**Table of Contents**

- (ii) have a registered address in and are resident for tax purposes in a member state of the European Economic Area ( **EEA** );
- (iii) hold their ScottishPower Shares immediately prior to the Effective Date in certificated form or whose Iberdrola CDIs are held on their behalf by the Corporate Nominee pursuant to the arrangements described in paragraph 20(e) above;
- (iv) are not, and who are not acting on behalf of any person who is, in the United States or a US person , as that term is defined in Regulation S under the US Securities Act; and
- (v) are selling all (but not some only) of their New Iberdrola Shares.

**SCOTTISHPOWER SHAREHOLDERS WHO HOLD THEIR SCOTTISHPOWER SHARES IN UNCERTIFICATED FORM (BUT WHO ARE OTHERWISE ELIGIBLE TO MAKE USE OF THE DEALING FACILITY) AND WHO WISH TO MAKE USE OF THE DEALING FACILITY (WHETHER IMMEDIATELY AFTER THE EFFECTIVE DATE OR AT SUCH OTHER DATE AS PERMITTED BY THE TERMS OF THE DEALING FACILITY) MUST CONVERT, AT THEIR OWN COST, THEIR HOLDINGS OF SCOTTISHPOWER SHARES INTO CERTIFICATED FORM PRIOR TO THE EFFECTIVE DATE IN ORDER TO PARTICIPATE IN THE DEALING FACILITY.**

ScottishPower Shareholders who meet the criteria set out in (ii), (iii) and (iv) above but who are not otherwise eligible to use the Dealing Facility for free (because, for example, they hold more than 5,000 ScottishPower Shares immediately prior to the Reorganisation Record Time) will be required to pay all charges (including any dealing charges, settlement charges and foreign exchange commissions) for use of the Dealing Facility.

ScottishPower ADS Holders will not be entitled to participate in the Dealing Facility with respect to the Iberdrola ADSs received in exchange for their ScottishPower ADSs.

Eligible Holders wishing to make use of the Dealing Facility should note that Iberdrola anticipates announcing its 2007 first quarter results in the last week of April 2007, after the estimated Effective Date.

***Participation in the Dealing Facility***

ScottishPower Shareholders who are eligible to make use of the Dealing Facility and wish to participate in the Dealing Facility can apply to use the Dealing Facility by completing the grey Upfront Dealing Facility Instruction Form enclosed with the Dealing Facility Documentation Pack, which has been despatched with this document to all eligible ScottishPower Shareholders. The Upfront Dealing Facility Instruction Form should be completed in accordance with the instructions set out on the Form and returned by post or by hand (during normal business hours) to Lloyds TSB Registrars at 3rd Floor, Princess House, 1 Suffolk Lane, London EC4R 0AX by 3.00 p.m. (London time) on 19 April 2007 or such later time (if any) to which the right to make the relevant election may be extended. A reply-paid envelope, for use in the UK only, is enclosed for your convenience.

Completed Upfront Dealing Facility Instruction Forms received by Lloyds TSB Registrars after the date referred to above will not be executed.

## Edgar Filing: - Form

If you wish to participate in the Dealing Facility after the Effective Date and have not returned an Upfront Dealing Facility Instruction Form on or before 19 April 2007 or such later time (if any) to which the right to make the relevant election may be extended, you must complete an Ongoing Dealing Facility Instruction Form, which will be sent to you together with your Statement of Ownership, as soon as practicable after the Effective Date.

Both Dealing Facility Instruction Forms will be subject to the terms and conditions set out in the Dealing Facility Documentation Pack.

Dealing Facility Instruction Forms returned by facsimile will not be accepted.

## **Table of Contents**

No sale instructions can be revised once a Dealing Facility Instruction Form has been received. As soon as reasonably practicable after the instructions to sell have been accepted, subject to and in accordance with the full terms and conditions on which the service will be provided, the relevant New Iberdrola Shares will be sold. No assurance can be given as to the price that will be received for the New Iberdrola Shares sold through the Dealing Facility.

Former ScottishPower Shareholders who sell through the Dealing Facility will be sent the proceeds of such sale in Sterling by cheque through the post. In the case of joint holders, the proceeds will be sent to the first registered holder.

Participation in the Dealing Facility is completely voluntary. If you elect not to participate, you will receive your New Iberdrola Shares in the manner described in paragraph 2 of this Part 4. Subject to any legal restrictions on transfer in any jurisdiction, former ScottishPower Shareholders who do not want, or are not able, to sell their New Iberdrola Shares through the Dealing Facility described in this paragraph 23 may nonetheless sell or transfer their New Iberdrola Shares as described in paragraph 1(f) of Part 8 of this document. Certain Spanish and UK tax consequences of such a disposal are set out in paragraph 26 of this Part 4 of this document.

### ***Conditions***

The Dealing Facility cannot be used to buy additional New Iberdrola Shares or to buy or sell other securities or investment products. Persons wanting to sell their New Iberdrola Shares are not obliged to sell them through the Dealing Facility. Persons wanting to use the Dealing Facility may also be required to provide evidence of their identity prior to despatch of proceeds, where required by applicable anti-money laundering laws.

ScottishPower understands from Iberdrola that the provider of the Dealing Facility will not acquire any New Iberdrola Shares pursuant to the facility for its own account.

The availability of the Dealing Facility is subject to the Scheme becoming effective. The availability of the Dealing Facility is not conditional on a minimum number of eligible ScottishPower Shareholders participating in the Dealing Facility, or on any minimum number of New Iberdrola Shares being sold through the Dealing Facility.

### ***Tax Consequences of Participation in the Dealing Facility***

If former ScottishPower Shareholders sell their New Iberdrola Shares (including through the Dealing Facility) Spanish tax requirements will apply if a gain is made on the sale of the New Iberdrola Shares. A former ScottishPower Shareholder who sells through the Dealing Facility will therefore be required to file a Spanish tax return with the Spanish tax authorities and, if any former ScottishPower Shareholder wishes to claim an exemption from Spanish tax in relation to any gain on any such disposal pursuant to the treaty for the avoidance of double taxation between the United Kingdom and Spain, the Spanish tax return must be accompanied by a certificate of residency from H.M. Revenue and Customs.

## Edgar Filing: - Form

However, in order to facilitate the use of the Dealing Facility, Iberdrola has agreed to arrange for former ScottishPower Shareholders wishing to claim such exemption who sell their New Iberdrola Shares through the Dealing Facility to be provided with assistance for the purposes of complying with applicable tax formalities, as described in the Dealing Facility Documentation Pack. Following discussions with H.M. Revenue and Customs and the Spanish tax authorities, Iberdrola has arranged for certain former ScottishPower Shareholders to benefit from a simplified procedure in relation to complying with the Spanish tax formalities for three months following the Effective Date.

The assistance will only be provided to former ScottishPower Shareholders who are resident in the United Kingdom for the purposes of the treaty for the avoidance of double taxation between the United Kingdom and Spain and entitled to its benefits. Further details of the persons to which this relates are set out in paragraph 26(a)(iii)(b) of this Part 4.

## **Table of Contents**

For former ScottishPower Shareholders who are not within this category, Iberdrola has agreed to make available in English (on the Iberdrola website and by post if requested) guidance on how to obtain and complete a Spanish tax return (Form 210), together with a translation of Form 210 into English. However, any former ScottishPower Shareholders who are in any doubt as to their tax position should consult their own professional advisers.

## ***Further Information***

For further information regarding the Dealing Facility, please refer to the Dealing Facility Documentation Pack which has been despatched with this document to all ScottishPower Shareholders. The Dealing Facility Documentation Pack includes the full terms and conditions on which this Facility will be provided.

## **24 Receipt of Iberdrola Dividends in Sterling**

Following the Scheme becoming effective, Uncertificated Holders will, for so long as the Iberdrola CDIs delivered to them are held in CREST and CREST continues to provide such service, be able, if they so wish, to have amounts in respect of dividends paid on the New Iberdrola Shares in Euros by Iberdrola converted into and paid to them in Sterling (without foreign exchange commission) by CREST Depository Limited.

As the vast majority of Certificated Holders are resident in the UK, Iberdrola will procure that the provider of the Corporate Nominee Facility will, for so long as CREST continues to provide such service, elect to receive any amounts in respect of dividends paid on New Iberdrola Shares represented by the Iberdrola CDIs held through the Corporate Nominee Facility, in Sterling. Accordingly, following the Offer becoming effective, Certificated Holders on whose behalf a Corporate Nominee holds Iberdrola CDIs pursuant to the arrangement described in paragraph 20(e) of this Part 4 will, for so long as such arrangement remains in place and CREST continues to provide such service, have amounts in respect of dividends paid on New Iberdrola Shares in Euros by Iberdrola converted into and paid to them in Sterling (without foreign exchange commission).

## **25 Receipt of Iberdrola Dividends in US Dollars**

Following the Scheme becoming effective and for such period as the Iberdrola ADR Facility is in place, dividends paid on New Iberdrola Shares underlying Iberdrola ADSs will be converted by the Iberdrola Depository into US Dollars and, after deduction of any fees and expenses related thereto, paid to holders of Iberdrola ADSs (including former ScottishPower ADS Holders).

## **26 Taxation**

### **(a) Spain**

(i) General

The comments set out below summarise the material Spanish tax treatment of Scheme Shareholders under the Scheme. They are based on current Spanish law and practice. They are intended as a general guide and apply only to Scheme Shareholders who are resident in the United Kingdom in accordance with the treaty for the avoidance of double taxation entered into by and between the United Kingdom and Spain (the **UK-Spain Treaty** ) and who are entitled to its benefits or to Scheme Shareholders who are resident in the United States in accordance with the treaty for the avoidance of double taxation and the prevention of fiscal evasion entered into by and between the United States and Spain (the **US-Spain Treaty** ) and who are entitled to its benefits. This summary is not a complete analysis or listing of all the possible tax consequences of the receipt, ownership and transfer of New Iberdrola Shares, and/or Loan Notes pursuant to the Offer and does not address all tax considerations that may be relevant to all categories of potential investors, some of whom may be subject to special rules. In particular, this tax section does not address the Spanish tax consequences applicable to look-through entities (such as trusts or estates).

---

**Table of Contents**

Accordingly, prospective investors should consult their own tax advisers as to the applicable tax consequences of the receipt, ownership and transfer of New Iberdrola Shares and/or Loan Notes, including the effect of tax laws of any other jurisdiction, based on their particular circumstances.

The term **Holder** means a beneficial owner of shares:

- (a) who is an individual or corporation resident for tax purposes in the United Kingdom in accordance with the UK-Spain Treaty and entitled to its benefits (a **UK Holder** ) or alternatively in the United States in accordance with the US-Spain Treaty and entitled to its benefits (a **US Holder** );
- (b) whose ownership of shares is not connected with a permanent establishment in Spain through which such Holder carries on, or has carried on, business or with a fixed base or permanent establishment in Spain from which such Holder performs, or has performed, independent personal services; and
- (c) who is treated as owning less than 10 per cent. (in the case of a UK Holder) or less than 25 per cent. (in the case of a US Holder) of the shares in the Spanish company (please note that, if the investor held a stake of at least 10 per cent./25 per cent. respectively, certain reduced rates or exemptions may be available on dividends distributed to such investor other than those summarised below).

Any Scheme Shareholders who do not fall within the above description or who are in any doubt as to their tax position in respect of the Scheme should consult their own professional advisers immediately.

(ii) Spanish tax consequences of the Scheme

No Spanish tax will arise to Scheme Shareholders in respect of the receipt by them of the New Iberdrola Shares and/or Loan Notes and/or cash.

No liability to Spanish transfer tax or value added tax will arise to Scheme Shareholders in respect of the issue of New Iberdrola Shares.

(iii) Dividends on New Iberdrola Shares

As a general rule, according to the Non-Resident Income Tax Law approved by Royal Decree Legislative 5/2004, of 5 March 2004 ( **NRIT** and the **NRIT Law** ), dividends paid on New Iberdrola Shares to a Holder are subject to NRIT withholding on the gross amount of dividends, currently at a tax rate of 18 per cent. Notwithstanding the above, the following NRIT exemptions or reduced rates may be applicable:

- (a) Dividends distributed by Spanish companies to a Holder who is an individual will be exempt from NRIT up to an annual amount of 1,500 for all of his/her Spanish sourced dividend income. However, please note that Iberdrola will have to deduct withholding taxes on the gross amount of the dividends and that Holders entitled to this exemption will have to seek a refund of such withholding

## Edgar Filing: - Form

taxes from the Spanish Tax Authorities as described below.

- (b) Holders will be entitled to the benefits of the UK-Spain Treaty or the US-Spain Treaty as applicable. Such Holders may benefit from a reduced tax rate, subject to the satisfaction of any conditions specified in the relevant double tax treaty, including providing evidence of the tax residence of the Holder by means of a certificate of tax residence duly issued by the tax authorities of the country of tax residence of the Holder or, as the case may be, the equivalent document regulated in the order which further develops the applicable double tax treaty stating that the Holder is resident for tax purposes in the relevant jurisdiction within the meaning of the corresponding double tax treaty entered into with Spain (for Spanish tax purposes, such certificate is valid for one year from the date it is issued). The UK-Spain Treaty generally provides for a maximum 15 per cent. NRIT rate on the gross amount of the dividend. The US-Spain Treaty also provides for a maximum 15 per cent. NRIT rate on the gross amount of the dividend.

## **Table of Contents**

Please note that withholdings on account of NRIT should be made by Iberdrola at the lower NRIT rate established in the relevant treaty if the tax residence of the relevant Holder is evidenced through a tax residence certificate provided to Iberdrola in a timely manner (or the equivalent document regulated in the order which further develops the applicable double tax treaty).

As regards refund of NRIT withholdings deducted on dividends distributed to Holders who are individuals (exempt up to a total annual amount of 1,500) for all of his/her Spanish sourced dividend income or to Holders entitled to a reduced rate under the relevant treaty (where they have failed to submit a tax residence certificate in a timely manner), please note that under legislation currently in force, the Holder would be required to file (i) the applicable Spanish tax return (currently, Form 210), (ii) a valid certificate of tax residence or equivalent document, and (iii) a certificate from the relevant Spanish companies stating that the amount of NRIT was withheld with respect to such Holder.

### (iv) Disposal of New Iberdrola Shares

Generally, capital gains derived from the transfer, exchange, redemption or sale of New Iberdrola Shares will be regarded as Spanish-sourced capital gains and, thus, are taxable under NRIT at a rate currently of 18 per cent. The capital gain is calculated as the difference between the sale price and the acquisition cost (value of New Iberdrola Shares received at the time of exchange).

Capital gains and losses will be calculated separately for each transaction. It is not possible to offset losses against capital gains.

However, capital gains obtained by a UK Holder derived from the transfer of New Iberdrola Shares will be exempt from NRIT in accordance with the UK-Spain Treaty.

Capital gains obtained by a US Holder derived from the transfer of New Iberdrola Shares are exempt from NRIT on capital gains obtained from such transfer if, according to the US-Spain Treaty, the main assets of Iberdrola are not real estate located in Spain. Notwithstanding this circumstance, capital gains obtained by a US Holder derived from the transfer of Iberdrola Shares may also be exempt from NRIT if the transfer of shares takes place on an official Spanish secondary stock market (such as the Bolsas de Valores) and are not obtained by the US Holder through a permanent establishment in Spain or through a country or territory that is defined as a tax haven by Spanish regulations (e.g. Jersey, Guernsey, the Isle of Man, the Cayman Islands, the Bahamas and Bermuda, among others).

Holders must submit a Spanish tax return (currently, Form 210) within one month from the date on which the relevant capital gain is realised in order to pay NRIT due on the gain. For the purposes of applying any of the aforementioned exemptions, the relevant Holder must provide a certificate of tax residence (for Spanish tax purposes, such certificate is valid for one year from the date it is issued) issued by the tax authorities of his/her country of residence (which, if applicable, must state that the Holder is resident for tax purposes in such country within the meaning of the relevant double tax treaty entered into with Spain) or equivalent document meeting the requirements of the Order which further develops the applicable double tax treaty, together with the Spanish tax return.

Holders who use the Dealing Facility and who are eligible to use the simplified procedure in relation to complying with the Spanish tax formalities are referred to the Dealing Facility Documentation Pack.

### (v) Loan Notes

## Edgar Filing: - Form

Income received by the Loan Note Holders on the transfer or redemption of the Loan Notes should be regarded as **interest** for NRIT purposes. As a general rule, interest received by Loan Note Holders will be subject to NRIT withheld at source on the gross amount of interest, currently at a tax rate of 18 per cent. The above notwithstanding, the following NRIT exemptions or reduced rates may be applicable according to the NRIT Law:

- (a) According to article 14.1(c) of the NRIT Law, interest and income upon transfer or redemption of debt instruments obtained by any UK Holder to whom the Loan Notes are allocated, who does not obtain the interest through a permanent establishment in Spain, are exempt from NRIT unless they are obtained through a tax haven or by a permanent establishment in Spain or outside the

---

**Table of Contents**

EU. Iberdrola will not levy the corresponding NRIT withholding tax if, before any interest is due or paid, whichever comes first, that UK Holder provides a certificate of tax residence issued by the competent UK tax authorities (for Spanish tax purposes, such certificate is valid for one year from the date it is issued).

(b) US Holders are entitled to the 10 per cent. reduced tax rate provided for in the US-Spain Treaty, subject to the satisfaction of any conditions specified in the relevant treaty, including providing a certificate of tax residence duly issued by the competent US tax authorities evidencing the US Holder as resident for tax purposes in the United States within the meaning of the US-Spain Treaty (for Spanish tax purposes, such a certificate is valid for one year from the date it is issued). Iberdrola will levy the corresponding NRIT at such reduced rate if, before any interest is due, the US Holder provides Iberdrola with a valid certificate of tax residence issued by the competent US tax authorities.

(vi) Spanish Wealth Tax

Unless an applicable treaty for the avoidance of double taxation provides otherwise, Holders who are individuals and who hold New Iberdrola Shares and/or Loan Notes or rights attached to such New Iberdrola Shares and/or Loan Notes on 31 December of every calendar year will be liable to pay Spanish wealth tax, for such calendar year, at marginal rates varying between 0.2 per cent. and 2.5 per cent. (which will depend on the overall value of the holder's Spanish assets and rights exercisable in Spain). In the case of New Iberdrola Shares, the Spanish wealth tax will be levied on the average market value of the shares during the last quarter of such year. The Spanish Ministry of Finance will publish each year such average market value of the shares. In the case of Loan Notes, the Spanish wealth tax will be levied on the face value including any redemption or refund premium.

UK Holders will not be subject to the Spanish wealth tax.

Spain has not entered into a treaty for the avoidance of double taxation in relation to wealth tax with the United States, therefore US Holders who are individuals are subject to Spanish wealth tax in the terms described above and will be required by Spanish law to file a tax return (Form D-714) between 1 May and 30 June of each year with respect to the Spanish net wealth they held in the previous year.

(vii) Spanish Inheritance and Gift Tax

Transfers of New Iberdrola Shares or Loan Notes upon death or by gift to individuals not resident in Spain for tax purposes will be subject to Spanish inheritance and gift tax, depending on the circumstances of the beneficiary. The tax may be levied at rates ranging from 0 per cent. up to 81.6 per cent.

Generally, where the beneficiary is the spouse, child, adopted child, grandchild, parent or grandparent of the deceased, the transfer will be exempt from Spanish inheritance and gift tax, provided that the value of New Iberdrola Shares or Loan Notes, together with any other assets inherited by the beneficiary from the deceased, does not exceed 15,956. This threshold may be increased in case of certain beneficiaries under the age of 21. To the extent that the threshold is exceeded, Spanish inheritance and gift tax will be chargeable at progressive rates ranging from 7.65 per cent. to 40.8 per cent., depending on the total value of Spanish assets transferred to that beneficiary and the other Spanish assets and rights held by the beneficiary.

## Edgar Filing: - Form

A transfer of New Iberdrola Shares and/or Loan Notes by way of gift to a beneficiary who is an individual will be subject to Spanish inheritance and gift tax in the same manner as it would be if it were a transfer on death save that there are no applicable thresholds for which transfers do not attract tax for the recipient.

A beneficiary of New Iberdrola Shares and/or Loan Notes transferred on death will be required to report such transfer within six months of the date of death in accordance with the applicable formalities under Spanish law, which will involve the submission of certain documentation to the Spanish tax authorities. A recipient of New Iberdrola Shares or Loan Notes transferred by way of gift will be required to comply with similar formalities under Spanish law within one month of the date of the gift.

**Table of Contents**

Inheritance and gifts granted to Holders which are non-Spanish resident corporations are generally subject to Spanish NRIT as capital gains, without prejudice to the exemptions referred to above under paragraph 26(a)(iv) above.

(viii) Spanish Transfer Tax and VAT

Subscription, acquisition and transfers of New Iberdrola Shares and Loan Notes are exempt from Transfer Tax and Value Added Tax for holders. Additionally, no stamp duty or commercial registration duties are levied on Holders as a result of such subscription, acquisition and transfers.

**(b) United Kingdom**

The paragraphs set out below summarise the UK tax treatment of Scheme Shareholders under the Scheme. They are based on current UK legislation and an understanding of current H.M. Revenue and Customs practice as at the date of this document.

The paragraphs are intended as a general guide and apply to Scheme Shareholders who are resident and, if individuals, ordinarily resident in the UK for tax purposes (save that paragraph 26(b)(v) below also refers to US holders). They relate only to Scheme Shareholders who hold their Scheme Shares directly as an investment (other than under a personal equity plan or an individual savings account) and who are absolute beneficial owners of those Scheme Shares. These paragraphs do not deal with certain types of shareholders, such as persons holding or acquiring shares in the course of trade or by reason of employment, collective investment schemes and insurance companies.

If you are in any doubt as to your taxation position or if you are resident or otherwise subject to taxation in any jurisdiction other than the UK, you should consult an appropriate professional adviser immediately.

(i) Tax on capital gains

Liability to UK tax on capital gains will depend on the individual circumstances of Scheme Shareholders and on the form of consideration received.

United Kingdom resident shareholders are informed that an application for clearance under Section 138 of the Taxation of Chargeable Gains Act 1992 has been made and clearance has been obtained.

(a) Reclassification of Scheme Shares

## Edgar Filing: - Form

The subdivision and reclassification of the share capital of ScottishPower, whereby the ScottishPower Shares will be subdivided and reclassified into A1 Shares, A2 Shares and A3 Shares, should be regarded as a reorganisation of ScottishPower's share capital. Accordingly, Scheme Shareholders should not be treated as having disposed of their Scheme Shares and no liability to UK tax on capital gains should arise in respect of this reclassification. The A1 Shares, A2 Shares and A3 Shares should be treated as acquired for the same amount and at the same time as the Scheme Shares were acquired.

### (b) Receipt of Cash

To the extent that a Scheme Shareholder receives cash under the Scheme, this should, except to the extent referred to in the next paragraph, be treated as a disposal, or part disposal, of his Scheme Shares which may, depending on the Scheme Shareholder's individual circumstances (including the availability of exemptions or allowable losses), give rise to a liability to UK tax on capital gains.

If a Scheme Shareholder receives cash and/or Loan Notes as well as New Iberdrola Shares and the amount of cash received is small in comparison with the value of his Scheme Shares, the Scheme Shareholder should not be treated as having disposed of the shares in respect of which the cash was received. Instead the cash should be treated as a deduction from the base cost of his Scheme Shares rather than as a part disposal.

**Table of Contents**

Under current H.M. Revenue and Customs practice, any cash payment of £3,000 or less or which is five per cent. or less of the market value of a Scheme Shareholder's holding of Scheme Shares should generally be treated as small for these purposes.

Any chargeable gain on a part disposal of a holding of Scheme Shares should be computed on the basis of an apportionment of the allowable cost of the holding by reference to the market value of the holding at the time of disposal.

(c) Receipt of New Iberdrola Shares

To the extent that a Scheme Shareholder receives New Iberdrola Shares in exchange for his Scheme Shares under the Scheme and does not hold (either alone or together with persons connected with him) more than five per cent. of, or of any class of, shares in or debentures of ScottishPower, he should not be treated as having made a disposal of his Scheme Shares. Instead, the New Iberdrola Shares should be treated as the same asset as those Scheme Shares acquired at the same time and for the same consideration as those shares.

Any Scheme Shareholder who holds (either alone or together with persons connected with him) more than five per cent. of, or of any class of, shares in or debentures of ScottishPower is advised that clearance has been obtained from H.M. Revenue and Customs under Section 138 of the Taxation of Chargeable Gains Act 1992 in respect of the Offer. As a result, any such shareholder should be treated in the manner described in the preceding paragraph.

(d) Disposal of New Iberdrola Shares

A subsequent disposal of the New Iberdrola Shares may, depending on individual circumstances (including the availability of exemptions, allowable losses and double tax relief), give rise to a liability to UK tax on capital gains.

Any chargeable gain or allowable loss on a disposal of the New Iberdrola Shares should be calculated taking into account a proportion of the allowable cost to the Holder of acquiring his Scheme Shares based on an apportionment of the allowable cost of his Scheme Shares by reference to the market value of the New Iberdrola Shares and, if relevant, Loan Notes at the time of the exchange between any cash and New Iberdrola Shares and, if relevant, Loan Notes received.

To this should be added, when calculating a chargeable gain but not an allowable loss, indexation allowance on that proportion of the original allowable cost. For corporate Shareholders, this indexation allowance will be calculated by reference to the date of disposal of the New Iberdrola Shares. For individual shareholders, the indexation allowance will be applied until April 1998 with taper relief (if available) applying thereafter until disposal, depending on the number of complete years for which the ScottishPower Shares and/or New Iberdrola Shares have been held.

(e) Loan Notes

## Edgar Filing: - Form

To the extent that a Scheme Shareholder receives Loan Notes in exchange for his Scheme Shares following a valid election under the Loan Note Alternative, he should not be treated as having made a disposal of his Scheme Shares. Instead, the Loan Notes should be treated as the same asset as those Scheme Shares acquired at the same time and for the same consideration as those shares.

Any Scheme Shareholder who holds (either alone or together with persons connected with him) more than five per cent. of, or of any class of, shares in or debentures of ScottishPower is advised that clearance has been obtained from H.M. Revenue and Customs under Section 138 of the Taxation of Chargeable Gains Act 1992 in respect of the Loan Note Alternative.

(i) UK resident non-corporate Scheme Shareholders

Any gain or loss which would otherwise have arisen on a disposal of Scheme Shares by an individual shareholder should be rolled-over into the Loan Notes and the Loan Notes should be treated as the same asset as his Scheme Shares acquired at the same time and price as his Scheme Shares.

---

**Table of Contents**

A subsequent disposal or part disposal of Loan Notes (including redemption) may, depending on individual circumstances, give rise to a liability to UK taxation on chargeable gains. Any chargeable gain or allowable loss on the disposal or part disposal (including redemption) of the Loan Notes should be calculated taking into account the original cost to the holder of acquiring the relevant Scheme Shares, and (when calculating a chargeable gain but not an allowable loss) indexation allowances on that cost up to and including the month of April 1998 and thereafter any available taper relief in respect of the period from 6 April 1998 (or later acquisition date) to the date of disposal.

(ii) UK tax resident corporate Scheme Shareholders

For a Scheme Shareholder within the charge to UK corporation tax, the Loan Notes will be qualifying corporate bonds for the purposes of UK taxation on chargeable gains. Accordingly, the whole of any gain or loss which would have arisen on a disposal of Scheme Shares at market value immediately prior to the exchange of Scheme Shares for Loan Notes will be held over and deemed to accrue on a subsequent disposal or part disposal (including redemption) of the Loan Notes. No further indexation allowance will be available to a corporate Scheme Shareholder for the period during which any gain is held over in this way.

Any profit, gain or loss accruing to such a corporate Scheme Shareholder in respect of a Loan Note on a disposal (including redemption) thereof (other than the held over gain which will be dealt with as referred to above) will not give rise to a chargeable gain or, as the case may be, an allowable loss for the purpose of United Kingdom taxation of chargeable gains, but will be taxed or relieved as income.

(ii) Tax on income

(a) Special Dividend

ScottishPower will not be required to withhold tax at source when paying the Special Dividend.

An individual Scheme Shareholder who is resident in the United Kingdom (for tax purposes) and who receives the Special Dividend from ScottishPower will be entitled to a tax credit which such shareholder may set off against his total income tax liability on the dividend. The tax credit will be equal to 10 per cent. of the aggregate of the dividend and the tax credit (the **gross dividend**), which is also equal to one-ninth of the cash dividend received. A United Kingdom resident individual Scheme Shareholder who is liable to income tax at the starting or basic rate will be subject to tax on the dividend at the rate of 10 per cent. of the gross dividend, so that the tax credit will satisfy in full such shareholder's liability to income tax on the dividend. A United Kingdom resident individual Scheme Shareholder who is not liable to income tax in respect of the gross dividend will not be entitled to repayment of the tax credit. In the case of a United Kingdom resident individual Scheme Shareholder who is liable to income tax at the higher rate, the tax credit will be set against but not fully match his tax liability on the gross dividend and he will have to account for additional tax equal to 22.5 per cent. of the gross dividend (which is also equal to 25 per cent. of the cash dividend received) to the extent that the gross dividend when treated as the top slice of his income falls above the threshold for higher rate income tax.

United Kingdom resident corporate Scheme Shareholders will generally not be subject to corporation tax on the Special Dividend paid by ScottishPower. Such shareholders will not be able to claim repayment of tax credits attaching to the Special Dividend.

(b) New Iberdrola Shares

A Scheme Shareholder who becomes a holder of New Iberdrola Shares under the Offer and is resident in the United Kingdom for tax purposes or a Shareholder who is carrying on a trade, profession or vocation in the United Kingdom through a branch or agency or, in the case of a corporate Scheme Shareholder, a permanent establishment in connection with which the shares are held will generally be subject to United Kingdom income tax (at the rate of 10 per cent. in the case of a basic rate or lower rate

## Table of Contents

taxpayer and 32.5 per cent in the case of a higher rate taxpayer) or corporation tax, as the case may be, on the gross amount of any dividends paid by Iberdrola before deduction of any Spanish tax withheld (if any). UK resident Shareholders may be able to apply for a reduced rate of withholding taxes under the applicable double tax treaty (see further above). Spanish withholding tax withheld from the payment of a dividend (if any) and not recoverable from the Spanish tax authorities will generally be available as a credit against the income tax or corporation tax payable by the relevant shareholder in respect of the dividend. Special rules apply to UK resident corporate Scheme Shareholders that alone or together with their associates hold 10 per cent. or more of the voting power or 10 per cent. or more of the ordinary share capital of Iberdrola.

An individual Scheme Shareholder who is resident, but neither domiciled nor ordinarily resident, in the United Kingdom may claim to be charged United Kingdom income tax in respect of dividends paid by Iberdrola only to the extent that amounts representing such dividends are remitted or deemed to be remitted to the United Kingdom.

### (c) Loan Notes

Where the holder of the Loan Notes is an individual, the gross amount of interest paid on the Loan Notes will form part of that holder's income for the purposes of UK income tax. Accordingly, such holders will generally pay income tax on such interest: at the starting rate (currently 10 per cent.), to the extent that it is treated as falling below the individual's starting rate limit; at the lower rate (currently 20 per cent.), to the extent that it is treated as falling below the individual's basic rate limit but above the individual's starting rate limit; and at the higher rate (currently 40 per cent.), to the extent that it is treated as falling above the individual's higher rate limit.

Where the holder of the Loan Notes is a company within the charge to corporation tax, the holder will generally be subject to corporation tax in respect of interest on, and any profits and gains arising from, the Loan Notes in accordance with generally accepted accounting practice.

As stated above, interest on Loan Notes held by UK resident Scheme Shareholders without a Spanish permanent establishment may be made without any deduction of Spanish tax (see above under paragraph 26(a)(v) Taxation Spain Loan Notes ). Spanish withholding tax which is withheld from the payment of interest (if any) and not recoverable from the Spanish tax authorities will generally be available as a credit against the income tax or corporation tax payable by the relevant Loan Note holder in respect of that interest.

On a transfer of Loan Notes by an individual, the charge to UK income tax may arise under the **accrued income Scheme** in respect of interest that has accrued since the preceding interest payment date.

### (iii) Other tax matters

Special tax provisions may apply to Scheme Shareholders who have acquired or who acquire their Scheme Shares by exercising options under the ScottishPower Share Schemes, including provisions imposing a charge to income tax.

Where ScottishPower Shares are issued to Convertible Bondholders upon exercise of Conversion Rights before the Reorganisation Record Date, the above tax treatment should apply as it does to other Scheme Shareholders. Where Convertible Bondholders exercise Conversion Rights such

## Edgar Filing: - Form

that the conversion date falls or is treated as falling after the Effective Date, this treatment should also apply, although any such Convertible Bondholder who holds (either alone or with persons connected with him) more than five per cent. of, or any class of, shares in or debentures of ScottishPower is advised that an application for clearance has not and will not be made to H.M. Revenue & Customs under Section 138 of the Taxation of Chargeable Gains Act 1992 in respect of the transfer of Scheme Shares by such shareholders in return for New Iberdrola Shares.

**Table of Contents**

ScottishPower has been advised that Section 703 of the Income and Corporation Taxes Act 1988 should not apply to the Scheme provided the relevant transactions are carried out by the relevant Scheme Shareholder for bone fide commercial reasons or in the ordinary course of making or managing investments, and that none has as their main object, or one of their main objects, to enable tax advantages to be obtained.

- (iv) Stamp Duty and stamp duty reserve tax ( **SDRT** )

No stamp duty or SDRT will generally be payable by Scheme Shareholders as a result of accepting the Offer.

- (v) US Holders

- (a) Tax on capital gains

Scheme Shareholders who are US holders (as defined in paragraph 26(c)(i) below) and who are not resident or ordinarily resident in the UK for the purposes of UK taxation and who do not carry on a trade in the UK through a branch or agency or, in the case of a corporate US holder, a permanent establishment will not be liable to UK taxation on chargeable gains in respect of the reclassification of the share capital of ScottishPower, or the receipt of cash or New Iberdrola Shares under the Scheme, or the subsequent disposal of New Iberdrola Shares.

- (b) Tax on income

Scheme Shareholders who are US holders (as defined in paragraph 26(c)(i) below) will not be subject to any UK withholding tax or deduction of tax at source in respect of the Special Dividend.

- (c) **United States**

**United States Internal Revenue Service Circular 230 Notice: To ensure compliance with Internal Revenue Service Circular 230, ScottishPower Shareholders and ScottishPower ADS Holders are hereby notified that: (a) any discussion of US federal tax issues contained or referred to in this document or any document referred to herein is not intended or written to be used, and cannot be used by ScottishPower Shareholders and ScottishPower ADS Holders for the purpose of avoiding penalties that may be imposed on them under the US Internal Revenue Code; (b) such discussion is written for use in connection with the promotion or marketing of the transactions or matters addressed herein; and (c) ScottishPower Shareholders and ScottishPower ADS Holders should seek advice based on their particular circumstances from an independent tax adviser.**

- (i) General

## Edgar Filing: - Form

This section describes the material US federal income tax consequences for US holders (as defined below) of the receipt and ownership of cash, New Iberdrola Shares or Iberdrola ADSs, or a combination of cash and New Iberdrola Shares, or a combination of cash and Iberdrola ADSs pursuant to the Offer. This section applies only to US holders that hold ScottishPower Shares or ScottishPower ADSs as capital assets, and prospective US holders of New Iberdrola Shares or Iberdrola ADSs that acquire New Iberdrola Shares or Iberdrola ADSs pursuant to the Offer and that will hold the New Iberdrola Shares or Iberdrola ADSs as capital assets. This section does not apply to special classes of US holders such as dealers in securities or currencies, holders with a functional currency other than the US Dollar, tax-exempt organisations, financial institutions, life insurance companies, holders liable for the alternative minimum tax, securities traders electing to account for their investment in ScottishPower Shares, ScottishPower ADSs, New Iberdrola Shares or Iberdrola ADSs on a mark-to-market basis, persons holding ScottishPower Shares, ScottishPower ADSs, New Iberdrola Shares or Iberdrola ADSs in a hedging transaction or as part of a straddle or conversion transaction, persons holding ScottishPower Shares, ScottishPower ADSs, New Iberdrola Shares or Iberdrola ADSs through a permanent establishment in the United Kingdom or Spain, or as business assets for which a permanent representative has been appointed in the United Kingdom or Spain, persons that acquired or acquire their ScottishPower ADSs, ScottishPower Shares, New Iberdrola Shares or Iberdrola ADSs, as applicable, pursuant to the exercise of any employee share option or otherwise as consideration and any person that acquired ScottishPower Shares upon the exercise of Convertible Bonds, and any persons that own actually or constructively 10 per cent. or more of the outstanding voting shares of ScottishPower or Iberdrola. In addition, this discussion does not address any tax consequences applicable to US holders who hold Iberdrola CDIs.

---

## **Table of Contents**

This section is based on the Internal Revenue Code of 1986, as amended, (the **Code** ), its legislative history, existing and proposed regulations, published rulings and court decisions all as currently in effect. These laws are subject to change, possibly on a retroactive basis. In addition, this section is based in part upon the representations of the ScottishPower Depositary and the assumption that each obligation in the ScottishPower Deposit Agreement and any related agreement has been and will be performed in accordance with its terms.

For purposes of this discussion, a **US holder** is a beneficial owner of ScottishPower Shares or ScottishPower ADSs or New Iberdrola Shares or Iberdrola ADSs acquired pursuant to the Offer that is for US federal income tax purposes (i) an individual who is a citizen or resident of the United States of America, (ii) a domestic corporation, (iii) an estate the income of which is subject to regular US federal income taxation regardless of its source, or (iv) a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more US persons has the authority to control all substantial decisions of that trust or the trust has a valid election in effect under applicable regulations to be treated as a US person.

If a partnership holds ScottishPower Shares, ScottishPower ADSs, New Iberdrola Shares or Iberdrola ADSs, the tax treatment of each partner will generally depend on the status of the partner and the activities of the partnership. Partners of a partnership holding ScottishPower Shares, ScottishPower ADSs, New Iberdrola Shares or Iberdrola ADSs should consult an independent tax adviser.

US holders should consult an independent tax adviser regarding the US federal, state and local, United Kingdom, Spanish and other tax consequences of exchanging ScottishPower Shares or ScottishPower ADSs and of owning and disposing of New Iberdrola Shares.

In general, and taking into account the earlier assumptions, for US federal income tax purposes, ScottishPower ADS Holders will be treated as the owner of the ScottishPower Shares represented by those ScottishPower ADSs, and Iberdrola ADS Holders should be treated as the owner of the New Iberdrola Shares represented by those Iberdrola ADSs.

### (ii) US Federal Income Tax Consequences of the Proposed Transaction

ScottishPower believes that it is not now, and this discussion assumes that ScottishPower is not now, and has not been at any time, a passive foreign investment company.

If US holders exchange their ScottishPower Shares or ScottishPower ADSs for cash, New Iberdrola Shares or Iberdrola ADSs, or a combination of cash and New Iberdrola Shares, or a combination of cash and Iberdrola ADSs pursuant to the proposed transaction, they will recognise capital gain or loss equal to the difference between:

- (a) the sum of (A) the fair market value (generally determined in US Dollars on the date of exchange) of the New Iberdrola Shares and Iberdrola ADSs received by the US holder and (B) the value (in US Dollars generally determined on the date of the exchange) of US or foreign currency received under the Offer; and
- (b) their tax basis, determined in US Dollars, in their ScottishPower Shares or ScottishPower ADSs, which is generally equal to the cost (in US Dollars) of the acquisition of the ScottishPower Shares or ScottishPower ADSs.

## Edgar Filing: - Form

Gain or loss will be long-term capital gain or loss if, at the time of the exchange, the holding period for ScottishPower Shares or ScottishPower ADSs exceeds one year. Currently, long-term capital gain of a non-corporate US holder is generally taxed at a maximum rate of 15 per cent. The deductibility of capital losses is subject to limitations. Any gain or loss generally will be treated as US source income or loss for foreign tax credit limitation purposes.

The tax basis in New Iberdrola Shares and Iberdrola ADSs received pursuant to the Offer will be the fair market value (in US Dollars) of those New Iberdrola Shares and Iberdrola ADSs on the date US holders receive them. The holding period for New Iberdrola Shares and Iberdrola ADSs received pursuant to the proposed transaction will begin on the day after receipt of such shares and ADSs.

**Table of Contents**

(iii) Loan Notes

The Loan Note Alternative will not be available to Excluded Overseas Persons or ScottishPower ADS Holders. The Loan Note Alternative would result in a taxable exchange of ScottishPower Shares or ScottishPower ADSs for Loan Notes for US federal income tax purposes, and therefore the Loan Note Alternative does not provide to US holders the same tax advantages that the Loan Note Alternative provides to UK taxpayers.

(iv) Taxation of the Special Dividend

ScottishPower believes that the Special Dividend should be treated as a dividend for US federal income tax purposes because it is to be paid by ScottishPower from its cash on hand and not from debt that would be repaid by Iberdrola. It is possible, however, that the Special Dividend could be considered part of the purchase price and taxed according to the principles discussed above in paragraph 26(c)(ii).

Under the US federal income tax laws, and assuming that ScottishPower is not and has not been a passive foreign investment company ( **PFIC** ), the gross amount of any dividend that is paid in respect of ScottishPower Shares or ScottishPower ADSs out of ScottishPower's current or accumulated earnings and profits (as determined for US federal income tax purposes) is subject to US federal income taxation. Dividends paid to non-corporate US holders in taxable years beginning before 1 January 2011 that constitute qualified dividend income will be taxable at a maximum tax rate of 15 per cent., provided that such non-corporate US holders hold the ScottishPower Shares or ScottishPower ADSs for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date and meet other holding period requirements. Provided that ScottishPower is not (and was not in 2006) a PFIC, dividends paid with respect to ScottishPower Shares or ScottishPower ADSs generally will be qualified dividend income.

US holders must include any foreign tax withheld from the dividend payment in determining the amount of dividend income even though they do not in fact receive it. The dividend will not be eligible for the dividends-received deduction generally allowed to US corporations in respect of dividends received from other US corporations. If a dividend is not paid in US Dollars, the amount of the dividend distribution that they must include in their income as a US holder will be the US Dollar value of the Sterling payments made, determined at the spot Sterling/US Dollar rate on the date the dividend distribution is includible in their income, regardless of whether the payment is in fact converted into US Dollars. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date they include the dividend payment in income to the date they convert the payment into US Dollars will be treated as ordinary income or loss and will not be eligible for the special tax rate applicable to qualified dividend income. The gain or loss generally will be income or loss from sources within the United States for foreign tax credit limitation purposes. Distributions in excess of current and accumulated earnings and profits, as determined for US federal income tax purposes, will be treated as a non-taxable return of capital to the extent of their basis in the ScottishPower Shares or ScottishPower ADSs and thereafter as capital gain.

Dividends will be income from sources outside the United States, and will, depending on a US holder's individual circumstances, be passive or general income which, in either case, is treated separately from other types of income for purposes of computing the foreign tax credit allowable.

(v) Consequences of Holding New Iberdrola Shares

## Edgar Filing: - Form

The Iberdrola Depositary Agreement and ancillary arrangements between Iberdrola and its depositary for the Iberdrola ADR Facility have not yet been signed. We assume that these will reflect standard market practice and in particular will not allow pre-cancellation or pre-release of ADSs in a manner that would adversely affect the US federal tax conclusions expressed below. In general, and taking into account this assumption, for US federal income tax purposes, Iberdrola ADS Holders will be treated as the owner of the Iberdrola Shares represented by those Iberdrola ADSs. If this assumption turns out to be incorrect, holders of Iberdrola ADSs may not be treated as described and should consult their own tax adviser regarding the possible US federal income tax treatment of their Iberdrola ADSs.

---

**Table of Contents**

*Dividends Received on New Iberdrola Shares or Iberdrola ADSs*

Under the US federal income tax laws, and subject to the PFIC rules discussed below, the gross amount of any dividend that is paid in respect of New Iberdrola Shares or Iberdrola ADSs out of Iberdrola's current or accumulated earnings and profits (as determined for US federal income tax purposes) is subject to US federal income taxation. Dividends paid to non-corporate US holders in taxable years beginning before 1 January 2011 that constitute qualified dividend income will be taxable at a maximum tax rate of 15 per cent, provided that such non-corporate US holders hold the New Iberdrola Shares or Iberdrola ADSs for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date and meet other holding period requirements. Provided that Iberdrola is not (and was not in 2006) a PFIC, as discussed below, and the holding period requirements discussed above are met and assuming that Iberdrola continues to be eligible for the benefits of the US-Spain treaty, dividends paid to a US holder with respect to New Iberdrola Shares or Iberdrola ADSs generally will be qualified dividend income.

US holders must include any foreign tax withheld from the dividend payment in determining the amount of dividend income even though they do not actually receive it. The dividend will not be eligible for the dividends-received deduction generally allowed to US corporations in respect of dividends received from other US corporations. If a dividend is not paid in US Dollars, the amount of the dividend distribution that non-corporate US holders must include in their income as a US holder will be the US Dollar value of the Euro payments made, determined at the spot Euro/US Dollar rate on the date the dividend distribution is includible in their income, regardless of whether the payment is in fact converted into US Dollars. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date non-corporate US holders include the dividend payment in income to the date they convert the payment into US Dollars will be treated as ordinary income or loss and will not be eligible for the special tax rate applicable to qualified dividend income. The gain or loss generally will be income or loss from sources within the United States for foreign tax credit limitation purposes. Distributions in excess of current and accumulated earnings and profits, as determined for US federal income tax purposes, will be treated as a non-taxable return of capital to the extent of their basis in the New Iberdrola Shares or Iberdrola ADSs and thereafter as capital gain.

Subject to certain limitations, any Spanish tax withheld and paid over to the Kingdom of Spain will be creditable against a US holder's US federal income tax liability. Special rules apply in determining the foreign tax credit limitation with respect to dividends that are subject to the maximum 15 per cent. tax rate. To the extent that a refund of the tax withheld is available under Spanish law or the US-Spain treaty (please see paragraph 26(a)(iii)(b)), the amount of tax withheld that is refundable will not be eligible for credit against such US holder's US federal income tax liability.

Dividends will be income from sources outside the United States, and will, depending on a US holder's individual circumstances, be passive or general income which, in either case, is treated separately from other types of income for purposes of computing the foreign tax credit allowable.

*Ownership and Disposal of New Iberdrola Shares or Iberdrola ADSs*

Subject to the PFIC rules discussed below, if US holders sell or otherwise dispose of their New Iberdrola Shares or Iberdrola ADSs, they will recognise a capital gain or loss for US federal income tax purposes equal to the difference between the US Dollar value of the amount that they realise and their tax basis, determined in US Dollars, in their New Iberdrola Shares or Iberdrola ADSs. The initial tax basis is determined as described above under paragraph 26(c)(ii). Capital gain of a non-corporate US holder that is recognised before 1 January 2011 is generally taxed at a maximum rate of 15 per cent. where the holder has a holding period greater than one year. The deductibility of capital losses is subject to limitations. The gain or loss will generally be income or loss from sources within the United States for foreign tax credit limitation purposes.

## Edgar Filing: - Form

US holders who are subject to Spanish capital gains tax, Spanish wealth tax or Spanish gift or inheritance tax (as described in paragraphs 26(a)(iv), 26(a)(vi) and 26(a)(vii) above) should consult their tax advisers as to the availability of and limitations upon any foreign tax credit with respect to such taxes.

---

**Table of Contents**

(vi) PFIC Rules

Iberdrola believes that neither New Iberdrola Shares nor Iberdrola ADSs should be treated as stock of a PFIC for US federal income tax purposes, but this conclusion is a factual determination that is made annually and thus may be subject to change.

If Iberdrola were to be treated as a PFIC, gain realised on the sale or other disposition of New Iberdrola Shares or Iberdrola ADSs would in general not be treated as capital gain. Instead unless the New Iberdrola Shares or Iberdrola ADSs were eligible for the mark-to-market election under the PFIC provisions of the Code and US holders make such an election, they would be treated as if they had realised such gain and certain excess distributions ratably over their holding period for the New Iberdrola Shares or Iberdrola ADSs. Such amount allocated to the current year and any year prior to the first year in which Iberdrola was a PFIC would be treated as ordinary income, and such amount allocated to the other years in the holding period would be taxed at the highest tax rate in effect for each such year to which the gain was allocated, together with an interest charge in respect of the tax attributable to each such year. With certain exceptions, a US holder's New Iberdrola Shares or Iberdrola ADSs will be treated as stock in a PFIC if Iberdrola were a PFIC at any time during such US holder's holding period in its New Iberdrola Shares or Iberdrola ADSs. Dividends that US holders receive from Iberdrola will not be eligible for the special tax rates applicable to qualified dividend income if Iberdrola is treated as a PFIC either in the taxable year of the distribution or the preceding taxable year, but instead will be taxable at rates applicable to ordinary income.

*Backup Withholding and Information Reporting*

For non-corporate US holders, information reporting requirements on Internal Revenue Service Form 1099 will generally apply to (i) the receipt of New Iberdrola Shares or Iberdrola ADSs and any cash in exchange for ScottishPower Shares or ScottishPower ADSs effected at a US office of a broker, (ii) dividend payments or other taxable distributions made in respect of ScottishPower Shares, ScottishPower ADSs, New Iberdrola Shares or Iberdrola ADSs within the United States, and (iii) the payment of proceeds from the sale of New Iberdrola Shares or Iberdrola ADSs effected at a US office of a broker.

Additionally, backup withholding may apply to such payments if a non-corporate US holder (i) fails to provide an accurate taxpayer identification number, (ii) is notified by the US Internal Revenue Service that it has failed to report all interest and dividends required to be shown on its federal income tax returns, or (iii) in certain circumstances, fails to comply with applicable certification requirements.

An exchange of ScottishPower Shares or ScottishPower ADSs for cash, New Iberdrola Shares or Iberdrola ADSs, or a sale of New Iberdrola Shares or Iberdrola ADSs, that is effected at a foreign office of a broker will be subject to information reporting if the broker is (i) a US person, (ii) a controlled foreign corporation for US tax purposes, (iii) a foreign person 50 per cent. or more of whose gross income is effectively connected with the conduct of a US trade or business for a specified three-year period, or (iv) a foreign partnership, if at any time during its tax year (A) one or more of its partners are US persons, as defined in US Treasury regulations, who in the aggregate hold more than 50 per cent. of the income or capital interest in the partnership, or (B) such foreign partnership is engaged in the conduct of a US trade or business, unless the US holder establishes an exemption. Backup withholding will apply if the exchange or sale is subject to information reporting and the US holder fails to establish an exemption from such backup withholding.

A US holder may generally obtain a refund of any amounts withheld under the backup withholding rules that exceed its income tax liability by filing a refund claim with the US Internal Revenue Service.

**27 Overseas Shareholders**

**(a) General**

The availability of the Scheme and the Offer (including the right to make an election under the Mix and Match Facility and the Loan Note Alternative) to Overseas Shareholders may be affected by the laws of the relevant jurisdictions. Overseas Shareholders should inform themselves about and observe any applicable legal requirements. It is the responsibility of all Overseas Shareholders to satisfy themselves as to the full observance of the laws of the relevant jurisdiction in connection therewith, including the

## **Table of Contents**

obtaining of any governmental, exchange control or other consents which may be required, or the compliance with other necessary formalities which are required to be observed and the payment of any issue, transfer or other taxes due in such jurisdiction.

In the event that the law or regulation of a country or territory or its internal states or other governmental subdivisions outside the United Kingdom may preclude the allotment or issue to any person of Iberdrola Shares or Iberdrola ADSs or may preclude the same except after compliance by ScottishPower or Iberdrola (as the case may be) with any governmental or other consent or any registration, filing or other formality with which ScottishPower or Iberdrola (as the case may be) is unable to comply or which Iberdrola regards as onerous, then Iberdrola may in its sole discretion elect to allot or sell such Iberdrola Shares to a third party and remit the proceeds (net of expenses) to such person.

### **(b) US Securities Laws**

The New Iberdrola Shares and Iberdrola ADSs to be distributed by ScottishPower pursuant to the Scheme will be distributed pursuant to exemptions from, or in transactions not subject to, the registration requirements of the Securities Act, including the exemption provided by Section 3(a)(10) thereof, and have not been and will not be registered under the Securities Act or the securities laws of any state of the United States.

For the purpose of establishing the exemption from the registration requirements of the Securities Act provided by Section 3(a)(10) thereof, ScottishPower will advise the Court that its sanctioning of the Scheme will be relied upon by Iberdrola for such purpose as an approval of the Scheme following a hearing on the fairness of the terms and conditions of the Scheme to ScottishPower Shareholders, at which hearing all such ScottishPower Shareholders are entitled to attend in person or through counsel to support or oppose the sanctioning of the Scheme and with respect to which adequate notification has been given to all such holders.

The Loan Notes to be issued pursuant to the Loan Note Alternative have not been, and will not be, listed on any stock exchange and have not been, and will not be, registered under the US Securities Act or under the securities laws of any state or other jurisdiction of the United States.

Please see paragraph 5 of this Part 4 of this document for further detailed information in respect of the Loan Note Alternative.

## **28 Helplines**

**If you are a ScottishPower Shareholder and have any questions relating to this document or the completion and return of the Forms of Proxy, Form of Election or the Dealing Facility Instruction Forms, please call Lloyds TSB Registrars, from 8.30 a.m. to 5.30 p.m. (London time) Monday to Friday, on Freefone 0800 023 2559 or, if calling from outside the United Kingdom, on +44 1903 276326.**

**If you are a ScottishPower ADS Holder and have questions relating to ScottishPower ADSs, the ADS Voting Instruction Card or the ADS Letter of Transmittal and Election Form, please call Georgeson Shareholder Communications on +1 212 440 9800 (if you hold ScottishPower ADSs in your capacity as a custodian or nominee) between 9.00 a.m. and 5.00 p.m. (New York time) Monday to Friday or on +1 800 657 4988 (for all other ScottishPower ADS Holders, including retail ScottishPower ADS Holders) between 9.00 a.m. and 11.00**

## Edgar Filing: - Form

**p.m. (New York time) Monday to Friday. The second number is toll free if called within the United States.**

**The helplines cannot provide advice on the merits of the Scheme or the Offer or give any financial or tax advice. Please note that calls to these numbers may be monitored or recorded.**

### **29 Action to be Taken**

Your attention is drawn to paragraph 7 of the letter from the chairman of ScottishPower set out in Part 1 and Part 3 of this document, which explains the action you should take in relation to the Scheme.

**Table of Contents**

**30 Further Information**

The terms of the Scheme are set out in full in Part 14 of this document. Your attention is also drawn to the further information contained in this document and, in particular, to Part 5, Part 6, Part 7 and Part 10 of this document, which form part of this Explanatory Statement.

Yours faithfully

for and on behalf of

Morgan Stanley & Co. Limited

Table of Contents

**APPENDIX A TO PART 4**

**SUBSCRIPTION AGREEMENT**

**FORM OF SHARE SUBSCRIPTION AGREEMENT**

74

**Table of Contents**

In [•], on [•] 2007

**THE PARTIES**

I. On the one side, Iberdrola, S.A., incorporated under the laws of the Kingdom of Spain, with registered office in Bilbao (Spain), calle Gardoqui 8, and with tax identification number (CIF) A-48.010.615 ( **Iberdrola** ).

Iberdrola is duly represented by [Mr./Ms.] [•], in [his/her] capacity as [•].

II. On the other side, the ScottishPower Shareholders (as defined in Clause 1 below).

The ScottishPower Shareholders are duly represented by [Mr./Ms.] [•], appointed pursuant to and upon the Scheme (as defined in Clause 1) becoming effective in accordance with Paragraph 7 of the Scheme.

III. On the third side, EC Nominees Limited ( **EC Nominees** ), a member of the Euroclear Group incorporated in England and Wales with registered number 2020401 and having its registered office at 2 Lambs Passage, London EC1Y 8BB.

EC Nominees is duly represented by [Mr./Ms.] [•], [duly empowered in [his/her] condition of [•] of EC Nominees].

**WHEREAS**

I. Iberdrola and ScottishPower (as defined in Clause 1 below) have reached an agreement on the terms of a recommended acquisition by Iberdrola of ScottishPower, which is to be implemented by way of the Scheme (as defined in Clause 1 below).

II. In a general shareholders meeting held on 29 March 2007, Iberdrola has approved the issuance of the New Iberdrola Shares (as defined in Clause 1 below), which are to be issued and allotted to EC Nominees on behalf of the ScottishPower Shareholders through the procedure established herein. The issuance of the New Iberdrola Shares has been verified by the Spanish Comisión Nacional del Mercado de Valores and has received all applicable regulatory approvals and clearances.

III. In accordance with paragraph 7 of the Scheme, [Mr./Ms.] [•] has been appointed to execute this Subscription Agreement (governed by Spanish law) for the New Iberdrola Shares (as defined in Clause 1 below) on behalf of the ScottishPower Shareholders.

IV. The Scheme has been fully implemented on the date hereof.

Now, therefore, Iberdrola, the ScottishPower Shareholders and EC Nominees enter into this Subscription Agreement, which shall be governed by the following:

**CLAUSES**

**1. Definitions**

**A2 Shares** means A2 ordinary shares of  $\frac{42}{2,907}$  pence each in the capital of ScottishPower and having the rights set out in the special resolution creating such shares;

**Act** means the Companies Act 1985 of the United Kingdom, as amended;

**Court** means the Court of Session in Edinburgh, Scotland;

**Table of Contents**

**CREST** means the relevant system to facilitate the transfer of title to shares in uncertificated form (as defined in the CREST Regulations) in respect of which CRESTCo is the Operator (as defined in the CREST Regulations);

**CRESTCo** means CRESTCo Limited;

**CREST Regulations** means the Uncertificated Securities Regulations 2001 (SI 2001 No. 3755) (as amended from time to time);

**Effective Date** means the date on which Parts 1 and 2 of the Scheme both become effective in accordance with paragraph 15 of the Scheme;

**Euroclear** means Euroclear Bank S.A./N.V., as operator of the Euroclear system;

**holder** means, in respect of A2 Shares, a registered holder thereof together with any person(s) entitled to deal therewith, including any executor, personal representative, trustee in sequestration, trustee in bankruptcy, guardian of a registered holder under the age of legal capacity, or judicial factor;

**Iberclear** means the Spanish Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A.U.;

**Iberdrola ADS** means an American depository share comprising one underlying New Iberdrola Share, and **Iberdrola ADSs** shall be construed accordingly;

**Iberdrola CDI** means a CREST depository interest representing an entitlement to a New Iberdrola Share;

**Iberdrola Depositary** means JPMorgan Chase Bank N.A.;

**New Iberdrola Shares** means the ordinary shares (*acciones ordinarias*) of 3 each in the capital of Iberdrola to be issued to ScottishPower Shareholders under the terms of the Scheme;

**New ScottishPower Shares** means the ordinary shares of <sup>42</sup>/2,907 pence each in the capital of ScottishPower to be created in accordance with the Scheme and having the rights set out in the special resolution creating such shares;

## Edgar Filing: - Form

**Reorganisation Record Time** means the reorganisation record time as defined in the scheme document dated 26 February 2007 sent to ScottishPower Shareholders;

**Scheme** means the scheme of arrangement under section 425 of the Act between ScottishPower and the ScottishPower Shareholders subject to any modification, addition or condition agreed by Iberdrola and ScottishPower and which is approved or imposed by the Court and agreed to by ScottishPower and Iberdrola;

**ScottishPower** means Scottish Power plc, incorporated in Scotland with registered number SC193794 and having its registered office at 1 Atlantic Quay, Robertson Street, Glasgow G2 8SP, Scotland;

**ScottishPower ADS** means an American depositary share comprising four underlying ScottishPower Shares and **ScottishPower ADSs** shall be construed accordingly;

**ScottishPower Deposit Agreement** means the amended and restated deposit agreement between ScottishPower and Morgan Guarantee Trust Company of New York, as depositary, and the holders from time to time of the American depositary shares thereunder, including the form of American depositary shares as filed on Form F-6 with the SEC on 24 April 2001;

## **Table of Contents**

**ScottishPower Depository** means JPMorgan Chase Bank N.A. or any successor thereto under the ScottishPower Deposit Agreement;

**ScottishPower Shareholder** means a holder of A2 Shares at the Reorganisation Record Time and **ScottishPower Shareholders** shall be construed accordingly;

**ScottishPower Shares** means the ordinary shares of 42 pence each in the capital of ScottishPower;

**Spanish Corporate Act** means *Real Decreto Legislativo 1564/1989, de 22 de diciembre, por el que se aprueba el texto refundido de la ley de sociedades anónimas*; and

**Subscription Agreement** means this agreement.

## **2. Subscription**

EC Nominees hereby subscribes, on behalf of the ScottishPower Shareholders, for 100% of the New Iberdrola Shares and Iberdrola hereby agrees to issue such New Iberdrola Shares.

## **3. Consideration**

The ScottishPower Shareholders, Iberdrola and EC Nominees agree that the cancellation of the A2 Shares on terms that the reserves arising on cancellation of such shares is fully applied in paying up the New ScottishPower Shares issued to Iberdrola satisfies the consideration for the New Iberdrola Shares, as approved by the general shareholders' meeting of Iberdrola held on 29 March 2007, in connection with: (i) the report drafted by the Board of Directors of Iberdrola on the capital stock increase with contribution in kind and exclusion of pre-emptive rights, issued pursuant to articles 144, 152, 155.1 and 159 of the Spanish Corporate Act; (ii) the independent expert's report on the valuation of the ScottishPower Shares, issued pursuant to article 38 of the Spanish Corporate Act; and (iii) the independent auditor's report on the exclusion of the pre-emptive rights, issued pursuant to article 159 of the Spanish Corporate Act.

## **4. Execution of Iberdrola Share Capital Increase**

Iberdrola will issue and allocate the New Iberdrola Shares to EC Nominees on behalf of the ScottishPower Shareholders on the date hereof immediately after signing of this Subscription Agreement.

## **5. Settlement**

## Edgar Filing: - Form

In respect of the issuance and allocation to EC Nominees of the New Iberdrola Shares, EC Nominees will be registered with Santander Central Hispano Investment, S.A. ( **SCHI** ), as participating entity of Iberclear, as the holder of the New Iberdrola Shares. EC Nominees shall (i) direct SCHI that the Iberdrola Depositary be registered with SCHI as the holder of the number of New Iberdrola Shares to which the ScottishPower Depositary is entitled under the Scheme in order for the Iberdrola Depositary to issue such number of Iberdrola ADSs to which holders of ScottishPower ADSs are entitled, and (ii) hold the interest in the remaining New Iberdrola Shares issued to EC Nominees on the date hereof on trust (as bare trustee under English law) for Euroclear, which shall credit that interest for the account of CREST Depositary Limited's nominee, CREST International Nominees (Belgium) Limited, in Euroclear so that the ScottishPower Shareholders receive entitlements in respect of the New Iberdrola Shares through Iberdrola CDIs issued by CREST Depositary Limited, which will hold said interest in the New Iberdrola Shares in accordance with the CREST International Manual and as bare trustee for such ScottishPower Shareholders under English law, all in accordance with the arrangements referred to in paragraph 19 of Part 4 of the document sent to ScottishPower Shareholders.

**Table of Contents**

**6. Governing Law**

This Subscription Agreement shall be governed by Spanish law.

**7. Jurisdiction**

The Scottish Courts shall have exclusive jurisdiction in relation to any dispute arising in respect of this Subscription Agreement.

**8. Notices**

Any notice or other communication, whether required or permitted to be given hereunder, shall be given in writing and shall be deemed to have been duly given if delivered by hand against receipt of the addressees, or if transmitted by fax or sent by prepaid registered post addressed to the parties to whom such notice is to be given at the addresses set out for such parties herein (or such other address as such parties may from time to time designate in writing to the other parties hereto in accordance with the provisions of this Clause). Any such notice shall be deemed to have been duly given if delivered at the time of delivery, if transmitted by fax at the time of termination of the transmission and if sent by prepaid registered post as aforesaid 48 hours after the same shall have been posted.

The addresses and contact details where notices shall be served by the parties are the following:

(i) Iberdrola  
[address]

Attn.: Mr./Ms. [●]

Fax no.: [●]

(ii) The ScottishPower Shareholders  
Mr./Ms. [●]

[address]

Fax no.: [●]

(iii) EC Nominees  
Attn: Mr. Ambrose Murphy

1 Boulevard du Roi Albert II

B-1210 Brussels (Belgium)

Fax no. +32 2 224 25 68

**9. Whole Agreement**

Subject to the terms of the Scheme and the Scheme Document, this Subscription Agreement contains the whole agreement between the parties hereto relating to the subject matter of this Subscription Agreement and supersedes all previous agreements (if any) between such parties in respect of such matters and each of the parties to this Subscription Agreement acknowledges that in agreeing to enter into this Subscription Agreement it has not relied on any representations or warranties except for those contained in this Subscription Agreement.

**10. Interpretation**

Capitalised terms used herein have the respective meanings ascribed thereto in Clause 1 and elsewhere in this Subscription Agreement.

**Table of Contents**

Except as otherwise expressly provided in this Subscription Agreement or as the context otherwise requires, the following rules of interpretation apply to this Agreement: (i) the singular includes the plural and the plural includes the singular; (ii) or is used in the inclusive sense (and/or) and the words include and including shall not be deemed to be terms of limitation, but rather shall be deemed to be followed by the words without limitation ; and (iii) headings are for convenience only and shall not affect the construction or interpretation of this Subscription Agreement.

As an expression of their consent, the parties initialise every page and sign at the bottom of the three (3) copies of this Subscription Agreement, at the place and on the date indicated above.

Iberdrola, S.A.	The ScottishPower Shareholders
By [Mr./Ms.] [•]	By [Mr./Ms.] [•]
EC Nominees Limited	By
By [Mr./Ms.] [•]	[Mr./Ms.] [•]

Table of Contents

**PART 5**

**CONDITIONS TO THE SCHEME AND THE OFFER**

The Offer is conditional upon the Scheme becoming effective by 31 July 2007 or such later date as Iberdrola and ScottishPower may, with the consent of the Panel, agree and (if required) the Court may allow.

**1 Conditions of the Scheme**

The Scheme is subject to the following conditions:

- (a) the approval by a majority in number representing not less than three-fourths in value of the holders of ScottishPower Shares who are present and voting, whether in person or by proxy, at the Court Meeting(s) (or any adjournment thereof);
- (b) the ScottishPower EGM Resolution being duly passed by the requisite majority at the ScottishPower EGM (or any adjournment thereof);
- (c) the sanction of the Scheme (with or without modification (but subject to such modification being acceptable to Iberdrola and ScottishPower)) and the confirmation of the associated Capital Reduction by the Court, certified copies of the Court Orders and, in respect of the Reduction Court Order, the minute of such reduction attached thereto being delivered for registration to the Registrar of Companies and, in relation to the Capital Reduction, being registered by him;
- (d) the negotiation and filing with the CNMV of the applicable documentation relating to the issue of the New Iberdrola Shares; and
- (e) the passing at the Iberdrola Shareholders Meeting (or at any adjournment of such meeting) of such resolution or resolutions as may be necessary or desirable to approve, effect and implement the Offer and the acquisition of ScottishPower Shares pursuant to the Offer (as such resolutions may be set out in the Iberdrola Shareholder Circular, including a resolution or resolutions to increase the share capital of Iberdrola and authorise the creation and allotment of New Iberdrola Shares), the making of any offer, proposal or other arrangement to holders of options under the ScottishPower Share Option Schemes and any necessary increases of the authorised share capital of Iberdrola and allotment and issue of New Iberdrola Shares in relation thereto.

**2 Conditions of the Offer**

In addition, Iberdrola and ScottishPower have agreed that the Offer will be conditional upon the following matters and, accordingly, the necessary actions to make the Scheme effective will not be taken unless such Conditions have been satisfied or waived prior to the Scheme being sanctioned by the Court in accordance with this paragraph 2:

## Edgar Filing: - Form

- (a)
- (i) the European Commission indicating that it will not initiate proceedings under Article 6(1)(c) of Council Regulation (EC) No. 139/2004 (the **Regulation** ) in relation to the Offer or any matter arising from or relating to the Offer;
  - (ii) if the European Commission makes a referral under Article 9 of the Regulation to the competent authorities of the UK it being established, in terms reasonably satisfactory to Iberdrola, that neither the Offer nor any matter arising from or relating to the Offer will be referred to the Competition Commission;
  - (iii) if the European Commission makes a referral under Article 9 of the Regulation to the competent authorities in Spain it being established, in terms reasonably satisfactory to

---

**Table of Contents**

Iberdrola, that neither the Offer nor any matter arising from or relating to the Offer will be referred to the *Tribunal de Defensa de la Competencia* for a second phase review; and

- (iv) no member state of the European Union taking steps to protect its legitimate interests pursuant to Article 21(4) of the Regulation which could reasonably foreseeably involve the imposition of measures which would be material in the context of the Iberdrola Group;
- (b) the CNE having approved the Offer, to the extent applicable, in terms reasonably satisfactory to Iberdrola;
- (c) all consents, authorisations, orders, permits and approvals of (or registrations, declarations, notices or filings with) (hereinafter referred to as **Filings and Approvals**) any court, tribunal, arbitrator, authority, agency, commission, official or other instrumentality of the United States or any state, county, city or other political subdivision thereof (including, without limitation, the US Federal Trade Commission, the US Department of Justice, the US Treasury Department, the US Federal Energy Regulatory Commission and any state public utility commissions) (each a **US Regulatory Authority**) required in connection with the execution, delivery and performance of the Announcement and the consummation of the Offer (including, but not limited to, Filings and Approvals under the US Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, the Exon-Florio provision of the Defence Production Act of 1950, as amended by Section 5021 of the Omnibus Trade and Competitiveness Act of 1988, Sections 203, 204 and 205 of the US Federal Power Act, including implementing regulations, as amended, the Public Utility Holding Act of 2005, including implementing regulations, the Public Utility Regulatory Practices of 1978, including implementing regulations, the Omnibus Trade and Competitiveness Act of 1988 and any applicable state legislation) having been obtained or made and the expiration of all or any applicable waiting periods, including any extensions thereof, no action by the relevant regulatory authority having been reversed, stayed, enjoined, set aside, annulled or suspended, all conditions to the consummation of such transactions prescribed by law, regulation or order having been satisfied and all opportunities for rehearing and/or appeals having been exhausted, except for filings in connection with the Offer and any other documents which shall be filed after the Effective Date and except where failure to have obtained or made any such consent, authorisation, order, permit, approval, filing or registration would not be material in the context of the Wider ScottishPower Group;
- (d) no Regulatory Authority having decided to take, institute, implement or threaten any action, proceeding, suit, investigation, enquiry or reference or enacted, made or proposed and there not continuing to be outstanding any statute, regulation, notice, order or decision that would or might be reasonably expected to:
  - (i) make the Offer or the acquisition or proposed acquisition of any shares or any securities in, or control or management of, ScottishPower by Iberdrola or any member of the Wider Iberdrola Group void, unenforceable and/or illegal in any jurisdiction or directly or indirectly prohibit, restrain, prevent or otherwise restrict, materially delay or otherwise interfere with the implementation of, or impose material additional conditions or obligations with respect to, or otherwise challenge or interfere with, the Offer or the acquisition of any shares or any securities in, or control or management of, ScottishPower by any member of the Wider Iberdrola Group;
  - (ii) require, prevent or delay the divestiture (or alter the terms of any proposed divestiture) by the Wider Iberdrola Group or the Wider ScottishPower Group of all or any part of their respective businesses, assets or properties, ownership of any of their respective assets or properties or any part thereof which is material in the context of the Wider Iberdrola Group;
  - (iii) impose any limitation on, or result in any delay in, the ability of any member of the Wider Iberdrola Group to acquire or hold or exercise effectively, directly or indirectly, all or any rights of ownership of shares or other securities (or the equivalent) in, or to exercise management control over, any member of the Wider ScottishPower Group or on the ability of

---

**Table of Contents**

any member of the Wider ScottishPower Group to hold or exercise effectively, directly or indirectly, all or any rights of ownership of shares or other securities (or the equivalent) in, or to exercise management control over, any other member of the Wider ScottishPower Group in a manner which is material in the context of the Wider ScottishPower Group;

- (iv) other than in the implementation of the Offer, require any member of the Wider Iberdrola Group or of the Wider ScottishPower Group to acquire or offer to acquire any shares or other securities (or the equivalent) or interest in any member of the Wider ScottishPower Group or any member of the Wider Iberdrola Group which is material in the context of the Wider Iberdrola Group;
- (v) impose any material limitation on the ability of any member of the Wider Iberdrola Group or the Wider ScottishPower Group to integrate or co-ordinate its business, or any part of it, with the businesses or any part of the businesses of any member of the Wider Iberdrola Group and/or the Wider ScottishPower Group or conduct all or part of their respective businesses which is material in the context of the Wider ScottishPower Group; or
- (vi) otherwise adversely affect the business, assets, financial or trading position or profits or prospects of any member of the Wider Iberdrola Group or of the Wider ScottishPower Group to an extent which would be material in the context of the Wider Iberdrola Group or the Wider ScottishPower Group (as the case may be),

and all applicable waiting and other time periods during which any such Regulatory Authority could decide to take, institute, implement or threaten any such action, proceeding, suit, investigation, enquiry or reference or take any other step under the laws of any jurisdiction having expired, lapsed or been terminated;

- (e) all necessary filings, applications and/or notifications having been made and all appropriate waiting periods (including any extensions thereof) under any applicable legislation or regulation of any jurisdiction having expired, lapsed or been terminated in each case in respect of the Offer and the acquisition of any shares or other securities in, or control of, ScottishPower by Iberdrola or any member of the Wider Iberdrola Group and all authorisations, orders, grants, recognitions, confirmations, licences, consents, clearances, permissions and approvals ( **authorisations** ) necessary in any jurisdiction for or in respect of the Offer and the proposed acquisition of any shares or other securities in, or control or management of, ScottishPower by Iberdrola or any member of the Wider Iberdrola Group being obtained in terms and in a form satisfactory to Iberdrola, acting reasonably, from appropriate Regulatory Authorities or from any persons or bodies with whom any member of the Wider Iberdrola Group or the Wider ScottishPower Group has entered into contractual arrangements and such authorisations together with all authorisations necessary or appropriate for any member of the Wider ScottishPower Group to carry on its business remaining in full force and effect in each case where the absence of such authorisation would have a material adverse effect on the Wider ScottishPower Group and there being no notice or other intimation of any intention to revoke, suspend, restrict or modify or not to renew any of the same having been made and all necessary statutory or regulatory obligations in any jurisdiction having been complied with;

For the avoidance of doubt, Iberdrola acknowledges that the Offer will not be conditional upon any steps which OFGEM may or may not take prior to the Effective Date, including, but not limited to, any steps which OFGEM may take to seek modifications to any of the licences held by ScottishPower;

- (f) save as fairly disclosed to Iberdrola by or on behalf of ScottishPower or as publicly announced by ScottishPower by the delivery of an announcement to a Regulatory Information Service before 28 November 2006 or as disclosed in the Annual Report and Accounts or the US Annual Report on Form 20-F of ScottishPower for the financial year ended 31 March 2006 or in ScottishPower's financial statements for the six months ended 30 September 2006 announced on 14 November 2006 or included herein, there being no provision of any agreement, arrangement, licence, permit,

---

**Table of Contents**

franchise or other instrument to which any member of the Wider ScottishPower Group is a party or by or to which any such member or any of its assets is or may be bound, entitled or subject which, in consequence of the Offer or the acquisition or proposed acquisition by any member of the Wider Iberdrola Group of any shares or other securities in the control or management of ScottishPower, would or might result in:

- (i) any monies borrowed by or any other indebtedness (actual or contingent) of, or any grant available to, any such member of the Wider ScottishPower Group becoming repayable or capable of being declared repayable immediately or earlier than the stated repayment date or the ability of such member to borrow monies or incur any indebtedness being or becoming capable of being withdrawn or inhibited;
- (ii) the creation or enforcement of any mortgage, charge or other security interest over the whole or any part of the business, property or assets of any such member of the Wider ScottishPower Group or any such security interest (whenever arising or having arisen) becoming enforceable;
- (iii) any assets or interest of any such member of the Wider ScottishPower Group being or falling to be disposed of or charged or any right arising under which any such asset or interest could be required to be disposed of or charged;
- (iv) the interest or business of any such member of the Wider ScottishPower Group in or with any other person, firm or company (or any agreements or arrangements relating to such interest or business) being terminated or adversely affected;
- (v) any such member of the Wider ScottishPower Group ceasing to be able to carry on business under any name under which it presently does so;
- (vi) the value of any such member of the Wider ScottishPower Group or its financial or trading position or prospects being prejudiced or adversely affected;
- (vii) any such agreement, arrangement, licence, permit, franchise or other instrument or the rights, liabilities, obligations or interests of any such member being terminated or adversely modified or any onerous obligation arising or any adverse action being taken or arising thereunder; or
- (viii) the creation of any liabilities (actual or contingent) by any such member,

and which in each such case would be material in the context of the Wider ScottishPower Group, and no event having occurred which, under any provision of any agreement, arrangement, licence, permit, franchise or other instrument to which any member of the Wider ScottishPower Group is a party or by or to which any such member or any of its assets may be bound or be subject, is likely to result in any events or circumstances as are referred to in sub-paragraphs (i) to (viii) of this paragraph (f) and which in each such case would be material in the context of the Wider ScottishPower Group;

- (g) save as fairly disclosed to Iberdrola by or on behalf of ScottishPower or as publicly announced by ScottishPower by the delivery of an announcement to a Regulatory Information Service before 28 November 2006 or as disclosed in the Annual Report and Accounts or US Annual Report on Form 20-F of ScottishPower for the year ended 31 March 2006 or in ScottishPower's financial statements for the six months ended 30 September 2006 announced on 14 November 2006, no member of the Wider ScottishPower Group having since 31 March 2006:
  - (i) issued or agreed to issue or authorised the issue of additional shares or securities of any class, or securities convertible into or exchangeable for, or rights, warrants or options to subscribe for or acquire, any such shares or convertible securities;

## Edgar Filing: - Form

- (ii) save in respect of the ScottishPower B Shares, recommended, declared, paid or made any bonus, dividend or other distribution, whether payable in cash or otherwise or proposed to

---

**Table of Contents**

do any of the foregoing (other than a distribution by any wholly-owned subsidiary of ScottishPower) and save for the interim dividend of 11.4p per ScottishPower Share payable by ScottishPower to the ScottishPower Shareholders in respect of the six months ended 30 September 2006 and any final dividend in respect of the financial year ending 30 March 2007 to the extent such dividend is in the ordinary course of business and is consistent with ScottishPower's publicly announced dividend policy; provided, however, that and notwithstanding any disclosure to ScottishPower prior to the date of the Announcement, ScottishPower shall not be entitled to pay and ScottishPower Shareholders shall not be entitled to receive such final dividend in the event that the Offer becomes effective prior to 11.59 p.m. on 31 May 2007;

- (iii) implemented or authorised any merger or demerger or acquired or disposed of or transferred, mortgaged or charged, or created any other security interest over, any asset or any right, title or interest in any asset or authorised, proposed or announced its intention to propose the same in each case which is material in the context of the Wider ScottishPower Group;
- (iv) entered into, implemented or authorised any reconstruction, amalgamation, scheme or other transaction or arrangement other than transactions between wholly-owned members of the ScottishPower Group;
- (v) save in respect of the ScottishPower B Shares and the ScottishPower Deferred Shares, purchased, redeemed or repaid any of its own shares or other securities or reduced or made or authorised any other change in its share capital;
- (vi) made, proposed, authorised or announced its intention to make, propose or authorise any change in its loan capital or issued or authorised the issue of any debentures or incurred or increased any material indebtedness or become subject to any material contingent liability;
- (vii) entered into, varied or terminated, or authorised the entry into, variation or termination of, any contract, commitment or arrangement (whether in respect of capital expenditure or otherwise) which is outside the ordinary course of business or which is of a long-term, onerous or unusual nature or magnitude or which involves or could involve an obligation of a nature or magnitude which is material in the context of the Wider ScottishPower Group;
- (viii) entered into any contract, commitment or arrangement which would be restrictive on the business of any member of the Wider ScottishPower Group which is material in the context of the Wider ScottishPower Group;
- (ix) been unable, or admitted in writing that it is unable, to pay its debts or having stopped or suspended (or threatened to stop or suspend) payment of its debts generally or having entered into or taken steps to enter into a moratorium, composition, compromise or arrangement with its creditors in respect of its debts or ceased or threatened to cease carrying on all or a substantial part of its business;
- (x) taken any corporate action or (to an extent which is material in the context of the Wider ScottishPower Group) had any step, application, filing in court, notice or legal proceedings started or served or threatened against it for its winding-up (voluntary or otherwise), dissolution or reorganisation (or for any analogous proceedings or steps in any jurisdiction) or for the appointment of a receiver, administrator, administrative receiver, liquidator, trustee or similar officer (or for the appointment of any analogous person in any jurisdiction) of all or any of its assets and revenues;
- (xi) waived, compromised or settled any claim to an extent which is material in the context of the Wider ScottishPower Group;
- (xii) entered into or varied or made an offer (which remains open for acceptance) to vary the terms of any contract, commitment or arrangement with any director or senior executive of ScottishPower or changed or entered into any commitment to change the terms of any ScottishPower Share Option Schemes;



---

**Table of Contents**

- (xiii) made or consented to any change to the terms of the trust deeds constituting the pension schemes established for its directors and/or employees and/or their dependants or to the benefits which accrue, or to the pensions which are payable thereunder, or to the basis upon which qualification for or accrual or entitlement to such benefits or pensions are calculated or determined, or to the basis upon which the liabilities (including pensions) of such pension schemes are funded or made, or agreed or consented to, any change to the trustees in each case as would be material in the context of the pension schemes operated by the ScottishPower Group; or
  - (xiv) entered into any contract, commitment or arrangement or passed any resolution or made any offer (which remains open for acceptance) which is material in the context of the Wider ScottishPower Group with respect to, or proposed or announced any intention to effect or propose, any of the transactions, matters or events referred to in this condition;
- (h) since 31 March 2006 save as fairly disclosed to Iberdrola by or on behalf of ScottishPower or as publicly announced by ScottishPower by the delivery of an announcement to a Regulatory Information Service before 28 November 2006, or as disclosed in the Annual Report and Accounts or US Annual Report on Form 20-F of ScottishPower for the year ended 31 March 2006 or in ScottishPower's financial statements for the six months ended 30 September 2006 announced on 14 November 2006:
- (i) no adverse change or deterioration having occurred in the business, assets, financial or trading position or profits or prospects of any member of the Wider ScottishPower Group which in any such case is material in the context of the Wider ScottishPower Group;
  - (ii) no litigation, arbitration proceedings, prosecution or other legal proceedings having been threatened, announced, instituted or remaining outstanding by, against or in respect of any member of the Wider ScottishPower Group or to which any member of the Wider ScottishPower Group is a party (whether as claimant or defendant or otherwise) and no investigation by any Regulatory Authority or other investigative body against or in respect of any member of the Wider ScottishPower Group having been threatened, announced, instituted or remaining outstanding by, against or in respect of any member of the Wider ScottishPower Group which in any such case is material in the context of the Wider ScottishPower Group;
  - (iii) no contingent or other liability having arisen which would or might materially and adversely affect any member of the Wider ScottishPower Group taken as a whole; and
  - (iv) no steps having been taken which are likely to result in the withdrawal (without replacement), cancellation or termination of any licence, permit or consent held by any member of the Wider ScottishPower Group which is necessary for the carrying on by the ScottishPower Group of the business and is material in the context of the Wider ScottishPower Group;
- (i) save as fairly disclosed to Iberdrola by or on behalf of ScottishPower or as publicly announced by ScottishPower by the delivery of an announcement to a Regulatory Information Service before 28 November 2006, or as disclosed in the Annual Report and Accounts or US Annual Report on Form 20-F of ScottishPower for the year ended 31 March 2006 or in ScottishPower's financial statements for the six months ended 30 September 2006 announced on 14 November 2006, Iberdrola not having discovered:
- (i) that any financial, business or other information concerning the Wider ScottishPower Group publicly disclosed at any time by any member of the Wider ScottishPower Group is misleading, contains a misrepresentation of fact or omits to state a fact necessary to make the information contained therein not misleading;
  - (ii) that any member of the Wider ScottishPower Group or any partnership, company or other entity in which any member of the Wider ScottishPower Group has an interest is subject to any liability, contingent or otherwise, which is material in the context of the Wider ScottishPower Group; or

---

**Table of Contents**

- (iii) any information which affects the import of any information disclosed at any time by or on behalf of the Wider ScottishPower Group and which is material in the context of the Wider ScottishPower Group;
  
- (j) save as fairly disclosed to Iberdrola by or on behalf of ScottishPower or as publicly announced by ScottishPower by the delivery of an announcement to a Regulatory Information Service before 28 November 2006, or as disclosed in the Annual Report and Accounts or US Annual Report on Form 20-F of ScottishPower for the year ended 31 March 2006 or in ScottishPower's financial statements for the six months ended 30 September 2006 announced on 14 November 2006, Iberdrola not having discovered that:
  - (i) any past or present member of the Wider ScottishPower Group has failed to comply with any applicable legislation, regulation or common law of any jurisdiction or any notice, order or requirement of any Regulatory Authority with regard to the use, treatment, storage, handling, transport, disposal, discharge, spillage, presence, release, leak or emission of any waste or hazardous or harmful substance or any substance likely to impair the environment or harm human or animal health or otherwise relating to environmental and/or health and safety matters or that there has otherwise been any such use, treatment, storage, handling, transport, disposal, discharge, presence, spillage, release, leak or emission (whether or not the same constituted non-compliance by any person with any such legislation or regulation, and whenever the same may have taken place), any of which would be likely to give rise to any liability (whether actual or contingent) or cost on the part of any member of the Wider ScottishPower Group which would be material in the context of the Wider ScottishPower Group; or
  
  - (ii) there is or is likely to be any unplanned obligation or liability (whether actual or contingent) to make good, repair, reinstate, remediate or clean up any property now or previously owned, occupied, operated or made use of or controlled by any past or present member of the Wider ScottishPower Group or any other property or controlled water under any environmental legislation, regulation, common law, notice or circular or order of any Regulatory Authority in any jurisdiction which would be material in the context of the Wider ScottishPower Group.

Iberdrola reserves the right to waive all or any of the Conditions in paragraph 2, in whole or in part.

For the avoidance of doubt, Iberdrola will not invoke the Conditions set out in paragraphs 2(a) to (j) inclusive so as to cause the Offer to lapse or to be withdrawn unless the circumstances which give rise to the right to invoke the relevant Condition(s) are of material significance to Iberdrola in the context of the Offer or unless a failure to do so would result in Iberdrola being in breach of any Law.

If Iberdrola is required by the Panel to make an offer or offers for any ScottishPower Shares under Rule 9 of the City Code, Iberdrola may make such alterations to the above Conditions as are necessary to comply with the provisions of that Rule.

The Offer will not proceed if, before the date of the Court Meeting and the ScottishPower EGM, the European Commission initiates proceedings under Article 6(1)(c) of the Regulation in respect of the Offer or any matter arising from or relating to the Offer or, following a referral by the European Commission to a competent authority in the United Kingdom under Article 9(1) of the Regulation, the Offer or any matter arising from or relating to the Offer is referred to the Competition Commission.

Iberdrola reserves the right to elect to effect the Offer by way of a Takeover Offer, subject to the prior written consent of ScottishPower. In such event, such offer will be implemented on and subject to the same terms and conditions (subject to appropriate amendments, including (without limitation) an acceptance condition set at 90 per cent. of the ScottishPower Shares to which such offer relates (but capable of waiver in accordance with Rule 10 of the City Code) in substitution for Condition 1), so far as applicable, to those that would apply to the Scheme.



Table of Contents

**PART 6**

**FINANCIAL INFORMATION OF SCOTTISHPOWER**

**Introduction**

Section A of this Part 6 of the document sets out financial information relating to ScottishPower for the two years ended 31 March 2006. Section B of this Part 6 of the document sets out the Interim Results of ScottishPower for the six months ended 30 September 2006.

**Financial Information on ScottishPower**

The financial information set out in Section A of this Part 6 for the two years ended 31 March 2006 and 31 March 2005 has been extracted, without material adjustment, from the 2006 Annual Report & Accounts in which the financial information for the year ended 31 March 2005 was restated to comply with the International Financial Reporting Standards ( **IFRS** ) following the Group's transition from reporting under UK GAAP to reporting under IFRS from 1 April 2005. A reconciliation from UK GAAP to IFRS is provided in Note 42 of Section A.

The financial information contained in Section A of this Part 6 does not constitute the Group's full statutory financial statements within the meaning of section 240 of the Act. The Annual Report & Accounts for ScottishPower for each of the years ended 31 March 2006 and 31 March 2005 have been delivered to the Registrar of Companies pursuant to section 232 of the Act. The reports of PricewaterhouseCoopers LLP, the Company's auditors for the years ended 31 March 2006 and 31 March 2005, were unqualified and did not contain a statement under section 237 (2) or (3) of the Act.

The information set out in Section B of this Part 6 has been extracted, without material adjustment, from the unaudited Interim Report and Accounts of ScottishPower for the six months ended 30 September 2006, which was published on 14 November 2006.

References in this Part 6 to the **Group** or **group** are to the ScottishPower Group.

**Table of Contents**

**SECTION A**

**AUDITED CONSOLIDATED FINANCIAL STATEMENTS OF SCOTTISHPOWER FOR THE  
TWO YEARS ENDED 31 MARCH 2006 AND 31 MARCH 2005**

**Accounting Policies and Definitions**

**Definitions**

**Business segment definitions**

ScottishPower defines business segments for management reporting purposes based on a combination of factors, principally differences in products and services and the regulatory environment in which the businesses operate.

Business segments have been included under either continuing operations or discontinued operations as appropriate.

The business segments of the group are defined as follows:

**Continuing operations**

**United Kingdom**

**Energy Networks (formerly Infrastructure Division):** the transmission and distribution businesses within the group's authorised area of Scotland and the distribution business of Manweb operating in Merseyside and North Wales.

**Energy Retail & Wholesale (formerly UK Division):** the generation of electricity from the group's own power stations, the purchase of external supplies of coal and gas for the generation of electricity, the purchase of external supplies of electricity and gas for sale to customers together with related billing and collection activities, gas storage, the sale of gas to industrial and domestic customers, and the sale of electricity to market participants in Scotland and England & Wales, and full participation in the British Electricity Trading and Transmission Arrangements ( **BETTA** ). BETTA replaced the New Electricity Trading Arrangements ( **NETA** ) in England & Wales with effect from 1 April 2005.

**United States**

**PPM Energy:** the competitive energy development, origination and marketing business serving wholesale customers in North American markets. Electricity products and services are provided from gas generation and renewable wind generation resources located across the US. Natural gas storage and hub services are provided from gas storage facilities located in Texas, New Mexico and Alberta, Canada.

**Other**

**Unallocated:** for the purposes of segmental analysis, this comprises corporate office costs and the revenue and costs of the non-regulated businesses, previously included within the PacifiCorp segment, which were not included in the sale of PacifiCorp.

**Discontinued operations**

**United States**

**PacifiCorp:** a vertically-integrated electric utility, disposed of on 21 March 2006, that included the generation, transmission and distribution and sale of electricity to retail, industrial and commercial customers in portions of six western states: Utah, Oregon, Wyoming, Washington, Idaho and California. The operations also included wholesale sales and power purchase transactions with various entities. The state regulatory commissions and Federal Energy Regulatory Commission ( **FERC** ) regulated the retail and wholesale operations. The subsidiaries of PacifiCorp supported its electric utility operations by providing coal mining facilities and services and environmental remediation.

## **Table of Contents**

### **Revenue cost definitions**

**Cost of sales:** the direct costs of the generation and purchase of electricity and the purchase and transportation of natural gas.

**Transmission and distribution costs:** the cost of transmitting units of electricity from the power stations through the transmission and distribution networks to customers. It includes the costs of metering, billing and debt collection.

**Administrative expenses:** the indirect costs of the businesses, the costs of corporate services and property rates.

### **Other definitions**

**Company or ScottishPower:** Scottish Power plc.

**Group:** Scottish Power plc and its consolidated subsidiaries.

**Associates:** entities in which the group holds a long-term interest and over which the group has significant influence.

**Jointly controlled entities:** entities in which the group holds a long-term interest and shares control with another company external to the group.

**Subsidiaries:** entities in which the group holds a long-term controlling interest.

### **Group Accounting Policies**

The principal accounting policies applied in preparing the group's consolidated Accounts are set out below. These are arranged to broadly follow the captions as they appear in the Group Income Statement and Group Balance Sheet. The principal accounting policies comprise the following:

- A. Basis of accounting
- B. Basis of consolidation

- C. Goodwill
- D. Foreign currencies
- E. Revenue
- F. Operating profit
- G. Taxation
- H. Intangible assets (excluding goodwill)
- I. Property, plant and equipment

**Table of Contents**

- J. Cash and cash equivalents
- K. Borrowing costs
- L. Impairment of property, plant and equipment and intangible assets (excluding goodwill)
- M. Mine reclamation and closure costs
- N. Decommissioning costs
- O. Leased assets
- P. Risk and financial instruments
- Q. Financial instruments (policies applied in the comparative figures for the year ended 31 March 2005)
- R. Inventories
- S. Grants and contributions
- T. Pensions and other post-retirement benefits
- U. Share-based payment
- V. Environmental liabilities
- W. Exchange rates
- A. Basis of accounting**

The Accounts have been prepared for the first time in accordance with International Accounting Standards ( **IAS** ), International Financial Reporting Standards ( **IFRS** ) and International Financial Reporting Interpretations Committee ( **IFRIC** ) interpretations as adopted by the EU as required by Regulation (EC) No. 1606/2002 of the European Parliament and those parts of the Companies Act 1985 applicable to companies reporting under IFRS. In previous years, the Accounts were prepared in compliance with UK Generally Accepted Accounting Practice ( **UK GAAP** ) and the Companies Act 1985. This has resulted in certain changes to previously applied accounting policies. The effect of these changes in accounting policies are explained in the disclosures concerning the transition from UK GAAP to IFRS required by IFRS 1 First-time Adoption of International Financial Reporting Standards set out in Note 42 to the Accounts.

## Edgar Filing: - Form

In preparing these Accounts, the group has applied all relevant IAS, IFRS and Interpretations issued by the IFRIC which have been adopted by the EU as of the date of approval of these Accounts. The differences between IFRS as adopted by the EU and those issued by the IASB are not material to the group.

As permitted by IFRS 1, the standards relating to financial instruments, IAS 32 Financial Instruments: Disclosure and Presentation and IAS 39 Financial Instruments: Recognition and Measurement have been applied with effect from 1 April 2005. Implementation of IAS 39 resulted in an increase in equity attributable to equity holders of Scottish Power plc of £281.4 million. The group has continued to use its previous UK GAAP accounting policies, as amended by IAS 21 The Effects of Changes in Foreign Exchange Rates for financial instruments, as set out in accounting policy Q. Financial instruments below, in preparing the IFRS financial information for the year ended 31 March 2005.

The format of the Group Income Statement has been prepared in accordance with the requirements of IAS 1 and reflects the impact of the adoption of IAS 32 and IAS 39 with effect from 1 April 2005.

## **Table of Contents**

Items which are included in operating profit are classified as exceptional where the directors consider that by virtue of their nature, size or incidence it is necessary for them to be displayed as a separate line item or separately within a line item if the financial statements are to be properly understood.

In order to provide readers with a clear, consistent and more useful presentation of the group's underlying performance, profit/(loss) for the financial year has been analysed between:

- (i) profit before exceptional items and certain remeasurements; and
- (ii) the effect of exceptional items and certain remeasurements.

Included in this latter category are:

items which are included in operating profit but classified as exceptional as the directors consider that by virtue of their nature, size or incidence, it is necessary for them to be displayed as a separate line item or separately within a line item if the financial statements are to be properly understood;

fair value gains and losses on operating derivatives and financing derivatives including, for 2004/05 only, the impact on results of contracts which were previously fair valued but which are now subject to IAS 39. All of the group's treasury activities and all but an immaterial proportion of the group's energy management activities are undertaken with a view to economically hedging the group's physical and financial exposures. A number of these contracts do not qualify for own use or hedge accounting under IAS 39 and are therefore fair valued through the Group Income Statement. In addition, those contracts which do qualify for cash flow hedge accounting can have an element of hedge ineffectiveness which is recorded in the income statement. The directors consider that this accounting treatment of fair valuing economic hedges and the resulting income statement volatility does not appropriately reflect the business purpose of these contracts. In order to provide a more meaningful presentation, the fair value movements on these contracts have been separated from all other aspects of the impact of IAS 39 which remain within underlying business performance. The fair value movements on such contracts to the extent they relate to operating activities are shown separately in the line item Fair value gains on operating derivatives and, to the extent they relate to financing derivatives in the line item Fair value losses on financing derivatives ;

the reversal of the depreciation charge for PacifiCorp for the period from 24 May 2005, when it became a discontinued operation, until its date of disposal, as required by IFRS 5 Non-current Assets Held for Sale and Discontinued Operations ; and

the taxation effect of the above items.

Further analysis of the items included in the column Exceptional items and certain remeasurements is provided in Note 2 to the Accounts.

This income statement format aligns with the group's calculations of adjusted earnings per share which were previously presented in the group's quarterly Accounts in 2005/06.

## **B. Basis of consolidation**

## Edgar Filing: - Form

The group Accounts incorporate the Accounts of the company and its subsidiaries to 31 March each year. Subsidiaries are those entities over which the group has the power to govern the financial and operating policies, generally accompanying a shareholding that confers more than half of the voting rights. For commercial reasons certain subsidiaries have a different year end. The consolidation includes the Accounts of these subsidiaries as adjusted for material transactions in the period between the year ends and 31 March. The group Accounts also include the group's share of results and net assets of associates and jointly controlled entities.

## **Table of Contents**

On acquisition, the assets and liabilities of a subsidiary are measured at their fair values at the date of acquisition. The cost of an acquisition is measured at the fair value of any assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. The interest of minority shareholders is initially stated at the minority's proportion of the fair values of the assets and liabilities recognised. In accordance with the exemption permitted by IFRS 1, business combinations accounted for prior to the group's date of transition to IFRS on 1 April 2004 have not been restated to comply with IFRS 3 Business Combinations.

The results of subsidiaries acquired or disposed of during the year are included in the income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

The group Accounts include the group's share of the post-tax results and net assets of associates and jointly controlled entities using the equity method of accounting. Associates are those entities over which the group has significant influence, but not control, generally accompanying a shareholding that confers between 20% to 50% of the voting rights. Jointly controlled entities are those entities over which the group has joint control with one or more external parties and over which there has to be unanimous consent by all parties to the strategic, financial and operating decisions.

On acquisition of all or part of a minority interest in a subsidiary, the assets and liabilities being acquired are measured at book value at the date of acquisition. The excess of the fair value of the purchase consideration over the book value of the assets acquired is recorded as goodwill. The results of the subsidiary relating to the minority interest for the period up until the date of acquisition are included in the income statement as amounts attributable to minority interests.

As a result of the group's decision to sell PacifiCorp, PacifiCorp has been treated as a disposal group held for sale and a discontinued operation in accordance with IFRS 5. As a consequence of the classification as a discontinued operation, the net profit of PacifiCorp has been shown in a single line Profit/(loss) for the year from discontinued operations, in the income statement.

The results of discontinued operations include the UK/US interest rate differential benefit, the loss following de-designation of net investment hedges arising from the group's US dollar hedging programme relating to PacifiCorp's net assets and the impact of the US dollar earnings hedges relating to the results of PacifiCorp. This programme terminated following completion of the sale of PacifiCorp.

### **C. Goodwill**

Goodwill represents the excess of the fair value of the purchase consideration over the group's share of the fair value of the identifiable assets and liabilities of an acquired subsidiary, associate, jointly controlled entity or business at the date of acquisition.

Goodwill is recognised as an asset and reviewed for impairment at least annually and whenever there is an indication of impairment. Goodwill is carried at cost less amortisation charged prior to the group's transition to IFRS on 1 April 2004 less accumulated impairment losses. Any impairment is recognised in the period in which it is identified.

## Edgar Filing: - Form

On disposal of a subsidiary, associate, jointly controlled entity or business, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Goodwill arising on acquisitions after 31 March 1998 but prior to the group's date of transition to IFRS, 1 April 2004, has been retained as an asset at the previous UK GAAP amounts as at that date. As required by IFRS 1, this goodwill was reviewed for impairment as at the date of transition to IFRS.

## **Table of Contents**

Goodwill arising on acquisitions prior to 1 April 1998 was written off against reserves. It has not been reinstated as an asset on transition to IFRS as permitted by IFRS 1 and will not be included in determining any subsequent profit or loss on disposal. Further details of goodwill written off to reserves are set out in Note 33 to the Accounts.

### **D. Foreign currencies**

Transactions undertaken by each of the group's entities are measured using the currency of the primary economic environment in which the entity operates (functional currency) and foreign currency items are translated into the functional currency at the spot rate at the date of the transaction. The group's consolidated Accounts are presented in sterling, which is the group's presentational currency.

The results and cash flows of overseas subsidiaries are translated to sterling at the average rate of exchange for each quarter of the financial year. The net assets of such subsidiaries and the goodwill arising on their acquisition are translated to sterling at the closing rates of exchange ruling at the balance sheet date.

Exchange differences which relate to the translation of overseas operations and foreign currency borrowings and changes in fair value of derivatives to the extent that they are effective net investment hedges are taken directly to the group's translation reserve and are shown in the statement of recognised income and expense. Upon disposal of the related operation, such translation differences are recognised as income or as expense in the period of disposal.

Cumulative translation differences in respect of the period prior to the group's date of transition to IFRS, 1 April 2004, have been transferred to the translation reserve, as required by IAS 21. These amounts will be included in the determination of any future gain or loss on disposal of the related operations.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate of exchange.

### **E. Revenue**

Revenue comprises the contracted sales value of energy, goods and other services supplied to customers during the year and excludes Value Added Tax and intra-group sales. Revenue from the sale of energy is the value of units supplied during the year and includes an estimate of the value of units supplied to customers between the date of their last meter reading and the year end, based on external data supplied by the electricity and gas market settlement processes.

### **F. Operating profit**

## Edgar Filing: - Form

The group's share of the post-tax results of associates and jointly controlled entities is included within operating profit as the operations are closely related to those of the parent and other subsidiaries.

### **G. Taxation**

The group's liability for current tax is calculated using the tax rates that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on the difference between the carrying amounts of assets and liabilities in the balance sheet and the corresponding tax bases used in the computation of taxable profits (temporary differences), and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profit will be available against which deductible temporary differences can be utilised.

**Table of Contents**

Deferred tax is calculated at the tax rates that are expected to apply in the period in which the liability is settled or the asset is realised, on a non-discounted basis, and is charged in the income statement, except where it relates to items charged or credited to equity (via the statement of recognised income and expense), in which case the deferred tax is also dealt with in equity and is shown in the statement of recognised income and expense.

**H. Intangible assets (excluding goodwill)****H1. Computer software costs**

The costs of acquired computer software are capitalised on the basis of the costs incurred to acquire and bring to use the specific software and are amortised on a straight-line basis over their operational lives. Costs directly associated with the development of computer software programmes that will probably generate economic benefits over a period in excess of one year are capitalised and amortised over their estimated operational lives. Costs include employee costs relating to software development and an appropriate proportion of relevant overheads directly attributable to bringing the software into use.

**H2. Hydro relicensing costs**

Costs relating to the relicensing of the group's hydroelectric plants were capitalised and amortised, generally on a straight-line basis, over the period of the licence. This policy applied to PacifiCorp, the group's former regulated US business.

**H3. Emissions allowances**

The group participates in the EU Emissions Trading Scheme. Purchased emissions allowances are initially recognised at cost (purchase price) within intangible assets. Allocated allowances awarded to the group by the government or a similar body are recorded at nominal value (nil value). The group recognises liabilities in respect of its obligations to deliver emissions allowances to the extent that the allowances to be delivered exceed allocated allowances. Any liabilities recognised are measured based on the cost of allowances purchased up to the level of purchased allowances held and thereafter at the market price of allowances at the balance sheet date.

The allowances held within intangible assets may be surrendered at the end of each compliance period reflecting the consumption of economic benefit. As a result, no amortisation is recorded during the period.

The main amortisation periods used by the group are set out below.

	Years
Computer software costs	3 - 10

**I. Property, plant and equipment**

Property, plant and equipment is stated at cost and is generally depreciated on the straight-line method over the estimated operational lives of the assets. Property, plant and equipment includes capitalised employee, interest and other costs that are directly attributable to the construction of fixed assets. Reviews are undertaken annually of the estimated remaining lives and residual values of property, plant and equipment. Residual values are assessed based on prices prevailing at each balance sheet date.

**Table of Contents**

Land is not depreciated except in the case of mines as set out in accounting policy M. Mine reclamation and closure costs below. The main depreciation periods used by the group are as set out below.

	Years	
Coal, oil-fired, gas and other generating stations	22	45
Hydro plant and machinery	20	100
Other buildings		40
Transmission and distribution plant	20	75
Towers, lines and underground cables	40	60
Vehicles, miscellaneous equipment and fittings	3	40

Repairs and maintenance costs are expensed during the period in which they are incurred.

**J. Cash and cash equivalents**

Cash and cash equivalents comprise cash on hand, available-for-sale financial assets, held-to-maturity investments to the extent that they are realisable within 90 days and bank overdrafts that are repayable on demand the next business day.

**K. Borrowing costs**

Borrowing costs directly attributable to the acquisition, construction or production of major qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use.

**L. Impairment of property, plant and equipment and intangible assets (excluding goodwill)**

At each balance sheet date, the group reviews the carrying amount of its property, plant and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash generating unit to which the asset belongs.

**M. Mine reclamation and closure costs**

Provision was made for mine reclamation and closure costs when an obligation arose out of events prior to the balance sheet date. The amount recognised was the present value of the estimated future expenditure determined in accordance with local conditions and requirements. A corresponding asset was also created of an amount equal to the provision. This asset, together with the cost of the mine, was subsequently depreciated on a unit of production basis. The unwinding of the discount was included within finance costs. This policy applied to PacifiCorp,

the group's former regulated US business.

**N. Decommissioning costs**

Provision is made, on a discounted basis, for the estimated decommissioning costs at the end of the producing lives of the group's power stations. Capitalised decommissioning costs are depreciated over the useful lives of the related assets. The unwinding of the discount is included within finance costs.

**O. Leased assets**

**O1. The group as lessee**

Assets leased under finance leases, where substantially all the risks and rewards of ownership are transferred to the group, are capitalised and depreciated over the shorter of the lease periods and the

## **Table of Contents**

estimated operational lives of the assets. The corresponding liability is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligations so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the group's accounting policy on K. Borrowing costs. Rentals payable under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

### **O2. The group as lessor**

Rentals receivable under finance leases are allocated to accounting periods to give a constant periodic rate of return on the net investment in the lease in each period. The amounts due from lessees under finance leases are recorded in the balance sheet as a finance lease receivable at the amount of the net investment in the lease after making provisions for bad and doubtful rentals receivable.

### **P. Risk and financial instruments**

#### **P1. Implementation of IAS 32 and IAS 39**

The group has adopted IAS 32 and IAS 39 in the financial year ended 31 March 2006. The EU adopted a regulation in November 2004 (as amended in November 2005) endorsing IAS 39 with the exception of certain provisions relating to hedge accounting. The group has applied the EU-adopted standard in preparing these Accounts. Applying the full version of the standard as opposed to the EU-adopted standard would have had no impact on the group's financial statements. In accordance with the transitional arrangements set out in those standards, the group has not restated the prior year's comparative figures to show the effect of IAS 32 and IAS 39. For the year ended 31 March 2005, financial instruments were accounted for in accordance with the group's previous policies for financial instruments under UK GAAP as set out below under the heading Q. Financial instruments (policies applied in the comparative figures relating to the year ended 31 March 2005). The effects of the implementation of IAS 32 and IAS 39 on 1 April 2005 are set out in Note 43 to the Accounts.

IAS 39 requires that certain financial assets be measured at fair value in the balance sheet with changes in fair value reported through either the income statement or for available-for-sale financial assets, through reserves. Exceptions apply to assets classified as loans and receivables and held-to-maturity investments, which are measured at amortised cost using the effective interest method.

With respect to financial liabilities, IAS 39 prescribes measurement at amortised cost using the effective interest method.

Derivative instruments are carried at fair value with special rules applying to all financial instruments which form part of a hedging relationship.

Commodity purchases and sales that do not qualify for the own use exemption are also measured at fair value through the income statement, or through reserves where cash flow hedge accounting is achieved.

## Edgar Filing: - Form

Embedded derivatives in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not carried at fair value. Unrealised gains or losses on remeasurement of embedded derivatives are reported in the income statement as part of fair value gains on operating derivatives and fair value losses on financing derivatives .

IAS 32 prescribes certain disclosures on the use and impact of financial instruments designed to help the users of the Accounts understand the significance of the financial instruments to an entity s

## Table of Contents

financial position, performance and cash flows, as well as factors that affect amounts, timing and risks associated with future cash flows.

### **P2. Risk control environment**

The group's strategy is to conduct business in a manner benefiting customers through balancing cost and risk while delivering shareholder value and protecting the group's performance and reputation by prudently managing the risks inherent in the business. To maintain this strategic direction the group develops and implements risk management policies and procedures, and promotes a rigid control environment at all levels of the organisation.

The risk policy developed by the Board is supported by a governance structure, which includes the Executive Team (the **ET**), a Business Risk and Investment Committee (the **BRIC**) for each business, Business Risk Assessment Teams and the independent Group Risk Management function.

The structure ensures that the risk management procedures established for each business to identify, assess, monitor, report, manage and mitigate each of the various types of risk involved in its business are adequately designed and implemented and that an effective and efficient system of internal controls is maintained. The businesses adhere to their specific business risk limits and guidelines which are endorsed by the BRIC and approved by the ET. These limits are consistent with the allocation of group risk capital to the businesses. The business limits are allocated based upon the group's total risk capital, being the capital that would cover acceptable potential losses resulting from market and credit risks. The Board has allocated a certain amount of risk capital, based on a 99% confidence interval over a two-year period. This risk capital amount is calculated as the maximum sustainable loss over a two-year period such that the group's financial ratios would still warrant an investment grade rating from rating agencies such as Standard & Poor's or Moody's.

The risks faced by the group fall into the following categories: market risk (both energy price and energy volumetric risk), operational risk, credit risk, insurance risk, interest rate risk, inflation risk, foreign exchange risk, liquidity risk, derivative risk, administrative risk, legal risk, regulatory risk, political risk, security risk, pension risk and risks relating to the availability of generation, adequate fuel supply and transportation.

The Board's position on risk and strategy for risk management are contained in the group Energy Management and Risk Management Policy. The Board implements its policies through a rigid risk governance structure, whereby responsibilities are vested with groups, committees and individuals on a global as well as business level. Further details on the group's risk policy are given in the individual risk sections below.

Generally, the risk management policy and control environment ensures that transactions undertaken and instruments used fall into the types of transactions approved by the Board and are properly validated within the authorised levels of authority. Transactions include instruments such as physically-settled instruments, financially-settled instruments, other contractual obligations, regulatory requirements, and other obligations. The types of instruments which can be used are approved for each business. Subject to the limits requirements discussed above, no transaction is executed unless it is an instrument approved by the BRIC. Further information on the value of derivative instruments utilised by the group is disclosed in Note 25 to these Accounts. Authorised personnel are permitted to engage only in those activities specified in the business operational policies and procedures.

## Edgar Filing: - Form

A clear reporting structure has been implemented within the group. It ensures that the portfolios are monitored on a timely basis and sufficient information is made available to management to enable quick response of the business to the dynamic characteristics of its market environment. Those reports include daily position, mark-to-market ( **MtM** ), Value at Risk ( **VaR** ) reports as well as periodical

## **Table of Contents**

fundamentals reports, stress and scenario reports, credit watch, credit exposure, accounting and insurance reports.

The group's exposure and risk management and control activities in the areas with greater significance to the Accounts are reviewed in greater detail below.

### **P2.1 Energy Management**

The group's risk policy relating to energy management is designed to ensure that the energy management and risk management ( **EMRM** ) activities are consistent with the level of risk tolerance acknowledged by the Board and that a risk control and management framework is established and maintained to monitor and measure risks in existing portfolios of assets and contracts, to develop and define appropriate strategies and transactions to manage those risks and to approve and authorise new transactions and energy instruments. The policy is reviewed at least on an annual basis to ensure that its relevance to the current environment is maintained.

Each business of the group that engages in energy management activities establishes a set of operational policies and procedures incorporating the policies and principles set out in the group Energy Management and Risk Management Policy and provides detailed information with respect to the roles and responsibilities of each function involved in EMRM activities. These operational policies and procedures are presented to the BRIC for approval at least annually.

The key risk control activities implemented by each business to address the energy management and risk management objectives of the group are:

#### **(a) Market risk**

The group uses a number of risk measurement procedures and techniques to ensure that risk is kept within pre-approved limits. These include earnings volatility control (daily VaR calculation), MtM stop loss limits, price exposure by tenor limits, stress tests and scenario analysis as well as individual transaction and physical position limits. The latter are defined as a maximum commitment value of an individual transaction, physical size of a transaction, VaR impact of the transaction, tenor, instrument types and other relevant measures. Valuation is undertaken on a daily basis by portfolio and exposure is assessed within a two-year rolling forward horizon. All valuation models are reviewed and approved by Risk Management on an ongoing basis, including changes to assumptions and model inputs. Changes that can have significant impact on the Accounts require additional review and approval by the BRIC, ET or Board, as appropriate.

The group utilises hedging instruments in accordance with the approved risk strategies designed to keep exposure within the risk limits discussed above.

#### **(b) Operational risk**

## Edgar Filing: - Form

Operational risk is associated with generation, including management of physical fuel supply for the former US mining operations, transmission and distribution and other key system assets subject to service or supply interruptions. It is measured through the impact of system failures on the fair value of contracts at market prices. This risk is controlled through insurance, maintenance and prudent operations practices.

### (c) **Credit risk**

Credit risk is the financial exposure generated by the potential default of third parties in fulfilling their obligations. It is mitigated and monitored by setting approved credit risk limits at both the counterparty and portfolio level.

At the counterparty level the group employs specific eligibility criteria in determining appropriate limits for each prospective counterparty and supplements this with netting and collateral agreements including margining, guarantees, letters of credit and cash deposits where appropriate. Counterparty exposures are then monitored on a daily basis.

## **Table of Contents**

The group also sets limits at the aggregate level to ensure the overall portfolio credit exposure remains within limit. Limits on counterparty concentration are placed and monitored at both the individual business level and also on the combined portfolio.

### **(d) Insurance risk**

Where cost effective, the group maintains a wide-ranging insurance programme providing financial protection, predominately against catastrophic risks. The insurance market has continued to show mixed trends in pricing over the past year. For property insurance, there has been a general increase in premiums due to the effects of hurricanes and other natural disasters. Business interruption insurance has generally increased due to increased exposures arising from significantly higher commodity prices. Other classes of insurance have resulted in net reductions in premiums due to competition in the insurance market and a favourable loss history. The group has worked closely with its insurance advisers and insurers to maintain efficiencies and long-term stability in premium costs. The renewal of the group's main insurance policies for 2006/07 has been completed with commercial insurers delivering a net premium reduction, albeit with the group taking on increased exposures for some classes. These increased exposures are not deemed to be significant.

## **P2.2 Treasury**

The group's risk policy within treasury and financing is designed to ensure that the group's exposure to variability of cash flows and asset values due to fluctuations in the market interest and foreign exchange rates and inflation are minimised and managed within levels consistent with the Board's risk appetite. All treasury transactions are undertaken to manage the risks arising from the group's underlying economic activities and no speculative trading is undertaken. The day-to-day treasury activities are performed by the group's treasury function. The latter reports to the Board on a regular basis through the monthly group Performance and Risk Report and is subject to internal audit.

### **(a) Interest rate risk**

The group is exposed to interest rate risk with respect to its assets and liabilities affected by changes in the market interest rates. The group manages its exposure to interest rate risk by maintaining a percentage of its debt at a fixed rate of interest. The long-term targeted benchmark is a mix of 70% fixed rate and 30% floating rate debt. The exposure is managed by either issuing fixed and floating rate debt in proportions consistent with the group's appetite for risk, or by using a range of derivative financial instruments to create the desired fixed/floating mix.

### **(b) Inflation risk**

To manage inflation risk, arising from the fact that a portion of UK revenues are linked to inflation, the group maintains part of its debt portfolio in index-linked liabilities. This is done either through issuing such liabilities or through swapping fixed rate into index-linked debt. The group's target index rate exposure is about 10% of the total liability portfolio.

### **(c) Foreign exchange risk**

The group's foreign operations expose it to foreign exchange risk, both translation and transaction risk. Translation risk is associated with changes in the value of the group's foreign assets due to movements in the underlying currency exchange rates. Transaction risk is seen as the risk of changes in the value of transactions and associated cash flows denominated in foreign currencies, due to changes in those currency

## Edgar Filing: - Form

exchange rates. The group aims to hedge a substantial proportion of its US net assets with dollar liabilities. The resulting stream of dollar interest on natural dollar debt therefore acts as a natural hedge to the translation of US profits.

## **Table of Contents**

In those cases where transaction risk arises as a result of imports of capital or other goods denominated in foreign currencies, the exposure is hedged as soon as it is committed.

### **(d) Liquidity risk**

In order to manage its liquidity risk and create financial efficiencies the group arranges that its debt maturities are spread over a wide range of dates thereby ensuring that the group is not subject to excessive refinancing risk in any one year. The group also utilises undrawn but committed revolving credit facilities.

### **(e) Derivative risk**

The use of derivative financial instruments (other than those described for energy commodities above) relates directly to underlying and anticipated indebtedness, foreign subsidiary net assets and business transactions denominated in foreign currencies.

## **P3. Hedging activities**

In order to manage the impact of financial risks to the group and report results consistent with the operational strategies, the Board has endorsed the use of derivative financial instruments as hedging tools. Those instruments include fixed and floating swaps (interest rate, cross currency and commodity agreements), swaptions, financial options, financial and commodity forward contracts, commodity futures, commodity options and other complex derivatives. Such physical and financially settled instruments are held by the group to match exposures and are not held for financial trading purposes. Exceptions exist in the group's competitive businesses, Energy Retail & Wholesale and PPM Energy, where a limited and controlled number of transactions and derivatives may be held for proprietary trading purposes.

The group utilises derivative instruments to manage its exposure to the variability of future cash flows caused by risks associated with recognised assets or liabilities or transactions highly probable of occurring (cash flow hedging). In addition, the group utilises hedging strategies with respect to the exposure to changes in fair value of recognised assets and liabilities or unrecognised firm commitments (fair value hedging). Finally, hedging of net investments in foreign operations is undertaken with respect to the group's US business PPM Energy.

Using regression analysis and comparative value changes, the group designates derivatives as hedging instruments when it is expected that there will be high correlation between the changes in fair value of the instrument and the changes in fair value of the hedged item. Such correlation needs to be within the limits of 80% to 125% for the hedge to be considered highly effective. The group assesses hedge effectiveness on at least a quarterly basis to establish whether the assumptions and application criteria for hedge accounting going forward continue to be supported. The group will discontinue hedge accounting from the time that a hedging relationship has ceased to be highly effective. Cash flow hedging designation is only undertaken for future transactions, which are and remain highly probable of occurring.

When certain conditions are met, the group applies the following accounting rules prescribed by IAS 39 for hedging activities:

### **P3.1 Cash flow hedges**

The portion of gain or loss of the hedging instrument that was determined to be an effective hedge is recognised directly in equity and forms part of the hedge reserve. The ineffective portion of the change in fair value of the hedging instruments is recognised in the income statement within Fair value gains on operating derivatives for hedges of underlying operations. For hedges of financing activities, any ineffectiveness is recognised within Fair value losses on financing derivatives in the income statement. If the cash flow hedge of a highly probable forecasted future transaction results in the recognition of a non-financial asset, the associated gains or losses on the derivative that had previously been recognised in equity are released to the income statement in line with consumption of the asset. For hedges that result in recognition of a financial asset or a liability, amounts deferred in equity are recognised in the income statement in the same period in which the hedged item affects the income statement.

## **Table of Contents**

### **P3.2 Fair value hedges**

The gain or loss from remeasuring the hedging instrument at fair value is recognised directly in the income statement. The gain or loss on the hedged item adjusts the carrying amount of the hedged item (when the item would otherwise have been measured at amortised cost) and is recognised in the income statement. The group starts amortisation of any such adjustments to the carrying value of the hedged item when the hedging relationship ends.

### **P3.3 Net investment hedges**

The group hedges its net investments in its US operations. The risk hedged relates to a proportion of the foreign currency exposure of the group's share of the businesses' net assets. The proportion of the gain or loss of the hedging instrument that was determined to be an effective hedge is recognised directly in equity and forms part of the translation reserve. The ineffective portion of the change in fair value of the hedging instrument is recognised in the income statement within Fair value losses on financing derivatives. On disposal of the foreign investment, the gains or losses on the hedging instrument that related to the effective portion of the hedge that had previously been recognised in equity are recycled to the income statement.

### **P3.4 Discontinuing hedge accounting**

The group discontinues prospectively hedge accounting when the hedge instrument expires or is sold, terminated or exercised, when the hedge relationship no longer qualifies for hedge accounting or when the designation is revoked. In the case of cash flow hedging, any gain or loss that has been recognised in equity until that time remains separately recognised in equity until the forecast transaction occurs. If the transaction is no longer expected to occur, related cumulative gains and losses which have been previously deferred in equity are recognised in the income statement.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement within Fair value losses on financing derivatives as they arise.

### **P4. Financial instruments**

Financial liability and equity instruments are classified according to the substance of the contractual arrangements. They are valued as described in Note 23 Financial assets and Note 24 Financial liabilities. An equity instrument is any contract that evidences residual interest in the assets of the group after deducting all of its liabilities.

All financial assets (excluding derivatives) are accounted for using settlement date accounting.

**P4.1 Equity investments**

The Group Income Statement includes the group's share of the post-tax results of associates and jointly controlled entities. The Group Balance Sheet includes the investment in associates and jointly controlled entities at the group's share of their net assets.

Other investments include investments where the group holds less than 20% of an entity's equity and does not exercise significant influence over the operating policies and strategic decisions of this entity. Such investments are initially measured at fair value. They are classified as either held for trading or available-for-sale and are measured at subsequent reporting dates, at fair value. The gains and losses from changes in fair value of available-for-sale equity investments are recognised directly in equity until the instrument is disposed of or determined to be impaired, at which point those cumulative gains and losses are included in the income statement for the period. Investments in equity instruments which do not have a quoted market price and whose value cannot be reliably measured are held at cost.

## **Table of Contents**

### **P4.2 Debt instruments**

The group measures all debt instruments, whether financial assets or financial liabilities, initially at fair value. This is taken to be the net transaction price paid or received. In cases where part of the consideration is for something other than the instrument itself, the group estimates the fair value of the instruments using a valuation technique whose inputs are made of observable market data, or based on the value of similar instruments traded at that time in observable markets.

Transaction costs (any such costs incremental to and directly attributable to the acquisition, issue or disposal of the financial instruments) are accounted for based on the classification of the instrument by the group. Namely, transaction costs for all instruments classified as fair value through the income statement are recognised in the income statement immediately upon recognition. For financial instruments carried at amortised cost, transaction costs are included in the calculation of the effective interest rate and in effect are amortised to the income statement over the life of the asset.

The subsequent measurement of financial instruments follows their classification by the group. Financial instruments classified as fair value through the income statement are remeasured to their fair value with gains and losses recognised in the income statement for the period. Available-for-sale financial assets are remeasured at fair value with gains and losses recorded in equity. Any related interest payments, impairment losses and foreign exchange gains and losses are recognised in the income statement in the period they occur. Other financial instruments, including loans and receivables and held-to-maturity investments, are measured at amortised cost using the effective interest method.

### **P4.3 Commodity contracts**

Commodity contracts entered into and held for the purpose of the group's own purchase, sale or usage requirements are accounted for under the own use exemption in IAS 39. All commodity contracts, which do not qualify for the own use exemption, including those non-physical contracts, entered into for the purpose of trading, but excluding contracts designated in hedging relationships to which special rules apply, are recorded at fair value on the balance sheet with changes in fair value reflected through the income statement. Details on the accounting policies for hedging are disclosed in accounting policy P3. Hedging activities .

### **P4.4 Treasury derivatives**

The group uses a number of derivatives to manage exposure to interest rate and currency fluctuations and the related value of net investments in foreign operations. When designated as hedges such instruments are accounted for in accordance with the methods described in accounting policy P3. Hedging activities . Additionally, amounts payable/receivable under interest rate hedges are accounted for as adjustments to finance costs/finance income for the period. Any other derivative instruments, which are used for the purpose of economic hedging but have not been designated in hedging relationships in accordance with IAS 39, are held at fair value with changes from remeasurement recorded through the income statement within Fair value losses on financing derivatives .

Instruments designated in hedging relationships include interest rate swaps, forward currency contracts and cross currency interest rate swaps. The latter swaps allow the designation of one instrument to hedge more than one risk where fixed for floating cross currency swaps are used.

**P5. Valuation of financial instruments**

The group's valuation strategies for derivative and other financial instruments utilise as far as possible quoted prices in an active trading market.

## **Table of Contents**

Futures, swaps and forward agreements are valued against the appropriate market-based curves. Forward price curves are developed using market prices from independent sources for liquid commodities, markets and products and modelled for illiquid commodities/markets and products.

Single-variable options are valued against market price and volatility curves. Dual-variable options are valued against market price, volatility and correlation curves between two variables. Volatility curves are developed for open positions in both liquid and illiquid markets. They are developed from actively traded options (implied volatility), where markets exist, or using historical forward volatilities and other relevant market data. Correlation curves are developed using historical spot and forward correlations and other relevant market data.

Structured transactions are disaggregated into their traded core components, and each component is valued against the appropriate market-based curves. For transactions where a market price for the point of delivery is not actively quoted, if possible, the transaction is valued at the most appropriate point of delivery where a market price exists with appropriate adjustments for the actual point of delivery, including if applicable currency adjustments.

Assets owned (long position) are valued against the quoted bid price. If assets are owed (short position) they are marked to the quoted offer price. Where valuation incorporates mid-market price data, additional liquidity adjustments are made to the fair value to bring it in accordance with the profile of net long/short exposure. The value of net long volatility positions is marked against the bid volatility curve. For net short volatility positions, the offer volatility curve is used. Other adjustments include discounting and credit adjustments, where those have not already been captured in the mark-to-market process.

In the absence of quoted prices for identical or similar assets or liabilities, it is sometimes necessary to apply valuation techniques where contracts are marked to approved models. Models are used for developing both the forward curves and the valuation metrics of the instruments themselves where the instruments are complex combinations of standard or non-standard products. All models are subject to rigorous testing prior to being approved for valuation and subsequent continuous testing and approval procedures designed to ensure the validity and accuracy of the model assumptions and inputs.

## **P6. Compound instruments**

The group accounts for compound financial instruments that contain both a liability and an embedded derivative component by separating these components and assigning individual values to each of them.

The group accounts for its US dollar convertible bonds as US dollar liabilities with the foreign exchange and equity-linked embedded derivative components of the convertible bonds separately identified and measured at fair value through the income statement. At the date of issue the value of the liability component was estimated using the prevailing market interest rate for a similar non-convertible debt. The fair value of embedded derivatives is the difference between the market value of the convertible bonds and the fair value of similar non-convertible debt. Issue costs and the opening value of the embedded derivative are amortised through the income statement to bring the debt back to par value at maturity.

Prior to the implementation of IAS 39, the US dollar convertible bond was accounted for at amortised cost with no anticipation of equity conversion.

**P7. Offsetting of financial assets and financial liabilities**

The group offsets a financial asset and a financial liability and reports the net amount only when the group has a legally enforceable right to set off the amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

## **Table of Contents**

### **Q. Financial instruments (policies applied in the comparative figures for the year ended 31 March 2005)**

#### **Q1. Debt instruments**

All borrowings were stated at the fair value of consideration received after deduction of issue costs. The issue costs and interest payable on bonds were charged to the income statement at a constant rate over the life of the bond. Premiums and discounts arising on the early repayment of borrowings were recognised in the income statement as incurred and received.

#### **Q2. Interest rate swaps/Forward rate agreements**

These are used to manage debt interest rate exposures. Amounts payable or receivable in respect of these agreements were recognised as adjustments to interest expense over the period of the contracts. Where associated debt was not retired in conjunction with the termination of an interest swap, gains and losses were deferred and were amortised to interest expense over the remaining life of the associated debt to the extent that such debt remained outstanding.

#### **Q3. Interest rate caps/Swaptions/Options**

Premiums received and paid on these contracts were amortised over the period of the contracts and were disclosed as interest income and expense. The accounting for interest rate caps and swaptions was otherwise in accordance with interest rate swaps detailed above.

#### **Q4. Cross currency interest rate swaps**

These are used to hedge both foreign exchange and interest rate exposures arising on foreign currency debt and to hedge overseas net investment. Where used to hedge debt issues, the debt was recorded at the hedge contracted rate and the accounting was otherwise in accordance with interest rate swaps detailed above. Where used to hedge overseas net investments, spot gains or losses were recorded on the balance sheet and in the statement of total recognised income and expense, with interest recorded in the income statement.

#### **Q5. Forward contracts**

The group enters into forward contracts for the purchase and/or sale of foreign currencies in order to manage its exposure to fluctuations in currency rates and to hedge overseas net investment. Unrealised gains and losses on contracts hedging forecast transactions were not accounted for until the maturity of the contract. Foreign currency receivables and payables that were hedged with forward contracts were translated at the contracted rate at the balance sheet date. Spot gains or losses on hedges of the overseas net investments were recorded on the balance sheet and in the statement of total recognised income and expense with the interest rate differential reflected in the income statement.

**Q6. Hydroelectric and temperature hedges**

These instruments were used in PacifiCorp, the group's former regulated US business, to hedge fluctuations in weather and temperature in the US. On a quarterly basis, the group estimated and recorded a gain or loss in the income statement corresponding to the total expected future cash flows from these contracts.

**Q7. Commodity contracts**

Where there was no physical delivery associated with commodity contracts, they were recorded at fair value on the balance sheet with movements reflected through the income statement. Gas and electricity future contracts are undertaken for hedging and proprietary trading purposes. Where the instrument was a hedge, the fair values were initially reflected on the balance sheet and subsequently reflected through the income statement to match the recognition of the hedged item. Where the instrument was for proprietary trading the fair values were reflected through the income statement.

## **Table of Contents**

### **R. Inventories**

Inventories are valued at the lower of average cost and net realisable value.

### **S. Grants and contributions**

Capital grants and customer contributions in respect of additions to property, plant and equipment are treated as deferred income within non-current liabilities and released to the income statement over the estimated operational lives of the related assets.

### **T. Pensions and other post-retirement benefits**

The group provides pensions through defined benefit schemes. The cost of providing benefits is determined using the projected unit credit method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses are recognised in full, directly in retained earnings, in the period in which they occur and are shown in the statement of recognised income and expense. The current service cost element of the pension charge is deducted in arriving at operating profit. The expected return on pension scheme assets and interest on pension scheme liabilities are included within finance income and finance costs. The retirement benefits obligation recognised in the balance sheet represents the net deficit in the group's defined pension schemes together with the net deficit in the group's other post-retirement benefit arrangements, principally healthcare benefits, which are accounted for on a similar basis to the group's defined benefit pension schemes.

### **U. Share-based payment**

IFRS 2 'Share-based Payment' has been applied to all grants of equity instruments after 7 November 2002, in accordance with the transitional provisions of the standard. The group makes equity-settled share-based payments to certain employees under the terms of the group's various employee share and share option schemes. Equity-settled share-based payments are measured at fair value at the date of grant and expensed on a straight-line basis over the vesting period, based on an estimate of the shares that will ultimately vest.

Fair value is measured by use of a Monte Carlo simulation method in respect of the group's Long Term Incentive Plan and the binomial method for the group's other share schemes. The expected lives used in the model have been adjusted for estimates of the effects of non-transferability, exercise restrictions and behavioural considerations.

Own shares held under trust for the group's employee share schemes are deducted in arriving at shareholders' equity. Purchases and sales of own shares are disclosed as changes in shareholders' equity.

### **V. Environmental liabilities**

## Edgar Filing: - Form

Provision for environmental liabilities is made when expenditure on remedial work is probable and the group is obliged, either legally or constructively through its environmental policies, to undertake such work. Where the amount is expected to be incurred over the long-term, the amount recognised is the present value of the estimated future expenditure and the unwinding of the discount is included within finance costs.

### W. Exchange rates

The exchange rates applied in the preparation of the Accounts were as follows:

	Year ended 31 March	
	2006	2005
Average rate for quarters ended:		
30 June	\$ 1.86/£	\$ 1.81/£
30 September	\$ 1.79/£	\$ 1.82/£
31 December	\$ 1.75/£	\$ 1.87/£
31 March	\$ 1.75/£	\$ 1.89/£
Closing rate as at 31 March	\$ 1.74/£	\$ 1.89/£

---

**Table of Contents****(a) IFRS**

In preparing the Accounts in conformity with IFRS, the directors are required to make estimates and assumptions that impact on the reported amounts of revenues, expenses, assets and liabilities. Actual results may differ from these estimates. Certain of the group's accounting policies have been identified as requiring critical accounting judgements or involving particularly complex or subjective decisions or assessments. These are discussed below and have been determined by the group's senior management and approved by the Audit Committee and should be read in conjunction with the full statement of Accounting Policies .

**(i) IFRS Financial instruments**

The group accounts for its derivative financial instruments in accordance with IAS 39. IAS 39 requires all derivatives to be recorded as assets and liabilities in the balance sheet at their fair value, except for those which qualify for specific exemption under the standard, such as commodity contracts which are for the purposes of the group's own purchase, sale or usage requirements. For derivatives designated as effective cash flow hedges, the changes in fair value of the derivative assets and liabilities are initially recognised in the hedge reserve and then subsequently transferred to the income statement as the hedged item is recognised in the income statement. For derivatives designated as net investment hedges, the changes in fair value of the derivative assets and liabilities are recognised in the translation reserve. In all other cases, changes in fair values of the derivative financial instruments are recognised in the income statement in the period in which they arise.

The group's valuation strategies for derivative and other financial instruments are set out in accounting policy P5. Valuation of financial instruments .

The assumptions within the models used to value financial instruments are critical, since any changes in assumptions could have a significant impact on the fair values and movements which are reflected in the Group Income Statement and Group Balance Sheet. There is little formal guidance to assist in applying IAS 39 to non-treasury contracts. As a result, significant judgements must be made in applying IAS 39 to the group's energy contracts in particular. Disclosures relating to the group's derivative financial instruments are set out in Note 25 to the Accounts.

**(ii) IFRS Revenue**

In the UK, prices for electricity and gas supplied to retail customers are determined within competitive markets. The assessment of energy sales to customers is based on meter readings, which are carried out on a systematic basis throughout the year. At the end of each accounting period, amounts of energy delivered to customers since the last billing date are estimated and the corresponding unbilled revenue is estimated and recorded as sales. Unbilled revenues included within accrued income in the Group Balance Sheet relating to the group's retail customers of continuing operations at 31 March 2006 amounted to £297 million (2005: £246 million).

**(iii) IFRS Tax**

The group's tax charge is based on the profit for the year and tax rates in force at the balance sheet date. Estimation of the tax charge requires an assessment to be made of the potential tax treatment of certain items which will only be resolved once finally agreed with the relevant tax authorities. In particular, the tax returns of the group's US businesses are examined by the Internal Revenue Service and state agencies on a several year lag. Assessment of the likely outcome of the examinations is based upon historical experience and the current status of examination

## Edgar Filing: - Form

issues. In addition, H.M. Revenue & Customs in the UK and the Internal Revenue Service in the US are reviewing the tax aspects of certain financial arrangements with ScottishPower Holdings Inc. (formerly PacifiCorp Holdings Inc.). The group believes that appropriate provision has been made against potential tax liabilities which may arise as a result of this review, however this cannot be guaranteed.

---

**Table of Contents**

(iv) IFRS Impairment of property, plant and equipment

In certain circumstances, accounting standards require property, plant and equipment to be reviewed for impairment. When a review for impairment is conducted, the recoverable amount is assessed by reference to the net present value of the expected future cash flows of the relevant Cash Generating Unit ( CGU ), or disposal value if higher. The discount rate applied is based on the group s weighted average cost of capital with appropriate adjustments for the risks associated with the CGU. Estimates of cash flows involve a significant degree of judgement and are consistent with management s plans and forecasts.

(v) IFRS Provisions and contingencies

In accounting for contingencies, the group applies IAS 37 Provisions, Contingent Liabilities and Contingent Assets . IAS 37 requires that a provision be recognised where there is a present obligation as a result of a past event, it is probable that a transfer of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised.

Contingent liabilities are required to be disclosed in the Notes to the Group Accounts, unless the possibility of a transfer of economic benefits is remote. Contingent gains are not recognised unless realisation of the profit is virtually certain. Appropriate disclosures of contingent liabilities are made regarding litigation, tax matters, and environmental issues, among others. The evaluation of these contingencies is performed by various specialists inside and outside of the group. Accounting for contingencies requires significant judgement by management regarding the estimated probabilities and ranges of exposure to potential loss. The directors assessment of the group s exposure to contingencies could change as new developments occur or more information becomes available. The outcome of the contingencies could vary significantly and could materially impact the group s results and financial position. The directors have used their best judgement in applying IAS 37 to these matters.

(vi) IFRS Retirement benefit obligations

The group operates a number of defined benefit schemes for its employees which are accounted for in accordance with IAS 19 Employee Benefits using the immediate recognition approach.

The expense and balance sheet items relating to the group s accounting for pension schemes under IAS 19 are based on actuarial valuations. Inherent in these valuations are key assumptions, including discount rates, earnings increases, mortality and increases in pensions in payment. These actuarial assumptions are reviewed annually in line with the requirements of IAS 19. The assumptions adopted are based on prior experience, market conditions and the advice of plan actuaries.

The group chooses a discount rate for each scheme which reflects yields on high-quality, fixed-income investments, specifically AA-rated corporate bonds of a similar duration to the liabilities. The discount rate used for the purposes of determining the IAS 19 pension charge for the year ended 31 March 2006 for the group s principal continuing pension schemes, being the ScottishPower and Manweb pension schemes, was 5.4% for both schemes. The discount rate used for the purposes of determining the pension liability at 31 March 2006 and the pension charge for the year ending 31 March 2007 is 5.0% for both schemes. The pension liability and pension charge both increase as the discount rate is reduced. If the IAS 19 charge for the year ended 31 March 2006 and the pension liability at 31 March 2006 had been based on a discount rate of 0.5% p.a. higher or lower than those actually used, the charge would have reduced or increased, respectively, by £7 million and the pension liability would have reduced or increased, respectively, by £240 million in respect of the group s principal continuing pension schemes.



---

**Table of Contents**
**(b) US GAAP**

In addition to preparing the group's Accounts in accordance with IFRS, the directors are also required to prepare a reconciliation of the group's profit or loss and shareholders' equity between IFRS and US GAAP. The adjustments required to reconcile the group's profit or loss and shareholders' equity from IFRS to US GAAP are explained in Note 44 to the Accounts. Certain of the group's US GAAP accounting policies have been identified as requiring critical accounting judgements or involving particularly complex or subjective decisions or assessments and these are discussed below. The discussion below should be read in conjunction with the full discussion of the differences between the group's IFRS and US GAAP accounting policies set out in Note 44 to the Accounts.

**(i) US GAAP – Derivative financial instruments**

US GAAP requires all derivative financial instruments within the scope of FAS 133 – Accounting for Derivative Instruments and Hedging Activities – and certain other subsequent amending standards and guidance to be fair valued. Although there are differences of detail between US GAAP and IFRS with respect to accounting for derivative financial instruments for which no ready market exists, the assumptions used to value these instruments are equally critical under both US GAAP and IFRS.

**(ii) USGAAP – Impairment of goodwill**

FAS 142 – Goodwill and Other Intangible Assets – deals with the accounting for goodwill and other intangible assets upon their acquisition and their subsequent measurement. The standard requires that goodwill is not amortised but is tested for impairment at least annually. Under FAS 142, the impairment test is in two stages. The first step is a screen for potential impairment. This compares an estimate of the fair value of the reporting unit that contains the goodwill with the carrying value of the net assets (including goodwill) in the balance sheet of that reporting unit. If this identifies a potential impairment then the second step is required. This requires assigning fair values to the assets and liabilities of the reporting unit (similar to what would be required under acquisition accounting). The difference between the fair value of these net assets and the estimate of the fair value of the reporting unit as a whole provides an implied fair value of the goodwill. If this implied fair value is less than the carrying value of the goodwill, then goodwill is impaired and an impairment charge requires to be recognised. In accordance with the requirements of the standard, the group performed its annual review at 30 September 2005. No impairment was identified as a result of this review.

**(iii) USGAAP – Retirement benefit obligations**

The group accounts for its pension schemes under US GAAP in accordance with FAS 87 – Employers' Accounting for Pensions . Under FAS 87, certain of the group's pension schemes had assets with a fair value at 31 March 2006 that was less than the accumulated benefit obligation under the schemes at the same date. As a result, at 31 March 2006 the group recognised a minimum pension liability under US GAAP of £159 million, of which £159 million was charged to accumulated other comprehensive income. The discount rate used for the purposes of calculating the charge under US GAAP for the group's principal continuing pension schemes was 5.4%. The discount rate used to calculate the minimum pension liability at 31 March 2006 was 5.0%. If a discount rate had been used for accumulated benefit obligation purposes which was 0.5% p.a. higher or lower than that actually used, the impact would have been to reduce or increase, respectively, the minimum pension liability by £56 million in respect of the group's principal continuing pension schemes.

**Table of Contents****Group Income Statement**

for the year ended 31 March 2006

	Notes	Year ended 31 March					
		Before exceptional items and certain remeasurements 2006	Exceptional items and certain remeasurements (Note 2) 2006	Total 2006	Before exceptional items and certain remeasurements 2005	Exceptional items and certain remeasurements (Note 2) 2005	Total 2005
		£m	£m	£m	£m	£m	£m
<b>Continuing operations</b>							
Revenue	1	5,446.1		5,446.1	4,595.0		4,595.0
Cost of sales	2	(3,965.7)		(3,965.7)	(3,375.1)	93.2	(3,281.9)
Transmission and distribution costs		(327.3)		(327.3)	(293.7)		(293.7)
Administrative expenses before exceptional items		(380.2)		(380.2)	(380.4)		(380.4)
Exceptional administrative expenses	2		(101.0)	(101.0)			
Administrative expenses		(380.2)	(101.0)	(481.2)	(380.4)		(380.4)
Fair value gains on operating derivatives	1, 2		85.3	85.3			
Other operating income		32.2		32.2	34.2		34.2
Share of loss of jointly controlled entities and associates	1	(0.6)		(0.6)			
Gain on disposal of gas storage project	2		80.9	80.9			
<b>Operating profit</b>	1, 3, 10	<b>804.5</b>	<b>65.2</b>	<b>869.7</b>	580.0	93.2	673.2
Finance income	5	186.4		186.4	212.2		212.2
Fair value losses on financing derivatives	2, 6		(115.4)	(115.4)			
Finance costs	7	(315.6)		(315.6)	(333.0)		(333.0)
<b>Net finance costs</b>		<b>(129.2)</b>	<b>(115.4)</b>	<b>(244.6)</b>	(120.8)		(120.8)
<b>Profit before tax</b>		<b>675.3</b>	<b>(50.2)</b>	<b>625.1</b>	459.2	93.2	552.4
Income tax	2, 8, 10	(161.7)	44.3	(117.4)	(109.3)	(28.1)	(137.4)
<b>Profit for the year from continuing operations</b>		<b>513.6</b>	<b>(5.9)</b>	<b>507.7</b>	349.9	65.1	415.0
<b>Discontinued operations</b>							
Profit/(loss) for the year from discontinued operations	9, 10	299.9	736.1	1,036.0	318.2	(921.9)	(603.7)
<b>Profit/(loss) for the financial year</b>		<b>813.5</b>	<b>730.2</b>	<b>1,543.7</b>	668.1	(856.8)	(188.7)
<b>Attributable to:</b>							
Equity holders of Scottish Power plc	33	813.1	730.2	1,543.3	663.4	(856.8)	(193.4)
Minority interest							
equity	34	0.4		0.4	1.3		1.3
non-equity	34				3.4		3.4
		<b>813.5</b>	<b>730.2</b>	<b>1,543.7</b>	668.1	(856.8)	(188.7)

Edgar Filing: - Form

<b>Basic earnings/(loss) per share</b>	10		
Continuing operations		27.54p	22.60p
Discontinued operations		56.23p	(33.16)p
<hr/>			
Continuing and discontinued operations		83.77p	(10.56)p
<hr/>			
<b>Adjusted basic earnings per share</b>	10		
Continuing operations		27.85p	19.04p
Discontinued operations		16.28p	17.20p
<hr/>			
Continuing and discontinued operations		44.13p	36.24p
<hr/>			
<b>Diluted earnings/(loss) per share</b>	10		
Continuing operations		27.33p	22.03p
Discontinued operations		55.82p	(31.49)p
<hr/>			
Continuing and discontinued operations		83.15p	(9.46)p
<hr/>			
<b>Adjusted diluted earnings per share</b>	10		
Continuing operations		27.12p	18.65p
Discontinued operations		15.40p	16.33p
<hr/>			
Continuing and discontinued operations		42.52p	34.98p
<hr/>			
<b>Dividends per share</b>			
Dividends per ordinary share (paid and proposed)	11	25.00p	22.50p
<hr/>			

**Table of Contents****Group Statement of Recognised Income and Expense**

for the year ended 31 March 2006

	<b>Year ended 31 March</b>	
	<b>2006</b>	<b>2005</b>
	<b>£m</b>	<b>£m</b>
Gains on effective cash flow hedges recognised	<b>747.9</b>	
Exchange movement on translation of overseas results and net assets	<b>244.1</b>	(100.2)
(Losses)/gains on net investment hedges	<b>(276.5)</b>	146.6
Gains on revaluation of available-for-sale securities	<b>0.4</b>	
Actuarial gains/(losses) on retirement benefits	<b>39.1</b>	(63.3)
Tax on items taken directly to equity	<b>(193.2)</b>	(27.5)
<b>Net income/(expense) recognised directly in equity for the year</b>	<b>561.8</b>	(44.4)
Profit/(loss) for the year	<b>1,543.7</b>	(188.7)
<b>Total income and expense for the year</b>	<b>2,105.5</b>	(233.1)
Cumulative adjustment for the implementation of IAS 39 (net of tax)	<b>281.4</b>	
Cumulative translation gain transferred to income statement on disposal of discontinued operations (net of tax)	<b>(484.6)</b>	
Gains removed from equity and recognised in the year	<b>(484.5)</b>	
Tax on items transferred from equity	<b>145.4</b>	
<b>Total recognised income and expense</b>	<b>1,563.2</b>	(233.1)
All of the above movements are reflected in Note 33.		
<b>Total income and expense for the year attributable to:</b>		
Equity holders of Scottish Power plc	<b>2,105.1</b>	(237.8)
Minority interests		
equity	<b>0.4</b>	1.3
non-equity		3.4
	<b>2,105.5</b>	(233.1)

**Table of Contents****Group Cash Flow Statement**

for the year ended 31 March 2006

	Notes	Year ended 31 March	
		2006 £m	2005 £m
<b>Continuing operations</b>			
<b>Operating activities</b>			
Cash generated from operations	12	864.5	681.4
Dividends received from jointly controlled entities		1.4	2.0
Interest paid		(214.5)	(131.5)
Interest received		71.3	31.0
Income taxes paid		(74.8)	(56.2)
Reallocation from discontinued operations		67.8	122.2
<b>Net cash from operating activities</b>		<b>715.7</b>	<b>648.9</b>
<b>Continuing operations</b>			
<b>Investing activities</b>			
Purchase of intangible assets		(57.3)	(21.5)
Proceeds from sale of intangible assets		3.2	
Purchase of property, plant and equipment		(940.3)	(421.2)
Proceeds from sale of property, plant and equipment		21.4	19.0
Investment in jointly controlled entities and (purchase)/sale of other investments		(72.8)	18.8
Deferred income received		25.3	25.6
Deferred income repaid		(2.5)	(37.3)
Purchase of subsidiaries and jointly controlled entities	13	(9.0)	(343.7)
Sale of businesses and subsidiaries	13	2,850.9	(7.4)
Equity investment in discontinued operations		(271.4)	
Dividend received from discontinued operations		97.8	104.8
<b>Net cash provided by/(used in) investing activities</b>		<b>1,645.3</b>	<b>(662.9)</b>
<b>Continuing operations</b>			
<b>Financing activities</b>			
Issue of share capital		35.1	21.9
Share buy-back		(10.4)	
Dividends paid to company's equity holders		(428.1)	(386.1)
Dividends paid to minority interests		(2.5)	(1.0)
Net consideration received/(paid) in respect of own shares held under trust		27.0	(23.3)
Repayments of borrowings		(102.8)	(295.6)
Proceeds from borrowings			783.6
Reallocation from discontinued operations		61.7	232.0
<b>Net cash (used in)/provided by financing activities</b>		<b>(420.0)</b>	<b>331.5</b>
<b>Net increase in net cash and cash equivalents continuing operations</b>	14	<b>1,941.0</b>	<b>317.5</b>
<b>Net (decrease)/increase in net cash and cash equivalents discontinued operations</b>	9	<b>(103.7)</b>	<b>83.4</b>
<b>Net increase in net cash and cash equivalents</b>		<b>1,837.3</b>	<b>400.9</b>



**Table of Contents****Movement in Net Cash and Cash Equivalents**

for the year ended 31 March 2006

	Notes	Year ended 31 March	
		2006 £m	2005 £m
Net cash and cash equivalents at beginning of year		1,727.3	1,327.2
Less: Net cash and cash equivalents at beginning of year discontinued operations		97.4	14.4
<hr/>			
Net cash and cash equivalents at beginning of year continuing operations		1,629.9	1,312.8
Increase in net cash and cash equivalents on implementation of IAS 39 on 1 April 2005	43	0.7	
<hr/>			
Net cash and cash equivalents at 1 April 2005 as restated under IFRS continuing operations		1,630.6	1,312.8
Net increase in net cash and cash equivalents		1,941.0	317.5
Effect of foreign exchange rate changes		7.4	(0.4)
Mark-to-market movements on certain money market funds		4.0	
<hr/>			
<b>Net cash and cash equivalents at end of year continuing operations</b>	(a)	<b>3,583.0</b>	1,629.9

(a) Net cash and cash equivalents in respect of continuing operations at 31 March 2006 comprises cash and cash equivalents of £3,584.4 million less bank overdrafts of £1.4 million.

An analysis of net cash and cash equivalents is set out in Note 14.

**Reconciliation of Movement in Net Cash and Cash Equivalents to Movement in Net Debt**

for the year ended 31 March 2006

	Year ended 31 March 2006	
	£m	
Net debt at beginning of year	(4,334.8)	
Less: Net debt at beginning of year discontinued operations	(2,307.6)	
<hr/>		
Net debt at beginning of year continuing operations	(2,027.2)	
Decrease in net debt on implementation of IAS 39 on 1 April 2005 continuing operations	0.5	
<hr/>		
Net debt at 1 April 2005 as restated under IFRS continuing operations	(2,026.7)	
Net increase in net cash and cash equivalents	1,941.0	
Outflow of net cash and cash equivalents from decrease in debt	102.8	

## Edgar Filing: - Form

Foreign exchange	(113.2)
Mark-to-market movements on net debt	11.3
Other non-cash and cash equivalent movements	2.1
<hr/>	
<b>Net debt at end of year continuing operations</b>	<b>(82.7)</b>
<hr/>	

An analysis of net debt is set out in Note 14.

**Table of Contents****Group Balance Sheet**

as at 31 March 2006

	Notes	2006 £m	2005 £m
<b>Non-current assets</b>			
Intangible assets			
goodwill	16	100.8	885.1
other intangible assets	16	147.6	409.5
Property, plant and equipment	17	5,489.8	9,334.9
Investments accounted for using the equity method	18	126.7	53.1
Other investments	19	4.1	120.3
Trade and other receivables	21	10.7	56.2
Derivative financial instruments	23, 25	602.4	
Finance lease receivables	22	104.6	158.4
<b>Non-current assets</b>		<b>6,586.7</b>	<b>11,017.5</b>
<b>Current assets</b>			
Inventories	20	207.5	185.4
Trade and other receivables	21	1,444.3	1,675.5
Derivative financial instruments	23, 25	867.5	
Finance lease receivables	22	20.5	17.3
Cash and cash equivalents	14	3,584.4	1,747.8
<b>Current assets</b>		<b>6,124.2</b>	<b>3,626.0</b>
<b>Total assets</b>	15	<b>12,710.9</b>	<b>14,643.5</b>
<b>Current liabilities</b>			
Loans and other borrowings	24	(523.0)	(912.5)
Derivative financial instruments	24, 25	(426.6)	
Obligations under finance leases	27	(6.7)	(14.5)
Trade and other payables	28	(1,369.7)	(1,632.9)
Current tax liabilities		(406.3)	(338.9)
Provisions	30	(26.5)	(80.1)
<b>Current liabilities</b>		<b>(2,758.8)</b>	<b>(2,978.9)</b>
<b>Non-current liabilities</b>			
Loans and other borrowings	24	(3,079.4)	(4,996.8)
Derivative financial instruments	24, 25	(149.7)	
Obligations under finance leases	27	(58.0)	(158.8)
Trade and other payables	28	(36.6)	(2.7)
Retirement benefit obligations	35	(155.5)	(635.5)
Deferred tax liabilities	29	(823.3)	(1,161.4)
Provisions	30	(65.8)	(182.2)
Deferred income	31	(482.8)	(570.1)
<b>Non-current liabilities</b>		<b>(4,851.1)</b>	<b>(7,707.5)</b>
<b>Total liabilities</b>	15	<b>(7,609.9)</b>	<b>(10,686.4)</b>

Edgar Filing: - Form

<b>Net assets</b>		<b>5,101.0</b>	3,957.1
<b>Equity</b>			
Share capital	32, 33	<b>935.6</b>	932.7
Share premium	33	<b>2,326.0</b>	2,294.7
Hedge reserve	33	<b>595.2</b>	
Translation reserve	33	<b>8.2</b>	484.6
Other reserves	33	<b>431.4</b>	430.5
Retained earnings/(loss)	33	<b>804.5</b>	(241.1)
<b>Equity attributable to equity holders of Scottish Power plc</b>	15	<b>5,100.9</b>	3,901.4
<b>Minority interests</b>			
equity	34	<b>0.1</b>	3.2
non-equity	34		52.5
<b>Total equity</b>		<b>5,101.0</b>	3,957.1
<b>Net asset value per share</b>	15	<b>275.7p</b>	212.9p

**Table of Contents****Notes to the Group Accounts**

for the year ended 31 March 2006

**1 Segmental income statement information**

For management purposes, the group is currently organised into three continuing operating businesses, Energy Networks (formerly Infrastructure Division Power Systems), Energy Retail & Wholesale (formerly UK Division Integrated Generation and Supply) and PPM Energy and therefore reports its primary segment information on this basis. PacifiCorp, the group's former regulated US business, is included within the discontinued operations segment following the group's decision on 24 May 2005 to dispose of the business. The results of this discontinued operation are disclosed in Note 9.

The group has also reviewed the classification, for segmental purposes, of revenue and operating profit relating to corporate activities (previously allocated across business segments) and to the non-regulated businesses (previously included within the PacifiCorp segment) which were not included in the sale of PacifiCorp. These are now included within Unallocated in the segmental analyses below.

**(a) Revenue by segment**

	Notes	Total revenue		Inter-segment revenue		External revenue	
		2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
<b>Continuing operations</b>							
<b>United Kingdom</b>							
Energy Networks		861.7	728.9	(299.5)	(348.8)	562.2	380.1
Energy Retail & Wholesale		4,344.4	3,712.5	(17.1)	(27.5)	4,327.3	3,685.0
<b>United Kingdom total</b>		<b>5,206.1</b>	<b>4,441.4</b>	<b>(316.6)</b>	<b>(376.3)</b>	<b>4,889.5</b>	<b>4,065.1</b>
<b>Continuing operations</b>							
<b>United States</b>							
PPM Energy		545.9	502.0			545.9	502.0
<b>United States total</b>		<b>545.9</b>	<b>502.0</b>			<b>545.9</b>	<b>502.0</b>
Unallocated revenue	(i)					10.7	27.9
<b>Total</b>	(ii)					<b>5,446.1</b>	<b>4,595.0</b>

(i) Unallocated revenue comprises revenue of the non-regulated businesses, previously included within the PacifiCorp segment, which were not included in the sale of PacifiCorp.

Edgar Filing: - Form

(ii) In the segmental analysis revenue is shown by geographical origin. Revenue analysed by geographical destination is not materially different.

**(b) Operating profit by segment**

		Before fair value gains/(losses) on operating derivatives and exceptional items	Fair value gains/(losses) on operating derivatives (Note 2)	Exceptional items (Note 2)	Fair value gains/(losses) on operating derivatives and exceptional items	Total	Before certain remeasurements 2005	Certain remeasurements (Note 2) 2005	Total 2005
	Notes	£m	£m	£m	£m	£m	£m	£m	£m
<b>Continuing operations</b>									
<b>United Kingdom</b>									
Energy Networks	(iii)	524.6		(18.0)	(18.0)	506.6	427.4		427.4
Energy Retail & Wholesale	(iii)	214.1	88.7	72.2	160.9	375.0	93.5	91.8	185.3
<b>United Kingdom total</b>		<b>738.7</b>	<b>88.7</b>	<b>54.2</b>	<b>142.9</b>	<b>881.6</b>	<b>520.9</b>	<b>91.8</b>	<b>612.7</b>
<b>Continuing operations</b>									
<b>United States</b>									
PPM Energy	(iii)	90.6	(3.0)	(34.6)	(37.6)	53.0	58.6	1.4	60.0
<b>United States total</b>		<b>90.6</b>	<b>(3.0)</b>	<b>(34.6)</b>	<b>(37.6)</b>	<b>53.0</b>	<b>58.6</b>	<b>1.4</b>	<b>60.0</b>
Unallocated (expense)/income	(i), (iii)	(24.8)	(0.4)	(39.7)	(40.1)	(64.9)	0.5		0.5
<b>Total</b>	(ii), (iii)	<b>804.5</b>	<b>85.3</b>	<b>(20.1)</b>	<b>65.2</b>	<b>869.7</b>	<b>580.0</b>	<b>93.2</b>	<b>673.2</b>

(i) Unallocated (expense)/income comprises corporate office costs and the operating results of the non-regulated businesses, previously included within the PacifiCorp segment, which were not included in the sale of PacifiCorp.

**Table of Contents**

- (ii) Share of (loss)/profit in jointly controlled entities and associates included in operating profit by segment for the year ended 31 March 2006 is as follows: Energy Networks £(3.5) million (2005 £0.2 million), Energy Retail & Wholesale £1.4 million (2005 £(1.9) million), PPM Energy £1.5 million (2005 £(0.5) million) and unallocated income £nil (2005 £2.2 million).
- (iii) The reconciliation of operating profit for the year ended 31 March 2005 under UK GAAP on the previous segmental basis to operating profit under IFRS on the revised segmental basis is provided below.

**Reconciliation of adjusted operating profit by segment for the prior year**

	Year ended 31 March 2005				Unallocated (expense)/income £m	Total £m
	Energy Networks £m	Energy Retail & Wholesale £m	PPM Energy £m			
	<b>Operating profit* under UK GAAP previous segmental basis</b>	<b>416.3</b>	<b>180.5</b>	<b>58.6</b>		
Reallocation of corporate costs	8.7	15.3	1.3	(38.2)	(12.9)	
Reallocation of PacifiCorp non-regulated businesses				39.1	39.1	
<b>Operating profit* under UK GAAP revised segmental basis</b>	<b>425.0</b>	<b>195.8</b>	<b>59.9</b>	<b>0.9</b>	<b>681.6</b>	
IFRS adjustments	2.2	(8.6)	0.6	(2.6)	(8.4)	
Reclassification of jointly controlled entities and associates	0.2	(1.9)	(0.5)	2.2		
<b>Operating profit* under IFRS revised segmental basis</b>	<b>427.4</b>	<b>185.3</b>	<b>60.0</b>	<b>0.5</b>	<b>673.2</b>	

\* Before goodwill amortisation and exceptional item for UK GAAP and before exceptional item for IFRS.

**(c) Amortisation and depreciation by segment**

	Amortisation		Depreciation	
	2006	2005	2006	2005
	£m	£m	£m	£m
<b>Continuing operations</b>				
<b>United Kingdom</b>				
Energy Networks	7.4	7.7	99.9	98.6
Energy Retail & Wholesale	20.2	61.3	94.8	88.6
<b>United Kingdom total</b>	<b>27.6</b>	<b>69.0</b>	<b>194.7</b>	<b>187.2</b>
<b>Continuing operations</b>				
<b>United States</b>				
PPM Energy	3.4	1.3	12.1	12.0
<b>United States total</b>	<b>3.4</b>	<b>1.3</b>	<b>12.1</b>	<b>12.0</b>
Unallocated	1.5	1.0	9.3	8.4
<b>Total</b>	<b>32.5</b>	<b>71.3</b>	<b>216.1</b>	<b>207.6</b>

(d) Fair value gains on operating derivatives by segment

Included in operating profit above are fair value gains on operating derivatives as follows:

	Unwind of opening position		Mark-to-market gains/(losses)		Hedge ineffectiveness		Total	
	2006	2005	2006	2005	2006	2005	2006	2005
	£m	£m	£m	£m	£m	£m	£m	£m
<b>Continuing operations</b>								
<b>United Kingdom</b>								
Energy Networks								
Energy Retail & Wholesale			92.7		(4.0)		88.7	
<b>United Kingdom total</b>			92.7		(4.0)		88.7	
<b>Continuing operations</b>								
<b>United States</b>								
PPM Energy	110.6		(114.3)		0.7		(3.0)	
<b>United States total</b>	110.6		(114.3)		0.7		(3.0)	
Unallocated			(0.4)				(0.4)	
<b>Total</b>	110.6		(22.0)		(3.3)		85.3	

**Table of Contents****(e) Significant non-cash expenditure by segment**

	Impairment of trade receivables	
	2006	2005
	£m	£m
<b>Continuing operations</b>		
<b>United Kingdom</b>		
Energy Networks	0.3	
Energy Retail & Wholesale	55.8	41.3
<b>United Kingdom total</b>	<b>56.1</b>	<b>41.3</b>
<b>Continuing operations</b>		
<b>United States</b>		
PPM Energy		
<b>United States total</b>		
Unallocated		
<b>Total</b>	<b>56.1</b>	<b>41.3</b>

Other significant non-cash expenditures are disclosed in Note 2.

**2 Exceptional items and certain remeasurements**

Exceptional items and certain remeasurements included in profit for the year from continuing operations are as follows:

	Notes	2006 £m	2005 £m
<b>(a) Exceptional administrative expenses</b>			
Corporate restructuring costs	(i)	(42.0)	
Impairment of finance lease receivables	(ii)	(25.4)	
Credit support facility costs	(iii)	(33.6)	
		<b>(101.0)</b>	
<b>(b) Gain on disposal of gas storage project</b>	(iv)	<b>80.9</b>	
<b>Total exceptional items</b>	10	<b>(20.1)</b>	
<b>(c) IAS 39 adjustments</b>			
Onerous contract releases/intangible assets charges relating to commodity contracts in prior year	10		92.4
Proprietary trading profit in prior year	10		0.8
Fair value gains on operating derivatives in current year	1, 10	85.3	
Fair value losses on financing derivatives in current year	6, 10	(115.4)	

<b>Total IAS 39 adjustments</b>	<b>(30.1)</b>	<b>93.2</b>
<b>Tax on exceptional items and certain remeasurements</b>		
Tax on exceptional administrative expenses	<b>35.1</b>	
Tax on IAS 39 adjustments	<b>9.2</b>	<b>(28.1)</b>
	<b>44.3</b>	<b>(28.1)</b>
<b>Total exceptional items and certain remeasurements (net of tax)</b>	<b>(5.9)</b>	<b>65.1</b>

- (i) A gross exceptional charge of £42.0 million and related tax credit of £12.7 million relating to costs of the corporate restructuring. Costs of the corporate restructuring by segment for the year ended 31 March 2006 are as follows: Energy Networks £18.0 million, Energy Retail & Wholesale £8.7 million, PPM Energy £1.0 million and Unallocated expense £14.3 million.
- (ii) A gross exceptional charge of £25.4 million and related tax credit of £9.6 million relating to the impairment of the group's aircraft leases within the Unallocated segment.
- (iii) A gross exceptional charge of £33.6 million and related tax credit of £12.8 million within PPM Energy relating to probable liabilities in relation to a credit support facility provided by PacifiCorp Holdings Inc. (now ScottishPower Holdings Inc.) to certain providers of debt to the Klamath Co-Generation project at the project's inception in 1999. The project is owned by the City of Klamath Falls, but operated by PPM Energy which has a purchase contract for 47% of the output.
- (iv) A gross exceptional gain within Energy Retail & Wholesale of £80.9 million relating to the sale of the group's underground natural gas storage project at Byley to E.ON UK plc for £96.0 million. There is no tax effect of this exceptional item.

### 3 Operating profit

(a) Operating profit from continuing operations is stated after charging/(crediting):

	<b>2006</b>	2005
	<b>£m</b>	£m
Amortisation of intangible assets	<b>32.5</b>	71.3
Depreciation of property, plant and equipment	<b>216.1</b>	207.6
Release of grants and customer contributions	<b>(19.7)</b>	(17.5)
Research and development	<b>0.3</b>	0.2

**Table of Contents****(b) Auditors remuneration**

	2006 £m	2005 £m
Audit services		
statutory audit	1.2	1.1
audit-related regulatory reporting	0.3	0.5
Further assurance services	0.3	1.8
Tax services		
compliance services	0.5	0.4
advisory services	0.2	0.4
Other services	0.1	
<b>Total UK and US audit and non-audit fees paid to auditors for continuing operations</b>	<b>2.6</b>	<b>4.2</b>
Audit services		
statutory audit	0.8	0.6
audit-related regulatory reporting	0.2	0.2
Further assurance services	1.1	0.7
Tax services		
compliance services	0.7	0.6
advisory services	1.6	
Other services		
<b>US audit and non-audit fees paid to auditors for discontinued operations</b>	<b>4.4</b>	<b>2.1</b>
<b>Total UK and US audit and non-audit fees paid to auditors</b>	<b>7.0</b>	<b>6.3</b>

During the year the Audit Committee reviewed the independence and objectivity of the external audit firm. To prevent this independence being compromised policies are in place regarding the provision of non-audit services, and the hiring of former external audit staff. In line with best practice, the Audit Committee undertook a tender of the external audit contract in early 2006. Following a rigorous review process, it was agreed to recommend the appointment of Deloitte & Touche LLP as the group's external auditor for the year ending 31 March 2007. A resolution to this effect will be put to shareholders for approval at the upcoming AGM.

The policy on non-audit services prohibits the use of the external audit firm for specified services. It is considered appropriate, for commercial and practical reasons, including confidentiality, to use the external auditors for certain non-audit services. These permissible services are set out in the policy and have been pre-approved by the Audit Committee up to an initial fee value of £100,000 per assignment. Permissible services that are not listed in the policy require to be pre-approved individually by the Audit Committee or its Chairman; any assignments that exceed the fee limit must be reviewed and authorised by the Committee Chairman and the Finance Director.

For the year ended 31 March 2006, of the total audit and non-audit fees paid to the auditors of £7.0 million (2005 £6.3 million), £4.5 million (2005 £5.6 million) was charged to operating profit and £2.5 million was charged against the gain on disposal of PacifiCorp (2005 £0.7 million was included in the cost of acquisitions).

For the year ended 31 March 2006, fees for Further assurance services and Tax advisory services principally relate to services provided in connection with the disposal of PacifiCorp and the capital reorganisation and return of cash to shareholders. For the year ended 31 March 2005, fees for Further assurance services principally relate to due diligence work on acquisitions and advice regarding the implementation of s404 of the Sarbanes-Oxley Act and the implementation of IFRS.

**4 Employee information****(a) Employee costs**

	<b>2006</b>	2005
	<b>£m</b>	£m
Wages and salaries	<b>308.2</b>	268.2
Social security costs	<b>23.5</b>	21.5
Pension and other costs	<b>44.8</b>	37.8
<b>Total employee costs</b>	<b>376.5</b>	327.5
Less: charged as capital expenditure	<b>(75.9)</b>	(65.4)
<b>Charged to the income statement</b>	<b>300.6</b>	262.1

**Table of Contents****(b) Employee numbers**

The year end and average numbers of employees (full-time and part-time) employed by the group, including executive directors, were:

	At 31 March		Annual average	
	2006	2005	2006	2005
<b>Continuing operations</b>				
<b>United Kingdom</b>				
Energy Networks	3,380	3,328	3,394	3,260
Energy Retail & Wholesale	5,512	5,386	5,646	4,970
<b>United Kingdom total</b>	<b>8,892</b>	<b>8,714</b>	<b>9,040</b>	<b>8,230</b>
<b>Continuing operations</b>				
<b>United States</b>				
PPM Energy	371	278	363	240
<b>United States total</b>	<b>371</b>	<b>278</b>	<b>363</b>	<b>240</b>
Unallocated	530	504	550	461
<b>Total</b>	<b>9,793</b>	<b>9,496</b>	<b>9,953</b>	<b>8,931</b>

The year end and average numbers of full-time equivalent staff employed by the group, including executive directors, were:

	At 31 March		Annual average	
	2006	2005	2006	2005
United Kingdom	8,425	8,269	8,543	7,955
United States	370	277	363	240
Unallocated	516	480	534	433
<b>Total</b>	<b>9,311</b>	<b>9,026</b>	<b>9,440</b>	<b>8,628</b>

**5 Finance income**

	2006	2005
	£m	£m
Interest on bank and other deposits	66.8	60.4
Interest on finance lease receivables	7.0	42.5
Foreign exchange gains	2.2	2.0
Expected return on retirement benefit assets	110.4	107.3
<b>Total finance income</b>	<b>186.4</b>	<b>212.2</b>

**6 Fair value losses on financing derivatives**

Fair value losses on financing derivatives of £115.4 million include losses of £125.1 million for the year ended 31 March 2006, resulting from changes to the fair value of the embedded derivative within the \$700 million convertible bonds, primarily as a result of movement in the company's ordinary share price.

**7 Finance costs**

	Notes	2006 £m	2005 £m
Interest on bank loans and overdrafts		13.0	18.8
Interest on other borrowings		204.2	164.6
Interest on obligations under finance leases		6.0	40.1
Capitalised interest	(a)	(8.2)	(1.7)
Unwinding of discount on provisions		0.9	10.4
Interest on retirement benefit obligations		99.7	100.8
<b>Total finance costs</b>		<b>315.6</b>	<b>333.0</b>
<b>Interest cover (times)</b>	(b)	<b>6.1</b>	<b>4.7</b>

(a) The tax relief on the capitalised interest was £0.9 million (2005 £0.5 million).

(b) Interest cover is calculated by dividing operating profit before exceptional items and certain remeasurements by the sum of the total finance income (less foreign exchange gains) and total finance costs.

**Table of Contents****8 Income tax**

	2006	2005
	£m	£m
Current tax:		
UK Corporation tax	238.0	184.5
Adjustments in respect of prior years	(9.1)	(40.7)
<b>Total UK Corporation tax for year</b>	<b>228.9</b>	143.8
Foreign tax	(61.8)	(14.2)
Adjustments in respect of prior years	15.7	7.6
<b>Total foreign tax for year</b>	<b>(46.1)</b>	(6.6)
<b>Total current tax for year</b>	<b>182.8</b>	137.2
Deferred tax:		
Origination and reversal of timing differences	(25.3)	3.1
Adjustments in respect of prior years	(40.1)	(2.9)
<b>Total deferred tax for year</b>	<b>(65.4)</b>	0.2
<b>Total income tax expense</b>	<b>117.4</b>	137.4

The tax charge on profit on ordinary activities for the year varied from the standard rate of UK Corporation tax as follows:

	2006	2005
	£m	£m
Corporation tax at 30%	187.5	165.7
Effect of tax rate applied to overseas earnings	(16.7)	6.9
Adjustments in respect of prior years	(33.5)	(36.0)
Utilisation of UK capital losses	(24.3)	
Other permanent differences	4.4	0.8
<b>Income tax expense for the year</b>	<b>117.4</b>	137.4

**9 Discontinued operations**

On 24 May 2005, the group entered into a sale agreement to dispose of PacifiCorp, the group's former US regulated business. This operation was classified as a disposal group held for sale and a discontinued operation in accordance with IFRS 5 as of that date. The disposal was completed on 21 March 2006, on which date control of PacifiCorp passed to MidAmerican Energy Holdings Company ( **MidAmerican** ).

## Edgar Filing: - Form

The results of the discontinued operation for the period to 20 March 2006 and year ended 31 March 2005, which have been included in the Group Income Statement, are as follows:

		2006	2005
	Notes	£m	£m
Revenue		2,498.9	2,250.9
Fair value gains on operating derivatives		64.6	
Depreciation and amortisation	(a)	(32.1)	(216.2)
Exceptional item impairment of goodwill	(b)		(922.0)
Other net operating costs		(1,721.8)	(1,500.0)
<hr/>			
Operating profit/(loss)		809.6	(387.3)
Net finance costs	(c)	(178.3)	(66.7)
<hr/>			
Profit/(loss) before tax		631.3	(454.0)
Attributable tax expense		(214.7)	(149.7)
<hr/>			
<b>Profit/(loss) after tax from discontinued operations</b>		<b>416.6</b>	<b>(603.7)</b>
<hr/>			
Exceptional item gain on sale of PacifiCorp	(e)	619.4	
<hr/>			
<b>Profit/(loss) for the period/year</b>		<b>1,036.0</b>	<b>(603.7)</b>

(a) The depreciation and amortisation charge for the period to 20 March 2006 of £32.1 million represents the depreciation and amortisation charged for the period until 23 May 2005. Under IFRS 5, non-current assets held for sale are not subject to depreciation or amortisation and, therefore, the above results did not include charges of £190.8 million in relation to depreciation and amortisation for the period from 24 May 2005 to 20 March 2006.

(b) In November 2004, the Board began a strategic review of PacifiCorp as a result of its performance and the significant investment it required in the immediate future. In May 2005, the Board concluded that in light of the prospects for PacifiCorp, the scale and timing of the capital investment required and the likely profile of returns, shareholders' interests were best served by a sale of PacifiCorp and a return of capital to shareholders. As a consequence, the group undertook a review of the carrying value of the goodwill allocated to the PacifiCorp reporting segment as at 31 March 2005. The estimated recoverable value was based on net realisable value, with reference to the price of comparable businesses, recent market transactions and the estimated proceeds from disposal. This resulted in an exceptional charge, in the year ended 31 March 2005, for impairment of goodwill of £922.0 million.

**Table of Contents**

(c) An analysis of net finance costs is given below:

	2006 £m	2005 £m
Interest charge	174.5	158.7
Interest receivable	(20.6)	(9.5)
Net interest cost on retirement benefit obligations	3.8	5.9
	<b>157.7</b>	<b>155.1</b>
Other finance items allocated to discontinued operations:		
Fair value losses on financing derivatives	13.5	
Interest rate differential	(39.0)	(88.4)
Loss following de-designation of net investment hedges	46.1	
	<b>20.6</b>	<b>(88.4)</b>
<b>Net finance costs</b>	<b>178.3</b>	<b>66.7</b>

Net finance costs include the UK/US interest rate differential benefit of £39.0 million (2005 £88.4 million) arising from the group's US dollar hedging programme relating to PacifiCorp's net assets for the year ended 31 March 2006. This programme has terminated following the sale of PacifiCorp on 21 March 2006.

(d) The cash flows of the discontinued operation, which have been included in the Group Cash Flow Statement, are as follows:

	2006 £m	2005 £m
Net cash from operating activities – discontinued operations	569.9	404.6
Net cash used in investing activities – discontinued operations	(420.3)	(471.3)
Net cash (used in)/provided by financing activities – discontinued operations	(253.3)	150.1
<b>Net (decrease)/increase in net cash and cash equivalents – discontinued operations</b>	<b>(103.7)</b>	<b>83.4</b>

(e) The gain on sale of PacifiCorp is analysed as follows:

	Notes	31 March 2006 £m
Intangible assets		
goodwill		854.2
other intangible assets		215.4
Property, plant and equipment		5,424.3
Investments		172.4
Other non-current assets		128.3
Current assets		530.8
Current liabilities		(749.4)
Non-current liabilities		(3,907.0)
Book value of PacifiCorp net assets disposed		2,669.0
Book gain on sale (pre-tax)	(i)	122.5
Net disposal proceeds		2,791.5

Satisfied by:		
Cash received for net assets		<b>2,911.4</b>
Cash expenses		<b>(26.2)</b>
<hr/>		
Net disposal cash proceeds	(ii)	<b>2,885.2</b>
Accrued expenses		<b>(74.3)</b>
Impairment of assets	(iii), 17	<b>(19.4)</b>
<hr/>		
Net disposal proceeds		<b>2,791.5</b>
<hr/>		
(i) The gain on sale of PacifiCorp comprises:		
Book gain on sale (pre-tax)		<b>122.5</b>
Tax credit on sale	(iv)	<b>12.3</b>
Cumulative translation gains realised on sale transferred from equity	33	<b>484.6</b>
<hr/>		
<b>Gain on sale of PacifiCorp</b>		<b>619.4</b>
<hr/>		

- (ii) The book gain on sale excludes cash outflows of £116.7 million relating to the settlement of certain treasury derivative financial instruments following the sale of PacifiCorp, which had previously been marked-to-market.
- (iii) PPM Energy has leased a power plant to PacifiCorp since 2002. As part of the final settlement achieved with MidAmerican on completion of the sale of PacifiCorp, the group agreed to a reduction in lease rentals receivable by PPM Energy from PacifiCorp in respect of this lease. As a consequence of this reduction in lease rentals, an impairment of £19.4 million has been charged against the gain on sale. Other sale expenses (cash and accrued) of £100.5 million principally comprise legal and other professional fees of £37.8 million and a provision of £32.9 million for royalties payable to MidAmerican.
- (iv) The disposal of PacifiCorp gives rise to a net taxable capital loss for the group which is offset against other taxable capital gains made in the current year. As a result the gain on sale has benefited from a tax credit of £12.3 million.
- (f) The operating profit before goodwill amortisation and exceptional items for PacifiCorp for the year ended 31 March 2005 under UK GAAP on the previous segmental basis was £541.7 million. The operating profit, as adjusted for exceptional items and contracts now within the scope of IAS 39, of PacifiCorp for the year ended 31 March 2005 under IFRS on the revised segmental basis was £534.6 million. The movements comprise reallocation of corporate costs of £12.9 million, reallocation of PacifiCorp non-regulated operating profit of £(39.1) million, IFRS adjustments of £19.2 million and adjustments for contracts now within the scope of IAS 39 of £(0.1) million.

**Table of Contents**

- (g) Employee costs of £334.4 million (2005 £307.6 million) were charged against the results of the discontinued operation for the period from 1 April 2005 to 20 March 2006. These comprised wages and salaries of £364.4 million (2005 £310.8 million), social security costs of £23.4 million (2005 £19.5 million) and pension and other costs of £55.0 million (2005 £63.6 million) less amounts charged as capital expenditure of £108.4 million (2005 £86.3 million). The average number of employees (full-time and part-time), including executive directors, employed by the discontinued operation during the year was 6,597 (2005 6,610).

**10 Earnings per share and reconciliation of adjusted profits, earnings per share and diluted earnings per share****(a) Earnings per share**

Earnings per share have been calculated by dividing the profit/(loss) for the year (as adjusted for minority interests) by the weighted average number of ordinary shares in issue during the year, based on the following information:

	2006 £m	2005 £m
<b>Basic earnings per share</b>		
Profit/(loss) attributable to equity holders of Scottish Power plc		
Continuing	507.3	413.7
Discontinued	1,036.0	(607.1)
Continuing and Discontinued	1,543.3	(193.4)
Weighted average share capital (number of shares, million)	1,842.4	1,830.8
<b>Diluted earnings per share</b>		
Profit/(loss) attributable to equity holders of Scottish Power plc		
Continuing	507.3	424.7
Discontinued	1,036.0	(607.1)
Continuing and Discontinued	1,543.3	(182.4)
Weighted average share capital (number of shares, million)	1,856.0	1,928.0

The difference between the profit for the financial year from continuing operations for the purposes of the basic and the diluted earnings per share calculations is analysed as follows:

	2006 £m	2005 £m
Basic earnings per share profit for the financial year	507.3	413.7
Interest on convertible bonds		11.0
<b>Diluted earnings per share profit for the financial year</b>	<b>507.3</b>	<b>424.7</b>

The difference between the weighted average share capital for the purposes of the basic and the diluted earnings per share calculations is analysed as follows:

2006	2005
------	------

## Edgar Filing: - Form

Number of shares (million)		
Basic earnings per share weighted average share capital	<b>1,842.4</b>	1,830.8
Outstanding share options and shares held in trust for the group's employee share schemes	<b>13.6</b>	6.2
Convertible bonds		91.0
<b>Diluted earnings per share weighted average share capital</b>	<b>1,856.0</b>	1,928.0

The group's convertible bonds were dilutive for the year ended 31 March 2005 and anti-dilutive for the year ended 31 March 2006 based on the continuing profit attributable to equity holders of Scottish Power plc.

**Table of Contents****(b) Reconciliation of adjusted profits, earnings per share and diluted earnings per share**

Set out below are the reconciliations of adjusted profits, earnings per share and diluted earnings per share which have been prepared in accordance with the methodology set out in Group Accounting Policy A. Basis of accounting .

		2006	2005
	Note	£m	£m
<b>Adjusted profit from continuing operations</b>			
<b>Continuing operations</b>			
<b>Operating profit</b>		<b>869.7</b>	673.2
IAS 39 adjustments			
onerous contract releases/intangible assets charges relating to commodity contracts in prior year			(92.4)
proprietary trading profit in prior year			(0.8)
fair value gains on operating derivatives in current year		<b>(85.3)</b>	
Other items			
exceptional items	2	<b>20.1</b>	
<b>Adjusted operating profit</b>		<b>804.5</b>	580.0
<b>Net finance costs</b>		<b>(244.6)</b>	(120.8)
IAS 39 adjustments			
fair value losses on financing derivatives in current year		<b>115.4</b>	
<b>Adjusted net finance costs</b>		<b>(129.2)</b>	(120.8)
<b>Adjusted profit before tax</b>		<b>675.3</b>	459.2
<b>Tax</b>		<b>(117.4)</b>	(137.4)
tax on adjusting items		<b>(44.3)</b>	28.1
<b>Adjusted tax</b>		<b>(161.7)</b>	(109.3)
<b>Adjusted profit from continuing operations</b>		<b>513.6</b>	349.9
		<b>2006</b>	2005
<b>Adjusted profit from discontinued operations</b>			
<b>Discontinued operations</b>			
<b>Profit/(loss) for the period from discontinued operations</b>	9	<b>1,036.0</b>	(603.7)
IAS 39 adjustments			
proprietary trading loss in prior year			(0.1)
fair value gains on operating derivatives in current year		<b>(64.6)</b>	
fair value losses on financing derivatives in current year		<b>13.5</b>	
loss following de-designation of net investment hedges		<b>46.1</b>	
Other items			
gain on sale of discontinued operations before tax	9	<b>(607.1)</b>	
PacifiCorp depreciation 24 May 2005 – 20 March 2006	9	<b>(190.8)</b>	
impairment of PacifiCorp goodwill	9		922.0
Tax on adjusting items		<b>66.8</b>	
Net adjusting items		<b>(736.1)</b>	921.9
<b>Adjusted profit from discontinued operations</b>		<b>299.9</b>	318.2

	2006	2005
<b>Adjusted total profit attributable to equity holders of Scottish Power plc</b>	<b>£m</b>	<b>£m</b>
<b>Adjusted total profit for the year</b>	<b>813.5</b>	<b>668.1</b>
Minority interests	(0.4)	(4.7)
<b>Adjusted total profit attributable to equity holders of Scottish Power plc</b>	<b>813.1</b>	<b>663.4</b>
	2006	2005
<b>Adjusted total basic earnings per share</b>	<b>£m</b>	<b>£m</b>
Weighted average share capital (number of shares, million)	1,842.4	1,830.8
<b>Adjusted total basic earnings per share</b>	<b>44.13p</b>	<b>36.24p</b>
	2006	2005
<b>Adjusted continuing basic earnings per share</b>	<b>£m</b>	<b>£m</b>
<b>Adjusted profit from continuing operations</b>	<b>513.6</b>	<b>349.9</b>
Minority interests	(0.4)	(1.3)
<b>Adjusted continuing profit attributable to equity holders of Scottish Power plc</b>	<b>513.2</b>	<b>348.6</b>
<b>Adjusted continuing basic earnings per share</b>	<b>27.85p</b>	<b>19.04p</b>

**Table of Contents**

	2006	2005
	£m	£m
<b>Adjusted diluted earnings per share</b>		
Basic earnings per share - adjusted total profit attributable to equity holders of Scottish Power plc	<b>813.1</b>	663.4
Interest on convertible bonds	<b>14.9</b>	11.0
<b>Diluted earnings per share - adjusted total profit attributable to equity holders of Scottish Power plc</b>	<b>828.0</b>	674.4
Basic earnings per share - weighted average share capital (number of shares, million)	<b>1,842.4</b>	1,830.8
Outstanding share options and shares held in trust for the group's employee share schemes	<b>13.6</b>	6.2
Convertible bonds	<b>91.4</b>	91.0
<b>Diluted earnings per share - weighted average share capital (number of shares, million)</b>	<b>1,947.4</b>	1,928.0
<b>Adjusted total diluted earnings per share</b>	<b>42.52p</b>	34.98p
Basic earnings per share - adjusted profit from continuing operations attributable to equity holders of Scottish Power plc	<b>513.2</b>	348.6
Interest on convertible bonds	<b>14.9</b>	11.0
<b>Diluted earnings per share - adjusted profit from continuing operations attributable to equity holders of Scottish Power plc</b>	<b>528.1</b>	359.6
<b>Adjusted diluted earnings per share from continuing operations</b>	<b>27.12p</b>	18.65p

The group's convertible bonds were dilutive for the years ended 31 March 2006 and 31 March 2005 based on the adjusted profit from continuing operations attributable to equity holders of Scottish Power plc.

**11 Dividends**

	2006	2005	2006	2005
	pence per	pence per	£m	£m
	ordinary	ordinary		
	share	share		
Final dividend paid for prior year	<b>7.65</b>	6.25	<b>139.4</b>	112.9
First interim dividend paid	<b>5.20</b>	4.95	<b>96.0</b>	91.1
Second interim dividend paid	<b>5.20</b>	4.95	<b>96.3</b>	91.0
Third interim dividend paid	<b>5.20</b>	4.95	<b>96.4</b>	91.1
<b>Total dividends paid</b>	<b>23.25</b>	21.10	<b>428.1</b>	386.1
Proposed final dividend	<b>9.40</b>	7.65	<b>138.6</b>	139.4

The proposed final dividend of 9.40 pence per ordinary share is payable on 28 June 2006 to shareholders on the register at 2 June 2006. The proposed final dividend is payable on the new ordinary shares issued as part of the capital restructuring and return of cash to shareholders as explained in more detail in Note 41. The proposed final dividend was approved by the Board on 24 May 2006 and as required by IAS 10 'Events After the Balance Sheet Date' has not been included as a liability in these Accounts.

**12 Reconciliation of operating profit to cash generated from continuing operations**

	<b>2006</b>	<b>2005</b>
	<b>£m</b>	<b>£m</b>
Operating profit	<b>869.7</b>	673.2
Adjustments for:		
Fair value gains on operating derivatives	<b>(85.3)</b>	
Share of loss in jointly controlled entities and associates	<b>0.6</b>	
Exceptional items	<b>20.1</b>	
Amortisation	<b>32.5</b>	71.3
Depreciation	<b>216.1</b>	207.6
Loss/(profit) on sale of property, plant and equipment	<b>4.2</b>	(0.8)
Amortisation of share scheme costs	<b>7.5</b>	5.6
Release of deferred income	<b>(19.7)</b>	(17.5)
Movement in provisions	<b>14.6</b>	(151.5)
<hr/>		
Operating cash flows before movements in working capital	<b>1,060.3</b>	787.9
(Increase)/decrease in inventories	<b>(96.7)</b>	6.9
Increase in trade and other receivables	<b>(356.4)</b>	(312.8)
Increase in trade payables	<b>257.3</b>	199.4
<hr/>		
<b>Cash generated from continuing operations</b>	<b>864.5</b>	681.4
<hr/>		

**Table of Contents****13 Analysis of cash flows in respect of acquisitions and disposals**

	Acquisition 2006	Disposals 2006	Acquisitions 2005	Disposals 2005
	£m	£m	£m	£m
Cash consideration for jointly controlled entities including expenses			(18.3)	
Cash consideration for subsidiaries including expenses	(9.0)	2,852.0	(352.2)	
Cash and cash equivalents acquired			26.8	
Expenses and other costs paid in respect of prior year disposals		(1.1)		(7.4)
	(9.0)	2,850.9	(343.7)	(7.4)

In 2006, the cash flows in respect of the acquisition represent the remaining 50% of Core Utility Solutions Limited acquired from Alfred McAlpine. The cash flows in respect of disposals principally represent the sale of PacifiCorp (£2,885.2 million), the group's former regulated US business and associated settlement of certain treasury derivative financial instruments (£116.7 million), and the sale of the group's underground natural gas storage project at Byley to E.ON UK plc (£83.5 million).

In 2005, the cash flows in respect of the acquisition of subsidiaries represented the purchase of Damhead Creek, the remaining 50% of Brighton Power Station and Atlantic Renewable Energy Corporation. The cash flows in respect of the acquisition of jointly controlled entities represents PPM Energy's investment in the Maple Ridge joint venture. The cash flows in respect of disposals principally represented expenses and other costs related to prior year disposals.

**14 Analysis of net debt**

	Less:		Implementation of IAS 39						
	Net debt		at 1 April						
	at 1 April 2005	Net debt at 1 April 2005	Net debt at 1 April 2005	Net debt at 1 April 2005	Net debt at 1 April 2005				Net debt at 31 March 2006
	At 1 April 2005	-discontinued operations (Note (a))	-continuing operations	-continuing operations (Note (b))	-continuing operations	Cash flow £m	Exchange £m	Other non-cash changes (Note (c)) £m	-continuing operations £m
	£m	£m	£m	£m	£m				£m
Cash at bank and other deposits	1,747.8	116.6	1,631.2	0.7	1,631.9	1,941.0	7.5	4.0	3,584.4
Overdrafts	(20.5)	(19.2)	(1.3)		(1.3)		(0.1)		(1.4)
Net cash and cash equivalents	1,727.3	97.4	1,629.9	0.7	1,630.6	1,941.0	7.4	4.0	3,583.0
Debt due after one year	(4,996.8)	(1,920.9)	(3,075.9)	(18.9)	(3,094.8)	6.8	(77.8)	86.4	(3,079.4)
Debt due within one year	(892.0)	(399.3)	(492.7)	18.7	(474.0)	96.0	(34.9)	(108.7)	(521.6)
Finance leases	(173.3)	(84.8)	(88.5)		(88.5)		(7.9)	31.7	(64.7)

Total	(4,334.8)	(2,307.6)	(2,027.2)	0.5	(2,026.7)	2,043.8	(113.2)	13.4	<b>(82.7)</b>
-------	-----------	-----------	-----------	-----	-----------	---------	---------	------	---------------

- (a) On 24 May 2005, the components of net debt relating to the PacifiCorp disposal group were reclassified as Assets classified as held for sale and Liabilities classified as held for sale in accordance with IFRS 5.
- (b) On the implementation of IAS 39 on 1 April 2005, certain components of net debt were remeasured resulting in a £0.5 million decrease in net debt.
- (c) Other non-cash changes to net debt represents amortisation of finance costs of £(2.2) million, finance costs of £(8.3) million representing the effects of the RPI on bonds carrying an RPI coupon, reclassifications to other balance sheet categories of £(19.1) million, fair value hedge adjustments to the carrying value of debt instruments of £11.3 million and a decrease of £31.7 million, relating to the financing of the group's US aircraft portfolio. In addition, £100.0 million of debt due after one year has become due within one year.

**Table of Contents****15 Segmental balance sheet information****(a) Total assets and liabilities by segment**

	Notes	Total assets		Total liabilities	
		31 March		31 March	
		2006	2005	2006	2005
		£m	£m	£m	£m
<b>Continuing operations</b>					
<b>United Kingdom</b>					
Energy Networks		3,385.4	3,157.8	(750.1)	(694.9)
Energy Retail & Wholesale		4,023.1	2,579.0	(1,082.5)	(805.1)
<b>United Kingdom total</b>		<b>7,408.5</b>	5,736.8	<b>(1,832.6)</b>	(1,500.0)
<b>Continuing operations</b>					
<b>United States</b>					
PPM Energy		1,400.7	667.5	(410.8)	(195.2)
<b>United States total</b>		<b>1,400.7</b>	667.5	<b>(410.8)</b>	(195.2)
<b>Total continuing operations</b>		<b>8,809.2</b>	6,404.3	<b>(2,243.4)</b>	(1,695.2)
Discontinued operations PacifiCorp (United States)			5,916.1		(1,068.4)
Unallocated assets/(liabilities)	(i)	3,901.7	2,323.1	(5,366.5)	(7,922.8)
<b>Total</b>	(ii)	<b>12,710.9</b>	14,643.5	<b>(7,609.9)</b>	(10,686.4)

(i) Unallocated assets/(liabilities) include net debt, tax liabilities, retirement benefit obligations, investments and treasury-related derivatives. Unallocated assets/(liabilities) at 31 March 2005 relate to both continuing and discontinued operations. Unallocated assets/(liabilities) at 31 March 2006 relate solely to continuing operations.

(ii) Investments in jointly controlled entities and associates included in total assets by segment are as follows: Energy Networks £nil (2005 £3.2 million), Energy Retail & Wholesale £10.8 million (2005 £11.1 million), PPM Energy £115.9 million (2005 £38.8 million) and Unallocated assets/(liabilities) £nil (2005 £nil).

**(b) Net asset value per share**

Net asset value per share has been calculated based on net assets (after adjusting for minority interests) and the number of shares in issue (after adjusting for the effect of shares held in trust) at the end of the respective financial years:

	2006	2005
Net assets (as adjusted) (£ million)	5,100.9	3,901.4
Number of ordinary shares in issue at year end (as adjusted) (number of shares, million)	1,850.1	1,832.3

**(c) Capital expenditure by segment**

	Note	Intangible assets		Property, plant and equipment	
		2006 £m	2005 £m	2006 £m	2005 £m
<b>Continuing operations</b>					
<b>United Kingdom</b>					
Energy Networks	(i)	11.9	8.4	286.3	277.0
Energy Retail & Wholesale	(i)	46.3	15.3	177.3	133.6
<b>United Kingdom total</b>		<b>58.2</b>	<b>23.7</b>	<b>463.6</b>	<b>410.6</b>
<b>Continuing operations</b>					
<b>United States</b>					
PPM Energy		2.6	3.5	423.8	56.3
<b>United States total</b>		<b>2.6</b>	<b>3.5</b>	<b>423.8</b>	<b>56.3</b>
<b>Total continuing operations</b>		<b>60.8</b>	<b>27.2</b>	<b>887.4</b>	<b>466.9</b>
Unallocated		2.6	2.6	19.3	8.0
<b>Total</b>	(i)	<b>63.4</b>	<b>29.8</b>	<b>906.7</b>	<b>474.9</b>

- (i) Capital expenditure on property, plant and equipment by business segment is stated gross of capital grants and customer contributions. Capital expenditure on property, plant and equipment for continuing operations net of capital grants and customer contributions amounted to £886.9 million (2005 £449.3 million). Capital grants and customer contributions receivable in respect of continuing operations during the year of £19.8 million (2005 £25.6 million) comprised Energy Networks £19.5 million (2005 £25.1 million) and Energy Retail & Wholesale £0.3 million (2005 £0.5 million).

**Table of Contents****16 Intangible assets**

Other intangible assets							
		Goodwill	Computer software	Hydro relicensing	Other	Total	Total
	Note	£m	£m	£m	£m	£m	£m
<b>(a) Year ended 31 March 2005</b>							
<b>Cost:</b>							
At 1 April 2004		2,339.7	566.6	47.7		614.3	2,954.0
Additions			43.7	20.6		64.3	64.3
Acquisitions	(i)				142.8	142.8	142.8
Disposals			(12.0)			(12.0)	(12.0)
Exchange		(61.7)	(6.9)	(2.1)		(9.0)	(70.7)
<b>At 31 March 2005</b>		<b>2,278.0</b>	<b>591.4</b>	<b>66.2</b>	<b>142.8</b>	<b>800.4</b>	<b>3,078.4</b>
<b>Amortisation:</b>							
At 1 April 2004		483.8	305.7	2.1		307.8	791.6
Amortisation for the year			61.3	1.7	34.4	97.4	97.4
Impairment		922.0					922.0
Disposals			(10.9)			(10.9)	(10.9)
Exchange		(12.9)	(3.3)	(0.1)		(3.4)	(16.3)
<b>At 31 March 2005</b>		<b>1,392.9</b>	<b>352.8</b>	<b>3.7</b>	<b>34.4</b>	<b>390.9</b>	<b>1,783.8</b>
<b>Net book value:</b>							
<b>At 31 March 2005</b>		<b>885.1</b>	<b>238.6</b>	<b>62.5</b>	<b>108.4</b>	<b>409.5</b>	<b>1,294.6</b>
At 1 April 2004		1,855.9	260.9	45.6		306.5	2,162.4
<b>Year ended 31 March 2006</b>							
<b>Cost:</b>							
At 1 April 2005		2,278.0	591.4	66.2	142.8	800.4	3,078.4
Derecognised on implementation of IAS 39	(ii)				(142.8)	(142.8)	(142.8)
At 1 April 2005 as restated		2,278.0	591.4	66.2		657.6	2,935.6
Discontinued operations Additions for the period to 23 May 2005			2.0	0.8		2.8	2.8
Transferred to assets classified as held for sale on 24 May 2005	(iii)	(2,170.4)	(240.9)	(67.0)		(307.9)	(2,478.3)
		107.6	352.5			352.5	460.1
Continuing operations Acquisition	(iv)	8.0					8.0
Additions	(v)		44.5		18.9	63.4	63.4
Disposals	(v)		(2.9)		(4.1)	(7.0)	(7.0)
Exchange		0.9	0.7			0.7	1.6
<b>At 31 March 2006</b>		<b>116.5</b>	<b>394.8</b>		<b>14.8</b>	<b>409.6</b>	<b>526.1</b>
<b>Amortisation:</b>							
At 1 April 2005		1,392.9	352.8	3.7	34.4	390.9	1,783.8
Derecognised on implementation of IAS 39	(ii)				(34.4)	(34.4)	(34.4)
At 1 April 2005 as restated		1,392.9	352.8	3.7		356.5	1,749.4
Discontinued operations Amortisation for the period to 23 May 2005			3.5	0.2		3.7	3.7
Transferred to assets classified as held for sale on 24 May 2005	(iii)	(1,377.2)	(124.2)	(3.9)		(128.1)	(1,505.3)
		15.7	232.1			232.1	247.8
Continuing operations Amortisation for the year	(vi)		32.5			32.5	32.5
Disposals			(2.8)			(2.8)	(2.8)
Exchange			0.2			0.2	0.2
<b>At 31 March 2006</b>		<b>15.7</b>	<b>262.0</b>			<b>262.0</b>	<b>277.7</b>
<b>Net book value:</b>							
<b>At 31 March 2006</b>		<b>100.8</b>	<b>132.8</b>		<b>14.8</b>	<b>147.6</b>	<b>248.4</b>
At 1 April 2005		885.1	238.6	62.5	108.4	409.5	1,294.6

(i) Other intangible assets acquired in the year ended 31 March 2005 represented in-the-money gas contracts acquired on the Damhead Creek and South Coast Power transactions.

## Edgar Filing: - Form

- (ii) On the implementation of IAS 39 on 1 April 2005, in-the-money gas contracts acquired on the Damhead Creek and South Coast Power transactions were reclassified and remeasured as Derivative financial instruments .
- (iii) On 24 May 2005, the intangible assets relating to the PacifiCorp disposal group were reclassified as Assets classified as held for sale in accordance with IFRS 5.
- (iv) Goodwill of £8.0 million arose on the group's acquisition of the remaining 50% of Core Utility Solutions Limited, which became a 100% subsidiary of the group.
- (v) Additions and disposals in the Other category in the year ended 31 March 2006 are in respect of emissions allowances.
- (vi) Amortisation of £8.1 million is included in Cost of sales in the Group Income Statement; £12.5 million in Transmission and distribution costs and £11.9 million in Administrative expenses .

**Table of Contents****(b) Impairment tests for goodwill**

Goodwill has been allocated for impairment testing purposes to three individual cash-generating units Rye House power station, Katy gas storage facility and Core Utility Solutions Limited. The carrying amount of goodwill allocated to Rye House power station (£82.2 million) is significant in comparison with the total carrying amount of goodwill (£100.8 million). The recoverable amount of Rye House power station has been determined based on a value-in-use calculation. That calculation uses cash flow projections based on a financial business plan covering a ten-year period, and a discount rate of 13.5% pre-tax. A business plan covering a ten-year period has been used due to the long-term nature of the business. Cash flows beyond that period have been extrapolated using a steady 2.5% growth rate which results in no growth in real terms beyond the financial business plan period. The value-in-use calculation also takes into account the extrinsic value of the power station as calculated by a widely recognised option pricing model. The extrinsic value of the station represents the additional value of the station from the capture of short-term volatilities in the electricity, natural gas and carbon markets. Management believes that any reasonably possible change in the key assumptions on which Rye House's recoverable amount is based would not cause Rye House's carrying amount to exceed its recoverable amount.

**Key assumptions used for value-in-use calculations:**

Growth rate (beyond period covered by business plan) 2.5% nominal, 0% real

Discount rate (pre-tax) 13.5%

Forward price of underlying commodities (used to calculate extrinsic value)

Volatility of underlying commodities (used to calculate extrinsic value)

Correlations of underlying commodities (used to calculate extrinsic value)

**Basis for determining values assigned to key assumptions:**

Use of a 0% real growth rate is derived from past experience and future expectations for the station

Discount rate is determined on the basis of market data and the divisional cost of capital

Market quotes/management future expectations

Market quotes/historical analysis

Historical analysis

**17 Property, plant and equipment**

	Land and buildings £m	Plant and machinery £m	Vehicles and equipment £m	Total £m
<b>Year ended 31 March 2005</b>				
<b>Cost:</b>				
At 1 April 2004	595.4	9,714.8	717.0	11,027.2
Additions	23.8	849.3	70.6	943.7
Acquisitions	13.1	439.1		452.2
Disposals	(3.0)	(92.7)	(59.2)	(154.9)
Exchange	(4.5)	(140.9)	(13.2)	(158.6)
<b>At 31 March 2005</b>	<b>624.8</b>	<b>10,769.6</b>	<b>715.2</b>	<b>12,109.6</b>
<b>Depreciation:</b>				
At 1 April 2004	181.7	2,004.3	349.6	2,535.6
Charge for the year	16.6	296.6	84.5	397.7
Disposals	(2.0)	(76.4)	(55.3)	(133.7)
Exchange	(0.6)	(19.2)	(5.1)	(24.9)

Edgar Filing: - Form

<b>At 31 March 2005</b>	195.7	2,205.3	373.7	2,774.7
<b>Net book value:</b>				
<b>At 31 March 2005</b>	429.1	8,564.3	341.5	9,334.9
At 1 April 2004	413.7	7,710.5	367.4	8,491.6



## Edgar Filing: - Form

- (f) The net book value of property, plant and equipment held under finance leases at 31 March 2006 was £90.3 million (2005 £97.3 million). The charge for depreciation against these assets during the year was £3.0 million (2005 £5.9 million).
- (g) Included within other operating income in the income statement is £8.8 million (2005 £4.4 million) relating to compensation received from third parties for items of property, plant and equipment that were impaired, lost or given up.
- (h) Assets pledged as security for liabilities at 31 March 2006 amounted to £nil (2005 £6.9 million).

### 18 Investments accounted for using the equity method

	Jointly controlled entities		Associates Shares	Total £m
	Shares £m	Loans £m	£m	
At 1 April 2004	23.5	38.8	2.7	65.0
Additions	18.3	1.5		19.8
Share of retained (loss)/profit	(0.4)	(1.8)	2.2	
Disposals and other	(2.3)	(8.8)	(0.9)	(12.0)
Transfer of joint venture to a subsidiary		(19.1)		(19.1)
Exchange	(0.6)			(0.6)
<b>At 31 March 2005</b>	<b>38.5</b>	<b>10.6</b>	<b>4.0</b>	<b>53.1</b>
Additions	70.1	0.3		70.4
Share of retained profit/(loss)	6.2	(7.1)	0.3	(0.6)
Disposals and other	(1.0)	(0.4)	(0.5)	(1.9)
Exchange	5.7			5.7
<b>At 31 March 2006</b>	<b>119.5</b>	<b>3.4</b>	<b>3.8</b>	<b>126.7</b>

**Table of Contents**

Aggregated amounts relating to jointly controlled entities and associates are given below:

	Jointly controlled			
	entities		Associates	
	2006	2005	2006	2005
	£m	£m	£m	£m
Income	13.1	27.4	1.2	1.2
Reversal of impairment				2.1
Expenses	(14.0)	(29.6)	(0.9)	(1.1)
<b>(Loss)/profit for the year</b>	<b>(0.9)</b>	<b>(2.2)</b>	<b>0.3</b>	<b>2.2</b>
Non-current assets	148.4	62.8	2.7	3.1
Current assets	12.7	22.1	2.1	1.8
<b>Total assets</b>	<b>161.1</b>	<b>84.9</b>	<b>4.8</b>	<b>4.9</b>
Current liabilities	(8.9)	(7.4)	(0.2)	
Non-current liabilities	(32.7)	(39.0)	(0.8)	(0.9)
<b>Total liabilities</b>	<b>(41.6)</b>	<b>(46.4)</b>	<b>(1.0)</b>	<b>(0.9)</b>
<b>Net assets</b>	<b>119.5</b>	<b>38.5</b>	<b>3.8</b>	<b>4.0</b>

**19 Other investments**

	Notes	Available-for-sale investments £m	Other investments £m	Total £m
At 1 April 2004		57.2	72.6	129.8
Additions		2.3	2.6	4.9
Disposals and other		(8.7)	(2.5)	(11.2)
Exchange		(2.0)	(1.2)	(3.2)
At 1 April 2005		48.8	71.5	120.3
Remeasurement adjustment on implementation of IAS 39	(a)	(2.1)		(2.1)
At 1 April 2005 - as restated		46.7	71.5	118.2
Discontinued operations - Additions to 23 May 2005			1.3	1.3
- Transferred to assets classified as held for sale on 24 May 2005	(b)	(46.7)	(72.3)	(119.0)
Continuing operations - Additions			0.5	0.5
- Disposals			3.5	3.5
- Exchange			(0.1)	(0.1)
At 31 March 2006	(c)		0.2	0.2
<b>At 31 March 2006</b>	<b>(c)</b>		<b>4.1</b>	<b>4.1</b>

## Edgar Filing: - Form

- (a) On the implementation of IAS 39 on 1 April 2005, available-for-sale investments previously recorded at cost were restated to fair value. This resulted in a reduction in the carrying value of such investments by £2.1 million.
- (b) On 24 May 2005, available-for-sale investments and other investments relating to the PacifiCorp disposal group were reclassified as Assets classified as held for sale in accordance with IFRS 5.
- (c) At 31 March 2006 the group held £4.1 million of investments for which no quoted market price is available and whose fair value could not be reliably measured. Those investments are held at cost.

## 20 Inventories

	2006	2005
	£m	£m
Raw materials and consumables	102.7	110.8
Fuel stocks	103.0	71.1
Work in progress	1.8	3.5
	<b>207.5</b>	<b>185.4</b>

- (a) Inventories with a value of £2,790.6 million (2005 £2,199.4 million) were recognised as an expense during the year.
- (b) The value of inventories written down during the year was £nil (2005 £0.4 million).

**Table of Contents****21 Trade and other receivables**

	Note	2006 £m	2005 £m
<b>(a) Current receivables:</b>			
Trade receivables	(i)	491.9	521.5
Prepayments and accrued income		786.1	668.9
Other debtors		166.3	485.1
		<b>1,444.3</b>	<b>1,675.5</b>
<b>(b) Non-current receivables:</b>			
Other receivables		10.7	56.2
		<b>10.7</b>	<b>56.2</b>
		<b>1,455.0</b>	<b>1,731.7</b>

- (i) Trade receivables are stated net of provisions for doubtful debts of £78.4 million (2005 £60.6 million) which has been estimated by management, taking into account future cash flows, based on prior experience and assessment of the current economic environment within which the group operates.
- (ii) The group enters into standard netting agreements with its commodity trading counterparties in order to mitigate the credit risk exposure of the business. In addition, the group utilises other forms of collateral to manage its credit risk exposure. These forms of collateral include margining for trading with exchanges, cash collateral utilised for bilateral and brokered trading as well as letters of credit. The total value of all such collateral held with respect to current receivables at the balance sheet date is £76.2 million.
- (iii) With the exception of retail customers, the group considers that 100% of its credit risk can be considered to be with counterparties in related energy industries or with financial institutions operating in energy markets.
- (iv) Trading terms are governed by Industry Standard agreements which typically provide for interest to be charged where payments are not made on the specified settlement date.

**22 Finance lease receivables**

	2006 £m	2005 £m
<b>Amounts receivable under finance leases:</b>		
Current receivables	20.5	17.3
Non-current receivables	104.6	158.4
	<b>125.1</b>	<b>175.7</b>
<b>Gross receivables from finance leases:</b>		
Within one year	28.4	31.8
Between one and five years	79.2	132.2

## Edgar Filing: - Form

More than five years	<b>63.6</b>	91.9
	<b>171.2</b>	255.9
Unearned future finance income on finance leases	<b>(46.1)</b>	(80.2)
Net investment in finance leases	<b>125.1</b>	175.7
The net investment in finance leases is analysed as follows:		
Within one year	<b>20.5</b>	17.3
Between one and five years	<b>53.0</b>	88.7
More than five years	<b>51.6</b>	69.7
	<b>125.1</b>	175.7

The group enters into finance leasing arrangements principally in respect of its US aircraft portfolio. The average lease term of finance leases entered into is 13 to 19 years. The net investment in finance leases at 31 March 2006 of £125.1 million is stated after provision for impairment of £25.4 million.

**Table of Contents****23 Financial assets**

The group has taken exemption under IFRS 1 from applying the standards IAS 32 and IAS 39 in the comparative period. As a result, comparative information disclosed within this note has not been prepared in accordance with IFRS but in accordance with UK GAAP applicable in the comparative period.

**(a) Categories of financial assets**

	Notes	At 31 March 2006		
		UK £m	US £m	Total £m
Derivative financial assets (current and non-current):				
Financial assets at fair value through the income statement	(i)	376.7	136.1	512.8
Hedging derivatives	(ii)	951.2	5.9	957.1
		<b>1,327.9</b>	<b>142.0</b>	<b>1,469.9</b>
Cash and cash equivalents:				
Held-to-maturity investments	(iii)	241.4		241.4
Cash		65.6	141.2	206.8
Available-for-sale financial assets	(iv)	3,136.2		3,136.2
		<b>3,443.2</b>	<b>141.2</b>	<b>3,584.4</b>
Receivables	(v)	1,174.7	226.4	1,401.1
Finance lease receivables (current and non-current)	(vi)	3.9	121.2	125.1
Other investments		2.6	1.5	4.1
		<b>5,952.3</b>	<b>632.3</b>	<b>6,584.6</b>

(i) Included within this category are instruments which, although classified as fair value through the income statement, have been transacted for risk mitigation purposes. The fair value of those instruments is derived from quoted market prices, rates from third-party sources and other valuation methods.

(ii) Further detail on hedging derivative instruments is disclosed in Note 25.

(iii) Held-to-maturity investments include non-derivative debt instruments with fixed and determinable payments and fixed maturity which the group intends to hold to maturity. Those include fixed rate deposits. Those investments are accounted for at cost.

(iv) Included in the available-for-sale financial assets are money market fund deposits classified within the cash and cash equivalents line in the Group Balance Sheet. Available-for-sale financial assets are accounted for at fair value.

(v) Balances outwith the scope of IAS 32, principally prepayments, have been excluded. Receivables are accounted for at amortised cost.

## Edgar Filing: - Form

- (vi) Finance lease receivables are recorded in the balance sheet at the amount of the net investment in the lease after making any necessary impairment provisions for bad and doubtful rentals receivable.

### (b) Terms of cash and cash equivalents and finance lease receivables

	Notes	At 31 March 2006			At 31 March 2005		
		IFRS			UK GAAP		
		UK	US	Total	UK	US	Total
		£m	£m	£m	£m	£m	£m
Fixed rate financial assets	(i)	245.3	121.2	366.5	3.9	84.2	88.1
Floating rate financial assets	(ii)	3,201.8	141.2	3,343.0	1,524.0	234.4	1,758.4
		<b>3,447.1</b>	<b>262.4</b>	<b>3,709.5</b>	1,527.9	318.6	1,846.5

All financial assets in the UK are denominated in pounds sterling and those in the US are denominated in US Dollars.

- (i) Included within fixed rate financial assets at 31 March 2006 are amounts receivable under finance leases of £125.1 million. Included within fixed rate financial assets at 31 March 2005 were amounts receivable under finance leases of £153.4 million less non-recourse finance of £65.3 million.
- (ii) Included within floating rate financial assets of the group's UK and US operations are cash deposits of which £nil in the UK and £nil in the US (2005 £2.3 million and £nil in the UK and US respectively) are subject to either a legal assignment or a charge in favour of a third party.

The fair values of the financial assets disclosed above are not materially different from their book values.

Based on the floating rate treasury financial assets of £3,343.0 million at 31 March 2006 (2005 £1,758.4 million), a 100 basis point change in interest rates would result in a £33.4 million change in profit before tax for the year (2005 £17.6 million).

**Table of Contents**

None of the treasury assets above create potentially significant credit exposure on the basis that all counterparties are required to have a short-term rating of at least A-1, P-1 or F-1 from one of the three major rating agencies.

	Weighted average interest rate at which financial assets are fixed				Weighted average period for which interest is fixed			
	At 31 March 2006		At 31 March 2005		At 31 March 2006		At 31 March 2005	
	IFRS		UK GAAP		IFRS		UK GAAP	
	UK	US	UK	US	UK	US	UK	US
	%	%	%	%	Years	Years	Years	Years
Fixed rate financial assets	4.6	11.0	10.0	10.0	0.1	4	8	4

All amounts in the analysis above take into account the effect of interest rate swaps and currency swaps and the effect of price hedging. Floating rate investments pay interest at rates based on LIBOR, certificate of deposit rates, prime rates or other short-term market rates. The average interest rates on short-term floating rate financial assets as at 31 March 2006 were as follows: UK operations 4.5%, US operations 4.4% (2005 4.8% and 2.0% respectively).

At 31 March 2005, the group also had certain equity investments which have been excluded from the disclosures above because they had no maturity date. The book value of these investments was £48.8 million and the fair value was £46.9 million.

**24 Financial liabilities**

The group has taken exemption under IFRS 1 from applying the standards IAS 32 and IAS 39 in the comparative period. As a result, comparative information disclosed within this note has not been prepared in accordance with IFRS but in accordance with UK GAAP applicable in the comparative period.

**(a) Categories of financial liabilities**

	Notes	At 31 March 2006		
		UK	US	Total
		£m	£m	£m
Derivative financial liabilities (current and non-current):				
Financial liabilities designated at fair value through the income statement	(i)	392.5	142.6	535.1
Hedging derivatives	(ii)	41.2		41.2
		433.7	142.6	576.3
Loans and other borrowings (current and non-current):				
unsecured	(iii)	3,486.5	32.2	3,518.7
secured	(iii)		83.7	83.7

## Edgar Filing: - Form

		<b>3,486.5</b>	<b>115.9</b>	<b>3,602.4</b>
Payables	(iv)	<b>1,004.0</b>	<b>274.2</b>	<b>1,278.2</b>
Provisions	(iv)	<b>8.0</b>	<b>33.6</b>	<b>41.6</b>
Obligations under finance leases (current and non-current)	(v)		<b>64.7</b>	<b>64.7</b>
		<b>4,932.2</b>	<b>631.0</b>	<b>5,563.2</b>

- (i) Included within this category are instruments which, although classified as fair value through the income statement, have been transacted for risk mitigation purposes. The fair value of those instruments is derived from quoted market prices, rates from third-party sources and other valuation methods.
  
- (ii) Further detail on hedging derivative instruments is disclosed in Note 25.
  
- (iii) Loans and other borrowings include non-derivative financial liabilities, other than liabilities relating to own use commodity purchases and settled commodity derivatives, which have been accounted for as part of payables. Loans and other borrowings are accounted for at amortised cost. Refer to Note 24(c) for further analysis.
  
- (iv) Balances outwith the scope of IAS 32, principally payments received on account and other amounts not contractually committed, have been excluded. The fair value of payables disclosed above are not materially different from their book values.
  
- (v) Obligation under finance leases comprises the fixed rate non-recourse debt in relation to the US lease portfolio. Maturity analysis is given in Note 27.

**Table of Contents****(b) Maturity analysis of loans and other borrowings**

	At 31 March 2006		
	IFRS Book value £m	Fair value £m	2005 UK GAAP* Book value £m
<b>UK operations</b>			
Within one year, or on demand	488.6	656.1	
Between one and two years	25.8	25.8	
Between two and three years	410.7	420.9	
Between three and four years	635.8	642.8	
Between four and five years	50.0	51.8	
More than five years	1,875.6	2,058.4	
	<b>3,486.5</b>	<b>3,855.8</b>	
<b>US operations</b>			
Within one year, or on demand	34.4	34.4	
Between one and two years	2.4	2.4	
Between two and three years	2.5	2.5	
Between three and four years	2.7	2.7	
Between four and five years	2.9	2.9	
More than five years	71.0	71.0	
	<b>115.9</b>	<b>115.9</b>	
<b>Total</b>			
Within one year, or on demand	523.0	690.5	553.4
Between one and two years	28.2	28.2	213.9
Between two and three years	413.2	423.4	90.1
Between three and four years	638.5	645.5	611.7
Between four and five years	52.9	54.7	1,047.0
More than five years	1,946.6	2,129.4	3,378.7
	<b>3,602.4</b>	<b>3,971.7</b>	<b>5,894.8</b>

Finance leases included within each of the repayment categories listed above for the year ended 31 March 2005 are as follows: within one year or on demand £nil, between one and two years £0.2 million, between two and three years £0.3 million, between three and four years £0.3 million, between four and five years £0.5 million and in more than five years £12.7 million.

The minimum future finance lease payments for the year ended 31 March 2005 are detailed as follows: within one year or on demand £1.7 million, between one and two years £1.8 million, between two and three years £1.9 million, between three and four years £1.9 million, between four and five years £2.0 million and in more than five years £22.7 million. These payments include interest charges allocated to future years of £18.0 million.

\* As disclosed in Note 20(c) to the group's Annual Report & Accounts 2004/05.

**Table of Contents****(c) Analysis of loans and other borrowings by instrument and maturity**

		2006								2005		
		IFRS								UK GAAP		
		Weighted average interest rate		2007	2008	2009	2010	2011	Thereafter	Book value Total	Fair value	Book value*
		Notes	2006	2005*	£m	£m	£m	£m	£m	£m	£m	£m
<b>Analysis by instrument and maturity</b>												
<b>Unsecured debt of UK operations</b>												
Uncommitted bank loans	(i)	4.7%	4.2%	7.1						7.1	7.1	7.2
Medium-term notes/private placements	(ii)	5.7%	5.8%	100.0	25.8	102.2	21.2		612.9	862.1	955.1	963.6
Loan notes		4.8%	4.8%									1.1
European Investment Bank loans	(iii)	5.8%	5.9%			50.2	98.0	50.0		198.2	202.4	199.2
Variable rate Australian dollar bond 2011	(iv)	5.3%	5.4%						262.2	262.2	274.2	235.1
4.000% US dollar convertible bonds	(v)	4.4%	4.4%	381.5						381.5	548.7	365.4
5.250% deutschmark bond 2008	(vi)	6.8%	6.8%			258.3				258.3	268.0	246.1
6.625% euro-sterling bond 2010	(vii)	6.7%	6.7%				200.9			200.9	211.2	198.8
4.910% US dollar bond 2010	(viii)	5.0%	5.0%				315.7			315.7	309.8	289.9
5.375% US dollar bond 2015	(viii)	5.1%	5.1%						344.2	344.2	335.7	325.1
8.375% euro-sterling bond 2017	(vii)	8.5%	8.5%						204.9	204.9	252.7	198.0
6.750% euro-sterling bond 2023	(vii)	6.8%	6.8%						251.6	251.6	296.5	247.3
5.810% US dollar bond 2025	(viii)	5.9%	5.9%						199.8	199.8	194.4	183.5
				488.6	25.8	410.7	635.8	50.0	1,875.6	3,486.5	3,855.8	3,460.3
<b>Unsecured debt of US operations</b>												
Bank overdrafts	(i)			1.4						1.4	1.4	20.5
Commercial paper	(ix)		2.9%									248.0
Pollution control revenue bonds	(x)		2.5%									178.7
Finance leases	(xi)		11.9%									14.0
Other borrowings	(xii)	4.4%	2.9%	30.8						30.8	30.8	9.8
				32.2						32.2	32.2	471.0
<b>Unsecured debt</b>				520.8	25.8	410.7	635.8	50.0	1,875.6	3,518.7	3,888.0	3,931.3
<b>Secured debt of US operations</b>												
First mortgage and collateral bonds	(xiii)		7.0%									1,636.5
Pollution control revenue bonds	(x)		3.3%									209.7
Other secured borrowings	(xiv)	7.1%	6.9%	2.2	2.4	2.5	2.7	2.9	71.0	83.7	83.7	117.3
<b>Secured debt</b>				2.2	2.4	2.5	2.7	2.9	71.0	83.7	83.7	1,963.5
<b>Total debt</b>				523.0	28.2	413.2	638.5	52.9	1,946.6	3,602.4	3,971.7	5,894.8

\* As disclosed in Note 20(a) to the group's Annual Report & Accounts 2004/05.

Weighted average interest rates in the analysis above take into account the effect of interest rate swaps and currency swaps used to convert underlying debt into sterling and the effect of price hedging.

**(i) Bank overdrafts and uncommitted short-term borrowings**

For short-term borrowings (overdrafts and uncommitted bank loans) the book value approximates the fair value because of their short maturities.

**(ii) Medium-term notes/private placements**

Scottish Power plc and Scottish Power UK plc have an established joint US \$7.0 billion euro-medium-term note programme. Scottish Power plc has not yet issued under the programme. Paper is issued in a range of currencies and swapped back into sterling. As at 31 March 2006, maturities range from 1 to 34 years. The fair value of those medium-term loans/placements as at 31 March 2006 has been calculated as £955.1 million. The fair value has been calculated by discounting the estimated cash flows at the appropriate market discount rate.

Some of those notes (total value of £300.0 million) contain a Loss of licences covenant that will require repayment of the outstanding amount should the UK group lose all of its electricity licences (distribution, transmission and supply licences). The notes can be redeemed by the group with 30 to 90 days notice in case of unfavourable and unavoidable change in the UK tax laws impacting on the note payments.

---

**Table of Contents**
**(iii) European Investment Bank ( EIB ) loans**

These loans incorporate agreements with various interest rates and maturity dates. The maturity dates of these arrangements range from 2009 to 2011. The fair values of the European Investment Bank loans at 31 March 2006 have been calculated by discounting their future cashflows at market rates adjusted to reflect the redemption adjustments allowed under each agreement.

**(iv) Variable rate Australian dollar bond 2011**

The bond has been issued by Scottish Power UK plc. The bond's fair value at 31 March 2006 has been estimated using quoted market prices converted at the spot rate of exchange as appropriate. The bond contains a Loss of licences covenant that will require repayment of the entire debt should the UK group lose all of its electricity licences (distribution, transmission and supply licences). The bond contains an early redemption option where the group can choose to repay the principal amount and accrued interest at any time by giving 30 to 90 days notice to the lender.

**(v) US dollar convertible bonds**

Scottish Power Finance (Jersey) Limited ( the issuer ) has issued US \$700 million 4% step-up perpetual subordinated convertible bonds guaranteed by Scottish Power plc. The bonds are convertible into redeemable preference shares of the issuer which will be exchangeable immediately on issuance for ordinary shares in Scottish Power plc. The Exchange Price was initially set at £4.60 but will be subject to change on the occurrence of certain events set out in the Offering Circular, including payments of dividends greater than amounts set out in the bond agreement, capital restructuring and change of control. Subsequent to 31 March 2006 and, as a result of the return of cash to shareholders, the Exchange Price has been adjusted to £4.544. The exchange rate to be used to convert US dollar denominated preference shares into sterling is 1.6776. Conversion of the bonds into shares is at the option of the bondholders. During the period up to 3 July 2011, they can opt to convert the bonds into preference shares of the issuer which are immediately exchangeable into ordinary shares of Scottish Power plc. If the bonds remain outstanding after 10 July 2011, they will bear interest at the rate of 4% per annum above the London Interbank Offer Rate for three month US dollar deposits. The bonds are perpetual, so there is no fixed redemption date. There are, however, occasions where redemption may occur. The issuer may redeem the bonds: i) if, after 10 July 2009, for the preceding 30 dealing days the average of the middle market quotations of any ordinary share has been at least 130% of the average Exchange Price; ii) if, at any time, conversion rights have been exercised and/or purchases effected in respect of 85% or more in principal amount of the bonds; or iii) at any time after 10 July 2011, provided all the outstanding bonds are redeemed. Under ii) and iii), the redemption amount will be principal value plus accrued, unpaid interest. Under i), the redemption will be by way of issue of shares. The bondholders may require redemption if an offer is made to the shareholders of Scottish Power plc to buy their shares in the company. The redemption amount will be principal value plus accrued, unpaid interest.

The fair value of the liability component of these bonds has been estimated by discounting the related future cash flows at a market rate. The derivative component relating to the conversion option of this bond has been valued and is accounted for within Derivative Financial Instruments on the balance sheet.

The bond also contains a Loss of licences covenant that will require repayment of the entire debt should the UK group lose all of its electricity licences (distribution, transmission and supply licences).

In the light of evolving practice, the group has changed the classification of its convertible bonds from Non-current liabilities to Current liabilities and restated comparative figures accordingly. The bonds are perpetual and have no fixed redemption date; although they can be redeemed in limited circumstances. Bondholders can convert into ordinary shares of Scottish Power plc at any time and, therefore, the bonds

## Edgar Filing: - Form

meet the definition of current liabilities in IAS 1 Presentation of Financial Statements and the IASB's Framework for the Preparation and Presentation of Financial Statements.

### (vi) Deutschmark bond

The bond has been issued by Scottish Power UK plc. The bond's fair value at 31 March 2006 has been estimated using quoted market prices converted at the spot rate of exchange as appropriate. The bond

## **Table of Contents**

also contains a Loss of licences covenant that will require repayment of the entire debt should the UK group lose all of its electricity licences (distribution, transmission and supply licences). The bond contains an early redemption option where the group can repay it with 30 to 90 days notice in case of unfavourable and unavoidable change in the UK tax laws impacting on the bond payments.

### **(vii) Euro-sterling bonds**

These are quoted euro bonds with various maturities. Their fair values at 31 March 2006 are based on their quoted closing clean market price converted at the spot rate of exchange as appropriate. The bonds also contain a Loss of licences covenant that will require repayment of the entire debt should the UK group lose all of its electricity licences (distribution, transmission and supply licences). The bonds also contain early redemption options where the group can repay them with 30 to 90 days notice in case of an unfavourable and unavoidable change in the UK tax laws impacting on the bond payments. The sterling bond due 2017 can also be redeemed at any time by the group at the higher of principal amount or Redemption Price (as determined by Midland Bank plc) on giving 30 to 90 days notice to the lender. In a similar way the sterling bond due 2023 can be redeemed on giving 30 to 45 days notice at the higher of principal amount or Redemption Price.

### **(viii) US dollar 4.0 billion US shelf registration**

In March 2005, Scottish Power plc established a US \$4.0 billion US shelf registration for the issuance of debt and other securities. An inaugural issue of \$1.5 billion of bonds was made during March 2005. These bonds were split into three maturities of 5, 10 and 20 years, with respective notional values being US \$550 million, US \$600 million and US \$350 million. The bonds fair value at 31 March 2006 has been estimated using quoted market prices converted at the spot rate of exchange as appropriate.

### **(ix) Commercial paper**

Scottish Power UK plc has an established US \$2.0 billion (2005 US \$2.0 billion) euro-commercial paper programme. Paper was issued in a range of currencies and swapped back into sterling. As at 31 March 2005, PacifiCorp had a \$1.5 billion domestic commercial paper programme. No issues are outstanding under the Scottish Power UK plc programme or have been made under this programme since April 2002. As at 31 March 2005, PacifiCorp had borrowings of £248.0 million under its commercial paper programme. Amounts borrowed under commercial paper programmes are repayable in less than one year. There was no commercial paper outstanding as at 31 March 2006.

### **(x) Pollution control revenue bonds**

These were bonds issued by qualified tax exempt entities to finance, or refinance, the cost of certain pollution control, solid waste disposal and sewage facilities. As at 31 March 2005, PacifiCorp had entered into agreements with the issuers pursuant to which PacifiCorp received the proceeds of the issuance and agreed to make payments sufficient to pay principal of, interest on, and certain additional expenses. The interest on the bonds was not subject to federal income taxation for most bondholders. In some cases, PacifiCorp issued first mortgage and collateral bonds as collateral for repayment.

### **(xi) Finance leases**

These are facility leases that were accounted for as capital leases, maturity dates range from 2014 to 2022.

**(xii) Other unsecured borrowings**

The book value of other unsecured borrowings equates to their fair value because of their short maturities.

**Table of Contents****(xiii) First mortgage and collateral bonds**

First mortgage and collateral bonds of PacifiCorp may be issued in amounts limited by its Domestic Electric operation's property, earnings and other provisions of the mortgage indenture. A floating charge at 31 March 2005 over approximately US \$13.1 billion of the eligible assets (based on original costs) of PacifiCorp was used as collateral for PacifiCorp's first mortgage and collateral trust bonds.

**(xiv) Other secured borrowings**

Included within other secured borrowings is ScottishPower's share of debt in a joint arrangement for the Klamath Co-Generation plant. The borrowings of the joint arrangement are the subject of a guarantee, for US \$60.0 million, provided by Scottish Power Holdings Inc. (formerly PacifiCorp Holdings Inc.) in respect of second lien revenue bonds. The fair value of those borrowings is £83.7 million.

	2007		2009		2010		2011		Thereafter	Total	Fair value
<b>Maturity horizons by currency of loans and other borrowings</b>	£m	2008 £m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Fixed rate (GBP)	100.0	25.8	55.0	249.0	50.0	809.7	<b>1,289.5</b>	<b>1,447.9</b>			
Weighted average interest rate (GBP)	6.5%	6.7%	5.5%	6.5%	5.8%	6.4%	6.4%				
Fixed rate (USD) - UK group	381.5			315.7		596.9	<b>1,294.1</b>	<b>1,444.1</b>			
Weighted average interest rate (USD) - UK group	4.0%			5.0%		5.5%	4.9%				
Fixed rate (USD) - US group	2.2	2.4	2.5	2.7	2.9	71.0	<b>83.7</b>	<b>83.7</b>			
Weighted average interest rate (USD) - US group	7.1%	7.1%	7.1%	7.1%	7.1%	7.1%	7.1%				
Fixed rate (EUR)			299.1				<b>299.1</b>	<b>308.9</b>			
Weighted average interest rate (EUR)			5.2%				5.2%				
Index-linked (GBP)						206.8	<b>206.8</b>	<b>245.8</b>			
Weighted average interest rate (GBP)						RPI+3.5%	RPI+3.5%				
Variable rate (GBP)	7.1		30.0	57.0			<b>94.1</b>	<b>94.1</b>			
Weighted average interest rate (GBP)			6m LIBOR	3m LIBOR			4m LIBOR				
Variable rate (USD) - UK group			20.2				<b>20.2</b>	<b>20.1</b>			
Weighted average interest rate (USD) - UK group			3m \$ LIBOR				3m \$ LIBOR				
Variable rate (USD) - US group	32.2						<b>32.2</b>	<b>32.2</b>			
Weighted average interest rate (USD) - US group			1m LIBOR				1m LIBOR				
Variable rate (AUD)						262.2	<b>262.2</b>	<b>274.2</b>			
Weighted average interest rate (AUD)						3m BBSW	3m BBSW				
Variable rate (EUR)			6.4	14.1			<b>20.5</b>	<b>20.7</b>			
Weighted average interest rate (EUR)			3m LIBOR	6m LIBOR			5m LIBOR				
<b>Total debt</b>	<b>523.0</b>	<b>28.2</b>	<b>413.2</b>	<b>638.5</b>	<b>52.9</b>	<b>1,946.6</b>	<b>3,602.4</b>	<b>3,971.7</b>			

The disclosures represent the interest profile and currency profile of financial liabilities before the impact of derivative hedging instruments.

## Edgar Filing: - Form

The average variable rates above, LIBOR, exclude margins. LIBOR is the Sterling London Inter Bank Offer Rate. \$LIBOR is the US dollar London Inter Bank Offer Rate.

GBP Pounds Sterling, USD American Dollars, CAD Canadian Dollars, DKK Danish Krone, EUR Euros, JPY Japanese Yen, AUD Australian Dollars. BBSW is the Australian Bank Bill Rate.

Reference to m in m LIBOR represents months.

### (d) Interest rate analysis of loans and other borrowings

	Note	At 31 March 2006			At 31 March 2005		
		IFRS		Total £m	UK GAAP		Total £m
		GBP £m	USD £m		GBP £m	USD £m	
Fixed rate borrowings		1,487.7	665.0	2,152.7	1,285.4	2,995.1	4,280.5
Floating rate borrowings	(i)	1,417.5	32.2	1,449.7	1,010.9	603.4	1,614.3
		<b>2,905.2</b>	<b>697.2</b>	<b>3,602.4</b>	<b>2,296.3</b>	<b>3,598.5</b>	<b>5,894.8</b>

- (i) Based on the floating rate treasury debt of £1,449.7 million at 31 March 2006 (2005 £1,614.3 million), a 100 basis point change in interest rates would result in a £14.5 million change in profit before tax for the year (2005 £16.1 million).

	Weighted average interest rate at which borrowings are fixed/capped				Weighted average period for which interest is fixed/capped			
	At 31 March 2006		At 31 March 2005		At 31 March 2006		At 31 March 2005	
	IFRS		UK GAAP		IFRS		UK GAAP	
	GBP	USD	GBP	USD	GBP	USD	GBP	USD
	%	%	%	%	Years	Years	Years	Years
Fixed rate borrowings	5.6	4.6	6.7	6.1	6	8	10	10

**Table of Contents**

All amounts in the analysis above take into account the effect of interest rate swaps and currency swaps used to convert underlying debt into sterling. This does not include currency swaps used as part of the hedging of the US net investment. Floating rate borrowings bear interest at rates based on LIBOR, certificate of deposit rates, interbank borrowing rates, prime rates or other short-term market rates. The average interest rate on short-term borrowings as at 31 March 2006 were as follows: GBP 4.7%, USD 4.8% (2005 4.7% and 2.9% respectively).

**(e) Borrowing facilities**

The group has the following undrawn committed borrowing facilities at 31 March 2006 in respect of which all conditions precedent have been met. The facility was renegotiated on 20 December 2005. All facilities are floating rate facilities. The ability to draw on these facilities is governed by certain covenants relating to the performance of the group relative to its interest and dividend payments as well as the group's gearing. None of these covenants have been breached in the course of the year or at the year end.

	<b>At 31 March 2006</b>	At 31 March 2005
	<b>IFRS</b>	UK GAAP
	<b>£m</b>	£m
Expiring between two and five years	<b>500.0</b>	952.4

Commitment fees on the above facilities were as follows: UK Operations £1.7 million (2005 £1.8 million); US Operations £nil (2005 £0.6 million).

**(f) Fair value of financial instruments**

Information required under UK GAAP for the year ended 31 March 2005 relating to the fair value of financial instruments is set out below.

	At 31 March 2005 UK GAAP	
	Book amount £m	Fair value £m
Short-term debt and current portion of long-term debt	547.1	547.1
Long-term debt	5,376.3	5,818.4
Cross-currency swaps	(28.6)	(44.9)
<b>Total debt</b>	<b>5,894.8</b>	<b>6,320.6</b>
Interest rate swaps	(4.1)	(31.7)
Interest rate swaptions	2.6	1.5
Forward contracts	(46.4)	(81.0)
Net investment forward contracts	(39.9)	(28.1)
Net investment cross-currency swaps	(80.3)	(76.5)
Energy hedge contracts		(31.8)

## Edgar Filing: - Form

Energy trading contracts	(5.7)	(5.7)
<b>Total financial instruments</b>	<b>5,721.0</b>	<b>6,067.3</b>

The assumptions used to estimate fair values of financial instruments at 31 March 2005 are summarised below:

- (i) For short-term borrowings (uncommitted borrowing, commercial paper and short-term borrowings under the committed facilities), the book value approximates to fair value because of their short maturities.
- (ii) The fair values of all quoted euro bonds are based on their closing clean market price converted at the spot rate of exchange as appropriate.
- (iii) The fair values of the EIB loans have been calculated by discounting their future cash flows at market rates adjusted to reflect the redemption adjustments allowed under each agreement.
- (iv) The fair values of unquoted debt have been calculated by discounting the estimated cash flows for each instrument at the appropriate market discount rate in the currency of issue in effect at the balance sheet date.

**Table of Contents**

- (v) The fair values of the sterling interest rate swaps and sterling forward rate agreements have been estimated by calculating the present value of estimated cash flows.
- (vi) The fair values of the sterling interest rate swaptions are estimated using the sterling yield curve and implied volatilities as at 31 March 2005.
- (vii) The fair values of the cross-currency swaps have been estimated by adding the present values of the two sides of each swap. The present value of each side of the swap is calculated by discounting the estimated future cash flows for that side, using the appropriate market discount rates for that currency in effect at the balance sheet date.
- (viii) The fair values of the forward contracts are estimated using market forward exchange rates on 31 March 2005.
- (ix) The fair values of electricity and gas forwards and futures are estimated using market forward commodity price curves as at 31 March 2005.
- (x) The fair values of weather derivatives have been estimated assuming for water related derivatives a normal water year in several water basins, and for temperature related derivatives, a normal daily high temperature of certain cities in the US.
- (g) Fair value of financial assets and liabilities held for trading**

Information required under UK GAAP for the year ended 31 March 2005 relating to the fair value of financial assets and liabilities held for trading is set out below.

	2005 UK GAAP £m
Net realised and unrealised gains included in profit and loss account	10.5
Fair value of financial assets held for trading at 31 March 2005	33.1
Fair value of financial liabilities held for trading at 31 March 2005	(27.4)

In the UK and US a limited amount of proprietary trading within the limits and guidelines of the risk management framework is undertaken. The transactions included in the table above consist of forward purchase and sale contracts of electricity and forward purchase and sale contracts of gas and gas futures contracts. These contracts were marked to market value using externally derived market prices and any gain or loss arising was recognised in the profit and loss account.

**(h) Currency exposures**

Information required under UK GAAP for the year ended 31 March 2005 relating to currency exposure is set out below.

The group uses forward contracts, cross-currency interest rate swaps and borrowings in foreign currencies to mitigate the currency exposures arising from its net investments overseas. Gains and losses arising on net investments overseas and the forward contracts, cross-currency interest rate swaps and foreign currency borrowings used to hedge the currency exposures are recognised in the Statement of Recognised Income and Expense.

Other than the transactions referred to above, the group did not hold material net monetary assets or liabilities in currencies other than functional currency at 31 March 2005.

## **25 Hedging and derivative instruments**

Hedging activities are undertaken by the group to manage risk exposure in three main areas: Energy Market Risk, Credit Risk and Treasury Management.

### **Energy Market Risk**

The group is exposed to market risk associated with fluctuations in the market price of electricity and generation fuel compounded by volumetric risk caused by unplanned changes in the load and output

## **Table of Contents**

of its portfolio of generation assets. The risk management policies are implemented at the business level with the oversight of the businesses Risk Management committees. The businesses which are exposed to and therefore undertake activities to manage energy market risk are Energy Retail & Wholesale and PPM Energy.

### **Energy Retail & Wholesale**

Energy Retail & Wholesale's hedging activities associated with energy market risk are undertaken within the Energy Wholesale function. The strategy of the business is to mitigate the economic risks associated with electricity generation, purchase of fuel and supply of electricity and natural gas to end users in both the wholesale and retail markets and also to optimise the value of the asset portfolio. From a reporting perspective the objective is to report earnings results that are consistent with its operational strategies and hence recognise the earnings effect of financial and non-financial derivative transactions executed to hedge economic business risks in the same period in which the hedged operational activity impacts earnings. The aim is to minimise earnings volatility, which would otherwise be present as a result of fair valuing all derivative contracts under IAS 39. To achieve this objective, where effectiveness documentation and reporting requirements are met, cash flow hedge accounting is applied by designation of a series of derivative trades and deferring in equity the fair value changes of open derivative positions until the period in which forecast transactions occur. A number of contracts do not qualify for own use or hedge accounting under IAS 39 and are therefore wholly or partially fair valued through the income statement.

Cash flow hedging strategies are developed for each of the electricity, natural gas and coal portfolios to hedge the variability in cash flows associated with changes in the market price of each commodity. Forward (fixed price/fixed volume) contracts are designated as hedging instruments in the power and gas hedges, and financial swaps are designated in the coal hedge.

The electricity hedge is in relation to a long-term electricity procurement contract where volumes purchased are based on floating prices, thereby exposing the business to cash flow variability. The cash flows on this contract are expected to occur until March 2011.

The gas and coal hedges relate to the cash flow variability associated with purchases of natural gas and coal at floating prices that are required to meet forecast demand for each commodity. Forecast demand is based on existing customer numbers and historic profiles of demand at levels that are highly probable of occurring. The associated cash flows extend until December 2010 for gas and December 2008 for coal.

The assessment of effectiveness of all hedging relationships currently in place is carried out on a monthly basis as part of the financial reporting cycle. Prospective assessment is carried out at inception of the hedge and on an ongoing basis to verify that the forecast is still highly probable of occurring. Retrospective assessment is also carried out to assess the effectiveness in the period under review. Prospective and retrospective assessment is performed using statistical analysis and the business can apply the hedge accounting rules prescribed by IAS 39 if the hedging relationship passes the criteria of a three-step regression test.

Hedge effectiveness is measured and respective entries recorded in the balance sheet, reserves and income statement on a monthly basis.

### **PPM Energy**

## Edgar Filing: - Form

PPM Energy undertakes hedging activities to mitigate the economic risks associated with the purchase, transportation, and storage of natural gas. The instruments utilised for economic hedging include:

Fixed price financial basis and index swaps for natural gas

European-style call and put options for natural gas and electricity

140

## **Table of Contents**

American-style call and put options for natural gas

Forward fixed price electricity contracts

Under IAS 39 the business has designated cash flow hedges to manage the variability of cash flows resulting from changes in the market price of gas for quantities of natural gas injected (purchased) and withdrawn (sold) from storage and to reduce volatility of earnings. PPM Energy designates forward gas purchase and sale contracts into the gas storage hedging portfolio. The actual injections and withdrawals of gas from storage occur continuously and the associated cash flows occur on a monthly basis.

Hedge effectiveness is measured and respective entries recorded in the balance sheet, reserves and income statement on a monthly basis.

## **Credit Risk**

The group is exposed to both settlement risk (defined as the risk of a counterparty failing to pay for energy and/or services which have been delivered), as well as replacement risk (defined as the risk of incurring additional costs in order to replace a sale or purchase contract following a counterparty default). Credit risk is mitigated by contracting with multiple counterparties and limiting exposure to individual counterparties to clearly defined limits based upon the risk of counterparty default.

Aggregated portfolio risk is monitored and reported by credit risk indices simulations to quantify the value at risk within the existing portfolio.

With the exception of retail customers, the group considers that 100% of its credit risk can be considered to be with counterparties in related energy industries or with financial institutions operating in energy markets. At the counterparty level the group employs specific eligibility criteria in determining appropriate limits for each prospective counterparty and supplements this with netting and collateral agreements including margining, guarantees, letters of credit and cash deposits where appropriate. Counterparty exposures are then monitored on a daily basis.

## **Treasury Management**

Within the Treasury function the group utilises a number of financial instruments to manage interest rate, foreign currency and value of net investment exposures. The following hedging strategies are currently in place:

### **Cash flow hedges**

Hedging of forecasted interest payments on debt instruments issued by the group: Currently the interest payable on a loan with the European Investment Bank is being hedged to protect the group from variability of cash flows resulting from changes in the interest rates to which the

## Edgar Filing: - Form

payments are linked. Those payments are designated in a cash flow hedging relationship and are expected to occur quarterly up to the maturity of the loan in 2010. An interest rate swap has been designated as a hedging derivative instrument.

Hedging of forecast interest payments on debt instruments denominated in foreign currencies: The group utilises loans denominated in EUR and in USD. Details on those loans are disclosed in Note 24. The interest payments which the group makes on those debts are subject to cash flow risk arising from changes in the EUR and USD exchange rates. Payments are occurring on a quarterly or semi-annual basis up to the maturities of the loans, which extend to 2008. The group has designated cross-currency interest rate swaps as hedges to those interest and principal payments.

Hedging of asset purchases: The group is subject to cash flow risk relating to the value of forecast purchases of various assets (such as coal and wind turbines) which are denominated in foreign currencies. The risk being hedged relates to changes in the foreign exchange rate of the forecast purchase price. The group enters into forward foreign exchange rate contracts to hedge those risks.

## **Table of Contents**

### **Fair value hedges**

Hedging the value of issued sterling debt: The group has issued a number of medium-term loan notes at fixed interest rates. Those have been designated in a hedging relationship with floating for fixed rate swaps as the hedging derivatives. The objective of this hedging strategy is to protect the value of the group's fixed loan notes from changes as a result of fluctuations of the market interest rates.

Hedging the value of cross currency debt: The group has issued debt instruments denominated in EUR, JPY, USD and AUD. The value of the group's liability with respect to those instruments is subject to foreign exchange risk and interest rate risk. As a result the group has entered into cross-currency swaps as hedges and has designated those within a fair value hedging relationship.

### **Net investment hedges**

ScottishPower hedges a proportion of the value of its net investments in its US operations. The risk being hedged is risk of changes in the value of the share of net assets in those operations due to fluctuations of the USD exchange rate. The instruments designated as hedges in the net investment portfolio are cross-currency interest rate swaps, forward USD contracts as well as debt issued in USD.

### **Other hedging strategies**

Hedge assessment for all of the treasury hedging relationships currently in place is done on a quarterly basis. Assessment is done prospectively to verify that the forecast transactions are still highly probable of occurring (for cash flow hedges) as well as retrospectively, to assess the effectiveness in the period under review. Retrospective assessment is performed using the dollar offset approach which compares the change in fair value of the hedging instrument within the hedged item. The changes in fair value of the hedging derivative instruments are compared to the changes in fair value of the hedged items to assess whether a high level of correlation exists between those changes. An effectiveness test result between 80 and 125% means that the group can apply the hedge accounting rules prescribed by IAS 39.

Hedge effectiveness is measured and respective entries recorded in the balance sheet, reserves and income statement on a quarterly basis.

Treasury instruments are valued using quoted market prices only. Swaps and forward agreements are valued against the appropriate market-based curves. Forward price curves are developed using market prices from independent sources for liquid markets and products. No illiquid markets or products are used.

Analysis of the derivative financial instruments disclosed on the balance sheet is shown below.

#### **(a) Analysis of derivative financial instruments**

	Notes	Assets £m	Liabilities £m	Total 2006 £m
<b>Amounts falling due after more than one year:</b>				
Treasury derivatives		82.6	(38.6)	44.0
Derivative commodity contracts	(i)	519.8	(111.1)	408.7
		602.4	(149.7)	452.7
<b>Amounts falling due within one year:</b>				
Treasury derivatives		41.1	(192.7)	(151.6)
Derivative commodity contracts	(i)	826.4	(233.9)	592.5
		867.5	(426.6)	440.9
	(ii)	1,469.9	(576.3)	893.6
This is analysed by derivative type as follows:				
Fair value of commodity market risk hedging instruments	(b)			820.1
Fair value of treasury risk hedging instruments	(c)			95.8
Fair value of other commodity derivative contracts and embedded derivatives	(d)			181.1
Other treasury derivative contracts	(e)			(203.4)
				893.6

- (i) These include derivative commodity contracts which are measured at fair value through the income statement as well as derivative contracts designated in hedging relationships.

**Table of Contents**

(ii) Tables (b) to (e) analyse each of these categories by type and maturity profile.

**(b) Fair value of commodity market risk hedging instruments**

	Notes	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	Thereafter £m	Total £m
<b>Cash flow hedges:</b>								
<b>UK operations</b>								
Commodity hedges	(i)	492.2	184.0	105.3	30.4	2.3		<b>814.2</b>
<b>US operations</b>								
<b>Hedging of injections and withdrawals of gas from storage</b>								
Forward gas sales and purchases and financial contracts	(ii)	5.9						<b>5.9</b>
<b>Total</b>		<b>498.1</b>	<b>184.0</b>	<b>105.3</b>	<b>30.4</b>	<b>2.3</b>		<b>820.1</b>

Derivatives which have a positive fair value are shown in the table above without brackets.

- (i) The fair value of derivative contracts in hedge relationships is determined using published market prices where available and, for illiquid periods, the forward price curves are derived from modelling techniques, which take into account market expectations and information available to all knowledgeable market participants.
- (ii) The fair value of forward gas sales and purchases and financial contracts is determined using quoted market prices.

**(c) Fair value of treasury risk hedging instruments**

	Notes	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	Thereafter £m	Total £m
<b>Interest rate swaps</b>								
	(i)							
Variable to fixed (GBP)					(2.8)			<b>(2.8)</b>
Weighted average pay rate					6.3%			6.3%
Weighted average receive rate					3m LIBOR			3m LIBOR
Fixed to variable (GBP)		3.8	0.8		7.7		10.9	<b>23.2</b>
Weighted average pay rate		6m LIBOR	6m LIBOR		6m LIBOR		6m LIBOR	6m LIBOR
Weighted average receive rate		6.5%	6.7%		6.7%		8.0%	7.3%
<b>Cross-currency swaps</b>								
	(ii)							
Receive fixed USD pay variable GBP							1.7	<b>1.7</b>
Weighted average pay rate (GBP)							6m LIBOR	6m LIBOR
Weighted average receive rate (USD)							4.6%	4.6%
Receive variable USD pay fixed GBP				(1.2)				<b>(1.2)</b>
Weighted average pay rate (GBP)				4.9%				4.9%
Weighted average receive rate (USD)				3m LIBOR				3m LIBOR
Receive variable AUD pay variable GBP							32.4	<b>32.4</b>
Weighted average pay rate (GBP)							6m LIBOR	6m LIBOR
Weighted average receive rate (AUD)							3m BBSW	3m BBSW

Edgar Filing: - Form

Receive fixed EUR pay fixed GBP		10.1				<b>10.1</b>
Weighted average pay rate (GBP)		6.7%				6.7%
Weighted average receive rate (EUR)		5.3%				5.3%
Receive fixed EUR pay variable GBP		4.1				<b>4.1</b>
Weighted average pay rate (GBP)		6m LIBOR				6m LIBOR
Weighted average receive rate (EUR)		5.0%				5.0%
Receive variable EUR pay variable GBP		0.4				<b>0.4</b>
Weighted average pay rate (GBP)		6m LIBOR				6m LIBOR
Weighted average receive rate (EUR)		3m LIBOR				3m LIBOR
Receive variable EUR pay variable GBP		1.4				<b>1.4</b>
Weighted average pay rate (GBP)		6m LIBOR				6m LIBOR
Weighted average receive rate (EUR)		6m EURIBOR				6m EURIBOR
Receive fixed USD pay variable GBP		0.7	0.1			<b>0.8</b>
Weighted average pay rate (GBP)		4.6%	4.9%			4.7%
Weighted average receive rate (USD)		4.9%	5.4%			5.0%
<b>Forward contracts</b>	(iii)					
Buy GBP, sell USD		27.6	10.1			<b>37.7</b>
Buy USD, sell GBP		(6.7)	(6.0)			<b>(12.7)</b>
Buy GBP, sell EUR			(0.2)			<b>(0.2)</b>
Buy EUR, sell GBP		0.8				<b>0.8</b>
Buy DKK, sell GBP		0.1				<b>0.1</b>
<b>Total</b>		<b>25.6</b>	<b>4.7</b>	<b>13.4</b>	<b>7.0</b>	<b>45.1</b>
						<b>95.8</b>

**Table of Contents**

EURIBOR is the Euro European Inter Bank Offer Rate.

The abbreviations contained in the table are defined in Note 24(c). The above table includes derivatives relating to the partial hedging of the net assets of the US operations, hedging interest rate risk and foreign exchange risk on debt issues and hedging foreign exchange risk on a small number of business transactions.

Derivatives which have a positive fair value are shown in the table above without brackets, while derivatives with a negative fair value are shown as bracketed.

- (i) The fair values of the sterling interest rate swaps have been estimated by calculating the present value of estimated cash flows.
- (ii) The fair values of the cross-currency interest rate swaps have been estimated by adding the present values of the two sides of each swap. The present value of each side of the swap is calculated by discounting the estimated future cash flows for that side, using the appropriate market discount rates for that currency in effect at the balance sheet date.
- (iii) The fair values of the forward contracts are estimated using quoted market forward exchange rates as at 31 March 2006.

**(d) Fair value of other commodity derivative contracts and embedded derivatives**

	Notes	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	Thereafter £m	Total £m
Energy forwards and futures	(i)	(52.7)	(1.2)	(6.5)	(6.0)	(3.5)	0.1	<b>(69.8)</b>
Structured contracts	(ii)	139.6	85.4	50.0	18.7	4.5	(19.1)	<b>279.1</b>
Other	(iii)	7.5	(5.7)	(5.4)	(6.4)	(4.4)	(13.8)	<b>(28.2)</b>
<b>Total</b>		<b>94.4</b>	<b>78.5</b>	<b>38.1</b>	<b>6.3</b>	<b>(3.4)</b>	<b>(32.8)</b>	<b>181.1</b>

Listed above are contracts which are derivatives and do not qualify for own use exemption under IAS 39. Also included are embedded derivative elements in non-derivative commodity contracts accounted for on an accruals basis, which are required to be valued separately, as well as entire commodity contracts, including their derivative components, which have been fair valued due to the fact that embedded derivatives could not be separated. The fair values of the above derivative instruments have been calculated following the methods and assumptions outlined for the designated hedging instruments above, with the exception of the following other derivative contracts, which have been valued as indicated below.

- (i) Included in this category are instruments which are held for trading and others which, although classified as fair value through the income statement, have been transacted for risk mitigation purposes. The fair value of those instruments is derived from published market prices from third party sources and other valuation techniques.
- (ii) The fair value of structured, long-term commodity contracts is calculated using published market prices and other forecast prices which are based on models and other valuation methods.

## Edgar Filing: - Form

- (iii) Included within this category are other non-standard derivative contracts and embedded derivatives in own use commodity contracts which are required to be valued separately. Non-standard derivatives have been valued using published market prices from third party sources. Embedded derivatives in own use commodity contracts have been valued using the with and without approach. This means that the contract has been valued as a whole and also as a stand-alone contract excluding the derivative component. The difference between those two valuations has been determined to be the value of the derivative component.

**Table of Contents****(e) Other treasury derivative contracts**

	Notes	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	Thereafter £m	Total £m
<b>Interest rate swaps</b>								
Fixed to index-linked (GBP)							(23.1)	<b>(23.1)</b>
Weighted average pay rate							3.35 x RPI	3.35 x RPI
Weighted average receive rate							6.2%	6.2%
Fixed to variable (GBP)		1.0						<b>1.0</b>
Weighted average pay rate		6m LIBOR						6m LIBOR
Weighted average receive rate		5.3%						5.3%
Variable to fixed (GBP)			(0.8)				(1.8)	<b>(2.6)</b>
Weighted average pay rate			6.6%				5.5%	5.8%
Weighted average receive rate			6m LIBOR				3m LIBOR	3m LIBOR
Variable to variable (GBP)				1.0	0.2			<b>1.2</b>
Weighted average pay rate				6m LIBOR	6m LIBOR			6m LIBOR
Weighted average receive rate	(i)			CMS <sub>1</sub>	CMS <sub>2</sub>			CMS <sub>2</sub>
<b>Swaptions</b>								
Variable to fixed (GBP)	(ii)						(2.5)	<b>(2.5)</b>
Weighted average pay rate							4.3%	4.3%
Weighted average receive rate							6m LIBOR	6m LIBOR
<b>Forward contracts</b>								
Buy GBP, sell USD		(0.5)	0.1					<b>(0.4)</b>
Buy USD, sell GBP		4.6	0.2					<b>4.8</b>
Buy CAD, sell USD			0.2					<b>0.2</b>
Buy USD, sell CAD		0.5						<b>0.5</b>
Buy DKK, sell USD			0.2					<b>0.2</b>
Buy JPY, sell USD			0.1					<b>0.1</b>
<b>Other contracts</b>								
Embedded derivative on convertible bonds		(182.8)						<b>(182.8)</b>
<b>Total</b>		<b>(177.2)</b>		<b>1.0</b>	<b>0.2</b>		<b>(27.4)</b>	<b>(203.4)</b>

The fair values of the above derivative instruments have been calculated in accordance with the methods and assumptions outlined for the designated hedging instruments above, with the exception of the following other derivative contracts, which have been valued as indicated below.

The above derivative instruments represent derivative instruments that do not qualify for hedge accounting under IAS 39 and embedded derivatives.

(i) CMS<sup>1</sup> Interest received floats on a 10-year swap rate with a base minimum of 3.5%; CMS<sup>2</sup> interest received floats on 10-year swap rate. CMS refers to constant maturity swaps.

(ii) The fair values of the sterling interest rate swaptions are estimated using the sterling yield curve and implied volatilities as at 31 March 2006.

Edgar Filing: - Form

(f) Total fair value of hedging and derivative contracts and embedded derivatives at 31 March 2006

	Notes	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	Thereafter £m	Total £m
Energy Retail & Wholesale		587.9	267.2	150.6	38.1	(5.3)	(36.7)	1,001.8
PPM Energy		4.6	(4.7)	(7.2)	(1.4)	4.2	3.9	(0.6)
Treasury	(i)	(151.6)	4.7	14.4	7.2		17.7	(107.6)
<b>Total</b>		<b>440.9</b>	<b>267.2</b>	<b>157.8</b>	<b>43.9</b>	<b>(1.1)</b>	<b>(15.1)</b>	<b>893.6</b>
Valued based on actively quoted market prices and rates from third party sources	(ii)	291.3	160.3	62.6	5.8	4.2	20.0	544.2
Valued based on models and other valuation methods	(iii)	149.6	106.9	95.2	38.1	(5.3)	(35.1)	349.4
		<b>440.9</b>	<b>267.2</b>	<b>157.8</b>	<b>43.9</b>	<b>(1.1)</b>	<b>(15.1)</b>	<b>893.6</b>

**Table of Contents**

Derivatives which have a positive fair value are shown in the table above without brackets, while derivatives with a negative fair value are shown as bracketed.

- (i) Included in this category is the embedded derivative within the 4% US \$ convertible bonds. For further details see Note 24(c)(v).
- (ii) Included within this category are derivative contracts which are traded in active markets and for which published market price and rate information is available for the whole contract term.
- (iii) This category principally includes commodity purchase contracts which extend over liquid and illiquid periods. The liquid periods for power and gas extend to March 2008 and June 2009, respectively. Fair values for these contracts have been calculated utilising forward price curves for illiquid periods which have been developed internally using various models and assumptions that are intended to simulate expected market price levels. Given the proportionately small element of these contracts that falls within the illiquid period, any range of reasonably possible alternative assumptions applied to power and gas prices is unlikely to have a significant impact on contract fair values. For indicative purposes, a 1% movement in commodity prices in the illiquid period would result in an approximately £1.2 million impact on reported fair values.

The weighted average term for the commodity trading portfolio is 1.8 years. The maximum term of any contract is 10.5 years.

The weighted average term of the treasury trading portfolio at year end is 3.8 years. The weighted average term of the hedging derivative instruments is 3.6 years. The maximum term of any contract is 24 years.

**26 Effect of hedging and derivative instruments on the results**

The group has taken exemption under IFRS 1 from applying the standards IAS 32 and IAS 39 in the comparative period. Accordingly no comparative information is disclosed within footnote (a). Comparative information prepared in accordance with UK GAAP applicable in the comparative period is set out in footnote (b).

(a) An analysis of the effect of hedging and derivative financial instruments on the income statement is given below:

	2006
	Notes
	£m
<b>Continuing operations</b>	
<b>Fair value gains on operating derivatives:</b>	
<b>Cash flow hedges</b>	
Losses on ineffective hedging recognised in the year	(i) (3.3)
<b>Effect of other derivative instruments and fair value contracts</b>	
Losses on other derivative market instruments classified as held for trading	(ii) (9.5)
Gains on structured contracts	111.8
Losses on embedded derivative components in non-derivative instruments	(13.7)
	<b>85.3</b>

Edgar Filing: - Form

<b>Continuing operations</b>	
<b>Fair value losses on financing derivatives:</b>	
Gains on other derivative instruments	9.7
Losses on embedded derivative components in non-derivative instruments	(125.1)
	(115.4)
<b>Discontinued operations</b>	
<b>Fair value gains on operating derivatives:</b>	
Gains on other derivative market instruments classified as held for trading	64.6
	64.6
<b>Discontinued operations</b>	
<b>Fair value losses on financing derivatives:</b>	
Losses on other derivative instruments	(13.5)
<b>Net investment hedges</b>	
Loss following de-designation of net investment hedges	(iii) (46.1)
	(59.6)

**Table of Contents**

	Notes	2006 £m
<b>Other items</b>		
<b>Fair value hedges</b>		
Movements to the fair value of hedging instruments recorded in the year	(iv)	1.5
Movements to the fair value of a hedged item recorded in the year	(v)	(3.2)
Amortisation of movements in fair value of hedged items	(vi)	1.2
		<b>(0.5)</b>
<b>Cash flow hedges</b>		
Gains removed from equity and recognised in the year	(vii)	496.4
		<b>496.4</b>
<b>Total</b>		<b>470.8</b>

- (i) These amounts relate to cumulative changes in the fair value of hedging instruments, which have more than offset the cash flow movements on the hedged items. In accordance with IAS 39 the excess gain/loss has been recorded in the income statement classified as Fair value gains on operating derivatives . Refer to Note 1(d).
- (ii) This is the impact on the income statement of amounts valued using models and valuation methods as described in Note 25(f).
- (iii) These amounts relate to the loss following de-designation of net investment hedges arising from the group's US dollar hedging programme relating to PacifiCorp's net assets on 1 April 2005. Refer to Note 9(c).
- (iv) The adjustments relate to the change in fair value of the financial fixed and floating ISDA swaps entered into to hedge the fair value of the coal stock held by the group and a change in fair value of the cross-currency and interest rate swaps entered into to hedge the fair value of foreign currency and sterling debt.
- (v) The adjustments relate to a change in fair value of the coal stock held by the group as well as a change in the fair value of foreign currency and sterling denominated debt, which have been designated as hedged items in fair value hedging relationships.
- (vi) The charge for the year relates to amortisation of previously recorded movements in the fair value of hedged items designated in fair value hedging relationships.
- (vii) The amount relates to gains and losses on the effective portions of cash flow hedges which have previously been deferred in equity which have been transferred to the income statement in the current year to match timing of occurrence of the hedged cash flows or where hedged forecasted cash flows are no longer expected to occur. The ineffective portions of cash flow hedges are dealt with in (i) above.

**(b) Comparative information**

The group has taken exemption under IFRS 1 from applying the standards IAS 32 and IAS 39 to the comparative period. The comparatives relating to hedging and derivative instruments for the year ended 31 March 2005 are presented below under UK GAAP in accordance with the disclosure requirements of FRS 13 Financial Reporting Standard 13 Derivatives and other financial instruments .



**Table of Contents****Hedges**

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. Unrecognised gains and losses on instruments used for hedging, and the movements therein, are as follows:

	Note	2005		Total net gains/(losses) £m
		Gains £m	Losses £m	
Unrecognised gains and (losses) on hedges at 1 April 2004		181.0	(112.6)	68.4
Transfer from gains to losses	(i)			
Transfer from losses to gains	(i)	(28.2)	28.2	
(Gains) and losses arising in previous years that were recognised in 2004/05		(22.2)	10.4	(11.8)
Gains and (losses) arising before 1 April 2004 that were not recognised in 2004/05		130.6	(74.0)	56.6
Gains and (losses) arising in 2004/05 that were not recognised in 2004/05		32.5	39.9	72.4
Unrecognised gains and (losses) on hedges at 31 March 2005		163.1	(34.1)	129.0
(Losses) and gains expected to be recognised in 2005/06		(26.6)	6.2	(20.4)
Gains and (losses) expected to be recognised in 2006/07 or later		136.5	(27.9)	108.6

(i) Figures in the table above are calculated by reference to the 31 March 2005 fair value of the derivative concerned.

The analysis above excludes any gains and losses in respect of the net investment cross-currency swaps and net investment forward contracts and losses of £17.6 million relating to certain other forward contracts as gains and losses arising on these contracts would have been recognised in the statement of total recognised gains and losses.

**27 Obligations under finance leases**

	2006 £m	2005 £m
Finance leases are repayable as follows:		
Current	6.7	14.5
Non-current	58.0	158.8
	64.7	173.3
Finance lease liabilities - minimum lease payments:		
Within one year	13.2	33.7

Edgar Filing: - Form

Between one and five years	<b>52.1</b>	125.1
More than five years	<b>27.3</b>	129.9
	<b>92.6</b>	288.7
Future finance charges on finance leases	<b>(27.9)</b>	(115.4)
Present value of finance lease liabilities	<b>64.7</b>	173.3
The present value of finance lease liabilities is as follows:		
Within one year	<b>6.7</b>	14.5
Between one and five years	<b>33.9</b>	66.0
More than five years	<b>24.1</b>	92.8
	<b>64.7</b>	173.3

The group enters into finance leases principally in respect of its US aircraft portfolio. These lease obligations are non-recourse to the group. The finance leases have maturity dates ranging from 2008 to 2015. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

**Table of Contents****28 Trade and other payables****(a) Current payables:**

	Note	2006 £m	2005 £m
Trade payables	(i)	201.9	134.5
Other taxes and social security		23.5	45.0
Payments received on account		94.5	48.6
Capital payables and accruals		114.2	149.7
Other payables		45.4	268.1
Accrued expenses		890.2	987.0
		<b>1,369.7</b>	<b>1,632.9</b>

**(b) Non-current payables:**

Other payables		36.6	2.7
		<b>36.6</b>	<b>2.7</b>
		<b>1,406.3</b>	<b>1,635.6</b>

- (i) Trade payables include amounts due on commodity activities. The group has posted amounts of collateral with respect to certain of those liabilities. The value of such collateral posted at 31 March 2006 is £140.8 million.

**29 Deferred tax**

Deferred tax provided in the Accounts is as follows:

	2006 £m	2005 £m
Accelerated capital allowances	649.5	1,274.5
Other temporary differences	173.8	(113.1)
	<b>823.3</b>	<b>1,161.4</b>

	Notes	Accelerated capital allowances £m	Other timing differences £m	Total £m
Deferred tax provided at 1 April 2004		1,219.5	(188.9)	1,030.6

## Edgar Filing: - Form

Charge to income statement		54.3	77.2	131.5
Acquisitions		17.1	16.7	33.8
Exchange		(18.3)	0.8	(17.5)
Other movements		1.9	(18.9)	(17.0)
<hr/>				
Deferred tax provided at 1 April 2005		1,274.5	(113.1)	1,161.4
Increase arising on implementation of IAS 39	(a)		109.6	109.6
<hr/>				
Deferred tax provided at 1 April 2005 as restated		1,274.5	(3.5)	1,271.0
Transferred to liabilities classified as held for sale	(b)	(718.0)	201.8	(516.2)
<hr/>				
		556.5	198.3	754.8
Charge/(credit) to income statement continuing operations		45.1	(110.5)	(65.4)
Exchange		47.9	(4.7)	43.2
Recorded in the Statement of Recognised Income and Expense	(c)		90.7	90.7
<hr/>				
<b>Deferred tax provided at 31 March 2006</b>		<b>649.5</b>	<b>173.8</b>	<b>823.3</b>

- (a) On the implementation of IAS 39 on 1 April 2005, certain assets and liabilities of the group were remeasured resulting in an increase in the deferred tax provision of £109.6 million.
- (b) On 23 May 2005, the deferred tax provision relating to the PacifiCorp disposal group was reclassified as Liabilities classified as held for sale in accordance with IFRS 5.
- (c) In the Statement of Recognised Income and Expense, the deferred tax charge is offset by a current tax credit of £42.9 million.

**Table of Contents****30 Provisions**

	At 1 April 2004 £m	Acquisitions £m	New provisions £m	Unwinding of discount £m	Utilised during year £m	Released during year £m	Exchange £m	At 31 March 2005 £m
<b>2004/05</b>								
Reorganisation and restructuring	3.2				(3.0)			0.2
Environmental and health	60.5			0.8	(12.8)	(30.8)	(0.1)	17.6
Decommissioning costs	84.3	3.5	7.4	5.8	(7.0)		(2.2)	91.8
Onerous contracts	120.5	83.5		8.7	(148.1)			64.6
Other post-employment benefits	6.5		3.3		(2.6)		(0.2)	7.0
Mine reclamation costs	79.6		5.1	3.3	(10.9)		(2.4)	74.7
Other	9.0		8.0		(10.5)		(0.1)	6.4
	363.6	87.0	23.8	18.6	(194.9)	(30.8)	(5.0)	262.3

	At 1 April 2005 £m	Movements Derecognition on implementation of IAS 39 £m	Transferred in discontinued operations Note (g) £m	Transferred to liabilities classified as held for sale Note (g) £m	New provisions £m	Unwinding of discount £m	Utilised during year £m	Transferred to retirement benefit obligations £m	Exchange £m	At 31 March 2006 £m
<b>2005/06</b>										
Reorganisation and restructuring	0.2				42.0		(3.5)	(18.4)		20.3
Environmental and health	17.6		(0.4)	(13.5)	1.0		(1.5)		0.1	3.3
Decommissioning costs	91.8		3.8	(73.4)	4.4	0.9			0.1	27.6
Credit support facility					33.6				0.2	33.8
Onerous contracts	64.6	(64.6)								
Other post-employment benefits	7.0		0.4	(7.4)						
Mine reclamation costs	74.7		2.0	(76.7)						
Other	6.4		(0.1)	(2.7)	3.6				0.1	7.3
	262.3	(64.6)	5.7	(173.7)	84.6	0.9	(5.0)	(18.4)	0.5	92.3

	2006 £m	2005 £m
<b>Analysis of total provisions</b>		
Short-term	26.5	80.1
Long-term	65.8	182.2
	92.3	262.3

## Edgar Filing: - Form

- (a) The provision for reorganisation and restructuring was increased during the year by a charge to the income statement of £42.0 million relating to the costs of the corporate restructuring. Of the total charge, £18.4 million relates to payments made to the company's pension schemes and this amount has been transferred to retirement benefit obligations. The provision was expected to cover the costs of a reduction of employee numbers through redundancies of 356 from 2005/06 onwards, with the balance of the positions to be eliminated through the corporate restructuring being achieved through redeployment and attrition. At 31 March 2006 the group had made redundancy payments under the restructuring to 73 employees.
  
- (b) The environmental and health provisions at 31 March 2005 principally comprised the costs of notified environmental remediation work and constructive obligations in respect of potential environmental remediation costs identified by an external due diligence review in the US. These costs were expected to be incurred in the period up to March 2012. Following the completion of a detailed environmental exposure study £30.8 million of the environmental and health provision was released to the income statement in the year ended 31 March 2005.
  
- (c) The provision for decommissioning costs is the discounted future estimated costs of decommissioning the group's power plants. The decommissioning of these plants is expected to occur over the period between 2012 and 2036.
  
- (d) This provision relates to probable liabilities in relation to a credit support facility provided by PacifiCorp Holdings Inc. (now Scottish Power Holdings Inc.) to certain providers of debt to the Klamath Co-Generation project at the project's inception in 1999. The project is owned by the City of Klamath Falls, but operated by PPM Energy which has a purchase contract for 47% of the output liabilities. This provision is expected to be utilised in the period to 2017.

**Table of Contents**

- (e) The provision for onerous contracts comprised the costs of contracted energy purchases. As a consequence of the implementation of IAS 39 on 1 April 2005 the provision for onerous contracts has been derecognised.
- (f) The other category comprises various provisions which are not individually sufficiently material to warrant separate disclosure.
- (g) The movements in provisions relating to the PacifiCorp disposal group in the period from 1 April 2005 to 23 May 2005 (the date when provisions relating to the PacifiCorp disposal group were reclassified as Liabilities classified as held for sale in accordance with IFRS 5) were as follows:
- (i) Environmental and health utilised during the period £(0.2) million, released during the period £(0.6) million and exchange £0.4 million.
- (ii) Decommissioning costs new provisions £0.9 million, unwinding of discount £0.6 million, utilised during the period £(0.1) million and exchange £2.4 million.
- (iii) Other post-employment benefits new provisions £0.6 million, utilised during the period £(0.4) million and exchange £0.2 million.
- (iv) Mine reclamation costs unwinding of discount £0.5 million, utilised during the period £(0.6) million, released during the period £(0.4) million and exchange £2.5 million.
- (v) Other new provisions £0.7 million, utilised during the period £(0.9) million and exchange £0.1 million.

**31 Deferred income**

	At 1 April 2004 £m	Receivable during year £m	Released to income statement £m	Disposals/ Other £m	Exchange £m	At 31 March 2005 £m
Grants and customer contributions	577.8	51.3	(19.2)	(37.3)	(2.5)	570.1

	At 1 April 2005 £m	Movements in discontinued operations Note (a) £m	Transferred to liabilities classified as held for sale Note (b) £m	Receivable during year Note (c) £m	Released to income statement £m	Disposals/ Other £m	Exchange £m	At 31 March 2006 £m
Grants and customer contributions	570.1	4.2	(93.5)	25.3	(19.7)	(3.6)		482.8

## Edgar Filing: - Form

(a) Movements in grants and customer contributions relating to the PacifiCorp disposal group for the period from 1 April 2005 to 23 May 2005 comprised £2.8 million grants receivable, £(0.3) million released to the income statement and £1.7 million exchange.

(b) On 23 May 2005, those grants and customer contributions relating to the PacifiCorp disposal group were reclassified as Liabilities classified as held for sale in accordance with IFRS 5.

(c) Grants and customer contributions receivable during the year of £25.3 million includes grants and contributions of £19.8 million relating to capital expenditure.

### 32 Share capital

	2006	2005
	£m	£m
<b>Authorised:</b>		
3,000,000,000 (2005 3,000,000,000) ordinary shares of 50p each	1,500.0	1,500.0
	1,500.0	1,500.0
<b>Allotted, called up and fully paid:</b>		
1,871,235,749 (2005 1,865,343,685) ordinary shares of 50p each	935.6	932.7
	935.6	932.7

**Table of Contents**

**(a) Employee share schemes**

The group has a range of share-based plans for employees. Options have been granted and awards made to eligible employees to subscribe for or receive by transfer ordinary shares or ADSs in Scottish Power plc in accordance with the rules of each plan.

The ScottishPower Sharesave Schemes are savings related and under normal circumstances share options are exercisable on completion of a three or five year save-as-you-earn contract as appropriate.

The PacifiCorp Stock Incentive Plan ( PSIP ) relates to options over ScottishPower ADSs. Following the sale of PacifiCorp on 21 March 2006, participants will have 12 months from the date of sale in which to exercise their options.

Awards granted under the Long Term Incentive Plan will vest only if the Remuneration Committee is satisfied that certain performance measures related to the sustained underlying financial performance of the group and improvements in customer service standards are achieved over a period of three financial years commencing with the financial year preceding the date an award is made. The number of shares which become exercisable is dependent on the company's Total Shareholder Return Performance compared to a group of international energy companies.

Options granted under the Executive Share Option Plan 2001 ( ExSOP ) to executive directors and certain senior managers in the UK are subject to the performance criterion that the percentage increase in the company's annualised earnings per share, excluding goodwill amortisation and exceptional items, be at least 3% (adjusted for any increase in the RPI). Options granted to US participants under the ExSOP are not subject to any outstanding performance criteria.

The Employee Share Ownership Plan ( ESOP ) allows eligible employees to make contributions from pre-tax salary to buy shares in ScottishPower which are held in trust (Partnership Shares). These shares are matched by the company up to a value of £50 per month (Matching Shares) and are also held in trust. At the launch of the ESOP, Free Shares were offered to employees.

**(i) Summary of movements in share options in ScottishPower shares**

ScottishPower		Executive		PacifiCorp		Total
Sharesave Schemes	Weighted average exercise price	Share Option Schemes#	Weighted average exercise price	Stock Incentive Plan##	Weighted average exercise price	
(number of shares 000s)	(pence)	(number of shares 000s)	(pence)	(number of shares 000s)	(pence)	(number of shares 000s)

## Edgar Filing: - Form

Outstanding at 1 April 2003	7,441	377.7	9,456	411.5	13,613	500.8	30,510
Granted	2,758	301.0	5,892	352.8			8,650
Exercised	(17)	326.8	(102)	320.3	(590)	347.5	(709)
Lapsed	(2,794)	392.3	(34)	369.5	(1,327)	469.9	(4,155)
<b>Outstanding at 1 April 2004</b>	<b>7,388</b>	<b>343.6</b>	<b>15,212</b>	<b>376.5</b>	<b>11,696</b>	<b>430.4</b>	<b>34,296</b>
Granted	2,143	312.0	5,911	384.4			8,054
Exercised	(298)	382.6	(1,808)	369.5	(3,001)	345.3	(5,107)
Lapsed	(1,599)	383.4	(364)	337.8	(161)	441.8	(2,124)
<b>Outstanding at 1 April 2005</b>	<b>7,634</b>	<b>324.9</b>	<b>18,951</b>	<b>382.3</b>	<b>8,534</b>	<b>443.3</b>	<b>35,119</b>
Granted	2,144	374.0					2,144
Exercised	(1,184)	350.0	(9,701)	387.7	(5,368)	454.2	(16,253)
Lapsed	(513)	338.5	(1,204)	455.5	(87)	514.8	(1,804)
<b>Outstanding at 31 March 2006</b>	<b>8,081</b>	<b>333.4</b>	<b>8,046</b>	<b>393.5</b>	<b>3,079</b>	<b>535.0</b>	<b>19,206</b>
Exercisable at 1 April 2003	176	409.0	811	462.3	11,081	516.8	12,068
Exercisable at 1 April 2004	76	382.9	1,439	435.6	10,852	436.6	12,367
Exercisable at 1 April 2005	3	344.1	4,100	428.8	8,534	443.3	12,637
Exercisable at 31 March 2006	73	329.2	4,996	399.6	3,079	535.0	8,148

# The Executive Share Option figures are a combination of the options outstanding under the Executive Share Option Scheme and the ExSOP.

## PacifiCorp Stock Incentive Plan are options over ScottishPower ADSs; for the purpose of the table above, ADSs have been converted to ScottishPower shares as follows: one ScottishPower ADS equals four ScottishPower ordinary shares. Participants have 12 months from the date of the sale of PacifiCorp to exercise their options. Eligibility for participation in the ExSOP was extended during the year ended 31 March 2003 to certain senior managers in the US.

**Table of Contents****(ii) Analysis of share options outstanding at 31 March 2006**

	Date of grant	Number of participants	Number of outstanding options (000s)	Option price (pence)	Normal exercisable date
<b>ScottishPower Sharesave Schemes</b>					
	9 June 2000	2	1	453.0	6 months to March 2006
	8 June 2001	597	821	386.0	6 months to March 2007
	7 June 2002	595	1,151	323.0	6 months to March 2006 or 2008
	6 June 2003	1,542	2,274	301.0	6 months to March 2007 or 2009
	24 June 2004	1,501	1,826	312.0	6 months to March 2008 or 2010
	22 June 2005	1,941	2,008	374.0	6 months to March 2009 or 2011
<b>Executive Share Option Plan 2001</b>					
UK#	21 August 2001	70	666	483.0	21 August 2004 to 21 August 2011
UK#	2 May 2002	42	915	406.0	2 May 2005 to 2 May 2012
US standard*	2 May 2002	20	245	339.1	2 May 2003 to 2 May 2012**
US conditional* #	2 May 2002	11	153	339.1	2 May 2005 to 2 May 2012
UK##	10 May 2003	102	2,006	376.3	10 May 2006 to 10 May 2013
US*	10 May 2003	72	599	351.4	10 May 2004 to 10 May 2013**
UK##	27 May 2004	111	2,414	389.3	27 May 2007 to 27 May 2014
US*	27 May 2004	86	1,048	413.6	27 May 2005 to 27 May 2014**
<b>PacifiCorp Stock Incentive Plan</b>					
	3 June 1997	10	115	490.5	29 November 1999 to 3 June 2007***
	12 August 1997	4	33	527.6	29 November 1999 to 12 August 2007***
	10 February 1998	63	1,116	595.9	29 November 1999 to 10 February 2008***
	13 May 1998	3,545	819	575.9	29 November 1999 to 13 May 2008***
	9 February 1999	11	183	471.7	9 February 2000 to 9 February 2009***
	11 May 1999	1,454	335	426.8	11 May 2000 to 11 May 2009***
	16 February 2000	5	52	388.0	16 February 2001 to 16 February 2010***
	24 March 2000	1	381	457.2	24 March 2001 to 24 March 2010***
	24 April 2001	5	45	370.1	24 April 2002 to 24 April 2011***

\* Options granted under the Executive Share Option Plan 2001 to US based participants and options granted under the PacifiCorp Stock Incentive Plan are over ScottishPower ADSs. For the purpose of the table above, such options have been converted to ScottishPower ordinary shares as follows: one ScottishPower ADS equals four ScottishPower ordinary shares. The US \$ ADS option exercise price was converted so that it may be represented in terms of ScottishPower ordinary shares. The price was further converted at the closing exchange rate on 31 March 2006 to be quoted in pence in the table above. Eligibility for participation in the Executive Share Option Plan 2001 was extended during the year ended 31 March 2003 to executive directors and certain senior managers in the US.

\*\* Options become exercisable in the following proportions: one third on the first anniversary of grant, a further one third on the second anniversary of grant, and the final one third on the third anniversary of grant.

\*\*\* Following the sale of PacifiCorp, participants will have 12 months in which to exercise their options.

# Performance condition applied which has now been met.

## Performance condition applied which as yet is untested.

## Edgar Filing: - Form

Where reference is made to PacifiCorp Stock Incentive Plan, this is to identify the plan under which the options over ScottishPower ADSs have been granted. For the PacifiCorp Stock Incentive Plan, the date of grant refers to the date the original PacifiCorp Common Stock options were granted. These options were exchanged for options over ScottishPower ADSs following the acquisition on 29 November 1999.

### (iii) Range of exercise prices and remaining contractual life of share options at 31 March 2006

	Options outstanding			Options exercisable	
	Number	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable	Weighted average exercise price
Range of exercise prices	outstanding	(months)	(pence)		(pence)
Between 300.5p and 350.0p	5,649	27	311.7	453	335.3
Between 350.5p and 400.0p	7,945	65	378.8	2,083	373.6
Between 400.5p and 450.0p	2,298	36	412.5	2,298	412.5
Between 450.5p and 500.0p	1,346	38	474.8	1,346	474.8
Between 500.5p and 550.0p	33	12	527.6	33	527.6
Between 550.5p and 600.0p	1,935	12	587.4	1,935	587.4
<b>Total</b>	<b>19,206</b>	<b>43</b>	<b>391.1</b>	<b>8,148</b>	<b>450.6</b>

**Table of Contents****(iv) Shares in the company held under trust during the year are as follows:**

		Dividends	Shares held at 1 April 2004 (000s)	Shares acquired during year (000s)	Shares transferred during year (000s)	Shares held at 31 March 2005 (000s)	Nominal value at 31 March 2005 (£m)	Market value at 31 March 2005 (£m)
<b>2004/05</b>								
Long Term Incentive Plan	(a)	no	3,979	976	(896)	4,059	2.0	16.6
ScottishPower Sharesave Schemes	(b)	yes	6,243		(298)	5,945	3.0	24.3
Executive Share Option Plan 2001	(c)	yes	15,546	5,530	(1,949)	19,127	9.6	78.2
PacifiCorp Stock Incentive Plan	(d)	no	59		(34)	25		0.1
Employee Share Ownership Plan	(e)	no	3,815	1,181	(1,060)	3,936	2.0	16.1
			29,642	7,687	(4,237)	33,092	16.6	135.3

		Dividends	Shares held at 1 April 2005 (000s)	Shares acquired during year (000s)	Shares transferred during year (000s)	Shares held at 31 March 2006 (000s)	Nominal value at 31 March 2006 (£m)	Market value at 31 March 2006 (£m)
<b>2005/06</b>								
Long Term Incentive Plan	(a)	no	4,059		(588)	3,471	1.7	20.2
ScottishPower Sharesave Schemes	(b)	yes	5,945		(1,184)	4,761	2.4	27.7
Executive Share Option Plan 2001	(c)	yes	19,127		(9,771)	9,356	4.7	54.5
PacifiCorp Stock Incentive Plan	(d)	no	25		(25)			
Employee Share Ownership Plan	(e)	no	3,936	959	(1,331)	3,564	1.8	20.7
			33,092	959	(12,899)	21,152	10.6	123.1

- (a) Shares of the company are held under trust as part of the Long Term Incentive Plan for executive directors and other senior managers.
- (b) Shares of the company are held in two Qualifying Employee Share Ownership Trusts as part of the Scottish Power plc Sharesave Scheme and the Scottish Power UK plc Sharesave Scheme. Holders of options granted under the Scottish Power plc scheme will be transferred shares by the associated Trust upon the exercise of the options. As there are no longer any options outstanding under the Scottish Power UK plc scheme, it is intended to transfer shares held in the Scottish Power UK plc trust to the Scottish Power plc trust at a future time. Details of options granted under these schemes are disclosed above.
- (c) Shares of the company are held under trust as part of the Executive Share Option Plan 2001 for executive directors and other senior managers.
- (d) Options granted under the PacifiCorp Stock Incentive Plan were over ScottishPower ADSs; for the purposes of the table above, ADS options have been converted to ScottishPower ordinary share options as follows: one ScottishPower ADS option equals four ScottishPower ordinary share options.
- (e) Shares of the company are held in the Employee Share Ownership Plan Trust on behalf of employees of the ScottishPower group. Shares appropriated under the Free Element and the Matching Element are subject to forfeiture for a period of three years from the date of appropriation. Shares appropriated under the Partnership Element of the Employee Share Ownership Plan are not subject to forfeiture.
- (f) The company's practice has been to purchase shares in the market through an employee benefit trust to satisfy options and awards granted under the Executive Share Option Plan 2001 and the Long Term Incentive Plan. New shares have been issued in relation to the Qualifying Employee Share Trusts associated with the Sharesave Schemes, the Executive Share Option Scheme, the PacifiCorp Stock Incentive Plan and the Employee Share Ownership Plan in the last ten

## Edgar Filing: - Form

years. In the ten year period to 31 March 2006, new shares issued to satisfy discretionary options and awards represented 0.58% of the issued share capital. New shares issued to satisfy options and awards under all share plans represented 3.75% of the issued share capital, leaving available dilution headroom of 6.25%.

### (v) Share option pricing

For the purposes of valuing options to arrive at the stock-based compensation charge, the Binomial model or the Monte Carlo option pricing models have been used, as appropriate. The assumptions used in the models were as follows:

	Binomial Model		Monte Carlo model	
	2006	2005	2006	2005
Dividend yield	6.3%	6.6%	4.9%	5.3%
Risk-free interest rate	4.1%	5.0%	n/a	n/a
Volatility	20.8%	24.3%	15.3%	14.4%
Expected life of the options (years)	1-5	1-5	3	3

#### Binomial model

The expected volatility is based on historical volatility over the last three years and the risk-free interest rate is the yield on UK government bonds of a term consistent with the assumed option life.

**Table of Contents**

Monte Carlo model

The expected volatility is based on historical volatility over the last two years.

The weighted average fair value of share options granted during the period were:

	2006	2005
	pence	pence
Long Term Incentive Plan	197.0	166.0
ScottishPower Sharesave Schemes	66.0	71.0
Executive Share Option Plan 2001		59.0
Employee Share Ownership Plan	476.0	368.0

The charge for share-based payments in respect of share options is £7.9 million (2005 £6.8 million) which comprised entirely of equity-settled transactions.

**(vi) Purchases of equity securities made by the issuer during the year**

No share purchases in the market were made during the year pursuant to the LTIP and the ExSOP. The company's policy is to purchase in the market only the number of shares required to satisfy options and awards granted under the LTIP and the ExSOP.

The company obtained authority from shareholders at its 2005 AGM to make market purchases of up to 185,999,745 ordinary shares during the period of approximately 12 months after the AGM. On 10 February 2006, 1,750,000 ordinary shares were purchased for cancellation at an average price of 596.5 pence per share.

**(b) Subsequent events**

On 4 May 2006 shareholder approval was obtained at an Extraordinary General Meeting of the company for a proposed return of cash to shareholders of £2.25 billion via a B Share structure including a capital restructuring, reorganisation and the issue of new ordinary shares and B Shares. Further details are given in Note 41.

**Table of Contents****33 Analysis of movements in equity attributable to equity holders of Scottish Power plc**

	Note	Number of shares 000s	Share capital £m	Share premium £m	Hedge reserve £m	Translation reserve £m	Other reserves £m	Retained earnings/ (loss) £m	Total £m
<b>At 1 April 2004</b>		1,859,539	929.8	2,275.7		484.6	424.7	399.1	4,513.9
Exchange movement on translation of overseas results and net assets						(100.2)			(100.2)
Gains on net investment hedges						146.6			146.6
Actuarial losses on retirement benefits								(63.3)	(63.3)
Tax on items taken directly to equity						(46.4)		18.9	(27.5)
Loss for the year attributable to equity holders of Scottish Power plc								(193.4)	(193.4)
Dividends								(386.1)	(386.1)
Revaluation reserve arising on the purchase of the remaining 50% of the Brighton Power Station							5.8		5.8
Share capital issued									
ESOP		2,776	1.4	9.8					11.2
PacifiCorp Stock Incentive Plan		3,029	1.5	9.2					10.7
Consideration paid in respect of purchase of own shares held under trust								(30.7)	(30.7)
Credit in respect of employee share awards								6.8	6.8
Consideration received in respect of sale of own shares held under trust								7.6	7.6
<b>At 1 April 2005</b>		1,865,344	932.7	2,294.7		484.6	430.5	(241.1)	3,901.4
Cumulative adjustment for the implementation of IAS 39 (net of tax)	43				416.6	(2.1)		(133.1)	281.4
<b>At 1 April 2005 as restated</b>		1,865,344	932.7	2,294.7	416.6	482.5	430.5	(374.2)	4,182.8
Gains on effective cash flow hedges recognised					747.9				747.9
Exchange movement on translation of overseas results and net assets						244.1			244.1
Cumulative translation gain transferred to income statement on disposal of discontinued operations (net of tax)						(484.6)			(484.6)
Losses on net investment hedges						(276.5)			(276.5)
Gains on revaluation of available-for-sale securities								0.4	0.4
Actuarial gains on retirement benefits								39.1	39.1
Tax on items taken directly to equity					(224.9)	42.7		(11.0)	(193.2)
Profit for the year attributable to equity holders of Scottish Power plc								1,543.3	1,543.3
(Gains)/losses removed from equity and recognised in the year					(493.1)			8.6	(484.5)
Tax on items transferred from equity					148.7			(3.3)	145.4
Dividends								(428.1)	(428.1)
Share capital issued									
ESOP		2,343	1.1	11.0					12.1
PacifiCorp Stock Incentive Plan		5,299	2.7	20.3					23.0
Share buy-back		(1,750)	(0.9)				0.9	(10.4)	(10.4)
Consideration paid in respect of purchase of own shares held under trust								(3.3)	(3.3)
Credit in respect of employee share awards								7.9	7.9
Consideration received in respect of sale of own shares held under trust								35.5	35.5
<b>At 31 March 2006</b>		1,871,236	935.6	2,326.0	595.2	8.2	431.4	804.5	5,100.9

## Edgar Filing: - Form

- (a) Other reserves comprise a revaluation reserve of £5.8 million (2005 £5.8 million), a capital redemption reserve of £19.2 million (2005 £18.3 million) and a merger reserve of £406.4 million (2005 £406.4 million).
- (b) Expected realisation of the hedge reserve

The following represents the profile of gains and losses included within the hedge reserve at the year end, which are expected to be realised in the income statement in the course of the next 5 years and thereafter.

<b>Hedge reserve</b>	2007	2008	2009	2010	2011	Thereafter	<b>Total</b>
	£m	£m	£m	£m	£m	£m	£m
Gains and (losses) on effective cash flow hedges	507.5	190.8	110.5	36.2	6.3	3.3	<b>854.6</b>
Deferred tax							<b>(259.4)</b>
<b>Net hedge reserve</b>							<b>595.2</b>

- (c) Cumulative goodwill written off to retained earnings as at 31 March 2006 was £572.3 million (2005 £572.3 million).

**Table of Contents****34 Minority interests**

	Notes	Equity 2006 £m	Non-equity 2006 £m	Total 2006 £m	Equity 2005 £m	Non-equity 2005 £m	Total 2005 £m
At 1 April		3.2	52.5	55.7	3.4	57.5	60.9
Reclassification on implementation of IAS 32	(a)		(52.5)	(52.5)			
At 1 April as restated		3.2		3.2	3.4	57.5	60.9
Redemption of preferred stock of PacifiCorp	(b)					(4.1)	(4.1)
Group income statement		0.4		0.4	1.3	3.4	4.7
Dividends paid to minority interests		(2.5)		(2.5)	(1.5)	(2.8)	(4.3)
Acquisition of the remaining 50% of a subsidiary		(1.0)		(1.0)			
Exchange						(1.5)	(1.5)
At 31 March		0.1		0.1	3.2	52.5	55.7

(a) On the implementation of IAS 32 on 1 April 2005, minority interests previously classified as non-equity were reclassified as liabilities.

(b) Non-equity minority interests at 31 March 2005 included 100% of the preferred stock and preferred stock subject to mandatory redemption of PacifiCorp. Of the total preferred stock subject to mandatory redemption at 31 March 2005, £2.0 million was due to be redeemed within 1 year, £2.0 million was due to be redeemed within the following year with the remaining £23.8 million redeemable after 2 years. The fair value of preferred stock subject to mandatory redemption at 31 March 2005 was £29.6 million. The fair value of other preferred stock was not materially different from its book value. The weighted average rate of return on preferred stock subject to mandatory redemption was 7.5% and on other preferred stock was 5.1%.

**35 Retirement benefit obligations****(a) Group pension arrangements**

Following a review of the group's UK pension arrangements, the ScottishPower Final Salary LifePlan and the ScottishPower Executive Top-Up Plan were merged with the ScottishPower Pension Scheme as at 31 March 2006. This will lead to economies of scale in relation to the ongoing running costs in the delivery of the pension benefits due to the group's current and past staff. From 1 April 2006 new entrants will have access to a defined contribution Stakeholder Pension Plan. The merged ScottishPower Pension Scheme and the Manweb Pension Scheme are closed to new entrants.

In the UK pension arrangements the age profile of the two closed defined benefit schemes is expected to rise over time, due to the lack of new entrants. This will in turn result in increasing service costs for these two schemes due to the method of actuarial valuation used (the projected unit method). The group believes that the projected unit method is appropriate when adopted across all schemes (closed and open), and in aggregate provides a reasonable basis for assessing the group's pension costs.

As a result of the proposed return of cash to shareholders and capital reorganisation on the sale of PacifiCorp, ScottishPower reached agreement with the trustees of the UK Pension schemes to make special contributions to each scheme in order to fund the deficit (as at 31 December 2005)

## Edgar Filing: - Form

in respect of each scheme over a period of up to 5 years.

ScottishPower made an aggregate lump sum payment of £28.2 million during March 2006 into the relevant schemes. On completion of the return of cash to shareholders, an aggregate lump sum contribution of £100.0 million will be made to the relevant schemes and four further aggregate annual payments of £13.2 million will be made to the relevant schemes commencing on 31 March 2007, subject to a deficit continuing in those schemes at each due payment date. ScottishPower has received a clearance statement from the Pensions Regulator, that it would not be reasonable to impose liability for a contribution notice on the applicants to the clearance application in respect of the proposed return of cash.

Each of the pension schemes are invested in an appropriately diversified range of equities, bonds, property and private markets. The broad proportions of each asset class in which the schemes aim to be invested are as follows, however it is important to note that this may vary from time to time as markets change and as cash may be held for strategic reasons.

	Equities %	Bonds %	Property %	Private markets %	Total %
ScottishPower	66	26	8		100
Manweb	60	40			100
Final Salary LifePlan	100				100
US pensions	58	35		7	100
US other post-retirement benefits	64	35		1	100

---

## **Table of Contents**

In broad terms, the investment strategies adopted by the schemes aim to ensure that sufficient assets are available to meet scheme liabilities as they fall due. The ScottishPower and Manweb schemes' investment strategies reflect the large and growing proportion of their liabilities which relate to pensions in payment and therefore include a growing bond element. A significant equity element is still retained, however, to provide potential for long-term outperformance relative to bonds and therefore to reduce the groups' contribution requirements. This strategy will be reviewed on an ongoing basis by the trustees and they will continue to seek the company's views and comments on asset allocation.

US arrangements are managed and invested in accordance with all applicable requirements, including the Employee Retirement Income Security Act ( **ERISA** ) and the Internal Revenue Service ( **IRS** ) revenue code. The ERISA is the US legislation which regulates pension institutions in a number of areas. The US arrangements employ an investment approach whereby a mix of equities and fixed income investments are used to maximise the long-term return of plan assets for a prudent level of risk. Risk tolerance is established through careful consideration of plan liabilities, plan funded status and corporate financial condition. The investment portfolio contains a diversified blend of equity and fixed income investments. Equity investments are diversified across US and non-US stocks, as well as growth, value, small and large capitalisation. Fixed income investments are diversified across US and non-US bonds. Other assets such as private equity are used judiciously with a view to enhancing long-term returns while improving portfolio diversification. The US arrangements primarily minimise the risk of large losses through diversification but also monitors and manages other aspects of risk through quarterly investment portfolio reviews, annual liability measurements and periodic asset/liability studies.

### **ScottishPower**

Scottish Power UK plc operates a funded pension scheme of the company providing defined retirement and death benefits based on final pensionable salary. This scheme was open prior to 1 January 1999 to employees of ScottishPower. Members are required to contribute to the Scheme at a rate of 5% of pensionable salary. Scottish Power UK plc meets the balance of cost of providing benefits, and company contributions paid are based on the results of the formal actuarial valuation of the Scheme and are agreed by Scottish Power UK plc and the Scheme Trustees.

The assets of the Scheme are held separately from those of the company in a trustee administered fund. Included in the Scheme assets are 110,168 ScottishPower shares (£641,177, based on market value as at 31 March 2006), purchased only as part of a pooled strategy to match the relative weightings in the UK Stock Exchange index.

The pension charge for the year is based on the advice of the Scheme's independent qualified actuary.

Following the formal actuarial valuation of the Scheme as at 31 March 2003, employer contributions of 15% of pensionable salaries were reinstated from that date. At the point of the merger of the Final Salary LifePlan and the Executive Top-Up Plan into the ScottishPower Pension Scheme the company paid a lump sum payment of £14.8 million to fund the deficits in these schemes. This amount was paid in March 2006 and, on completion of the return of cash to shareholders, a further £18.0 million lump sum payment will be paid to the scheme. Four annual payments of £2.0 million will be made to the scheme commencing on 31 March 2007, subject to a deficit continuing in those schemes at each due payment date.

### **Manweb**

## Edgar Filing: - Form

Prior to 1 January 1999, most of the Manweb employees were entitled to join the Manweb Group of the Electricity Supply Pension Scheme, which provides pension and other related benefits based on final pensionable salary to employees throughout the Electricity Supply Industry in England & Wales. The ongoing contributions to the Scheme are based on the results of the formal actuarial valuation of the Scheme and the advice of the Scheme Actuary.

## **Table of Contents**

The assets are held in a separate trustee administered fund. The Scheme assets no longer include any ScottishPower shares. For funding and expensing purposes the Scheme assets are taken at market value plus a smoothing adjustment appropriate at the valuation date.

The pension charge for the year is based on advice from an independent qualified actuary.

The actual contributions payable by participating employers during the year ranged between 8.1% and 14.1% for different sections of membership (but tending towards the higher rates), or other rates for particular groups or as required by a business transfer agreement. The rates of contributions payable have been reviewed following the results of the formal actuarial valuation of the Scheme as at 31 March 2004. The contributions payable have been increased, principally by a lump sum payment paid in March 2005 of £26.8 million. As described above, as a result of the return of cash to shareholders following the sale of PacifiCorp, the company agreed an enhanced funding plan with the trustees, a £13.4 million lump sum payment was paid in March 2006 and, on completion of the return of cash to shareholders, a further £82.0 million lump sum payment will be paid to the scheme. Four annual payments of £11.2 million will be made to the scheme commencing on 31 March 2007, subject to a deficit continuing in those schemes at each due payment date.

## **Final Salary LifePlan**

Up until 31 March 2005 the assets of the LifePlan were held in a separate trustee administered fund. The pension charge for the year is based on the advice of the LifePlan's independent qualified actuary, representing the assessed balance of cost of the accruing benefits after allowing for members' contributions of 5% of pensionable salaries. The same actuarial assumptions have been adopted for both funding and expensing purposes.

The Final Salary LifePlan closed to new entrants with effect from 31 March 2006. A separate Stakeholder Pension Plan was established for new entrants from 1 April 2006. Future service benefits within the Final Salary LifePlan were also changed from that date. Most significantly, the Normal Retirement Age was increased from 63 to 65 and pension increases in payment were reduced from the increase in the Retail Prices Index subject to a maximum of 5% p.a. to a maximum of 2.5% p.a. From 1 April 2006 the LifePlan benefits will be provided from the LifePlan section of the merged ScottishPower Pension Scheme.

The actual contributions payable by participating employers during the year were 15% of pensionable salaries, except where required by a business transfer agreement.

## **US arrangements**

The US businesses operate pension plans covering substantially all their employees. Benefits are based on the employee's years of service and final pensionable salary, adjusted to reflect estimated social security benefits. Pension costs are funded annually by no more than the maximum amount which can be deducted for federal income tax purposes. The US businesses pension figures in these Accounts include the unfunded SERP. The SERP accounts for less than 5% of the US businesses' liabilities. The US businesses meet the entire cost of accruing benefits under the US businesses' plans. The assets for the funded Plan are held in a separate fund. For funding and expensing purposes, the Plan assets are valued at market levels, and liabilities costed on financial assumptions in line with market return expectations.

## Edgar Filing: - Form

In March 2006 the regulated business, PacifiCorp was sold by ScottishPower, with ScottishPower retaining the US non-regulated businesses. The disposal of PacifiCorp is reflected in the closing deficit position for US pension arrangements.

The pension charge for the year is based on the advice of the Plan's independent qualified actuary.

The actual contributions payable by participating employers during the year were 15.9% of pensionable earnings. The employers' planned contribution for 2006/07 are 6.0% of pensionable earnings.

**Table of Contents**

The US businesses also provided other post-retirement benefits to certain employees. The group has provided £2.9 million as at 31 March 2006 (2005 £133.2 million) for these benefits. The related charge for the year was £8.5 million (2005 £21.3 million). The split of the charge between continuing and discontinued operations was £0.3 million and £8.2 million respectively. Further details of these benefits are disclosed below.

**Additional pension arrangements**

The group also operates pension arrangements for senior executives, namely the ScottishPower Executive Top-Up Plan (for benefits which are held within UK Inland Revenue limits) and the Unfunded Unapproved Retirement Benefit Scheme ( UURBS ) for benefits beyond these limits. The UURBS has no invested assets and the group has provided £22.2 million as at 31 March 2006 (2005 £17.4 million) for the benefit promises which will ultimately be paid by the group.

Further details of the group's pensions arrangements, as required under US GAAP, are disclosed in Note 44.

**(b) The amounts recognised in the balance sheet in respect of retirement benefit obligations are detailed below:**

	<b>31 March 2006</b>	31 March 2005
	<b>£m</b>	£m
UK pension arrangements	<b>(145.6)</b>	(210.4)
US pension arrangements	<b>(7.0)</b>	(291.9)
US other post-retirement benefits	<b>(2.9)</b>	(133.2)
	<b>(155.5)</b>	(635.5)

**(c) Pensions**

The group operates defined benefit and defined contribution pension schemes as described earlier in this Note. Formal actuarial valuations were carried out as described earlier and updated to 31 March 2006 by a qualified independent actuary. The pension figures shown below for the year ended 31 March 2006 and for the year ended 31 March 2005 comply with the current pension accounting standard, IAS 19. Figures are shown separately for the UK and US arrangements. The major assumptions applied by the actuary are given in footnote (e).

**(i) Analysis of net liability relating to pensions**

<b>UK pension arrangements Value at 31 March 2006</b>	UK pension arrangements Value at 31 March 2005	<b>US pension arrangements Value at 31 March 2006</b>	US pension arrangements Value at 31 March 2005
<b>£m</b>	£m	<b>£m</b>	£m

Edgar Filing: - Form

Present value of funded obligations	<b>(2,808.7)</b>	(2,443.8)	<b>(23.7)</b>	(710.3)
Fair value of scheme assets	<b>2,685.3</b>	2,250.8	<b>18.7</b>	418.4
	<b>(123.4)</b>	(193.0)	<b>(5.0)</b>	(291.9)
Present value of unfunded obligations	<b>(22.2)</b>	(17.4)	<b>(2.0)</b>	
Net liability	<b>(145.6)</b>	(210.4)	<b>(7.0)</b>	(291.9)
Amounts in the balance sheet:				
Liabilities	<b>(145.6)</b>	(210.4)	<b>(7.0)</b>	(291.9)
Assets				
Net liability	<b>(145.6)</b>	(210.4)	<b>(7.0)</b>	(291.9)

**Table of Contents**

(ii) The amounts recognised are as follows:

	<b>UK pension arrangements Year to 31 March 2006 £m</b>	UK pension arrangements Year to 31 March 2005 £m	<b>US pension arrangements Year to 31 March 2006 £m</b>	US pension arrangements Year to 31 March 2005 £m
Current service cost	43.4	35.5	17.7	14.9
Interest on obligation	129.9	127.0	42.5	39.6
Expected return on scheme assets	(143.7)	(135.2)	(40.1)	(35.4)
Past service cost	18.5			1.3
<b>Total income statement charge*</b>	<b>48.1</b>	27.3	<b>20.1</b>	20.4
<b>Actual return on scheme assets</b>	<b>469.0</b>	209.6	<b>56.0</b>	35.6
<b>Net actuarial (gains)/losses recognised in the Statement of Recognised Income and Expense</b>	<b>(49.1)</b>	64.6	<b>(3.9)</b>	24.4

\*The amounts above are stated before capitalisation of employee costs relating to self-constructed assets.

(iii) The split of the amounts recognised in the income statement, in relation to the US pension arrangements for the years ending 31 March 2006 and 2005 between continuing and discontinued operations is as follows:

	<b>Continuing operations</b>		<b>Discontinued operations</b>	
	<b>US pension arrangements Year to 31 March 2006 £m</b>	US pension arrangements Year to 31 March 2005 £m	<b>US pension arrangements Year to 31 March 2006 £m</b>	US pension arrangements Year to 31 March 2005 £m
Current service cost	0.9	0.5	16.8	14.4
Interest on obligation	1.2	1.0	41.3	38.6
Expected return on scheme assets	(1.1)	(1.0)	(39.0)	(34.4)
Past service cost		0.1		1.2
<b>Total income statement charge*</b>	<b>1.0</b>	0.6	<b>19.1</b>	19.8
<b>Actual return on scheme assets</b>	<b>1.5</b>	0.1	<b>54.5</b>	35.5
<b>Net actuarial losses/(gains) recognised in the Statement of Recognised Income and Expense</b>		0.6	<b>(3.9)</b>	23.8

\*The amounts above are stated before capitalisation of employee costs relating to self-constructed assets.

(iv) Changes in the present value of the defined benefit obligation are as follows:

	<b>UK pension arrangements Year to 31 March 2006</b>	UK pension arrangements Year to 31 March 2005	<b>US pension arrangements Year to 31 March 2006</b>	US pension arrangements Year to 31 March 2005
--	--	--	--	--

Edgar Filing: - Form

	£m	£m	£m	£m
Defined benefit obligation at 1 April	2,461.2	2,257.3	710.3	692.1
Current service cost	43.4	35.5	17.7	14.9
Interest on obligation	129.9	127.0	42.5	39.6
Scheme members contributions	10.4	8.9		
Past service costs	18.5			1.3
Actuarial losses	276.2	139.0	12.0	24.6
Liabilities extinguished on settlements			(0.9)	
Disposal of PacifiCorp			(765.3)	
Benefits paid	(108.7)	(106.5)	(49.6)	(42.5)
Exchange differences on foreign plans			59.0	(19.7)
<b>Defined benefit obligation at 31 March</b>	<b>2,830.9</b>	<b>2,461.2</b>	<b>25.7</b>	<b>710.3</b>
<b>Analysis of defined benefit obligation</b>				
Plans that are wholly or partly funded	2,808.7	2,443.8	23.7	710.3
Plans that are wholly unfunded	22.2	17.4	2.0	
<b>Total</b>	<b>2,830.9</b>	<b>2,461.2</b>	<b>25.7</b>	<b>710.3</b>

**Table of Contents**

(v) Changes in the fair value of scheme assets are as follows:

	<b>UK pension arrangements Year to 31 March 2006 £m</b>	UK pension arrangements Year to 31 March 2005 £m	<b>US pension arrangements Year to 31 March 2006 £m</b>	US pension arrangements Year to 31 March 2005 £m
Fair value of scheme assets at 1 April	2,250.8	2,085.3	418.4	402.0
Expected return on scheme assets	143.7	135.2	40.1	35.4
Actuarial gains	325.3	74.4	15.9	0.2
Assets distributed on settlements			(1.1)	
Employer contributions	63.8	53.5	38.5	35.9
Scheme members contributions	10.4	8.9		
Disposal of PacifiCorp			(476.3)	
Benefits paid	(108.7)	(106.5)	(49.6)	(42.5)
Exchange differences on foreign plans			32.8	(12.6)
Fair value of scheme assets at 31 March	2,685.3	2,250.8	18.7	418.4

**(d) Other post-retirement benefits**

ScottishPower's US operations provide post-retirement healthcare and life assurance benefits to certain employees. Actuarial valuations were carried out as at 31 March 2006 by a qualified independent actuary. The other post-retirement benefit figures shown below for the year ended 31 March 2006 and for the year ended 31 March 2005 comply with the current pension accounting standard, IAS 19. The major assumptions used by the actuary are described in footnote (e).

(i) The amounts recognised in the balance sheet are as follows:

	<b>Other post- retirement benefits Value at 31 March 2006 £m</b>	Other post- retirement benefits Value at 31 March 2005 £m
Present value of funded obligations	(5.3)	(292.2)
Fair value of scheme assets	2.4	159.0
Net liability	(2.9)	(133.2)

(ii) The amounts recognised in the income statement are as follows:

	<b>Other post- retirement benefits Year to 31 March 2006</b>	Other post- retirement benefits Year to 31 March 2005
--	--	--

Edgar Filing: - Form

	£m	£m
Current service cost	5.1	4.9
Interest on obligation	17.5	16.6
Expected return on scheme assets	(14.1)	(12.8)
Past service cost		12.6
<b>Total income statement charge*</b>	<b>8.5</b>	<b>21.3</b>
Actual return on scheme assets	14.0	9.8
<b>Net actuarial losses/(gains) recognised in the Statement of Recognised Income and Expense</b>	<b>13.9</b>	<b>(25.7)</b>

\*The amounts above are stated before capitalisation of employee costs relating to self-constructed assets.

(iii) The split of the amounts recognised in the income statement for the years ending 31 March 2006 and 2005 between continuing and discontinued operations is as follows:

	Continuing operations		Discontinued operations	
	Other post-retirement benefits		Other post-retirement benefits	
	Year to 31 March 2006 £m	Year to 31 March 2005 £m	Year to 31 March 2006 £m	Year to 31 March 2005 £m
Current service cost	0.2	0.1	4.9	4.8
Interest on obligation	0.3	0.3	17.2	16.3
Expected return on scheme assets	(0.2)	(0.2)	(13.9)	(12.6)
Past service cost		0.2		12.4
<b>Total income statement charge*</b>	<b>0.3</b>	<b>0.4</b>	<b>8.2</b>	<b>20.9</b>
Actual return on scheme assets	0.2	0.2	13.8	9.6
<b>Net actuarial losses/(gains) recognised in the Statement of Recognised Income and Expense</b>	<b>0.2</b>	<b>(0.4)</b>	<b>13.7</b>	<b>(25.3)</b>

\*The amounts above are stated before capitalisation of employee costs relating to self-constructed assets.

**Table of Contents**

(iv) Changes in the present value of the defined benefit obligation are as follows:

	<b>Other post- retirement benefits Year to</b>	<b>Other post- retirement benefits Year to</b>
	<b>31 March 2006</b>	<b>31 March 2005</b>
	<b>£m</b>	<b>£m</b>
Defined benefit obligation at 1 April	292.2	312.1
Current service cost	5.1	4.9
Interest on obligation	17.5	16.6
Scheme members' contributions	4.7	3.9
Past service costs		12.6
Actuarial losses/(gains)	13.8	(28.7)
Disposal of PacifiCorp	(333.5)	
Benefits paid	(23.7)	(21.7)
Exchange	29.2	(7.5)
Defined benefit obligation at 31 March	5.3	292.2
Analysis of defined benefit obligation		
Plans that are wholly or partly funded	5.3	292.2
Plans that are wholly unfunded		
Total	5.3	292.2

(v) Changes in the fair value of scheme assets are as follows:

	<b>Other post- retirement benefits Year to</b>	<b>Other post- retirement benefits Year to</b>
	<b>31 March 2006</b>	<b>31 March 2005</b>
	<b>£m</b>	<b>£m</b>
Fair value of scheme assets at 1 April	159.0	157.1
Expected return on scheme assets	14.1	12.8
Actuarial losses	(0.1)	(3.0)
Employer contributions	15.5	13.9
Scheme members' contributions	4.7	3.9
Disposal of PacifiCorp	(184.3)	
Benefits paid	(23.7)	(21.7)
Exchange	17.2	(4.0)
Fair value of scheme assets at 31 March	2.4	159.0

**(e) Actuarial assumptions**

(i) The major assumptions used by the actuary at the balance sheet date for both the pensions and other post-retirement benefits arrangements were as follows and are expressed as weighted averages:

Edgar Filing: - Form

	<b>UK arrangements at 31 March 2006</b>	UK arrangements at 31 March 2005	<b>US arrangements at 31 March 2006</b>	US arrangements at 31 March 2005
Rate of increase in salaries	<b>4.4% p.a.</b>	4.4% p.a.	<b>4.0% p.a.</b>	4.0% p.a.
Rate of increase in deferred pensions	<b>2.9% p.a.</b>	2.9% p.a.	<b>n/a</b>	n/a
Rate of increase in pensions in payment	<b>2.9% p.a.</b>	2.9% p.a.	<b>n/a</b>	n/a
Discount rate	<b>5.0% p.a.</b>	5.4% p.a.	<b>5.75% p.a.</b>	5.75% p.a.
Inflation assumption	<b>2.9% p.a.</b>	2.9% p.a.	<b>3.0% p.a.</b>	3.0% p.a.
Proportion of employees opting for early retirement	<b>n/a</b>	n/a	<b>70%</b>	70%
Annual increase in healthcare costs	<b>n/a</b>	n/a	<b>10% phasing to 5%</b>	9.5% phasing to 5%

Changes in assumed healthcare cost trend rates are not expected to have a significant effect on the amounts recognised in the income statement or balance sheet.

(ii) The weighted average life expectancy for mortality used to determine the benefit obligations were as follows:

	<b>UK arrangements at 31 March 2006</b>	UK arrangements at 31 March 2005	<b>US arrangements at 31 March 2006</b>	US arrangements at 31 March 2005
Member age 63 (current life expectancy)				
Male	<b>20.1</b>	18.6	<b>19.3</b>	18.3
Female	<b>24.3</b>	22.6	<b>21.8</b>	23.1
<hr/>				
Member age 45 (life expectancy at age 63)				
<hr/>				
Male	<b>22.1</b>	20.3	<b>19.3</b>	18.3
Female	<b>26.4</b>	24.4	<b>21.8</b>	23.1

**Table of Contents**

(iii) Allowance for cash commutation

Within the UK pension schemes, members are assumed to commute 25% of their benefits for a tax-free cash sum where this option is available.

(iv) The weighted average asset allocations at the year end were as follows:

	<b>UK pension arrangements Asset allocations at 31 March 2006</b>	UK pension arrangements Asset allocations at 31 March 2005	<b>US pension arrangements Asset allocations at 31 March 2006</b>	US pension arrangements Asset allocations at 31 March 2005	<b>Other post-retirement benefits Asset allocations at 31 March 2006</b>	Other post-retirement benefits Asset allocations at 31 March 2005
Equities	<b>64.2%</b>	63.4%	<b>58.3%</b>	55.6%	<b>63.6%</b>	62.0%
Bonds	<b>28.3%</b>	29.6%	<b>34.8%</b>	34.5%	<b>34.9%</b>	36.0%
Property	<b>5.2%</b>	5.5%	<b>n/a</b>	n/a	<b>n/a</b>	n/a
Cash	<b>2.3%</b>	1.5%	<b>n/a</b>	n/a	<b>n/a</b>	n/a
Private markets	<b>n/a</b>	n/a	<b>6.9%</b>	9.9%	<b>1.5%</b>	2.0%

The expected returns on each asset class were as follows:

	<b>UK pension arrangements Long-term rates of return expected at 31 March 2006</b>	UK pension arrangements Long-term rates of return expected at 31 March 2005	<b>US pension arrangements Long-term rates of return expected at 31 March 2006</b>	US pension arrangements Long-term rates of return expected at 31 March 2005	<b>Other post-retirement benefits Long-term rates of return expected at 31 March 2006</b>	Other post-retirement benefits Long-term rates of return expected at 31 March 2005
Equities	<b>7.5%</b>	7.3% p.a.	<b>9.25%</b>	9.25% p.a.	<b>9.25%</b>	9.25% p.a.
Bonds	<b>4.3%</b>	4.7% p.a.	<b>6.5%</b>	6.5% p.a.	<b>6.5%</b>	6.5% p.a.
Property	<b>6.5%</b>	6.3% p.a.	<b>n/a</b>	n/a	<b>n/a</b>	n/a
Cash	<b>4.2%</b>	4.45% p.a.	<b>n/a</b>	n/a	<b>n/a</b>	n/a
Private markets	<b>n/a</b>	n/a	<b>14.0%</b>	14.0% p.a.	<b>14.0%</b>	14.0% p.a.
Expected return on scheme assets	<b>6.5% p.a.</b>	6.4% p.a.	<b>8.75% p.a.</b>	8.8% p.a.	<b>8.75% p.a.</b>	8.4% p.a.

For the UK pension arrangements, the long-term rates of return have been derived as follows:

Equities: the long-term UK Government fixed interest stock yield, plus 3.5% p.a.

Bonds: an appropriate weighted average of long-term UK Government and UK corporate bond yields reflecting the actual split of holdings.

Property: the long-term equities rate of return less 1% p.a.

## Edgar Filing: - Form

Cash: the current UK base rate of interest.

In all cases, for IAS 19 reporting purposes the long-term rates of return have been reduced by 0.3% p.a. (2005 0.3% p.a., 2004 0.3% p.a.) to reflect scheme expenses to arrive at the figures shown above.

For the US pension and other post-retirement healthcare arrangements, the long-term rates of return have been derived as follows:

Equities: an expected real return of 6.25% plus 3% long-term inflation.

Bonds: an expected real return of 3.50% plus 3% long-term inflation.

Private markets: an expected real return of 11% plus 3% long-term inflation.

These return assumptions are based on both historical performance and independent advisers' forward-looking views of the financial markets.

**Table of Contents****(f) History of experience gains and losses**

The amounts for the current and comparative period in relation to defined benefit plans are given below:

	UK arrangements at 31 March 2006 £m	UK arrangements at 31 March 2005 £m	US arrangements at 31 March 2005 £m
<b>Defined benefit pension schemes</b>			
Difference between expected and actual return on scheme assets:			
amount	325.3	74.4	0.2
percentage of scheme assets	12%	3%	0%
Experience gains and losses on scheme liabilities:			
amount	18.1	(28.7)	(5.2)
percentage of scheme liabilities	1%	(1)%	(1)%
Total gains and losses:			
amount	49.1	(64.6)	(24.4)
percentage of scheme liabilities	2%	(3)%	(3)%

The US pension scheme assets and liabilities at 31 March 2006 are not material. The experience loss on scheme liabilities for these schemes in 2006 was £5.5 million.

The amounts for the current and comparative period in relation to other post-retirement benefits are given below:

	Other post- retirement benefits at 31 March 2005 £m
<b>Other post-retirement benefits</b>	
Difference between expected and actual return on scheme assets:	
amount	(3.0)
percentage of scheme assets	(2)%
Experience gains and losses on scheme liabilities:	
amount	36.4
percentage of scheme liabilities	12%
Total gains and losses:	
amount	25.7
percentage of scheme liabilities	9%

The US other post-retirement benefits scheme assets and liabilities at 31 March 2006 are not material. The experience loss on scheme liabilities for this scheme in 2006 was £15.6 million.

**36 Contingent liabilities**

Thus flotation

In November 1999, the group floated a minority stake in its internet and telecommunications business, Thus plc. This gave rise to a contingent liability to corporation tax on chargeable gains, estimated at amounts up to £570 million. On 19 March 2002, the group demerged its residual holding in Thus Group plc (the new holding company of Thus plc). The charge referred to above could still arise, in certain circumstances, before 19 March 2007. Members of the ScottishPower group have agreed to indemnify Thus Group plc for any such liability, except in circumstances arising without the consent of the ScottishPower group.

#### **Legal proceedings**

The group's businesses are parties to various legal claims, actions and complaints, certain of which may involve material amounts. Although the group is unable to predict with certainty whether or not it will ultimately be successful in these legal proceedings or, if not, what the impact might be, the directors currently believe that disposition of these matters will not have a materially adverse effect on the group's Accounts.

**Table of Contents****37 Financial commitments****(a) Capital commitments**

	<b>2006</b>	2005
	<b>£m</b>	£m
Contracted but not provided continuing operations	<b>532.1</b>	244.4

**(b) Other contractual commitments****(i) UK energy purchase commitments**

Long-term wholesale power, gas and coal contracts

In the UK, ScottishPower manages its energy resource requirements by integrating long-term firm, short-term and spot market purchases with its own generating resources to manage volume and price volatility and maximise value across the energy value chain. As part of its UK energy resource portfolio, ScottishPower is committed under long-term purchase contracts to purchases of £2,613.6 million, £1,651.8 million, £848.0 million, £524.5 million and £401.4 million for the years 2007 to 2011 respectively and £1,913.8 million thereafter.

**(ii) PPM contractual commitments**

At 31 March 2006, PPM had purchase commitments of £1,229.1 million, £84.6 million, £87.7 million, £36.9 million and £19.6 million for the years 2007 to 2011 and £nil thereafter. PPM's contractual commitments primarily consist of electricity and gas purchases made to optimise returns from generation resources and commercial activities.

**38 Operating lease arrangements****Operating lease payments continuing operations**

	<b>2006</b>	2005
	<b>£m</b>	£m
Minimum lease payments under operating leases recognised as an expense in the year	<b>30.0</b>	27.8
Sublease payments recognised as an expense in the year	<b>0.3</b>	0.8

## Edgar Filing: - Form

	<b>2006</b>	<b>2005</b>
	<b>£m</b>	<b>£m</b>
<b>The future minimum lease payments under non-cancellable operating leases are as follows:</b>		
Within one year	<b>10.8</b>	9.6
Between one and five years	<b>27.3</b>	22.1
More than five years	<b>67.6</b>	65.2
	<b>105.7</b>	96.9

The group leases various property, plant and equipment under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

Contingent based operating lease rents recognised as an expense in the income statement were £14.2 million (2005 £10.7 million).

Total future minimum non-cancellable sublease rentals expected to be received are £0.8 million (2005 £1.4 million).

	<b>2006</b>	<b>2005</b>
	<b>£m</b>	<b>£m</b>
<b>Operating lease receivables continuing operations</b>		
<b>The future minimum lease payments receivable under non-cancellable operating leases are as follows:</b>		
Within one year	<b>2.7</b>	2.8
Between one and five years	<b>7.0</b>	7.5
More than five years	<b>7.6</b>	8.0
	<b>17.3</b>	18.3

**Table of Contents**

The group leases fibre optic cable as ground wire for certain transmission lines and other equipment under operating leases. The lease arrangements have initial terms of 1 to 99 years and some contain provisions to extend the term at the option of the lessee. The leases have varying terms, escalation clauses and renewal rights.

**39 Related party transactions****(a) Trading transactions and balances arising in the normal course of business**

Type of related party	Note	Sales/(purchases) to/(from) other group companies during the year		Amounts due from/(to) other group companies as at 31 March	
		2006	2005	2006	2005
		£m	£m	£m	£m
<b>Sales by related party</b>					
Jointly controlled entities	(i)	6.7	113.6	1.7	2.4
<b>Purchases by related party</b>					
Jointly controlled entities	(i)	(0.3)	(86.9)		
Jointly controlled operations		(36.0)	(42.3)	(4.2)	(5.5)

During the year ended 31 March 2006, ScottishPower made management and similar charges to jointly controlled entities of £0.5 million (2005 £0.5 million).

During the prior year ended 31 March 2005, ScottishPower Energy Retail Limited acquired customers from N.E.S.T. Makers Limited, a jointly controlled entity, for £2.1 million.

- (i) On 28 September 2004, the group purchased the remaining 50% of the share capital of South Coast Power Limited and Shoreham Operating Company Limited (together **Brighton Power Station**). As a result Brighton Power Station ceased to be a jointly controlled entity from this date. The sales and purchases for 2005 include those transactions between the group and Brighton Power Station for the period from 1 April 2004 to 27 September 2004.

**(b) Funding transactions and balances arising in the normal course of business**

Type of related party	Interest payable to other group companies during the year		Amounts due to other group companies as at 31 March	
	2006	2005	2006	2005
	£m	£m	£m	£m
Jointly controlled entities	(0.6)	(0.6)	(11.0)	(10.6)
Jointly controlled operations			(2.1)	

The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received. During the year ended 31 March 2006, SP Distribution Limited provided funding of £0.9 million to Scottish Electricity Settlements Limited ( **SESL** ) of which £0.7 million was outstanding at the year end. The majority of the balance outstanding will be recovered direct from ELEXON, the Balancing and Settlement Code Company, in the year ending 31 March 2007. SESL has ceased trading and is to be wound up.

Amounts due to other group companies at 31 March 2006 include an amount of £7.4 million due from SESL. This balance is not expected to be recovered and as a result has been fully provided.

**(c) Remuneration of key management personnel**

The remuneration of the key management personnel of the group (which includes the Executive Team) is set out below.

	<b>2006</b>	2005
	<b>£m</b>	£m
Short-term employee benefits	<b>6.6</b>	7.3
Post-employment benefits	<b>4.1</b>	1.9
Termination benefits	<b>9.4</b>	
Share-based payment	<b>2.3</b>	1.5
	<b>22.4</b>	10.7

## **Table of Contents**

### **40 Accounting developments**

In preparing these Accounts, the group has applied all relevant IAS, IFRS and Interpretations issued by the IFRIC which have been adopted by the EU as of the date of approval of these Accounts. The group does not expect that the adoption, in the future, by the EU of other IAS, IFRS and Interpretations of the IFRIC issued by the IASB but not yet approved by the EU will have a material effect on the group's results and financial position. Assuming IFRS 7 Financial Instruments: Disclosures is approved by the EU, this standard will be mandatory for the group for the year ending 31 March 2008. This standard would require the group to disclose additional information about its financial instruments, their significance and the nature and extent of the risks to which they give rise, together with greater details as to the fair value of its financial instruments and its risk exposure. There will be no effect on the group's income or net assets of any future implementation of this standard.

### **41 Subsequent events**

On 4 May 2006 shareholder approval was obtained at an Extraordinary General Meeting of the company for a proposed return of cash to shareholders of £2.25 billion via a B share structure including a capital reorganisation, and the issue of new ordinary shares and B shares.

On 15 May 2006, one in every three of the company's existing ordinary shares were reclassified into B shares. The company's existing ordinary shares were subdivided and consolidated so that shareholders received approximately 1.1905 new ordinary shares for every existing ordinary share remaining after the reclassification.

Following the reclassification and the subdivision and consolidation, on 15 May 2006 there were 1,485,952,052 new ordinary shares and 623,864,749 B shares in issue all of which were admitted to the London Stock Exchange's main market for listed securities on that date.

In accordance with the terms of the B share prospectus, shareholders were able to elect between the following alternatives in respect of each B share that they held:

to receive a dividend of £3.60 after which the B Share would be converted into a deferred share with a negligible value;

to have it repurchased by the company for £3.60; or

to retain it and have the opportunity for it to be repurchased by the company on certain future dates up to 2011 for £3.60.

As a result of elections received from shareholders, on 22 May 2006 the company declared a B share dividend of £3.60 per share in respect of 370,655,937 B shares, totalling £1,334.4 million, and agreed to acquire a further 240,324,768 B Shares for a total consideration of £865.2 million (such repurchased B shares to be cancelled).

### **42 Reconciliation of previously reported financial statements under UK GAAP to IFRS**

## Edgar Filing: - Form

The group has presented its Accounts under IFRS for the first time in 2005/06. The following disclosures are required in the first year of preparation of accounts under IFRS. The following disclosures are provided below:

- (a) reconciliation of the group profit and loss account under UK GAAP to the group income statement under IFRS for the year ended 31 March 2005;
- (b) reconciliation of the group balance sheet under UK GAAP to IFRS as at 1 April 2004;
- (c) reconciliation of the group balance sheet under UK GAAP to IFRS as at 31 March 2005;

**Table of Contents**

- (d) reconciliation of the group cash flow statement under UK GAAP to IFRS for the year ended 31 March 2005;
- (e) notes to income statement reclassifications;
- (f) notes to balance sheet reclassifications; and
- (g) notes to IFRS remeasurements.

On transition to IFRS, the group has taken advantage of the following exemptions contained within IFRS 1 First-time Adoption of International Financial Reporting Standards :

Business combinations: the group has elected not to restate business combinations accounted for prior to 1 April 2004, the group's date of transition to IFRS. Acquisitions after this date, namely Damhead Creek and Brighton Power Station, have been restated to comply with IFRS 3 Business Combinations ;

Revaluation as deemed cost: Manweb distribution assets, which were last revalued in 1997, have been deemed to be recorded at cost;

Employee benefits: the cumulative actuarial losses relating to retirement benefits at the date of transition to IFRS have been recognised in retained earnings;

Financial instruments: the group has elected not to prepare comparative information in accordance with IAS 32 Financial Instruments: Disclosure and Presentation and IAS 39 Financial Instruments: Recognition and Measurement . These standards have been applied with effect from 1 April 2005.

Share-based payment: the group has applied IFRS 2 Share-based Payment to equity instruments granted after 7 November 2002 only.

The group has elected not to take advantage of the IFRS 1 exemption to reset the foreign currency translation reserve to zero at the date of transition to IFRS.

**Table of Contents**

(a) Reconciliation of the group profit and loss account under UK GAAP to the group income statement under IFRS for the year ended 31 March 2005

	Other IFRS adjustments											IFRS £m
	UK GAAP £m	IFRS reclassifi- cations £m	Income taxes IAS 12 £m	Property, plant and equipment IAS 16 £m	Leases IAS 17/ IFRIC 4 £m	Employee benefits IAS 19 £m	Impairment IAS 36 £m	Share-based payments IFRS 2 £m	Business combinations IFRS 3 £m	Goodwill IFRS 3 £m	Discontinued operations IFRS 5 £m	
<b>Continuing operations</b>												
Revenue	6,848.8	(2.9)									(2,250.9)	4,595.0
Cost of sales	(4,567.2)				7.2				(10.0)		1,288.1	(3,281.9)
<b>Operating profit</b>	<b>2,281.6</b>	<b>(2.9)</b>			<b>7.2</b>				<b>(10.0)</b>		<b>(962.8)</b>	<b>1,313.1</b>
Transmission distribution assets	(606.2)			1.3	0.1						311.1	(293.8)
Administrative expenses												
Goodwill amortisation												
Exceptional												
Goodwill amortisation	(511.3)			0.4		14.3		0.4			115.8	(380.2)
Exceptional	(117.5)									117.5		
Impairment of goodwill	(927.0)						5.0				922.0	
Administrative expenses	(1,555.8)			0.4		14.3	5.0	0.4		117.5	1,037.8	(380.2)
Other operating expense	33.0										1.2	34.2
<b>Operating profit before tax</b>	<b>152.6</b>	<b>(2.9)</b>		<b>1.7</b>	<b>7.3</b>	<b>14.3</b>	<b>5.0</b>	<b>0.4</b>	<b>(10.0)</b>	<b>117.5</b>	<b>387.3</b>	<b>673.7</b>
Share of profit/(loss) of associates	6.0	(6.0)										
<b>Operating profit before goodwill amortisation</b>	<b>1,203.1</b>	<b>(8.9)</b>		<b>1.7</b>	<b>7.3</b>	<b>14.3</b>		<b>0.4</b>	<b>(10.0)</b>		<b>(534.7)</b>	<b>673.7</b>
Exceptional	(117.5)									117.5		

Edgar Filing: - Form

dwil rtisation eptional												
airment of dwil	(927.0)					5.0					922.0	
erating fit	158.6	(8.9)		1.7	7.3	14.3	5.0	0.4	(10.0)	117.5	387.3	673
nce income	150.2	33.3			9.4	142.7					(123.4)	212
nce costs	(338.1)	(26.2)			(16.7)	(142.1)					190.1	(333)
finance s	(187.9)	7.1			(7.3)	0.6					66.7	(120)
fit on nary ivities ore dwil rtisation, eptional and tax dwil rtisation eptional	1,015.2	(1.8)		1.7		14.9		0.4	(10.0)		(468.0)	552
	(117.5)									117.5		
airment of dwil	(927.0)					5.0					922.0	
s)/profit ore tax me tax ense	(29.3)	(1.8)		1.7		14.9	5.0	0.4	(10.0)	117.5	454.0	552
	(274.1)	1.8	(16.3)	(0.5)	4.1	(5.1)			3.0		149.7	(137)
s)/profit n tinuing rations for financial	(303.4)		(16.3)	1.2	4.1	9.8	5.0	0.4	(7.0)	117.5	603.7	415
continued rations s for the ncial year n continued rations											(603.7)	(603)
s for the ncial year	(303.4)		(16.3)	1.2	4.1	9.8	5.0	0.4	(7.0)	117.5		(188)
ority rests quity tinuing rations)	(1.3)											
on-equity continued rations)	(3.4)											
s for the ncial year r minority rests	(308.1)											
s per re:	(16.83)p											(10.5)

Loss per  
primary share

Adjusted loss per  
primary share (16.83)p

(9.4

**Table of Contents****(b) Reconciliation of the Group Balance Sheet under UK GAAP to IFRS as at 1 April 2004**

	UK GAAP £m	IFRS reclassifications £m	IFRS remeasurements				IFRS £m
			Dividends IAS 10 £m	Income tax IAS 12 £m	Leases IAS 17/ IFRIC 4 £m	Employee benefits IAS 19 £m	
<b>Non-current assets</b>							
Intangible assets							
goodwill	1,855.9						1,855.9
other intangible assets		306.5					306.5
Property, plant and equipment	8,756.6	(306.5)			54.7	(13.2)	8,491.6
Investments accounted for using the equity method	65.0						65.0
Other investments	129.8						129.8
Trade and other receivables		78.0					78.0
Finance lease receivables		82.5			93.2		175.7
<b>Non-current assets</b>	<b>10,807.3</b>	<b>160.5</b>			<b>147.9</b>	<b>(13.2)</b>	<b>11,102.5</b>
<b>Current assets</b>							
Inventories	185.5						185.5
Trade and other receivables	1,466.7	(129.7)					1,337.0
Finance lease receivables		12.3			13.9		26.2
Cash and cash equivalents	1,347.3						1,347.3
<b>Current assets</b>	<b>2,999.5</b>	<b>(117.4)</b>			<b>13.9</b>		<b>2,896.0</b>
<b>Total assets</b>	<b>13,806.8</b>	<b>43.1</b>			<b>161.8</b>	<b>(13.2)</b>	<b>13,998.5</b>
<b>Current liabilities</b>							
Loans and other borrowings	(410.7)	(375.1)					(785.8)
Obligations under finance leases					(18.9)		(18.9)
Trade and other payables	(1,658.7)	248.9	112.9				(1,296.9)
Current tax liabilities		(237.7)					(237.7)
Provisions		(84.7)					(84.7)
<b>Current liabilities</b>	<b>(2,069.4)</b>	<b>(448.6)</b>	<b>112.9</b>		<b>(18.9)</b>		<b>(2,424.0)</b>
<b>Non-current liabilities</b>							
Loans and other borrowings	(4,661.1)	364.6					(4,296.5)
Obligations under finance leases		(15.0)			(166.2)		(181.2)
Trade and other payables		(17.6)					(17.6)
Retirement benefit obligations		(152.1)				(465.0)	(617.1)
Deferred tax liabilities	(1,242.2)			25.4	19.2	167.0	(1,030.6)
Provisions	(504.5)	225.6					(278.9)
Deferred income	(577.8)						(577.8)
<b>Non-current liabilities</b>	<b>(6,985.6)</b>	<b>405.5</b>		<b>25.4</b>	<b>(147.0)</b>	<b>(298.0)</b>	<b>(6,999.7)</b>
<b>Total liabilities</b>	<b>(9,055.0)</b>	<b>(43.1)</b>	<b>112.9</b>	<b>25.4</b>	<b>(165.9)</b>	<b>(298.0)</b>	<b>(9,423.7)</b>
<b>Net assets</b>	<b>4,751.8</b>		<b>112.9</b>	<b>25.4</b>	<b>(4.1)</b>	<b>(311.2)</b>	<b>4,574.8</b>
<b>Equity</b>							

Edgar Filing: - Form

Share capital	929.8						<b>929.8</b>
Share premium	2,275.7						<b>2,275.7</b>
Revaluation reserve	41.6	(41.6)					
Capital redemption reserve	18.3						<b>18.3</b>
Merger reserve	406.4						<b>406.4</b>
Translation reserve		484.6					<b>484.6</b>
Retained earnings	1,019.1	(443.0)	112.9	25.4	(4.1)	(311.2)	<b>399.1</b>
<b>Equity attributable to equity holders of Scottish Power plc</b>	<b>4,690.9</b>		<b>112.9</b>	<b>25.4</b>	<b>(4.1)</b>	<b>(311.2)</b>	<b>4,513.9</b>
<b>Minority interests</b>							
equity	3.1						<b>3.1</b>
non-equity	57.8						<b>57.8</b>
<b>Total equity</b>	<b>4,751.8</b>		<b>112.9</b>	<b>25.4</b>	<b>(4.1)</b>	<b>(311.2)</b>	<b>4,574.8</b>
<b>Net asset value per share</b>	<b>256.2p</b>						<b>246.6p</b>

**Table of Contents****(c) Reconciliation of the Group Balance Sheet under UK GAAP to IFRS as at 31 March 2005**

	IFRS remeasurements										IFRS £m
	UK GAAP £m	IFRS reclassifi- cations £m	Dividends IAS 10 £m	Income taxes IAS 12 £m	Property, plant and equipment IAS 16 £m	Leases IAS 17/ IFRIC 4 £m	Employee benefits IAS 19 £m	Impairment IAS 36 £m	Business combinations IFRS 3 £m	Goodwill IFRS 3 £m	
<b>Non-current assets</b>											
Intangible assets											
goodwill	765.2							5.0		114.9	885.1
other intangible assets	80.2	301.1								28.2	409.5
Property, plant and equipment	9,602.8	(301.1)			1.7	48.9	(17.4)				9,334.9
Investments accounted for using the equity method	53.1										53.1
Other investments	120.3										120.3
Trade and other receivables		56.2									56.2
Finance lease receivables		80.8				77.6					158.4
<b>Non-current assets</b>	10,621.6	137.0			1.7	126.5	(17.4)	5.0	28.2	114.9	11,017.5
<b>Current assets</b>											
Inventories	185.4										185.4
Trade and other receivables	1,791.3	(115.8)									1,675.5
Finance lease receivables		7.3				10.0					17.3
Cash and cash equivalents	1,747.8										1,747.8
<b>Current assets</b>	3,724.5	(108.5)				10.0					3,626.0
<b>Total assets</b>	14,346.1	28.5			1.7	136.5	(17.4)	5.0	28.2	114.9	14,643.5
<b>Current liabilities</b>											
Loans and other borrowings	(553.4)	(359.1)									(912.5)
Obligations under finance leases						(14.5)					(14.5)
Trade and other payables	(2,110.5)	338.2	139.4								(1,632.9)
Current tax liabilities		(338.9)									(338.9)
Provisions		(80.1)									(80.1)
	(2,663.9)	(439.9)	139.4			(14.5)					(2,978.9)

Edgar Filing: - Form

<b>Current liabilities</b>											
<b>Non-current liabilities</b>											
Loans and other borrowings	(5,341.4)	344.6								(4,996.8)	
Obligations under finance leases		(14.0)			(144.8)					(158.8)	
Trade and other payables		(2.7)								(2.7)	
Retirement benefit obligations		(133.8)				(501.7)				(635.5)	
Deferred tax liabilities	(1,333.5)		7.0	(0.5)	22.9	177.9		(35.2)		(1,161.4)	
Provisions	(399.5)	217.3								(182.2)	
Deferred income	(570.1)									(570.1)	
<b>Non-current liabilities</b>	<b>(7,644.5)</b>	<b>411.4</b>	<b>7.0</b>	<b>(0.5)</b>	<b>(121.9)</b>	<b>(323.8)</b>		<b>(35.2)</b>		<b>(7,707.5)</b>	
<b>Total liabilities</b>	<b>(10,308.4)</b>	<b>(28.5)</b>	<b>139.4</b>	<b>7.0</b>	<b>(0.5)</b>	<b>(136.4)</b>	<b>(323.8)</b>	<b>(35.2)</b>		<b>(10,686.4)</b>	
<b>Net assets</b>	<b>4,037.7</b>		<b>139.4</b>	<b>7.0</b>	<b>1.2</b>	<b>0.1</b>	<b>(341.2)</b>	<b>5.0</b>	<b>(7.0)</b>	<b>114.9</b>	<b>3,957.1</b>
<b>Equity</b>											
Share capital	932.7									932.7	
Share premium	2,294.7									2,294.7	
Revaluation reserve	45.5	(39.7)								5.8	
Capital redemption reserve	18.3									18.3	
Merger reserve	406.4									406.4	
Translation reserve		484.6	(2.1)		0.1	4.6			(2.6)	484.6	
Retained earnings	284.4	(444.9)	139.4	9.1	1.2		(345.8)	5.0	(7.0)	117.5	(241.1)
<b>Equity attributable to equity holders of Scottish Power plc</b>	<b>3,982.0</b>		<b>139.4</b>	<b>7.0</b>	<b>1.2</b>	<b>0.1</b>	<b>(341.2)</b>	<b>5.0</b>	<b>(7.0)</b>	<b>114.9</b>	<b>3,901.4</b>
<b>Minority interests</b>											
equity	3.2										3.2
non-equity	52.5										52.5
<b>Total equity</b>	<b>4,037.7</b>		<b>139.4</b>	<b>7.0</b>	<b>1.2</b>	<b>0.1</b>	<b>(341.2)</b>	<b>5.0</b>	<b>(7.0)</b>	<b>114.9</b>	<b>3,957.1</b>
<b>Net asset value per share</b>	<b>217.3p</b>										<b>212.9p</b>

**Table of Contents**

**(d) Reconciliation of the group cash flow under UK GAAP to IFRS as at 31 March 2005**

The consolidated statement of cash flows prepared in accordance with FRS 1 Cash flow statements presents substantially the same information as that required under IFRS. Under IFRS, however, there are certain differences from UK GAAP with regard to the classification of items within the cash flow statement and with regard to the definition of cash and cash equivalents.

Under UK GAAP, cash flows were presented separately for operating activities, dividends received from joint ventures and associates, returns on investments and servicing of finance, taxation, capital expenditure and financial investment, acquisitions and disposals, equity dividends paid, management of liquid resources and financing. Under IFRS, only three categories of cash flow activity are reported: operating activities, investing activities and financing activities.

Under IFRS, items which under UK GAAP would have been included within management of liquid resources fall within the definition of cash and cash equivalents.

The requirements of IAS 38 state that certain non-current assets, namely capitalised software and hydro relicensing costs, previously included within tangible assets, are reclassified as intangible assets. This has resulted in £54.6 million being reclassified from the purchase of property, plant and equipment to the purchase of intangible assets. A further £1.2 million has been reclassified from the purchase of property, plant and equipment to the proceeds from the sale of intangible assets.

IFRIC 4 contains guidance on the identification of lease arrangements. The group's arrangements have been assessed against the criteria contained in IAS 17 to determine, firstly, whether any arrangements qualify for lease accounting and, secondly, whether the leases should be categorised as operating or finance leases. The identification of additional finance leases has resulted in £11.7 million being reclassified from cash generated from operations to interest paid (£8.8 million) and proceeds from borrowings (£2.9 million).

**(e) Notes to income statement reclassifications**

Certain income statement items previously reported under UK GAAP have been reclassified to comply with the format of the group Accounts as presented under IFRS. The reclassifications below do not have any effect on the group's previously reported net income.

**(i) IAS 28/31 Associates/jointly controlled entities**

The group's share of the operating profit, interest and tax of associates and jointly controlled entities has been combined and disclosed on one line as share of profits of jointly controlled entities and associates in accordance with IAS 28 and IAS 31.

**(ii) IAS 17 Leases**

Net income in relation to finance leases in the US of £2.9 million for the year ended 31 March 2005 has been reclassified from revenue to finance income (£33.3 million) and finance costs (£30.4 million) in accordance with IAS 17. Under UK GAAP, these were accounted for on a net cash investment basis and qualified for linked presentation under FRS 5.

**(f) Notes to balance sheet reclassifications**

Certain balances, previously reported under UK GAAP, have been reclassified to comply with the format of the group's Accounts as presented under IFRS. None of these reclassifications have any effect on the group's previously reported net assets or shareholders' funds.

## **Table of Contents**

### **(i) IAS 1 Presentation of financial statements**

Trade and other receivables falling due after more than one year of £18.7 million at 31 March 2005 (2004 £35.3 million), previously reported as part of Current assets, have been reclassified and included within Non-current assets.

Finance lease receivables falling due after more than one year of £80.8 million at 31 March 2005 (2004 £82.5 million), previously reported as part of Current assets, have been reclassified and included within Non-current assets.

Finance lease receivables due within one year of £7.3 million at 31 March 2005 (2004 £12.3 million), previously included within Trade and other receivables, have been shown separately on the face of the balance sheet.

Provisions for liabilities and charges due within one year of £80.1 million at 31 March 2005 (2004 £84.7 million), previously presented within Non-current liabilities, have been reclassified and shown within Current liabilities.

Obligations under finance leases of £14.0 million at 31 March 2005 (2004 £15.0 million), previously presented within Loans and other borrowings, have been shown separately on the face of the balance sheet.

In light of evolving practice, the group has changed the classification of its convertible bonds from Non-current liabilities to Current liabilities and restated comparative figures accordingly. The bonds are perpetual and have no fixed redemption date; although they can be redeemed in limited circumstances as set out in Note 24. Bondholders can convert into ordinary shares of Scottish Power plc at any time and, therefore, the bonds meet the definition of current liabilities in IAS 1 Presentation of Financial Statements and the IASB's Framework for the Preparation and Presentation of Financial Statements.

### **(ii) IAS 12 Income taxes**

Current corporate tax balances of £338.9 million at 31 March 2005 (2004 £237.7 million), previously included within Trade and other payables falling due within one year, have been shown separately on the face of the balance sheet.

### **(iii) IAS 19 Employee benefits**

Pensions and other post-retirement benefits of £133.8 million at 31 March 2005 (2004 £152.1 million), previously included within Provisions for liabilities and charges and Trade and other payables, have been shown separately on the face of the balance sheet. Although this separate presentation is not required by IAS 19 Employee Benefits, this presentation has been adopted in view of the significance of these balances as accounted for under IAS 19.

**(iv) IAS 21 The effects of changes in foreign exchange rates**

Cumulative exchange gains and losses of £484.6 million at 31 March 2005 (2004 £484.6 million), net of related hedging gains and losses and taxation, are required by IAS 21 to be shown as a separate reserve. These were previously included within retained earnings.

Under IAS 21, all monetary items are required to be separately measured and presented at the closing balance sheet rate whereas UK GAAP permitted the use of the exchange rate specified in the contract. As a result, foreign currency debt is translated at the closing exchange rate and the group's related derivatives have been separately presented on the balance sheet rather than disclosing the net hedge position that existed under UK GAAP. At 31 March 2005, derivatives showing a gain of £37.5 million

## **Table of Contents**

(2004 £42.7 million) and £11.6 million (2004 £0.4 million) have been included within Non-current and Current trade and other receivables respectively. Those derivatives showing a loss of £2.7 million (2004 £17.6 million) and £17.9 million (2004 £nil) have been reclassified from Loans and other borrowings and included within Non-current and Current trade and other payables respectively.

### **(v) IAS 38 Intangible assets**

Certain Non-current assets at 31 March 2005, being capitalised software of £238.6 million (2004 £260.9 million) and hydro relicensing costs of £62.5 million (2004 £45.6 million), previously included within Tangible assets have been reclassified as Intangible assets as required by IAS 38.

### **(vi) IFRS 1 First-time adoption of IFRS**

The revaluation reserve of £39.7 million at 31 March 2005 (2004 £41.6 million), previously recognised in respect of the revaluation of the group's Manweb distribution assets has been reclassified to retained earnings. IFRS permits previously revalued tangible assets to be recognised at deemed cost at the date of the group's transition to IFRS. The group has applied this exemption in preparing its balance sheet in accordance with IFRS.

The group has elected not to take advantage of the IFRS 1 exemption to reset the translation reserve to zero at the date of the transition.

### **(g) Notes to IFRS remeasurements**

The IFRS remeasurements do not include any adjustments for IAS 32 and IAS 39 which have been applied by the group from 1 April 2005 in accordance with the exemptions set out in IFRS 1 (see Note 43).

### **(i) IAS 10 Events after the balance sheet date**

Dividends in respect of the group's ordinary shares declared after the balance sheet date are not accrued in the balance sheet as required by IAS 10. Previously, under UK GAAP, such dividends were accrued in the balance sheet.

### **(ii) IAS 12 Income taxes**

Under UK GAAP, deferred tax is provided based on timing differences, whilst IFRS has a wider scope and requires deferred tax to be provided on temporary differences.

In accordance with the requirements of IFRS, additional deferred tax has been provided on the temporary difference arising on acquisitions where the assets and liabilities acquired at fair value differ to their tax base.

**(iii) IAS 16 Property, plant and equipment**

The group calculates its depreciation charge in respect of property, plant and equipment based on cost less estimated residual values at current prices as required by IAS 16.

Previously, under UK GAAP, the group calculated its depreciation charge for property, plant and equipment based on cost or revalued amounts less estimated residual values at prices prevailing at the time of the initial recognition of the asset or subsequent revaluation.

**(iv) IAS 17/IFRIC 4 Leases**

The group has finance leases where it acts as a lessor and funds these through non-recourse debt. Under UK GAAP, these were accounted for on a net cash investment basis and qualified for linked

## **Table of Contents**

presentation whereby the non-recourse debt was offset against the receivable in accordance with FRS 5. Under IFRS, such leases are required to be accounted for as a receivable at an amount equal to the net investment in the lease and, unlike FRS 5, there is no concept of linked presentation in relation to non-recourse debt. The effect of this adjustment is to present separately a finance lease receivable of £86.5 million (2004 £106.3 million) and £88.5 million (2004 £109.4 million) of non-recourse debt. Income from finance leases for the year ended 31 March 2005 increased by £4.9 million, net of a tax credit of £3.7 million.

IFRIC 4 contains specific guidance on the identification of lease arrangements. The arrangements have been assessed against the criteria contained in IAS 17 to determine whether the leases should be categorised as operating or financing. As a consequence, new finance lease arrangements have been recognised on the balance sheet, resulting in the recognition of additional Property, plant and equipment of £48.9 million (2004 £54.7 million) and additional obligations under finance leases of £70.8 million (2004 £75.7 million). Profit before tax reduced by £1.2 million for the year ended 31 March 2005.

### **(v) IAS 19 Employee benefits**

Pensions and other post-retirement benefits have been accounted for in accordance with IAS 19. The group's accounting policy for pensions and other post-retirement benefits requires separate recognition of the operating and financing costs of defined benefit pension schemes and other post-retirement benefit arrangements in the income statement. IAS 19 permits a number of options for the recognition of actuarial gains and losses relating to defined benefit pension schemes and other post-retirement benefits. The group's accounting policy is to recognise any actuarial gains and losses in full immediately in the statement of recognised income and expense. Accordingly, the pension scheme deficits and the obligations relating to other post-retirement benefits are included as liabilities in the balance sheet.

Previously, under UK GAAP, the group's policy was to recognise a charge for its defined benefit pension schemes and other post-retirement benefits in arriving at operating profit. This cost comprised the regular cost of providing pensions and other post-retirement benefits and a charge or credit relating to the amortisation of actuarial gains and losses over the average remaining service lives of the employees covered by the relevant arrangements. The difference between the cumulative charge for pensions and other post-retirement benefits and the cumulative contributions paid in respect of those arrangements was previously recognised as an asset or liability in the balance sheet.

### **(vi) IFRS 2 Share-based payments**

The group's employee share and share option schemes have been accounted for in accordance with IFRS 2 Share-based Payment. This requires that a charge be recognised, using a fair value model, for all of the group's share and share option schemes.

Previously under UK GAAP, the group accounted for the cost of certain of its share and share option schemes based on an intrinsic value model.

### **(vii) IFRS 3 Business combinations**

## Edgar Filing: - Form

Under UK GAAP, goodwill is required to be amortised over its estimated useful economic life. On transition to IFRS, the balance of goodwill recognised under UK GAAP at that time was frozen . No future amortisation will be charged, although an annual review for impairment is required.

Under IFRS 3, the fair values attributed to deferred tax and intangible assets on acquisitions differ from those under UK GAAP.

**Table of Contents****(viii) IFRS 5 Discontinued operations**

As a result of the group's decision to sell PacifiCorp, PacifiCorp has been treated as a disposal group held for sale and a discontinued operation in accordance with IFRS 5. As a consequence of the classification as a discontinued operation, the net profit of PacifiCorp has been shown in one line in the income statement.

The results of discontinued operations include the UK/US interest rate differential benefit and the loss following de-designation of net investment hedges arising from the group's US dollar hedging programme relating to PacifiCorp's net assets and the impact of the US dollar earnings hedges relating to the results of PacifiCorp. This programme has been terminated following completion of the sale of PacifiCorp on 21 March 2006.

**43 Adoption of IAS 32 and IAS 39 at 1 April 2005****Effect on the Group Balance Sheet under IFRS as at 31 March 2005 on implementation of IAS 32 and IAS 39 with effect from 1 April 2005**

		31 March 2005 IFRS	IAS 32/39 adjustments £m	1 April 2005 IFRS after IAS 32/39 adjustment £m
	Notes	£m		
<b>Non-current assets</b>				
Intangible assets				
goodwill		885.1		885.1
other intangible assets	(a)	409.5	(108.4)	301.1
Property, plant and equipment		9,334.9		9,334.9
Investments accounted for using the equity method		53.1		53.1
Other investments		120.3	(2.1)	118.2
Trade and other receivables	(b)	56.2	(6.2)	50.0
Financial assets				
Derivative financial instruments			575.7	575.7
Finance lease receivables		158.4		158.4
<b>Non-current assets</b>		<b>11,017.5</b>	459.0	<b>11,476.5</b>
<b>Current assets</b>				
Inventories		185.4		185.4
Trade and other receivables	(b)	1,675.5	(186.2)	1,489.3
Financial assets				
Derivative financial instruments			336.7	336.7
Finance lease receivables		17.3		17.3
Cash and cash equivalents		1,747.8	0.7	1,748.5
<b>Current assets</b>		<b>3,626.0</b>	151.2	<b>3,777.2</b>
<b>Total assets</b>		<b>14,643.5</b>	610.2	<b>15,253.7</b>

<b>Current liabilities</b>				
Financial liabilities				
Loans and other borrowings		(912.5)	18.8	(893.7)
Derivative financial instruments			(9.7)	(9.7)
Obligations under finance leases		(14.5)		(14.5)
Trade and other payables	(c)	(1,632.9)	77.0	(1,555.9)
Current tax liabilities		(338.9)		(338.9)
Provisions		(80.1)		(80.1)
<b>Current liabilities</b>		<b>(2,978.9)</b>	<b>86.1</b>	<b>(2,892.8)</b>
<b>Non-current liabilities</b>				
Financial liabilities				
Loans and other borrowings		(4,996.8)	(66.9)	(5,063.7)
Derivative financial instruments			(357.5)	(357.5)
Obligations under finance leases		(158.8)		(158.8)
Trade and other payables	(c)	(2.7)	2.0	(0.7)
Retirement benefit obligations		(635.5)		(635.5)
Deferred tax liabilities	(d)	(1,161.4)	(109.6)	(1,271.0)
Provisions	(e)	(182.2)	64.6	(117.6)
Deferred income		(570.1)		(570.1)
<b>Non-current liabilities</b>		<b>(7,707.5)</b>	<b>(467.4)</b>	<b>(8,174.9)</b>
<b>Total liabilities</b>		<b>(10,686.4)</b>	<b>(381.3)</b>	<b>(11,067.7)</b>
<b>Net assets</b>		<b>3,957.1</b>	<b>228.9</b>	<b>4,186.0</b>

**Table of Contents**

	Notes	31 March 2005 IFRS £m	IAS 32/39 adjustments £m	1 April 2005 IFRS after IAS 32/39 adjustment £m
<b>Equity</b>				
Share capital		932.7		932.7
Share premium		2,294.7		2,294.7
Revaluation reserve		5.8		5.8
Capital redemption reserve		18.3		18.3
Merger reserve		406.4		406.4
Hedging reserve			416.6	416.6
Translation reserve		484.6	(2.1)	482.5
Retained earnings		(241.1)	(133.1)	(374.2)
<b>Equity attributable to equity holders of Scottish Power plc</b>		<b>3,901.4</b>	281.4	4,182.8
<b>Minority interests</b>				
equity		3.2		3.2
non-equity		52.5	(52.5)	
<b>Total equity</b>		<b>3,957.1</b>	228.9	4,186.0

IAS 32 and IAS 39 have been applied by the group from 1 April 2005 in accordance with the exemptions set out in IFRS 1. The reconciliation above shows the effect on the IFRS restated balance sheet at 31 March 2005 immediately following the implementation of IAS 32 and IAS 39 on 1 April 2005.

During the preparation of the group's Annual Report and Accounts for the year ended 31 March 2006, the group finalised its IAS 39 transition adjustment as at 1 April 2005. This resulted in the IAS 39 transition adjustment to equity attributable to equity holders of Scottish Power plc increasing by £16.9 million from £264.5 million to £281.4 million.

The principal adjustments arising from the implementation of IAS 32 and IAS 39 on 1 April 2005 were as follows:

- (a) In-the-money gas contracts were derecognised as other intangible assets and remeasured and disclosed within derivative financial instruments resulting in a decrease to other intangible assets of £108.4 million.
- (b) Non-current and Current trade and other receivables decreased by £192.4 million principally as a result of treasury net investment hedges previously classified within trade and other receivables being reclassified as derivative financial instruments.
- (c) Current and Non-current trade and other payables decreased by £79.0 million principally as a result of treasury net investment hedges previously classified within trade and other payables being reclassified as derivative financial instruments.
- (d) Deferred tax liabilities increased by £109.6 million being the tax effect of the cumulative IAS 39 adjustments.
- (e)

## Edgar Filing: - Form

Onerous contracts provisions were derecognised and remeasured and disclosed within derivative financial instruments resulting in a decrease in Non-current provisions of £64.6 million.

**Table of Contents****44 Summary of differences between IFRS and US Generally Accepted Accounting Principles ( GAAP )**

The consolidated Accounts of the group are prepared in accordance with IFRS which differs in certain significant respects from US GAAP. The effect of the US GAAP adjustments on profit for the financial year and equity attributable to equity holders of Scottish Power plc under US GAAP are set out in the tables below.

**(a) Reconciliation of profit/(loss) for the financial year to US GAAP:**

	2006	2005
	Notes	£m
<b>Profit/(loss) for the year under IFRS attributable to equity holders of Scottish Power plc</b>	<b>1,543.3</b>	<b>(193.4)</b>
US GAAP adjustments:		
Impairment of goodwill	(i)	(459.0)
US regulatory net assets	(ii)	(30.2)
Retirement benefit obligations	(iii)	(26.7)
Depreciation on revaluation uplift	(iv)	1.9
Decommissioning, environmental and mine reclamation liabilities	(v)	(9.0)
Derivative financial instruments	(vi)	(0.7)
Restructuring costs	(vii)	12.8
Gain on disposal of PacifiCorp	(ix)	(434.5)
Other	(x)	1.1
		<b>1,058.0</b>
Deferred tax effect of US GAAP adjustments	(viii)	27.4
		<b>(446.1)</b>
<b>Profit/(loss) for the year under US GAAP</b>		<b>(494.7)</b>
<b>Profit/(loss) for the year under US GAAP consists of profit from:</b>		
Continuing operations		596.2
Discontinued operations		(1,044.0)
		<b>549.3</b>
Continuing and discontinued operations		<b>(494.7)</b>
<b>Earnings/(loss) per share under US GAAP</b>		
Continuing operations		32.36p
Discontinued operations		(57.02)p
		<b>30.00p</b>
Continuing and discontinued operations		<b>(27.02)p</b>
<b>Diluted earnings/(loss) per share under US GAAP</b>		
Continuing operations		32.12p
Discontinued operations		(54.15)p
		<b>28.57p</b>
Continuing and discontinued operations		<b>(25.58)p</b>

**(b) Effect on equity attributable to equity holders of Scottish Power plc of differences between IFRS and US GAAP:**

Edgar Filing: - Form

	Notes	2006 £m	2005 £m
<b>Equity attributable to equity holders of Scottish Power plc under IFRS</b>		<b>5,100.9</b>	3,901.4
US GAAP adjustments:			
Goodwill	(i)	572.3	572.3
Business combinations	(i)	(10.2)	(191.0)
Amortisation of goodwill	(i)	(80.7)	143.8
Impairment of goodwill	(i)		(459.0)
US regulatory net assets	(ii)		559.3
Retirement benefit obligations	(iii)	244.5	481.4
Revaluation of fixed assets	(iv)	(59.8)	(59.8)
Depreciation on revaluation uplift	(iv)	16.2	14.3
Decommissioning, environmental and mine reclamation liabilities	(v)		(60.2)
Derivative financial instruments	(vi)	(315.4)	365.6
Restructuring costs	(vii)	12.8	
Other	(x)	25.3	(1.3)
Deferred tax effect of US GAAP adjustments	(viii)	15.0	(472.6)
<b>Equity attributable to equity holders of Scottish Power plc under US GAAP</b>		<b>5,520.9</b>	4,794.2

---

**Table of Contents**
**(c) Description of US GAAP adjustments****(i) Goodwill and business combinations****Goodwill**

The group has elected under IFRS 1 not to restate business combinations accounted for prior to 1 April 2004, the group's date of transition to IFRS. Under UK GAAP, goodwill arising from the purchase of operating entities before 31 March 1998 was written off directly to reserves, and, under IFRS, on future disposal or closure of a business, any goodwill previously taken directly to equity under a former GAAP will not be charged against income. Under UK GAAP, goodwill arising on acquisitions from 1998 was capitalised and amortised through the profit and loss account over its useful economic life. On 1 April 2004, amortisation ceased in accordance with IFRS 3 Business Combinations and the asset is reviewed for impairment at least annually and whenever there is an indicator of impairment. Any impairment is recognised in the period in which it is identified.

The goodwill adjustment is made to recognise goodwill previously written off to reserves under UK GAAP as an intangible asset under US GAAP.

Under US GAAP following the introduction of Statement of Financial Accounting Standard No. 142 Goodwill and Other Intangible Assets ( FAS 142 ) which was effective for the group from 1 April 2002, goodwill arising from the purchase of operating entities should be held as an indefinite lived intangible asset and is no longer amortised. Instead goodwill is subject to an impairment test performed at least annually. The implementation of FAS 142 two years earlier than the group's transition to IFRS, results in goodwill balances acquired between 31 March 1998 and 31 March 2004 reflecting two years' less amortisation under US GAAP than under IFRS.

The group has completed its annual goodwill impairment analysis under FAS 142 as at 30 September 2005 and has concluded that goodwill is not impaired.

The following table provides an analysis of goodwill included in the balance sheet under US GAAP for the years ended 31 March 2006 and 31 March 2005.

	2006	2005
	Note	£m
<b>Net book value of goodwill capitalised:</b>		
At 1 April		2,382.1
Acquisition	(i)	8.0
Impairment		(1,381.0)
Disposal of PacifiCorp		(406.6)
Exchange		29.6
		(49.9)
<b>As at 31 March</b>		<b>582.2</b>
		951.2

- (i) Goodwill of £8.0 million arose on the group's acquisition of the remaining 50% of Core Utility Solutions Limited, which became a 100% subsidiary of the group.

The table below shows an analysis of goodwill by business:

	Note	31 March 2006 £m	31 March 2005 £m
UK businesses			
Energy Networks		8.0	
Energy Retail & Wholesale		562.9	562.9
<b>United Kingdom total</b>			
		<b>570.9</b>	562.9
US businesses			
PacifiCorp			377.9
PPM	(i)	11.3	10.4
<b>United States total</b>			
		<b>11.3</b>	388.3
<b>Total</b>			
		<b>582.2</b>	951.2

- (i) Year-on-year movements on the net book value of goodwill capitalised for PPM of £0.9 million relate solely to foreign exchange.

## **Table of Contents**

### **Business combinations**

The group has elected under IFRS 1 not to restate business combinations accounted for prior to 1 April 2004, the group's date of transition to IFRS. Accordingly, the adjustment referred to as Business Combinations reflects principally the difference between calculating the goodwill arising on the acquisitions of Manweb and, for 2005, of PacifiCorp under IFRS and US GAAP. This adjustment is required due to the differences between IFRS and US GAAP in determination of acquisition price and valuation of assets and liabilities at the acquisition date.

In cases where traded equity securities are exchanged as consideration, IFRS requires the fair value of consideration to be determined at the date the transaction is completed, while US GAAP requires the fair value of such consideration to be determined at the date the acquisition is announced.

### **(ii) US regulatory net assets**

FAS 71 Accounting for the Effects of Certain Types of Regulation establishes US GAAP for utilities in the US whose regulators have the power to approve and/or regulate rates that may be charged to customers. FAS 71 provides that regulatory assets may be capitalised if it is probable that future revenue in an amount at least equal to the capitalised costs will result from the inclusion of that cost in allowable costs for ratemaking purposes. Due to the different regulatory environment, no equivalent GAAP applies under IFRS.

Under IFRS, no regulatory assets are recognised. All regulatory assets recognised under US GAAP related to PacifiCorp. Following the disposal of PacifiCorp on 21 March 2006, no regulatory assets are recognised under US GAAP for the continuing business.

Profit under US GAAP is consequently decreased by £30.2 million in 2006 (2005 £50.1 million).

### **(iii) Retirement benefit obligations**

The fundamental difference between IFRS and US GAAP is the method of recognition of actuarial gains and losses. The group under IFRS recognises actuarial gains and losses in full, directly in retained earnings, in the period in which they occur and are shown in the statement of recognised income and expense. Under US GAAP, actuarial gains and losses are recognised using the 10% corridor approach and deferred actuarial gains and losses are amortised on a straight-line basis over the average remaining service life of employees. A minimum pension liability is also recognised under US GAAP through comprehensive income when there is a deficit of plan assets relative to the accumulated benefit obligation.

### **(iv) Revaluation of fixed assets**

## Edgar Filing: - Form

The revaluation of assets is not permitted under US GAAP. The reconciling item reflects the revaluation reserve which was reclassified to retained earnings as at the date of the group's transition to IFRS, as previously revalued tangible assets were recognised at deemed cost at the date of the group's transition to IFRS. The reconciliation therefore adjusts assets to historical cost and the depreciation charge has been adjusted accordingly.

### **(v) Decommissioning, environmental and mine reclamation liabilities**

Under IFRS, future decommissioning and mine reclamation costs are provided for on a discounted basis with a corresponding increase to the cost of the asset. This increased cost is depreciated over the useful life of the asset. Under US GAAP, legal obligations associated with decommissioning and mine reclamation costs are accounted for on a similar basis in accordance with FAS 143 Accounting for Asset Retirement Obligations ( **FAS 143** ). For other decommissioning and mine reclamation costs,

---

## **Table of Contents**

regulated industries rateably accrue these costs and include them within US regulatory net assets, as the costs are recovered in depreciation rates. Under IFRS, provision is made for both legal and constructive environmental obligations at the balance sheet date. Under US GAAP, provision is made for legal obligations.

### **(vi) Derivative financial instruments**

The group uses derivative instruments in the normal course of business, to offset fluctuations in cash flows and equity associated with movements in exchange rates, interest rates and commodity prices.

FAS 133 Accounting for Derivative Instruments and Hedging Activities ( **FAS 133** ), as amended by FAS 138, was adopted by the group with effect from 1 April 2001. In April 2003, the FASB issued FAS No. 149 Amendment of Statement 133 on Derivative Instruments and Hedging Activities , ( **FAS 149** ). This statement amends and clarifies financial reporting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. This statement was effective for contracts entered into or modified after 30 June 2003. In applying this statement, the group began marking-to-market certain transactions that were entered into after 30 June 2003 that, prior to the implementation of FAS 149, would have qualified for the normal purchase and normal sales exemption under FAS 133.

The derivative financial instruments adjustment for the year ended 31 March 2006 represents the difference between accounting for derivative financial instruments under IFRS and US GAAP. Both IAS 39, the IFRS financial instruments standard, and FAS 133, the US GAAP equivalent, require all derivative financial instruments, as defined by the respective standards, to be fair valued. Both standards provide specific exemptions to this requirement; however the exemptions allowed are different between the respective standards, giving rise to a GAAP difference. In addition, a number of differences exist within the hedge accounting rules resulting in a further GAAP difference. The equivalent adjustment for the year ended 31 March 2005 represented the difference in accounting for derivative financial instruments under the group's former UK GAAP accounting policies for such items (which applied until the adoption of IAS 39 on 1 April 2005) and US GAAP.

### **Year ended 31 March 2006**

The key differences between accounting for derivatives under IFRS, under which the Accounts are prepared, and US GAAP, and in the group's application of their respective requirements, are as follows:

Commodity contracts which are a derivative for FAS 133, but not a derivative for IAS 39 for the following reasons:

Normal purchase normal sale ( **npns** ) treatment is an election under FAS 133, whereas under IAS 39, own use accounting is an exemption. As a result certain contracts are fair valued under FAS 133 but not under IAS 39.

Under FAS 133, a host contract containing an embedded derivative that is not clearly and closely related does not qualify for npns treatment.

## Edgar Filing: - Form

Under IAS 39, an embedded derivative that is not closely related can be bifurcated from the host contract, which is then available for own use accounting. Accordingly under FAS 133 some contracts will be fair valued in their entirety, while under IAS 39 the embedded derivative is bifurcated and fair valued and the host contract qualifies for own use accounting.

Under FAS 133, contracts which deliver at a liquid point where bookouts can occur may not qualify on a net basis not available for the npns election. Under IAS 39, such contracts may be available for own use accounting if it can be demonstrated that the contract is never settled.

Commodity contracts which are a derivative for IAS 39, but not a derivative for FAS 133. These contracts met the definition of a capacity contract under FAS 133 DIG C-15 and were available for npns accounting. This exemption does not exist under IAS 39, and the contracts are instead fair valued.

## **Table of Contents**

Certain derivatives which are designated by the group as cash flow hedging instruments under IAS 39 are not designated as hedging instruments under FAS 133. In addition, treasury derivatives which have been treated as a cash flow hedge under the transition exemptions in the amendment to IAS 39 on Hedging of Forecast Intragroup Transactions, are not available for hedge accounting under FAS 133. Accordingly, hedge accounting is not applied under US GAAP in respect of these arrangements.

Differences relating to the permissible methods of measuring embedded derivatives cause further GAAP adjustments. Consequently, under IFRS, the embedded derivative component of the convertible bonds is recorded through the income statement and the debt host component is accounted for as a hedging instrument of the US net investment. Under US GAAP, the entire bond is measured at fair value through the income statement and is not considered to qualify for hedge accounting.

There are differences in fair value methodology in relation to adjustments for credit risk and the bid/ask spread which are required by IAS 39 but not FAS 133. As a result, contracts with similar accounting under IAS 39 and FAS 133 may have different fair values.

In addition, the effect of changes in certain long-term energy contracts entered into to hedge PacifiCorp's future retail resource requirements, which were being fair valued under both FAS 133 and IAS 39, are subject to regulation in the US and the fair value gains and losses deferred as regulatory assets or liabilities under US GAAP pursuant to FAS 71 Accounting for the Effects of Certain Types of Regulation. No comparable standard exists under IFRS and accordingly no regulatory assets or liabilities were recognised under IFRS in respect of these contracts.

### **Year ended 31 March 2005**

The group exercised the exemption under IFRS 1 to present financial instruments in comparative periods in accordance with UK GAAP. Under UK GAAP, substantially all commodity contracts were accruals accounted on the basis that they were entered into for non-speculative purposes. In addition, under UK GAAP, certain derivative instruments used as hedges were not recognised on the balance sheet and the matching principle was used to match the gain or loss under these hedging contracts to the transaction to which they related. A number of these commodity contracts and derivative instruments were fair valued under FAS 133.

#### **(vii) Restructuring costs**

Under IFRS, a present obligation only exists when the entity is demonstrably committed to the restructuring. The group has in existence a detailed formal plan for the restructuring and is unable to withdraw because it has started to implement the plan and has announced its main features to those individuals affected. Under US GAAP, similar rules exist but US GAAP prohibits the recognition of a liability based solely on an entity's demonstrable commitment to a plan. A liability is only recognised when details of the plan have been communicated to, and formally accepted by, the affected employees.

#### **(viii) Deferred tax**

Under IFRS and US GAAP, full provision for deferred tax is required to the extent that accounting profit differs from taxable profit due to temporary timing differences. Provision is made based on enacted tax law.

## Edgar Filing: - Form

The item Effect of US GAAP adjustments reflects the additional impact of making full provision for deferred tax in respect of adjustments made in restating the balance sheet to US GAAP.

**Table of Contents****(ix) Gain on disposal of PacifiCorp**

On 24 May 2005, the group entered into a sale agreement to dispose of PacifiCorp, the group's former US regulated business. The disposal was completed on 21 March 2006, on which date control of PacifiCorp passed to MidAmerican.

A reconciliation of the gain on sale from IFRS to US GAAP is given below:

	Notes	31 March 2006 £m
Book value of PacifiCorp net assets disposed under IFRS		2,669.0
Business combinations	(i)	(194.6)
Amortisation of goodwill	(i)	241.3
Impairment of goodwill	(i)	(494.3)
US regulatory net assets	(ii)	524.1
Retirement benefit obligations	(iii)	172.1
Decommissioning, environmental and mine reclamation liabilities	(v)	(76.1)
Derivative financial instruments	(vi)	132.4
Other	(x)	(0.5)
Deferred tax	(viii)	(271.9)
Book value of PacifiCorp net assets disposed under US GAAP		2,701.5
Book gain on sale under US GAAP (pre-tax)	(a)	106.6
Net disposal proceeds under US GAAP		2,808.1
Satisfied by:		
Cash received for net assets under IFRS and US GAAP		2,911.4
Cash expenses under IFRS and US GAAP		(26.2)
Net disposal cash proceeds under IFRS and US GAAP		2,885.2
Accrued expenses under IFRS		(74.3)
GAAP adjustment Retirement benefit obligations		(2.8)
Accrued expenses under US GAAP		(77.1)
Impairment of assets under IFRS		(19.4)
GAAP adjustment Other	(b)	19.4
Impairment of assets under US GAAP		
Net disposal proceeds under US GAAP		2,808.1
(a) The gain on sale of PacifiCorp under US GAAP is analysed as follows:		
Book gain on sale under US GAAP (pre-tax)		106.6
Tax credit on sale		12.3
Cumulative exchange differences realised on sale under IFRS		484.6
GAAP adjustment Gain on disposal		(418.6)
Cumulative exchange differences realised on sale under US GAAP		66.0
Gain on disposal of PacifiCorp under US GAAP		184.9
Gain on disposal of PacifiCorp under IFRS	9	619.4
GAAP difference Gain on disposal	44(a)	(434.5)

## Edgar Filing: - Form

- (b) The impairment of assets, as discussed in Note 9(e)(iii), is not recognised under US GAAP as the determination of whether or not there is impairment under US GAAP is based on undiscounted cash flows which, in this case, are greater than the asset book value.

### (x) Other

Other differences between IFRS and US GAAP relate to capitalisation of finance costs, investment tax credits, stock compensation expense and impairment of assets.

Under US GAAP, the group applies Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to employees ( **APB 25** ), and related interpretations in accounting for plans and a compensation expense has been recognised accordingly for its share option schemes. As the group applies APB 25 in accounting for its plans, under FAS 123 Accounting for Stock-Based Compensation ( **FAS 123** ), it has adopted the disclosure only option in relation to its share option schemes. Had the group determined compensation cost based on the fair value at the grant date for its share options

**Table of Contents**

under FAS 123, the group's profit/(loss) for the financial year under US GAAP and earnings/(loss) per share under US GAAP would have been reduced to the pro forma amounts below:

	2006	2005
Profit/(loss) for the financial year under US GAAP (£ million)	1,085.4	(494.7)
Reversal of APB 25 stock compensation expense (£ million)	9.7	3.1
Stock compensation expense calculated under FAS 123 (£ million)	(0.6)	(5.3)
<b>Pro forma profit/(loss) for the financial year under US GAAP (£ million)</b>	<b>1,094.5</b>	<b>(496.9)</b>
Basic earnings/(loss) per share under US GAAP	58.91p	(27.02)p
<b>Pro forma basic earnings/(loss) US GAAP profit</b>	<b>59.41p</b>	<b>(27.14)p</b>
Diluted earnings/(loss) per share under US GAAP	58.48p	(25.58)p
<b>Pro forma diluted earnings/(loss) per share under US GAAP</b>	<b>58.97p</b>	<b>(25.69)p</b>

The option pricing model assumptions used to fair value the options granted during the year are given in Note 32(v).

**(xi) Reclassifications**

The reconciliations of profit/(loss) for the financial year and equity attributable to equity holders of Scottish Power plc at the year end from IFRS to US GAAP only include those items which have a net effect on profit or equity attributable to equity holders of Scottish Power plc. There are other GAAP differences, not included in the reconciliations, which would affect the classification of assets and liabilities or of income and expenditure. The principal items which would have such an effect are as follows:

- (a) Under IFRS debt issue costs are deducted from the carrying value of the related debt instrument. US GAAP requires such costs to be included as an asset.
- (b) Under IFRS customer contributions in respect of fixed assets are generally credited to a separate deferred income account. Under US GAAP such contributions are netted off against the cost of the related fixed assets.
- (c) Under US GAAP transmission and distribution costs would be included in cost of sales. Under IFRS these are included as a separate line item within the income statement.
- (d) The group implemented EITF No. 03-11 Reporting Gains and Losses on Derivative Instruments that are Subject to FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, and Not Held for Trading Purposes ( EITF 03-11 ) on 1 January 2004. EITF 03-11 addresses whether realised gains and losses should be shown gross or net in the income statement for contracts that are not held for trading purposes but are derivatives subject to FAS 133. This Issue led to a reduction in US GAAP reported turnover from continuing operations of £1,689.7 million (2005 £1,058.2 million) with an equivalent reduction in cost of goods sold as a result of the netting approach adopted for contracts within the scope of the Issue. Under IFRS these items are shown on a gross basis within the turnover and cost of sales lines of the income statement.

## Edgar Filing: - Form

- (e) Convertible bonds Under IFRS, as described in Note 42(f)(i), the convertible bonds are classified as current liabilities. Under US GAAP, the convertible bonds would be classified as a non-current liabilities.

### **(d) Consolidated statement of comprehensive income/(loss)**

Under US GAAP, certain items shown as components of common equity must be more prominently reported in a separate statement as components of comprehensive income/(loss). The group's Statement of Recognised Income and Expense, which is the equivalent IFRS primary statement, sets out these components.

**Table of Contents****(e) Doubtful debts**

The group estimates its provision for doubtful debts relating to trade debtors by a combination of two methods. Specific amounts are evaluated where information is available that a customer may be unable to meet its financial obligations. In these circumstances, assessment is made based on available information to record a specific provision against the amount receivable from that customer to adjust the carrying value of the debtor to the amount expected to be collected. In addition, a provision for doubtful debts within the portfolio of other debtors is made using historical experience and ageing analysis to estimate the provision required to reduce the carrying value of trade debtors to their estimated recoverable amounts. This process involves the use of assumptions and estimates which may differ from actual experience. The continuing group provided £56.1 million, £46.6 million and £26.8 million for doubtful debts in 2005/06, 2004/05 and 2003/04 respectively. Write-offs against the provision for doubtful debts for uncollectable amounts for the continuing group were £31.6 million, £43.9 million and £45.6 million in 2005/06, 2004/05 and 2003/04 respectively. On 24 May 2005, £6.7 million of a provision for doubtful debts relating to the PacifiCorp disposal group was reclassified as Assets classified as held for sale in accordance with IFRS 5.

**(f) Deferred tax**

The additional components of the estimated net deferred tax liability that would be recognised under US GAAP are as follows:

	<b>2006</b>	2005
	<b>£m</b>	£m
Non-current deferred tax (assets)/liabilities:		
Excess of book value over taxation value of fixed assets	<b>(13.0)</b>	20.1
Other temporary differences	<b>(2.0)</b>	452.5
	<b>(15.0)</b>	472.6

The deferred tax balance in respect of leveraged leases at the year end is £54.6 million (2005 £71.0 million).

**(g) Pensions**

At 31 March 2006, ScottishPower had six statutorily approved defined benefit pension schemes, one statutorily approved defined contribution scheme and one unapproved scheme. Further details of the arrangements are given in Note 35.

Benefits under the UK defined benefit plans reflect each employee's basic earnings, years of service and age at retirement. Funding of the defined benefit plans is based upon actuarially determined contributions, with members paying contributions at fixed rates and the employers meeting the balance of cost as determined by the scheme actuaries.

**Table of Contents**

Reconciliations of the beginning and ending balances of the projected pension benefit obligation and the funded status of these plans for the years ending 31 March 2006 and 31 March 2005 are as follows:

	2006	2005
	£m	£m
<b>Change in projected benefit obligation</b>		
Projected benefit obligation at 1 April	3,169.2	2,926.4
Service cost (excluding plan participants' contributions)	65.3	52.2
Interest cost	171.6	165.7
Plan amendments		0.5
Special termination benefits	18.5	
Plan participants' contributions	10.4	8.9
Expenses	(4.8)	
Actuarial loss	289.2	189.9
Benefits paid	(156.7)	(154.6)
Settlements		(0.1)
Disposal of PacifiCorp	(763.1)	
Exchange	56.8	(19.7)
<b>Projected benefit obligation at 31 March</b>	<b>2,856.4</b>	<b>3,169.2</b>
<b>Change in plans' assets</b>		
Fair value of plans' assets at 1 April	2,681.9	2,484.2
Actual return on plans' assets	515.8	266.8
Employer contributions	99.9	89.4
Plan participants' contributions	10.4	8.9
Benefits paid	(156.7)	(154.6)
Expenses	(4.8)	
Settlements		(0.1)
Disposal of PacifiCorp	(471.6)	
Exchange	34.2	(12.7)
<b>Fair value of plans' assets at 31 March</b>	<b>2,709.1</b>	<b>2,681.9</b>
<b>Reconciliation of funded status of the plans to prepaid benefit cost</b>		
Funded status of the plans	(147.3)	(487.3)
Unrecognised net actuarial loss	392.7	729.7
Unrecognised prior service cost	0.4	(0.2)
<b>Prepaid benefit cost</b>	<b>245.8</b>	<b>242.2</b>
<b>Amounts recognised in balance sheet</b>		
(UK arrangements)	£m	£m
Prepaid benefit cost	199.3	191.5
Accrued benefit liability	(107.6)	(112.1)
Accumulated other comprehensive loss	151.3	164.6
<b>Total recognised</b>	<b>243.0</b>	<b>244.0</b>

## Edgar Filing: - Form

### Amounts recognised in balance sheet

(US arrangements)	Note	2006 £m	2005 £m
Accrued benefit liability		(5.0)	(202.8)
Accumulated other comprehensive loss	(i)	20.3	68.3
US regulatory assets	(i)		148.5
Intangible assets		0.4	0.4
Exchange		(12.9)	(16.2)
<b>Total recognised</b>		<b>2.8</b>	<b>(1.8)</b>

- (i) For the US pension arrangements the fair value of the plan assets were less than the accumulated benefit obligation. Under FAS 87 a minimum pension liability is then recognised. This liability was recorded as a non-cash increase of £nil (2005 £148.5 million) to regulatory assets and £20.3 million (2005 £68.3 million) to accumulated other comprehensive loss.

**Table of Contents**

The value of plan assets relative to the accumulated benefit obligation at the year end were as follows:

	Value of plan assets at 31 March 2006	Value of plan assets at 31 March 2005	Accumulated benefit obligation at 31 March 2006	Accumulated benefit obligation at 31 March 2005
	£m	£m	£m	£m
ScottishPower	1,959.6	1,645.3	1,803.4	1,579.6
Manweb	684.3	581.8	767.5	675.0
Final Salary LifePlan	45.5	26.6	47.3	26.8
US arrangements	18.4	426.7	23.4	629.5

The value of plan assets relative to the projected benefit obligation at the year end were as follows:

	Value of plan assets at 31 March 2006	Value of plan assets at 31 March 2005	Projected benefit obligation at 31 March 2006	Projected benefit obligation at 31 March 2005
	£m	£m	£m	£m
ScottishPower	1,959.6	1,645.3	1,933.0	1,682.1
Manweb	684.3	581.8	813.6	724.0
Final Salary LifePlan	45.5	26.6	60.6	36.0
US arrangements	18.4	426.7	25.5	708.0

The components of pension benefit costs for the years ended 31 March 2006 and 2005 were as follows:

	Note	2006 £m	2005 £m
Service cost	(i)	66.0	52.2
Curtailment/settlement cost		18.5	
Interest cost		171.6	165.7
Expected return on plans assets		(192.4)	(180.0)
Amortisation of experience losses		33.7	21.2
Amortisation of prior service cost		0.1	(0.2)
Net periodic benefit cost		97.5	58.9

(i) Includes the contribution of £0.7 million (2005 £nil) to the PacifiCorp/IBEW Local Union 57 Retirement Trust Fund.

The components of the net periodic benefit cost is analysed between continuing operations and discontinued operations as follows:

Edgar Filing: - Form

	2006
	£m
<b>Continuing operations</b>	
Service cost	48.8
Curtailment/settlement cost	18.5
Interest cost	131.1
Expected return on plans' assets	(150.6)
Amortisation of experience losses	17.8
Amortisation of prior service cost	0.2
<hr/>	
Net periodic benefit cost	65.8
<hr/>	

	2006
	£m
<b>Discontinued operations</b>	
Service cost	17.2
Interest cost	40.5
Expected return on plans' assets	(41.8)
Amortisation of experience losses	15.9
Amortisation of prior service cost	(0.1)
<hr/>	
Net periodic benefit cost	31.7
<hr/>	

The group expects to contribute £145.6 million to the UK pension schemes (including one-off special contributions of £100.0 million on completion of the return of cash to shareholders) and £1.0 million (\$1.7 million) to the US pension arrangements schemes in the year ending 31 March 2007.

**Table of Contents**

The actuarial assumptions adopted in arriving at the above figures are as follows:

<b>UK arrangements assumptions at:</b>	<b>31 March 2006*</b>	<b>31 March 2005**</b>	<b>31 March 2004***</b>
Expected return on plans assets	<b>6.75% p.a.</b>	6.75%p.a.	6.75%p.a.
Discount rate	<b>5.0% p.a.</b>	5.4%p.a.	5.5%p.a.
Rate of increase in salaries	<b>4.4% p.a.</b>	4.4%p.a.	4.3%p.a.
Pension increases	<b>2.9% p.a.</b>	2.9%p.a.	2.8%p.a.

<b>US arrangements assumptions at:</b>	<b>31 March 2006*</b>	<b>31 March 2005**</b>	<b>31 March 2004***</b>
Expected return on plans assets	<b>8.50% p.a.</b>	8.75%p.a.	8.75%p.a.
Discount rate	<b>5.75% p.a.</b>	5.75%p.a.	6.25%p.a.
Rate of increase in salaries	<b>4.0% p.a.</b>	4.0%p.a.	4.0%p.a.
Inflation rates	<b>3.0% p.a.</b>	3.0%p.a.	3.0%p.a.

The expected return on plans assets has been derived by consideration of the plans actual investments, as discussed in Note 35.

\* Assumptions used to determine benefit obligations at 31 March 2006.

\*\* Assumptions used to determine net periodic benefit cost for year ended 31 March 2006 and benefit obligations at 31 March 2005.

\*\*\* Assumptions used to determine net periodic benefit cost for year ended 31 March 2005.

For the US arrangements the measurement dates for the years ended 31 March 2006 and 2005 are 31 December 2005 and 2004 respectively. The measurement dates for the UK arrangements are as at each respective year end.

**(h) Other post-retirement benefits**

PacifiCorp and PPM Energy provides healthcare and life insurance benefits through various plans for eligible retirees. The cost of other post-retirement benefits is accrued over the active service period of employees. The transition obligation represents the unrecognised prior service cost and is being amortised over a period of 20 years. PacifiCorp and PPM Energy funds other post-retirement benefit expense through a combination of funding vehicles. Over the period from 1 April 2005 to 20 March 2006, PacifiCorp made contributions totalling £16.7 million in respect of these arrangements. These funds are invested in common stocks, bonds and US government obligations.

The net periodic other post-retirement benefit cost and significant assumptions are summarised as follows:

	<b>2006</b>	<b>2005</b>
	<b>£m</b>	<b>£m</b>
Service cost	<b>4.9</b>	4.6
Interest cost	<b>17.0</b>	16.8
Expected return on plan assets	<b>(14.7)</b>	(14.3)
Amortisation of experience losses	<b>4.4</b>	3.4

Net periodic other post-retirement benefit cost

12.8 10.5

The components of the net periodic other post-retirement benefit cost is analysed between continuing and discontinued operations as follows:

	<b>2006</b>
<b>Continuing operations</b>	<b>£m</b>
Service cost	0.1
Interest cost	0.3
Expected return on plan assets	(0.1)
Amortisation of experience losses	0.1
<b>Net periodic other post-retirement benefit cost</b>	<b>0.4</b>
	<b>2006</b>
<b>Discontinued operations</b>	<b>£m</b>
Service cost	4.8
Interest cost	16.7
Expected return on plan assets	(14.6)
Amortisation of experience losses	4.3
Amortisation of prior service cost	1.2
<b>Net periodic other post-retirement benefit cost</b>	<b>12.4</b>

**Table of Contents**

The change in the accumulated other post-retirement benefit obligation, change in plans assets and funded status are as follows:

**Change in accumulated other post-retirement benefit obligation**

	2006	2005
	£m	£m
Accumulated other post-retirement benefit obligation at 1 April	279.5	302.1
Service cost	4.9	4.6
Interest cost	17.0	16.8
Plan participants contributions	4.7	3.9
Plan amendment	12.8	0.4
Actuarial loss/(gain)	19.2	(18.6)
Benefits paid	(23.7)	(21.7)
Disposal of PacifiCorp	(333.5)	
Exchange	24.2	(8.0)
<b>Accumulated other post-retirement benefit obligation at 31 March</b>	<b>5.1</b>	<b>279.5</b>

	2006	2005
	£m	£m
<b>Change in plan assets</b>		
Plan assets at fair value at 1 April	151.6	142.3
Actual return on assets	11.4	15.5
Company contributions	15.5	15.9
Plan participants contributions	4.7	3.9
Disposal of PacifiCorp	(184.3)	
Benefits paid	(23.7)	(21.7)
Exchange	27.2	(4.3)
<b>Plan assets at fair value at 31 March</b>	<b>2.4</b>	<b>151.6</b>

	2006	2005
	£m	£m
<b>Reconciliation of accrued other post-retirement costs and total amount recognised</b>		
Funded status of plan	(2.7)	(127.9)
Unrecognised net loss	1.6	88.3
Unrecognised prior service cost		0.7
Final contribution made after measurement date but before 31 March 2005		13.2
<b>Accrued other post-retirement benefit cost</b>	<b>(1.1)</b>	<b>(25.7)</b>

For other post-retirement benefits the group expects to contribute \$nil (£nil) in the year ending 31 March 2007.

The actuarial assumptions adopted in arriving at the above figures are as follows:

<b>US arrangements assumptions at:</b>	<b>31 March 2006*</b>	31 March 2005**	31 March 2004***
Expected return on plan assets	8.50% p.a.	8.75% p.a.	8.75% p.a.
Discount rate	5.75% p.a.	5.75% p.a.	6.25% p.a.
Initial healthcare cost trend under 65	10.0% p.a.	7.5% p.a.	8.5% p.a.

## Edgar Filing: - Form

Initial healthcare cost trend	over 65	<b>10.0% p.a.</b>	9.5% p.a.	10.5% p.a.
Initial healthcare cost trend rate		<b>5.0% p.a.</b>	5.0% p.a.	5.0% p.a.
Year that rate reaches ultimate	under 65	<b>2011</b>	2007	2007
Year that rate reaches ultimate	over 65	<b>2011</b>	2009	2009

---

The expected return on plan assets has been derived by consideration of the plans' actual investments, as discussed in Note 35.

\* Assumptions used to determine other post-retirement benefit obligations at 31 March 2006.

\*\* Assumptions used to determine net periodic other post-retirement benefit cost for year ended 31 March 2006 and benefit obligations at 31 March 2005.

\*\*\* Assumptions used to determine net periodic other post-retirement benefit cost for year ended 31 March 2005.

The measurement dates for the years ended 31 March 2006 and 2005 are 31 December 2005 and 2004, respectively.

**Table of Contents****Cash contributions and benefit payments**

	UK pension arrangements £m	US pension arrangements £m	Other post-retirement benefits £m
The company expects to contribute the following amounts in the year ended 31 March 2007	145.6	1.0	

The following benefit payments, which reflect expected future service as appropriate, are expected to be paid:

	UK pension arrangements £m	US pension arrangements £m	Other post-retirement benefits £m
Year ending 31 March 2007	108.9	1.6	0.3
Year ending 31 March 2008	111.8	1.6	0.3
Year ending 31 March 2009	114.5	1.6	0.3
Year ending 31 March 2010	117.4	1.6	0.3
Year ending 31 March 2011	120.3	1.6	0.3
Year ending 31 March 2012 to 2016 (inclusive)	651.0	7.3	1.9

**(i) Leveraged leases**

The pre-tax income from leveraged leases during the year was £3.0 million (2005 £2.4 million), the tax charge on the pre-tax income was £1.1 million (2005 £0.8 million) and the investment tax credit recognised in the income statement was £0.6 million (2005 £0.2 million). An impairment charge of £25.4 million was also recognised during the year, in respect of the corresponding finance lease receivable. Refer to Note 2(a)(ii).

**(j) Commitments and contingencies****Environmental issues**

The group's UK businesses are subject to numerous regulatory requirements with respect to the protection of the environment, including environmental laws which regulate the construction, operation and decommissioning of power stations, pursuant to legislation implementing environmental directives adopted by the EU and protocols agreed under the auspices of international bodies such as the United Nations Economic Commission for Europe. The group believes that it has taken and continues to take measures to comply with applicable laws and regulations for the protection of the environment. Applicable regulations and requirements pertaining to the environment change frequently, however, with the result that continued compliance may require material investments, or that the group's costs and results of operation are less

favourable than anticipated.

**(k) Guarantees**

In accordance with FASB Interpretation No. 45 ( **FIN 45** ) Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others: an Interpretation of FASB Statements No. 5, 57 and 107 and rescission of FASB Interpretation No. 34 , the group is required to disclose certain guarantees as defined in FIN 45. These guarantees principally relate to the group s disposal of its former operations and are typical of these types of transactions. Furthermore, disclosure is required under FIN 45 of guarantees even where the likelihood that a liability will crystallise is remote. FIN 45 also requires recognition of liabilities under US GAAP of the fair value of certain guarantees issued or modified after 31 December 2002. No such guarantees have been identified. The disclosures required to be made under FIN 45 are detailed below:

At 31 March 2006, the group had entered into a number of transactions involving the sale of parts of its business and the purchase of certain businesses and assets in accordance with overall group strategy. These transactions include the disposal of Southern Water, the demerger of Thus plc, the sale and disposal of the group s Appliance Retailing business, the sale of the Byley gas storage project, the sale of PacifiCorp and the disposal of other non-core activities.

---

## **Table of Contents**

It is standard practice in such transactions to obtain or grant contractual assurances, including in the form of warranties and indemnities. In conducting merger, disposal or acquisition transactions the group takes significant steps to quantify and mitigate risk at the outset of any transaction and as the transaction progresses. Steps include carrying out, or granting the facility for the conduct of, a thorough due diligence exercise to ascertain any likely liabilities and, where the group is the vendor, the use of caps and threshold levels for liability, inserting time limits on claim periods and detailed disclosure.

Under certain of the business disposals, indemnities under the Transfer of Undertakings (Protection of Employment) Regulations 1981 ( the Regulations ) are still outstanding. These indemnities relate to potential liabilities with respect to former employees of the group in relation to their period of employment in the group. Typically there is no maximum limit on claims under these indemnities.

On 23 April 2002, the group sold Aspen 4 Limited, the owner of the Southern Water group of companies. In such transactions it is standard practice for the vendor to give assurances, in the form of warranties and indemnities to the purchaser. In relation to this transaction the warranty liability period commenced on 23 April 2002 and ends on 23 April 2007 for environmental warranties and on 23 April 2009 for tax warranties. The warranty liability period for all other warranties expired on 23 April 2004. The sale and purchase agreement contains a number of limitations to and exclusions of liability and maximum financial exposure for breach of the warranties (apart from tax warranties) is capped at £900.0 million. For the tax warranties the maximum exposure is approximately £1,950.0 million. There are also minimum threshold claim levels to be reached before a potential claim arises at all and thereafter as to whether it can be made. The directors consider it extremely unlikely that there will be any material financial exposure to the group under these arrangements as a detailed due diligence exercise was carried out pre-disposal and detailed disclosures were made to the purchaser so as to make them aware of all relevant information concerning the business and, consequentially, to reduce the likelihood of claims being made against the group.

On 8 October 2001, certain business and assets of the group's former Appliance Retailing business were sold and the remainder of the business was closed. In such transactions it is standard practice for the vendor to give assurances in the form of certain warranties and indemnities to the purchaser. In relation to this transaction the warranty liability period commenced on 8 October 2001 and ended on 8 October 2003 with the exception of taxation and pensions warranties which end in October 2007. The stated limit for all warranty claims was £75.0 million. Under the transaction a number of properties were also assigned to the purchaser. The purchaser became insolvent in August 2003. By operation of law and through the putting in place of standard agreements at the time of the sale, the liability for rent and certain other items due under some of these lease arrangements have reverted to the group. The maximum liability to the group for rental payments in the event of insolvency of the purchaser was estimated at approximately £9.0 million per annum. Steps have been and are still being taken to mitigate the liability that arises from this, including surrendering leases to landlords and putting in place new tenants to take over the liability. It is thus extremely unlikely that the group will ultimately become liable to this extent.

On 24 May 2005, ScottishPower as Seller Parent, ScottishPower Holdings Inc. as Seller and MidAmerican as Buyer entered into a Stock Purchase Agreement pursuant to which ScottishPower Holdings Inc. agreed to sell and MidAmerican agreed to buy all of the common stock of PacifiCorp. ScottishPower, ScottishPower Holdings Inc. and MidAmerican entered into an amendment agreement to the Stock Purchase Agreement dated 21 March 2006 pursuant to which MidAmerican has agreed to release ScottishPower from indemnities and warranties other than those relating to corporate taxes and environmental issues in return for a US \$40 million reduction in certain payments due to be made by PacifiCorp to ScottishPower. The liability under the tax indemnity is estimated at \$170 million and provision has been made on this basis. As a result of the sale of PacifiCorp the US tax group holds sufficient capital losses to offset this liability. No provision has been made for the liability under environmental warranty. The directors consider it unlikely that there will be any material financial exposure to the group under this arrangement as a detailed due diligence exercise was carried out pre-disposal and detailed disclosures were made to the purchaser so as to make them aware of all relevant information concerning the business and, consequently, to reduce the likelihood of claims being made against the group.

---

**Table of Contents**

On 26 July 2005, ScottishPower Energy Management Limited entered into a Sale and Purchase Agreement with E.ON UK plc to dispose of the Byley gas storage project. Consistent with normal practice, certain warranties and two specific tax covenants were given in the agreement. The warranties will have ceased to have effect by 31 March 2007. The two specific tax covenants are not time limited. The directors consider it unlikely that there will be any material financial exposure due to the pre-disposal disclosures that were made.

ScottishPower Energy Retail Limited ( **SPERL** ) has entered into an agreement with Lloyds TSB in relation to energy marketing and services. This agreement contains indemnities in relation to transfer of staff by operation of the Regulations from SPERL to Lloyds TSB. The maximum liability is limited to £5.0 million. No claims have been intimated.

Under certain cash collateral agreements, APX Gas Limited, APX Power Limited, Calyon and Elexon can draw down and use cash collateral in event of default situations including upon a change in credit rating. The maximum financial exposure under these arrangements is £35.5 million.

Under the group's arrangements carried out in accordance with the standard terms and conditions of the International Swap Dealers Association, Inc. ( **ISDA** ) Master Agreement there are provisions that provide that the group will indemnify its counterparties against the payment (if any) of withholding tax and stamp duties and against losses incurred due to payments being made in currencies other than the currency chosen by the relevant counterparty. A liability under this indemnification will only arise on the occurrence of certain changes to tax laws in the jurisdiction of a relevant counterparty. The directors are not aware of any such contemplated changes.

Under the group's arrangements carried out in accordance with the International Emissions Trading Association ( **IETA** ) Emissions Trading Master Agreement there are provisions that provide that the group may have to indemnify its counterparties against the payment of certain emissions penalties (if incurred) in a situation where the group fails to make agreed trades and/or (if applied by the parties) that the group will pay its counterparties any losses suffered due to the cancellation of trades in the situation where either party has cancelled trades due to a detrimental change in taxation law and/or that the group will indemnify its counterparties against the payment (if any) of withholding taxes.

Under the group's arrangements carried out in accordance with the Grid Trade Master Agreement ( **GTMA** ) there is a provision that provides (if utilised) that the group will pay its counterparties any losses suffered due to the cancellation of trades in the situation where either party has cancelled trades due to a detrimental change in taxation law.

**(l) Consolidation of Variable-Interest Entities ( VIEs )**

FASB Interpretation No.46 Consolidation of Variable-Interest Entities, an Interpretation of Accounting Research Bulletin No.51 ( **FIN 46R** ) requires existing unconsolidated VIEs to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. The adoption of FIN 46R did not have a material impact on the group's results and financial position under US GAAP. The group continues to evaluate the impact of FIN 46R as implementation guidance evolves. If subsequent guidance or interpretation is different from management's current understanding, it is possible that the group's identification of VIEs and primary beneficiaries could change. The continuing group has not identified any VIEs requiring to be consolidated.

**(m) Recent Financial Accounting Standards Boards (FASB) pronouncements**

**EITF 05-6**

In June 2005, the Emerging Issues Task Force ( **EITF** ) reached consensus on Issue 05-6, Determining the Amortisation Period for the Leasehold Improvements Purchased after Lease Inception or Acquired

## **Table of Contents**

in a Business Combination . EITF 05-6 requires leasehold improvements acquired in a business combination to be amortised over the shorter of the useful life of the assets or a term that includes required lease periods and renewals deemed to be reasonably assured at the date of acquisition. Additionally, the Issue requires improvements placed in service significantly after and not contemplated at or near the beginning of the lease term to be amortised over the useful life of the assets or a term that includes required lease periods and renewals deemed to be reasonably assured at the date the leasehold improvements are purchased.

EITF 05-6 is effective immediately. The adoption of EITF 05-6 has not had a material impact on the group s results of operations or financial position under US GAAP.

### **FAS 123R and related FASB Staff Positions ( FSPs )**

In December 2004, the FASB issued FAS 123 (revised 2004), Share Based Payment . FAS 123R replaces FAS 123 and supersedes APB 25. FAS 123R requires that the cost resulting from all share based payment transactions be recognised in the financial statements at fair value and that excess tax benefits be reported as a financing cash inflow rather than as a reduction of taxes paid. FAS 123R is effective for the group from 1 April 2006. From the effective date, compensation cost is recognised based on the requirements of FAS 123R for all new share based awards and based on the requirements of FAS 123 for all awards granted prior to the effective date of FAS 123R that remain unvested on the effective date.

During 2005 the FASB issued FSP 123R-1, FSP 123R-2 and FSP 123R-3. These FSPs detail various aspects of the implementation of FAS 123R. ScottishPower is in the process of assessing the impact of the adoption of FAS 123R on the group s results of operations or financial position under US GAAP.

### **Other recent FASB pronouncements**

In November 2004, the FASB issued FAS 151, Inventory Costs an amendment of ARB No. 43, Chapter 4 . FAS 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs and wasted materials (spoilage) should be recognised as current period charges and requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. FAS 151 is effective for fiscal years beginning after 15 June 2005.

In December 2004, the FASB issued FAS 153, Exchanges of Non-monetary Assets an amendment of APB Opinion 29 , which amends APB Opinion 29, Accounting for Non-monetary Transactions to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with the general exception for exchanges of non-monetary assets that do not have commercial substance. FAS 153 is effective for non-monetary asset exchanges occurring in fiscal years beginning after 15 June 2005.

In March 2005, the FASB published FSP FIN 47 Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143 which clarifies the application of FAS 143 Accounting for Obligations Associated with the Retirement of Long-Lived Assets in respect of conditional asset retirement obligations. The FSP is effective in the first period beginning after 15 December 2005.

## Edgar Filing: - Form

In November 2005, the FASB issued FSP FAS 115-1 and FAS 124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments . FSP FAS 115-1 and FAS 124-1 address the determination as to when an impairment in equity securities (including cost method investments) and debt securities that can contractually be prepaid or otherwise settled in such a way that the investor would not recover substantially all of its cost should be deemed other-than-temporary. FSP FAS 115-1 and FAS 124-1 nullifies certain requirements under EITF Issue No. 03-01 The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments that required the investor to make an evidence-based judgement as to whether it has the ability and intent

**Table of Contents**

to hold an investment for a reasonable period of time sufficient for a forecasted recovery of fair value up to (or beyond) the cost of the investment in determining whether the impairment was other than temporary, and the measurement of the impairment loss. The guidance in FSP FAS 115-1 and FAS 124-1 is effective for reporting periods beginning after 15 December 2005.

In November 2005, the FASB issued FSP FIN 45-3 to provide clarification with respect to the application of FIN 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. FSP FIN 45-3 includes within its scope and provides guidance concerning the application of FIN 45 to a guarantee granted to a business (or to its owners) that the entity's revenue (or the revenue of a specified portion of the entity) will meet a minimum amount (referred to as a minimum revenue guarantee).

The group does not expect the adoption of the above pronouncements to have a material impact on its results of operations or financial position under US GAAP.

In May 2005, the FASB issued FAS 154, *Accounting Changes and Error Corrections*. FAS 154 replaces APB Opinion No. 20, *Accounting Changes* and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. FAS 154 applies to all voluntary changes in accounting principle and changes the accounting for and reporting of a change in accounting principle, and requires the retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. FAS 154 is effective for accounting changes and correction of errors made in fiscal years beginning after 15 December 2005. The adoption of FAS 154 will only have an effect when the group makes a change in accounting principle that is addressed by the standard.

**Table of Contents****SECTION B****UNAUDITED INTERIM RESULTS OF SCOTTISHPOWER****FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2006****Group Income Statement**

for the six months ended 30 September 2006

	Notes	Six months ended 30 September					
		Before exceptional items and certain remeasurements 2006 £m	Exceptional items and certain remeasurements (Notes 1 (b), 3) 2006 £m	Total 2006 £m	Before exceptional items and certain remeasurements 2005 (as restated Note 1) £m	Exceptional items and certain remeasurements (Notes 1(b), 3) 2005 (as restated Note 1) £m	Total 2005 (as restated Note 1) £m
<b>Continuing operations</b>							
Revenue	2	2,607.6		2,607.6	2,118.8		2,118.8
Cost of sales		(1,769.1)		(1,769.1)	(1,458.4)		(1,458.4)
Transmission and distribution costs		(167.6)		(167.6)	(153.2)		(153.2)
Administrative expenses	3	(193.0)		(193.0)	(185.5)	(46.5)	(232.0)
Net fair value losses on operating derivatives	2, 3		(121.2)	(121.2)		(160.6)	(160.6)
Other operating income		37.4		37.4	5.0		5.0
Share of profit/(loss) of jointly controlled entities and associates	2	1.7		1.7	(0.9)		(0.9)
Gain on disposal of gas storage project	3					78.6	78.6
<b>Operating profit</b>	2, 14	<b>517.0</b>	<b>(121.2)</b>	<b>395.8</b>	<b>325.8</b>	<b>(128.5)</b>	<b>197.3</b>
Finance income	4	124.0		124.0	105.2		105.2
Net fair value losses on financing derivatives	3, 5		(90.4)	(90.4)		(128.3)	(128.3)
Finance costs	6	(158.2)		(158.2)	(157.7)		(157.7)
<b>Net finance costs</b>		<b>(34.2)</b>	<b>(90.4)</b>	<b>(124.6)</b>	<b>(52.5)</b>	<b>(128.3)</b>	<b>(180.8)</b>
<b>Profit before tax</b>		<b>482.8</b>	<b>(211.6)</b>	<b>271.2</b>	<b>273.3</b>	<b>(256.8)</b>	<b>16.5</b>
Income tax	3, 7, 14	(153.3)	62.7	(90.6)	(36.6)	107.7	71.1
<b>Profit for the period from continuing operations</b>		<b>329.5</b>	<b>(148.9)</b>	<b>180.6</b>	<b>236.7</b>	<b>(149.1)</b>	<b>87.6</b>
<b>Discontinued operations</b>							
Profit for the period from discontinued operations	14				140.9	2.7	143.6
<b>Profit for the period</b>		<b>329.5</b>	<b>(148.9)</b>	<b>180.6</b>	<b>377.6</b>	<b>(146.4)</b>	<b>231.2</b>
<b>Attributable to:</b>							
Equity holders of Scottish Power plc		329.7	(148.9)	180.8	376.7	(146.4)	230.3
Minority interests		(0.2)		(0.2)	0.9		0.9
		<b>329.5</b>	<b>(148.9)</b>	<b>180.6</b>	<b>377.6</b>	<b>(146.4)</b>	<b>231.2</b>

Edgar Filing: - Form

<b>Basic earnings per ordinary share</b>	9		
Continuing operations		<b>11.54p</b>	4.72p
Discontinued operations			7.81p
Continuing and discontinued operations		<b>11.54p</b>	12.53p
<b>Adjusted basic earnings per ordinary share</b>	14		
Continuing operations		<b>21.05p</b>	12.83p
Discontinued operations			7.67p
Continuing and discontinued operations		<b>21.05p</b>	20.50p
<b>Diluted earnings per ordinary share</b>	9		
Continuing operations		<b>11.47p</b>	4.69p
Discontinued operations			7.76p
Continuing and discontinued operations		<b>11.47p</b>	12.45p
<b>Adjusted diluted earnings per ordinary share</b>	14		
Continuing operations		<b>20.23p</b>	12.53p
Discontinued operations			7.26p
Continuing and discontinued operations		<b>20.23p</b>	19.79p
<b>Dividend per ordinary share</b>			
Dividend per ordinary share (paid and proposed)	10	<b>11.40p</b>	10.40p

**Table of Contents****Group Statement of Recognised Income and Expense**

for the six months ended 30 September 2006

	<b>Six months ended</b>	
	<b>30 September</b>	
	2006	2005 (As restated Note 1)
	£m	£m
(Losses)/gains on effective cash flow hedges recognised	(309.4)	237.4
Exchange movement on translation of overseas results and net assets	(55.9)	201.7
Gains/(losses) on net investment hedges	44.9	(206.0)
Losses on revaluation of available-for-sale securities		(0.6)
Actuarial losses on retirement benefits	(110.7)	(22.5)
Tax on items taken directly to equity	122.3	(22.1)
<b>Net (expense)/income recognised directly in equity for the period</b>	<b>(308.8)</b>	<b>187.9</b>
Profit for the period	180.6	231.2
<b>Total income and expense for the period</b>	<b>(128.2)</b>	<b>419.1</b>
Cumulative adjustment for the implementation of IAS 39 (net of tax)		281.4
Net (gains)/losses removed from equity and recognised in the period	(17.8)	30.5
Tax on items transferred from equity	15.8	(12.5)
<b>Total recognised income and expense</b>	<b>(130.2)</b>	<b>718.5</b>
<b>Total income and expense for the period attributable to:</b>		
Equity holders of Scottish Power plc	(128.0)	418.2
Minority interests	(0.2)	0.9
	<b>(128.2)</b>	<b>419.1</b>

**Reconciliation of Movements in Equity**

for the six months ended 30 September 2006

	<b>Six months ended</b>	
	<b>30 September</b>	
	2006	2005 (As restated Note 1)
	£m	£m
<b>Profit for the period</b>	<b>180.6</b>	<b>231.2</b>
<b>Net (expense)/income recognised directly in equity for the period</b>	<b>(308.8)</b>	<b>187.9</b>
Net (gains)/losses removed from equity and recognised in the period (net of tax)	(2.0)	18.0
Dividends	(138.7)	(235.4)
Return of cash to shareholders	(2,249.9)	
Share capital issued	12.5	25.1

## Edgar Filing: - Form

Consideration paid in respect of purchase of own shares held under trust	(1.2)	(3.0)
Credit in respect of employee share awards	3.7	4.6
Consideration received in respect of sale of own shares held under trust	30.4	16.6
Net movement in minority interests	7.8	(1.2)
<hr/>		
<b>Net movement in equity</b>	<b>(2,465.6)</b>	243.8
Opening equity	5,101.0	3,957.1
Cumulative adjustment for the implementation of IAS 39 (net of tax)		281.4
Reclassification of non-equity minority interests on implementation of IAS 32		(52.5)
<b>Opening equity as restated for the adoption of IAS 32 and IAS 39</b>	<b>5,101.0</b>	4,186.0
<hr/>		
<b>Closing equity</b>	<b>2,635.4</b>	4,429.8
<hr/>		

**Table of Contents****Group Cash Flow Statement**

for the six months ended 30 September 2006

		Six months ended 30 September	
		2006	2005
	Notes	£m	£m
<b>Continuing operations</b>			
<b>Operating activities</b>			
Cash generated from operations	11	600.2	179.6
Dividends received from jointly controlled entities		0.9	0.2
Interest paid		(87.9)	(100.1)
Interest received		50.8	30.6
Income taxes paid		(95.5)	(53.8)
Reallocation from discontinued operations			6.6
<b>Net cash from operating activities</b>		<b>468.5</b>	<b>63.1</b>
<b>Continuing operations</b>			
<b>Investing activities</b>			
Purchase of intangible assets		(31.8)	(13.7)
Proceeds from sale of intangible assets		0.3	
Purchase of property, plant and equipment		(389.0)	(515.1)
Proceeds from sale of property, plant and equipment		14.0	5.2
Purchase of fixed asset investments		(46.8)	(58.1)
Deferred income received		29.9	10.7
Sale of businesses and subsidiaries		(17.8)	69.3
Increase in term deposits		(46.4)	
Equity investment in discontinued operations			(137.3)
Dividend received from discontinued operations			56.9
<b>Net cash used in investing activities</b>		<b>(487.6)</b>	<b>(582.1)</b>
<b>Continuing operations</b>			
<b>Financing activities</b>			
Share capital issued		12.5	25.1
Return of cash to shareholders	8	(2,203.5)	
Dividends paid to company's equity holders		(138.7)	(235.4)
Proceeds received from minority interests		7.8	(1.2)
Net consideration received in respect of own shares held under trust		29.2	14.0
Repayments of borrowings		(1.1)	(123.5)
Proceeds from borrowings		2.9	63.4
Reallocation from discontinued operations			57.2
<b>Net cash used in financing activities</b>		<b>(2,290.9)</b>	<b>(200.4)</b>
<b>Net decrease in net cash and cash equivalents continuing operations</b>		<b>(2,310.0)</b>	<b>(719.4)</b>
<b>Net decrease in net cash and cash equivalents discontinued operations</b>			<b>(40.9)</b>
<b>Net decrease in net cash and cash equivalents</b>		<b>(2,310.0)</b>	<b>(760.3)</b>

**Movement in Net Cash and Cash Equivalents**

for the six months ended 30 September 2006

	Note	Six months ended	
		30 September 2006	2005
		£m	£m
Net cash and cash equivalents at beginning of period		3,583.0	1,727.3
Less: Net cash and cash equivalents at beginning of period discontinued operations			97.4
<hr/>			
Net cash and cash equivalents at beginning of period continuing operations		3,583.0	1,629.9
Increase in net cash and cash equivalents on implementation of IAS 39 on 1 April 2005			0.7
<hr/>			
Net cash and cash equivalents at 1 April (2005 as restated on implementation of IAS 39) continuing operations		3,583.0	1,630.6
Net decrease in net cash and cash equivalents		(2,310.0)	(719.4)
Effect of foreign exchange rate changes		(25.7)	5.8
Mark-to-market movements on certain money market funds		(4.3)	1.6
<hr/>			
<b>Net cash and cash equivalents at end of period continuing operations</b>	(a)	<b>1,243.0</b>	<b>918.6</b>

- (a) Net cash and cash equivalents in respect of continuing operations at 30 September 2006 comprises cash and cash equivalents and term deposits of £1,289.6 million less term deposits of £46.4 million and bank overdrafts of £0.2 million and at 30 September 2005 comprises cash and cash equivalents of £920.2 million less bank overdrafts of £1.6 million.

**Table of Contents****Reconciliation of Movement in Net Cash and Cash Equivalents to Movement in Net Debt**

for the six months ended 30 September 2006

	<b>Six months ended</b>	
	<b>30 September</b>	
	2005	
	(As restated	
	<b>2006</b>	Note 1)
	<b>£m</b>	£m
Net debt at beginning of period	(82.7)	(4,334.8)
Less: Net debt at beginning of period – discontinued operations		(2,307.6)
<b>Net debt at beginning of period – continuing operations</b>	<b>(82.7)</b>	<b>(2,027.2)</b>
Decrease in net debt on implementation of IAS 39 on 1 April 2005 – continuing operations		0.5
<b>Net debt at 1 April (2005 as restated on implementation of IAS 39) – continuing operations</b>	<b>(82.7)</b>	<b>(2,026.7)</b>
Issue of B shares	(a) (2,249.9)	
	<b>(2,332.6)</b>	<b>(2,026.7)</b>
Net decrease in net cash and cash equivalents	(2,310.0)	(719.4)
Outflow of net cash and cash equivalents to shareholders under B share scheme	(a) 2,203.5	
(Inflow)/outflow of net cash and cash equivalents from (increase)/decrease in loans and borrowings	(1.8)	60.1
Outflow of net cash and cash equivalents from movement in term deposits	46.4	
Foreign exchange	105.3	(85.8)
Mark-to-market movements on net debt	(0.4)	(16.0)
Other non-cash and cash equivalent movements	5.7	(10.1)
<b>Net debt at end of period – continuing operations</b>	<b>(b) (2,283.9)</b>	<b>(2,797.9)</b>

(a) B shares issued as part of the capital reorganisation are classified as liabilities under IAS 32 and are therefore included within net debt.

(b) Net debt at end of period – continuing operations comprises:

	<b>30 September</b>	
	2005	
	(As restated	
	<b>2006</b>	Note 1)
	<b>£m</b>	£m
<b>Current assets</b>		
Cash and cash equivalents and term deposits	1,289.6	920.2
<b>Current liabilities</b>		
loans and other borrowings	(439.6)	(551.1)
obligations under finance leases	(4.1)	(10.1)
<b>Non-current liabilities</b>		
loans and other borrowings	(3,084.5)	(3,095.5)
obligations under finance leases	(45.3)	(61.4)
<b>Net debt at end of period – continuing operations</b>	<b>(2,283.9)</b>	<b>(2,797.9)</b>



**Table of Contents****Group Balance Sheet**

as at 30 September 2006

		30 September	31 March
		2005	2006
	30 September	(As restated Note 1)	(As restated Note 1)
	2006		
	£m	£m	£m
	Notes		
<b>Non-current assets</b>			
Intangible assets			
goodwill		92.6	100.8
other intangible assets		120.8	147.6
Property, plant and equipment		5,183.0	5,489.8
Investments accounted for using the equity method		114.0	126.7
Other investments			4.1
Trade and other receivables			10.7
Derivative financial instruments		687.2	600.0
Finance lease receivables		123.0	104.6
<b>Non-current assets</b>		<b>6,320.6</b>	<b>6,584.3</b>
<b>Current assets</b>			
Inventories		353.8	207.5
Trade and other receivables		923.2	1,199.1
Derivative financial instruments		786.3	844.8
Finance lease receivables		15.9	20.5
Cash and cash equivalents and term deposits		920.2	3,584.4
Assets classified as held for sale		7,621.9	
<b>Current assets</b>		<b>10,621.3</b>	<b>5,856.3</b>
<b>Total assets</b>	2	<b>16,941.9</b>	<b>12,440.6</b>
<b>Current liabilities</b>			
Loans and other borrowings		(551.1)	(523.0)
Derivative financial instruments		(665.4)	(403.9)
Obligations under finance leases		(10.1)	(6.7)
Trade and other payables		(1,043.6)	(1,124.5)
Current tax liabilities		(275.5)	(406.3)
Provisions		(27.6)	(26.5)
Liabilities classified as held for sale		(5,075.4)	
<b>Current liabilities</b>		<b>(7,648.7)</b>	<b>(2,490.9)</b>
<b>Non-current liabilities</b>			
Loans and other borrowings		(3,095.5)	(3,079.4)
Derivative financial instruments		(264.0)	(147.3)
Obligations under finance leases		(61.4)	(58.0)
Trade and other payables			(36.6)
Retirement benefit obligations		(208.2)	(155.5)
Deferred tax liabilities		(725.7)	(823.3)
Provisions		(27.3)	(65.8)
Deferred income		(481.3)	(482.8)

Edgar Filing: - Form

<b>Non-current liabilities</b>		<b>(4,789.9)</b>	(4,863.4)	(4,848.7)
<b>Total liabilities</b>	2	<b>(7,147.2)</b>	(12,512.1)	(7,339.6)
<b>Net assets</b>		<b>2,635.4</b>	4,429.8	5,101.0
<b>Equity</b>				
Share capital		<b>624.8</b>	935.5	935.6
Share premium		<b>2,337.4</b>	2,317.0	2,326.0
Hedge reserve		<b>339.9</b>	606.3	595.2
Translation reserve		<b>(3.2)</b>	513.0	8.2
Other reserves		<b>743.3</b>	430.5	431.4
Retained (loss)/earnings		<b>(1,414.5)</b>	(375.4)	804.5
<b>Equity attributable to equity holders of Scottish Power plc</b>		<b>2,627.7</b>	4,426.9	5,100.9
<b>Minority interests</b>		<b>7.7</b>	2.9	0.1
<b>Total equity</b>		<b>2,635.4</b>	4,429.8	5,101.0
<b>Net asset value per ordinary share</b>	9	<b>178.0p</b>	239.9p	275.7p

---

**Table of Contents**

**Notes to the Interim Accounts**

for the six months ended 30 September 2006

**1 Basis of Preparation**

- (a) The financial information included within these Interim Accounts has been prepared on the basis of accounting policies consistent with those set out in the Accounts for the year ended 31 March 2006 and in accordance with the Listing Rules of the Financial Services Authority. The group has not adopted IAS 34 Interim Financial Reporting .
- (b) The format of the Group Income Statement has been prepared in accordance with the requirements of IAS 1 Presentation of Financial Statements and reflects the impact of the adoption of IAS 32 Financial Instruments: Disclosure and Presentation and IAS 39 Financial Instruments: Recognition and Measurement with effect from 1 April 2005. In order to provide readers with a clear, consistent, and more useful presentation of the group's underlying performance, profit for the period has been analysed between (i) profit before exceptional items and certain remeasurements and (ii) the effect of exceptional items and certain remeasurements.

Included in this latter category are:

items which are included in operating profit but classified as exceptional as the directors consider that by virtue of their nature, size or incidence, it is necessary for them to be displayed as a separate line item or separately within a line item if the financial statements are to be properly understood;

fair value gains and losses on operating derivatives and financing derivatives. All of the group's treasury activities and all but an immaterial proportion of the group's energy management activities are undertaken with a view to economically hedging the group's physical and financial exposures. A number of these contracts do not qualify for own use or hedge accounting under IAS 39 and are therefore fair valued through the Group Income Statement. In addition, those contracts which do qualify for cash flow hedge accounting can have an element of hedge ineffectiveness which is recorded in the income statement. The directors consider that this accounting treatment of fair valuing economic hedges and the resulting income statement volatility does not appropriately reflect the business purpose of these contracts. In order to provide a more meaningful presentation, the fair value movements on these contracts have been separated from all other aspects of the impact of IAS 39 which remains within underlying business performance;

in the prior period, the reversal of the depreciation charge for PacifiCorp for the period from 24 May 2005, when it became a discontinued operation, as required by IFRS 5 Non-current Assets Held for Sale and Discontinued Operations ; and

the taxation effect of the above items.

Further analysis of the items included in the column Exceptional items and certain remeasurements is provided in Note 3 to the Accounts.

This income statement format aligns with the group's calculations of adjusted earnings per share as previously presented in the group's Accounts in 2005/06.

## Edgar Filing: - Form

- (c) During the preparation of the group's Accounts for the year ended 31 March 2006, the group revisited its IAS 39 transition adjustment as at 1 April 2005. This resulted in the IAS 39 adjustment to equity attributable to equity holders of Scottish Power plc changing by

201

**Table of Contents**

£16.9 million from £264.5 million to £281.4 million. Consequential adjustments were made to Other intangible assets, Trade and other payables, Non-current loans and other borrowings, Deferred tax liabilities, Hedge reserve, Translation reserve and Retained earnings at 1 April 2005. As a result of these changes comparative figures for the six month period to 30 September 2005 have been restated in the Group Statement of Recognised Income and Expense, Reconciliation of Movements in Equity and Group Balance Sheet and related notes. There is no impact on the Group Income Statement as a result of these adjustments.

The effect of the change in IAS 39 transition adjustment on the group's previously reported Net assets was to increase Net assets and Total equity by £14.7 million at 30 September 2005 and is analysed as follows:

	Note	As at 30 September 2005				
		Other intangible assets	Current trade and other payables	Non-current loans and other borrowings	Deferred tax liabilities	Net assets
		£m	£m	£m	£m	£m
As previously reported		149.0	(1,203.9)	(3,486.7)	(708.9)	4,415.1
Effect of change in IAS 39 transition adjustment		(28.2)	41.4	18.3	(16.8)	14.7
<b>As restated</b>	<b>(i)</b>	<b>120.8</b>	<b>(1,162.5)</b>	<b>(3,468.4)</b>	<b>(725.7)</b>	<b>4,429.8</b>

  

	Hedge reserve	Translation reserve	Retained earnings	Total equity
	£m	£m	£m	£m
As previously reported	569.9	510.9	(351.6)	4,415.1
Effect of change in IAS 39 transition adjustment	36.4	2.1	(23.8)	14.7
<b>As restated</b>	<b>606.3</b>	<b>513.0</b>	<b>(375.4)</b>	<b>4,429.8</b>

(i) The balance of Current trade and other payables has been further restated from £1,162.5 million to £1,043.6 million as a result of the netting of certain Trade and other payables and certain Trade and other receivables as described in Note 1(f) below and the balance of Non-current loans and other borrowings has been further restated from £3,468.4 million to £3,095.5 million as a result of the reclassification of the group's convertible bonds as described in Note 1(d) below.

(d) In the light of evolving practice and in line with the presentation adopted in the Accounts for the year ended 31 March 2006, the group has changed the classification of its convertible bonds from Non-current liabilities to Current liabilities and restated comparative figures accordingly. The bonds are perpetual and have no fixed redemption date; although they can be redeemed in limited circumstances. Bondholders can convert into ordinary shares of Scottish Power plc at any time and, therefore, the bonds meet the definition of current liabilities in IAS 1 and the IASB's Framework for the Preparation and Presentation of Financial Statements. The effect of this reclassification has been to increase Current liabilities at 30 September 2005 by £572.3 million and reduce Non-current liabilities by the same amount. This comprises an increase to Current loans and other borrowings of £372.9 million and an increase to Current derivative financial instruments of £199.4 million, with a corresponding decrease to Non-current loans and other borrowings of £372.9 million and a decrease to Non-current derivative financial instruments of £199.4 million.

(e) In the six months ended 30 September 2005, certain intra-segment transactions within PPM Energy were recorded on a gross basis instead of a net basis. The comparative figures for that period have, therefore, been restated with a reduction in Revenue and Cost of sales of £38.3 million. There is no impact on previously reported operating profit or net assets as a result of this restatement. The effect on periods prior to 1 April 2005 was not material. There is no impact on the results of the PPM Energy segment for the year

## Edgar Filing: - Form

ended 31 March 2006, which reported intra-segment transactions on a net basis.

- (f) Following a recent review of the group's energy-related agreements by counterparty against the criteria for offset of financial assets and financial liabilities contained in IAS 32, the group has determined that certain of its Trade and other receivables and Trade and other payables and Derivative financial assets and Derivative financial liabilities, which were previously shown on a gross basis, meet the criteria for offset and have, accordingly, been presented on a net basis in the Balance Sheet at 30 September 2006. Comparative figures have been restated

**Table of Contents**

accordingly. Previously reported Trade and other receivables and Trade and other payables have reduced by £118.9 million at 30 September 2005 and by £245.2 million at 31 March 2006. Previously reported Derivative financial assets and Derivative financial liabilities have reduced by £25.1 million at 31 March 2006 (30 September 2005 £nil). There is no effect on previously reported net assets.

- (g) The Interim Accounts are unaudited but have been formally reviewed by the auditors. The information shown for the year ended 31 March 2006 does not constitute statutory Accounts within the meaning of Section 240 of the Companies Act 1985 and has been extracted from the full Accounts for the year ended 31 March 2006 filed with the Registrar of Companies. The report of the group's former auditors, PricewaterhouseCoopers LLP, on these Accounts was unqualified and did not contain a Statement under either Section 237(2) or Section 237(3) of the Companies Act 1985.

**2 Segmental Information**

For management purposes, the group is currently organised into three operating businesses, Energy Networks, Energy Retail & Wholesale and PPM Energy and therefore reports its primary segment information on this basis. PacifiCorp, the group's former regulated US business, is included within discontinued operations.

**(a) Revenue by segment**

	Notes	Six months ended 30 September					
		Total revenue		Inter-segment revenue		External revenue	
		2006	2005	2006	2005	2006	2005
		(As restated Note 1)		(As restated Note 1)			
		£m	£m	£m	£m	£m	£m
<b>Continuing operations</b>							
<b>United Kingdom</b>							
Energy Networks	(i)	407.4	398.6	(130.7)	(135.3)	276.7	263.3
Energy Retail & Wholesale		2,015.5	1,647.5	(10.3)	(7.7)	2,005.2	1,639.8
<b>United Kingdom total</b>		<b>2,422.9</b>	<b>2,046.1</b>	<b>(141.0)</b>	<b>(143.0)</b>	<b>2,281.9</b>	<b>1,903.1</b>
<b>Continuing operations</b>							
<b>United States</b>							
PPM Energy		323.4	211.1			323.4	211.1
<b>United States total</b>		<b>323.4</b>	<b>211.1</b>			<b>323.4</b>	<b>211.1</b>
Unallocated revenue	(i)					2.3	4.6
<b>Total</b>	(ii)					<b>2,607.6</b>	<b>2,118.8</b>

- (i) Unallocated revenue includes revenue from certain non-regulated businesses, previously included within the Energy Networks segment, which are now managed as part of corporate office activities. Revenue from these businesses in the six months ended 30 September 2005 amounted to £1.9 million. Unallocated revenue also includes revenue of the non-regulated businesses, previously included within the PacifiCorp segment, which were not included in

## Edgar Filing: - Form

the sale of PacifiCorp.

(ii) In the segmental analysis revenue is shown by geographical origin. Revenue analysed by geographical destination is not materially different.

**Table of Contents****(b) Operating profit by segment**

	Notes	Six months ended 30 September			Six months ended 30 September				
		Before	Net fair value losses on operating derivatives (Note 3)	Total	Before	Net fair value losses on operating derivatives (Note 3)	Exceptional items (Note 3)	Net fair value losses on operating derivatives and exceptional items	Total
		2006	2006	2006	2005	2005	2005	2005	2005
		£m	£m	£m	£m	£m	£m	£m	£m
<b>Continuing operations</b>									
<b>United Kingdom</b>									
Energy Networks	(i)	244.5		244.5	240.8		(3.7)	(3.7)	237.1
Energy Retail & Wholesale		215.7	(130.5)	85.2	90.0	(96.3)	70.1	(26.2)	63.8
<b>United Kingdom total</b>		<b>460.2</b>	<b>(130.5)</b>	<b>329.7</b>	<b>330.8</b>	<b>(96.3)</b>	<b>66.4</b>	<b>(29.9)</b>	<b>300.9</b>
<b>Continuing operations</b>									
<b>United States</b>									
PPM Energy		67.9	9.6	77.5	9.6	(64.3)		(64.3)	(54.7)
<b>United States total</b>		<b>67.9</b>	<b>9.6</b>	<b>77.5</b>	<b>9.6</b>	<b>(64.3)</b>		<b>(64.3)</b>	<b>(54.7)</b>
Unallocated net expense	(i)	(11.1)	(0.3)	(11.4)	(14.6)		(34.3)	(34.3)	(48.9)
<b>Total</b>	(ii)	<b>517.0</b>	<b>(121.2)</b>	<b>395.8</b>	<b>325.8</b>	<b>(160.6)</b>	<b>32.1</b>	<b>(128.5)</b>	<b>197.3</b>

(i) Unallocated net expense includes the results of certain non-regulated businesses, previously included within the Energy Networks segment, which are now managed as part of corporate office activities. Operating profit from these businesses in the six months ended 30 September 2005 amounted to £2.1 million. Unallocated net expense also includes corporate office costs and the operating results of the non-regulated businesses, previously included within the PacifiCorp segment, which were not included in the sale of PacifiCorp.

(ii) Share of profit/(loss) in jointly controlled entities and associates included in operating profit by segment for the six months ended 30 September 2006 is as follows: Energy Networks £nil (2005 £(1.2) million), Energy Retail & Wholesale £0.6 million (2005 £0.3 million), PPM Energy £1.1 million (2005 £nil) and Unallocated net expense £nil (2005 £nil).

**(c) Net fair value losses on operating derivatives by segment**

Included in operating profit above are net fair value (losses)/gains on operating derivatives as follows:

		Six months ended 30 September		Total
Unwind of opening position	Mark-to-market losses	Hedge ineffectiveness		
2006	2005	2006	2005	

Edgar Filing: - Form

	£m	£m	2006 £m	2005 £m	£m	£m	2006 £m	2005 £m
<b>Continuing operations</b>								
<b>United Kingdom</b>								
Energy Networks								
Energy Retail & Wholesale	(49.3)	(29.3)	(81.1)	(64.2)	(0.1)	(2.8)	(130.5)	(96.3)
<b>United Kingdom total</b>	<b>(49.3)</b>	<b>(29.3)</b>	<b>(81.1)</b>	<b>(64.2)</b>	<b>(0.1)</b>	<b>(2.8)</b>	<b>(130.5)</b>	<b>(96.3)</b>
<b>Continuing operations</b>								
<b>United States</b>								
PPM Energy	18.5	28.6	(20.6)	(81.2)	11.7	(11.7)	9.6	(64.3)
<b>United States total</b>	<b>18.5</b>	<b>28.6</b>	<b>(20.6)</b>	<b>(81.2)</b>	<b>11.7</b>	<b>(11.7)</b>	<b>9.6</b>	<b>(64.3)</b>
<b>Unallocated</b>			<b>(0.3)</b>				<b>(0.3)</b>	
<b>Total</b>	<b>(30.8)</b>	<b>(0.7)</b>	<b>(102.0)</b>	<b>(145.4)</b>	<b>11.6</b>	<b>(14.5)</b>	<b>(121.2)</b>	<b>(160.6)</b>

**Table of Contents****(d) Total assets and liabilities by segment**

	Notes	Total assets			Total liabilities		
		30 September	31 March		30 September	31 March	
		2005	2006		2005	2006	
		30 September	(As restated	(As restated	30 September	(As restated	(As restated
		2006	Note 1)	Note 1)	2006	Note 1)	Note 1)
		£m	£m	£m	£m	£m	£m
<b>Continuing operations</b>							
<b>United Kingdom</b>							
Energy Networks	(i)	3,479.1	3,217.5	3,366.2	(697.1)	(652.7)	(743.4)
Energy Retail & Wholesale		3,227.9	3,223.5	3,752.8	(862.5)	(735.8)	(812.2)
<b>United Kingdom total</b>		<b>6,707.0</b>	6,441.0	7,119.0	<b>(1,559.6)</b>	(1,388.5)	(1,555.6)
<b>Continuing operations</b>							
<b>United States</b>							
PPM Energy		1,500.8	1,628.9	1,400.7	(354.5)	(591.0)	(410.8)
<b>United States total</b>		<b>1,500.8</b>	1,628.9	1,400.7	<b>(354.5)</b>	(591.0)	(410.8)
<b>Total continuing operations</b>		<b>8,207.8</b>	8,069.9	8,519.7	<b>(1,914.1)</b>	(1,979.5)	(1,966.4)
Discontinued operations PacifiCorp (United States)			7,621.9			(5,075.4)	
Unallocated assets/(liabilities)	(i)	1,574.8	1,250.1	3,920.9	(5,233.1)	(5,457.2)	(5,373.2)
<b>Total</b>	(ii)	<b>9,782.6</b>	16,941.9	12,440.6	<b>(7,147.2)</b>	(12,512.1)	(7,339.6)

(i) Unallocated assets/(liabilities) include the net assets of certain non-regulated businesses, previously included within the Energy Networks segment, which are now managed as part of corporate office activities. These businesses had assets of £18.0 million and liabilities of £4.3 million at 30 September 2005 and assets of £19.2 million and liabilities of £6.7 million at 31 March 2006. Unallocated assets/(liabilities) also include net debt, tax liabilities, retirement benefit obligations, investments and treasury-related derivatives. Unallocated assets/(liabilities) at 30 September 2005 relate to both continuing and discontinued operations. Unallocated assets/(liabilities) at 30 September 2006 and 31 March 2006 relate solely to continuing operations.

(ii) Investments in jointly controlled entities and associates included in total assets by segment are as follows: Energy Networks £0.6 million (30 September 2005 £1.5 million; 31 March 2006 £nil), Energy Retail & Wholesale £10.5 million (30 September 2005 £11.3 million; 31 March 2006 £10.8 million), PPM Energy £154.1 million (30 September 2005 £101.2 million; 31 March 2006 £115.9 million) and Unallocated assets/(liabilities) £nil (30 September 2005 £nil; 31 March 2006 £nil).

**3 Exceptional Items and Certain Remeasurements**

Exceptional items and certain remeasurements included in profit for the period from continuing operations for the six months ended 30 September 2006 are as follows:

	Notes	Six months ended	
		30 September 2005	2006 £m
<b>(a) Exceptional administrative expenses</b>			
Corporate restructuring costs	(i)		(21.1)
Impairment of finance lease receivables	(ii)		(25.4)
			(46.5)
<b>(b) Gain on disposal of gas storage project</b>	(iii)		78.6
<b>Total exceptional items</b>			32.1
<b>(c) IAS 39 adjustments</b>			
Net fair value losses on operating derivatives	2, 14	(121.2)	(160.6)
Net fair value losses on financing derivatives	5, 14	(90.4)	(128.3)
<b>Total IAS 39 adjustments</b>		(211.6)	(288.9)
<b>Tax on exceptional items and certain remeasurements</b>			
Tax on exceptional administrative expenses			15.9
Tax on IAS 39 adjustments		62.7	91.8
		62.7	107.7
<b>Total exceptional items and certain remeasurements (net of tax) continuing operations</b>		(148.9)	(149.1)

- (i) A gross exceptional charge of £21.1 million and related tax credit of £6.3 million for the six months ended 30 September 2005, relating to costs of the corporate restructuring. Costs of the corporate restructuring by segment for the six months ended 30 September 2005 are as follows: Energy Networks £3.7 million, Energy Retail & Wholesale £8.5 million, PPM Energy £nil and Unallocated net expense £8.9 million.
- (ii) A gross exceptional charge of £25.4 million and related tax credit of £9.6 million for the six months ended 30 September 2005, relating to the impairment of the group's aircraft leases within the Unallocated segment.
- (iii) A gross exceptional gain within Energy Retail & Wholesale of £78.6 million for the six months ended 30 September 2005, relating to the sale of the group's underground natural gas storage project at Byley to E.ON UK plc for £96.0 million. There is no tax effect of this exceptional item.

**Table of Contents****4 Finance Income**

	Six months ended	
	30 September 2006 £m	2005 £m
Interest income	53.3	48.7
Expected return on retirement benefit assets	70.7	56.5
<b>Total</b>	<b>124.0</b>	<b>105.2</b>

**5 Net Fair Value Losses on Financing Derivatives**

Net fair value losses on financing derivatives of £90.4 million (2005 £128.3 million) includes losses of £77.9 million (2005 £141.7 million) for the six months ended 30 September 2006, resulting from changes to the fair value of the embedded derivative within the \$700 million convertible bonds, primarily as a result of movement in the company's share price.

**6 Finance Costs**

	Six months ended	
	30 September 2006 £m	2005 £m
Interest charge	100.8	106.3
Unwinding of discount on provisions	0.5	0.4
Interest on retirement benefit obligations	56.9	51.0
<b>Total</b>	<b>158.2</b>	<b>157.7</b>

**7 Income Tax**

Income tax includes deferred tax and is computed as follows:

- (a) Tax is calculated on the profits for the period, before taking account of the income statement effect of any adjustments to the measurement and classification of financial instruments required by IAS 39, at the anticipated annual effective rate applicable to these profits.
- (b)

## Edgar Filing: - Form

Adjustments to profit arising from the application of measurement and classification rules for financial instruments contained in IAS 39 are tax effected, as appropriate, at the applicable territorial rate.

- (c) Charges or credits to income taxes relating to prior-year items are recognised in the period in which they arise.

### **8 Return of Cash to Shareholders**

On 4 May 2006 shareholder approval was obtained at an Extraordinary General Meeting of the company for a return of cash to shareholders of £2.25 billion via a B share structure including a capital reorganisation, and the issue of new ordinary shares and B shares.

On 15 May 2006, one in every three of the company's existing ordinary shares were reclassified into B shares. The company's existing ordinary shares were subdivided and consolidated so that shareholders received approximately 1.1905 new ordinary shares for every existing ordinary share remaining after the reclassification.

Following the reclassification and the subdivision and consolidation, on 15 May 2006 there were 1,485,952,052 new ordinary shares and 623,864,749 B shares in issue all of which were admitted to the London Stock Exchange's main market for listed securities on that date.

In accordance with the terms of the B share prospectus, shareholders were able to elect between the following alternatives in respect of each B share that they held:

to receive a dividend of £3.60 after which the B share would be converted into a deferred share with a negligible value;

**Table of Contents**

to have it repurchased by the company for £3.60; or

to retain it and have the opportunity for it to be repurchased by the company on certain future dates up to 2011 for £3.60.

As a result of elections received from shareholders, on 22 May 2006 the company declared a B share dividend of £3.60 per share in respect of 370,655,937 B shares, totalling £1,334.4 million, and agreed to acquire a further 240,324,768 B shares for a total consideration of £865.2 million. 12,884,044 B shares, with a value of £46.4 million, remain outstanding at 30 September 2006. Net costs amounted to £3.9 million.

**9 Earnings and Net Asset Value Per Ordinary Share**

- (a) Earnings per ordinary share have been calculated for all periods by dividing the profit for the period (as adjusted for minority interests) by the weighted average number of ordinary shares in issue during the period, based on the following information:

	Six months ended	
	30 September 2006	2005
	£m	£m
<b>Basic earnings per ordinary share</b>		
Profit attributable to equity holders of Scottish Power plc		
Continuing	180.8	86.7
Discontinued		143.6
Continuing and Discontinued	180.8	230.3
Weighted average ordinary share capital (number of shares, million)	1,566.4	1,837.5
<b>Diluted earnings per share</b>		
Profit attributable to equity holders of Scottish Power plc		
Continuing	180.8	86.7
Discontinued		143.6
Continuing and Discontinued	180.8	230.3
Weighted average ordinary share capital (number of shares, million)	1,576.1	1,849.4

The difference between the basic and diluted weighted average ordinary share capital is attributable to outstanding share options and shares held in trust for the group's employee share schemes. The group's convertible bonds were anti-dilutive for the six months ended 30 September 2006 and for the six months ended 30 September 2005 based on the continuing profit attributable to equity holders of Scottish Power plc.

- (b) Net asset value per ordinary share has been calculated based on the net assets (after adjusting for minority interests) and the number of shares in issue (after adjusting for the effect of shares held in trust) at the end of the respective financial periods:

	30 September 2006	30 September 2005	31 March 2006
--	-------------------	-------------------	---------------

Edgar Filing: - Form

		(As restated Note 1)	
Net assets (as adjusted) (£ million)	2,627.7	4,426.9	5,100.9
Number of ordinary shares in issue at the period end (as adjusted) (number of shares, million)	1,476.5	1,845.5	1,850.1

10 Dividends

	Six months ended 30 September		Six months ended 30 September	
	2006 pence per ordinary share	2005 pence per ordinary share	2006 £m	2005 £m
Final dividend paid for the prior year	9.40	7.65	138.7	139.4
First interim dividend paid		5.20		96.0
<b>Total dividends paid</b>	<b>9.40</b>	<b>12.85</b>	<b>138.7</b>	<b>235.4</b>
Proposed first interim dividend	11.40		168.9	
Proposed second interim dividend		5.20		96.3

The proposed first interim dividend of 11.40 pence per ordinary share is payable on 28 December 2006 to shareholders on the register at 24 November 2006. The proposed first interim dividend was approved by the Board on 14 November 2006 and as required by IAS 10 Events After the Balance Sheet Date has not been included as a liability in these Accounts.

**Table of Contents**

As part of the return of capital to ordinary shareholders, a dividend of £3.60 per B share was declared in respect of 370,655,937 B shares totalling £1,334.4 million. Further details of the return of capital to ordinary shareholders are set out in Note 8.

**11 Reconciliation of Operating Profit to Cash Generated from Continuing Operations**

	Six months ended	
	30 September	
	2005	
	(As restated	
	2006	Note 1)
	£m	£m
Operating profit	395.8	197.3
Adjustments for:		
Fair value losses on operating derivatives	121.2	160.6
Share of (profit)/loss in jointly controlled entities and associates	(1.7)	0.9
Exceptional items		(32.1)
Amortisation	10.8	16.4
Depreciation	118.9	103.0
(Profit)/loss on sale of property, plant and equipment	(9.7)	4.5
Amortisation of share scheme costs	3.7	4.6
Movement in deferred income	12.9	(10.2)
Movement in provisions	(103.0)	6.9
<b>Operating cash flows before movements in working capital</b>	<b>548.9</b>	<b>451.9</b>
Increase in inventories	(139.7)	(255.5)
Decrease/(increase) in trade and other receivables	374.3	(62.2)
(Decrease)/increase in trade and other payables	(183.3)	45.4
<b>Cash generated from continuing operations</b>	<b>600.2</b>	<b>179.6</b>

**12 Contingent Liabilities**

There have been no material changes to the group's contingent liabilities disclosed in the 2005/06 Annual Report & Accounts.

**13 Exchange Rates**

The relevant exchange rates applied in the preparation of these Interim Accounts were \$1.85/£ (average rate for the six-month period to 30 September 2006), \$1.87/£ (closing rate as at 30 September 2006), \$1.79/£ (average rate for the three-month period to 30 September 2005), \$1.86/£ (average rate for the three-month period to 30 June 2005), \$1.76/£ (closing rate as at 30 September 2005) and \$1.74/£ (closing rate as at 31 March 2006).

**14 Reconciliation of Adjusted Profits and Earnings Per Share**

Set out below is the reconciliation of adjusted profits and earnings per share which has been prepared in accordance with the methodology set out in Note 1(b):

	Note	Six months ended 30 September	
		2006	2005
		£m	£m
<b>Adjusted profit from continuing operations</b>			
<b>Continuing operations</b>			
<b>Operating profit</b>		<b>395.8</b>	197.3
IAS 39 adjustments			
net fair value losses on operating derivatives		<b>121.2</b>	160.6
Other items			
exceptional items	3		(32.1)
<b>Adjusted operating profit</b>		<b>517.0</b>	325.8
<b>Net finance costs</b>		<b>(124.6)</b>	(180.8)
IAS 39 adjustments			
net fair value losses on financing derivatives		<b>90.4</b>	128.3
<b>Adjusted net finance costs</b>		<b>(34.2)</b>	(52.5)
<b>Adjusted profit before tax</b>		<b>482.8</b>	273.3
<b>Tax</b>		<b>(90.6)</b>	71.1
tax on adjusting items		<b>(62.7)</b>	(107.7)
<b>Adjusted tax</b>		<b>(153.3)</b>	(36.6)
<b>Adjusted profit from continuing operations</b>		<b>329.5</b>	236.7



## Edgar Filing: - Form

Adjusted diluted earnings per share were 20.23 pence (2005 19.79 pence), of which 20.23 pence (2005 12.53 pence) was from continuing operations and nil pence (2005 7.26 pence) was from discontinued operations.

**Table of Contents**

**PART 7**

**FINANCIAL INFORMATION OF IBERDROLA**

**Introduction**

Section A of this Part 7 sets out financial information relating to Iberdrola for the two years ended 31 December 2006. Section B of this Part 7 sets out the unaudited pro forma financial information for the Enlarged Iberdrola Group considering the ScottishPower Group and Iberdrola Group on a combined basis.

**Financial Information on Iberdrola**

The financial information set out in Section A of this Part 7 does not constitute statutory accounts within the meaning of Section 240 of the Companies Act, but has been extracted, without material adjustment, from the published audited consolidated annual accounts of Iberdrola as of and in respect of the year ended 31 December 2006. The financial information for the year ended 31 December 2005 has been extracted, without material adjustment, from the comparatives set out in the 2006 audited consolidated annual accounts of Iberdrola.

The financial information contained in Section A of this Part 7 does not constitute Iberdrola's full statutory financial statements. The audited consolidated annual accounts of Iberdrola for 2005 and 2006 have been prepared in accordance with International Financial Reporting Standards, as adopted by the European Union (EU-IFRSs). The reports of Ernst & Young, Iberdrola's auditor for the year ended 31 December 2006, and Deloitte, S.L., Iberdrola's auditor for the year ended 31 December 2005, on the consolidated financial statements, audited in accordance with generally accepted auditing standards in Spain, contained unqualified opinions.

**Table of Contents**

**SECTION A**

**AUDITED CONSOLIDATED FINANCIAL STATEMENTS OF IBERDROLA FOR THE TWO YEARS ENDED 31 DECEMBER 2006**

**IBERDROLA, S.A. AND SUBSIDIARIES**

**Consolidated Annual Accounts and Consolidated Management Report for the  
year ended December 31, 2006**

**(Translation of a report and consolidated annual accounts originally issued in Spanish.**

**In the event of discrepancy, the Spanish-language version prevails)**

---

**Table of Contents**

**AUDIT REPORT ON THE CONSOLIDATED ANNUAL ACCOUNTS**

Translation of a report and consolidated annual accounts originally issued in Spanish. In the event of discrepancy, the Spanish-language version prevails (See Note 50)

To the Shareholders of

IBERDROLA, S.A.

We have audited the consolidated annual accounts of IBERDROLA, S.A. and its subsidiaries (the IBERDROLA Group), which comprise the consolidated balance sheet at December 31, 2006, the consolidated income statement, the consolidated statement of recognised income and expense, the consolidated cash flow statement and the notes thereto for the year then ended, the preparation of which is the responsibility of the Parent Company's directors. Our responsibility is to express an opinion on the aforementioned consolidated annual accounts taken as a whole, based upon work performed in accordance with auditing standards generally accepted in Spain, which require the examination, through the performance of selective tests, of the evidence supporting the annual accounts, and the evaluation of their presentation, of the accounting principles applied, and of the estimates made. Our work did not include the audit of the 2006 annual accounts of several subsidiaries, whose assets and net profit represent 7% and 18%, respectively, of the consolidated totals. Said annual accounts were audited by other auditors (see appendix to the notes for detail) and our opinion in this audit report on the IBERDROLA Group's consolidated annual accounts with regard to these subsidiaries is based solely on the reports of these auditors.

In accordance with Spanish mercantile law, for comparative purposes the Parent Company's directors have included for each of the captions included in the consolidated balance sheet, the consolidated income statement, the consolidated statement of recognised income and expense, the consolidated cash flow statement and the notes thereto, in addition to the figures of 2006, those of 2005. Our opinion refers only to the consolidated annual accounts for 2006. On February 23, 2006, other auditors issued their audit report on the 2005 consolidated annual accounts, in which they expressed an unqualified opinion.

In our opinion, based on our audit and on the reports of the other auditors, the accompanying 2006 consolidated annual accounts give a true and fair view, in all material respects, of equity and financial position of IBERDROLA, S.A. and its subsidiaries at December 31, 2006, and the consolidated results of its operations, the changes in consolidated equity contained in the consolidated statement of recognised income and expense and the consolidated cash flow for the year then ended and contain the required information necessary for their adequate interpretation and comprehension, in conformity with the international financial reporting standards adopted by the European Union which are consistent with those applied to the figures and information corresponding to the 2005 consolidated financial statements.

The accompanying consolidated management report for the year ended December 31, 2006 contains such explanations as the Parent Company directors consider appropriate concerning the situation of IBERDROLA, S.A. and its subsidiaries, the evolution of its business and other matters, and is not an integral part of the consolidated annual accounts. We have checked that the accounting information included in the consolidated management report mentioned above agrees with the consolidated annual accounts for the year ended December 31, 2006. Our work as auditors is limited to verifying the consolidated management report in accordance with the scope mentioned in this paragraph, and does not include the review of information other than that obtained from the accounting records of the Parent Company and the companies comprising its Group.

ERNST & YOUNG, S.L.  
(Registered in ROAC under nº S0530)

Edgar Filing: - Form

Juan María Román Gonçalves

February 21, 2007

212

Table of Contents

**CONSOLIDATED ANNUAL ACCOUNTS AND CONSOLIDATED  
MANAGEMENT REPORT  
FOR THE YEAR ENDED 31 DECEMBER 2006**

213

**Table of Contents****CONTENTS**

	<b>Page</b>
<b><u>Consolidated balance sheets at 31 December 2006 and 2005</u></b>	215
<b><u>Consolidated income statements for the years ended 31 December 2006 and 2005</u></b>	217
<b><u>Consolidated statements of recognised income and expense for the years ended 31 December 2006 and 2005</u></b>	218
<b><u>Consolidated cash flow statements for the years ended 31 December 2006 and 2005</u></b>	219
<b><u>Notes to the consolidated annual accounts</u></b>	220
1 <u>Group activities</u>	220
2 <u>Basis of presentation of the Consolidated Annual Accounts</u>	220
3 <u>Industry regulation and functioning of the electricity systems</u>	223
4 <u>Accounting policies</u>	227
5 <u>Financial risk management policy</u>	242
6 <u>Use of estimates and sources of uncertainty</u>	246
7 <u>Geographical and business segment reporting</u>	248
8 <u>Intangible assets</u>	253
9 <u>Investment property</u>	254
10 <u>Property, plant and equipment</u>	255
11 <u>Financial investments</u>	258
12 <u>Trade and other receivables</u>	260
13 <u>Measurement of financial instruments</u>	261
14 <u>Nuclear fuel</u>	261
15 <u>Inventories</u>	261
16 <u>Construction contracts</u>	262
17 <u>Current trade and other receivables</u>	262
18 <u>Cash and cash equivalents</u>	262
19 <u>Equity</u>	263
20 <u>Deferred income</u>	267
21 <u>Provisions for pensions and similar commitments</u>	267
22 <u>Other provisions</u>	271
23 <u>Bank borrowings and other financial liabilities-loans</u>	271
24 <u>Derivative financial instruments</u>	273
25 <u>Other non-current payables</u>	275
26 <u>Deferred taxes and income tax expense</u>	275
27 <u>Tax receivables and payables</u>	279
28 <u>Trade and other payables</u>	280
29 <u>Revenue</u>	281
30 <u>Procurements</u>	281
31 <u>Staff costs</u>	282
32 <u>Operating leases</u>	282
33 <u>Depreciation and amortisation charge, allowances and provisions</u>	283
34 <u>Gains on disposal of non-current assets</u>	283
35 <u>Finance income</u>	284
36 <u>Finance costs</u>	284
37 <u>Swaps</u>	284
38 <u>Business combinations</u>	284
39 <u>Contingent liabilities</u>	285
40 <u>Interests in joint ventures</u>	286
41 <u>Guarantee commitments to third parties</u>	288
42 <u>Remuneration of directors</u>	288
43 <u>Remuneration of senior executives</u>	291
44 <u>Balances and transactions with other related parties</u>	291
45 <u>Financial position and events after 31 December 2006</u>	293
46 <u>Takeover bid for Scottish Power, Plc.</u>	293
47 <u>Fees for services provided by auditors</u>	294
48 <u>Earnings per share</u>	294
49 <u>Preparation of the consolidated financial statements</u>	295
50 <u>Explanation added for translation to English</u>	295

Appendix

296

Consolidated management report for 2006

305

214

**Table of Contents**

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with IFRS,  
as adopted by the European Union (see Note 50). In the event of a discrepancy, the Spanish-language version prevails.

**IBERDROLA, S.A. AND SUBSIDIARIES****Consolidated Balance Sheets**

31 December 2006 and 2005

	Note	Thousands of Euros	
		2006	2005(*)
<b>ASSETS</b>			
<b>NON-CURRENT ASSETS:</b>			
<b>Intangible assets</b>	8	<b>900,125</b>	848,595
Goodwill		55,644	50,033
Other intangible assets		844,481	798,562
<b>Investment property</b>	9	<b>498,486</b>	550,546
<b>Property, plant and equipment</b>	10	<b>21,067,354</b>	19,942,254
Property, plant and equipment in use		19,362,285	17,664,216
Property, plant and equipment in the course of construction		1,705,069	2,278,038
<b>Non-current financial assets</b>		<b>2,723,881</b>	1,630,435
Investments accounted for using the equity method	11.a	761,410	475,840
Non-current equity instruments	11.b	1,603,399	914,046
Other non-current financial assets	11.c	279,207	165,497
Derivative financial instruments	24	79,865	75,052
<b>Non-current trade and other receivables</b>	12	<b>832,840</b>	1,468,504
<b>Deferred tax assets</b>	26	<b>1,221,965</b>	1,356,456
		<b>27,244,651</b>	25,796,790
<b>CURRENT ASSETS:</b>			
<b>Nuclear fuel</b>	14	<b>237,898</b>	211,686
<b>Inventories</b>	15	<b>1,192,727</b>	848,348
<b>Current trade and other receivables</b>	17	<b>2,790,578</b>	2,324,317
<b>Current financial assets</b>		<b>288,855</b>	669,194
Current equity instruments		147,179	3,492
Other current financial assets	11.c	123,296	650,900
Derivative financial instruments	24	18,380	14,802
<b>Tax receivables</b>	27	<b>601,560</b>	419,905
<b>Cash and cash equivalents</b>	18	<b>704,574</b>	208,420
		<b>5,816,192</b>	4,681,870
<b>TOTAL ASSETS</b>		<b>33,060,843</b>	30,478,660

(\*) The consolidated balance sheet at 31 December 2005 is presented for comparative purposes only.

## Edgar Filing: - Form

The accompanying Notes 1 to 50 and the Appendix are an integral part of the consolidated balances sheets as at 31 December 2006 and 2005

**Table of Contents**

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with IFRS,  
as adopted by the European Union (see Note 50). In the event of a discrepancy, the Spanish-language version prevails.

**IBERDROLA, S.A. AND SUBSIDIARIES****Consolidated Balance Sheets**

31 December 2006 and 2005

	Note	Thousands of Euros	
		2006	2005(*)
<b>EQUITY AND LIABILITIES</b>			
<b>EQUITY:</b>			
<b>Of shareholders of the Parent</b>	19	<b>10,418,214</b>	9,267,653
Share capital		2,704,648	2,704,648
Unrealised asset and liability revaluation reserve		739,100	153,494
Other reserves		5,361,810	4,876,751
Treasury shares		(3,223)	(2,479)
Translation differences		(44,377)	153,190
Net profit for the year		1,660,256	1,382,049
<b>Of minority interests</b>		<b>148,789</b>	147,002
		<b>10,567,003</b>	9,414,655
<b>NON-CURRENT LIABILITIES:</b>			
<b>Deferred income</b>	20	<b>817,607</b>	675,597
<b>Provisions</b>		<b>1,717,775</b>	1,379,221
Provisions for pensions and similar obligations	21	825,876	732,545
Other provisions	22	891,899	646,676
<b>Bank borrowings and other financial liabilities</b>		<b>12,618,183</b>	11,555,610
Bank borrowings-loans	23	12,575,158	11,390,185
Derivative financial instruments	24	43,025	165,425
<b>Other non-current payables</b>	25	<b>278,322</b>	238,248
<b>Deferred tax liabilities</b>	26	<b>605,282</b>	719,715
		<b>16,037,169</b>	14,568,391
<b>CURRENT LIABILITIES:</b>			
<b>Provisions</b>		<b>466,023</b>	416,829
Provisions for pensions and similar obligations	21	118,488	182,894
Other provisions	22	347,535	233,935
<b>Bank borrowings and other financial liabilities</b>		<b>1,734,063</b>	1,555,441
Bank borrowings loans	23	1,665,412	1,544,839
Derivative financial instruments	24	68,651	10,602
<b>Trade and other payables</b>		<b>4,256,585</b>	4,523,344
Trade payables	28	2,687,756	2,919,585
Current tax liabilities and other tax payables	27	635,009	575,765
Other current liabilities		933,820	1,027,994
		<b>6,456,671</b>	6,495,614

Edgar Filing: - Form

---

<b>TOTAL EQUITY AND LIABILITIES</b>	<b>33,060,843</b>	30,478,660
-------------------------------------	-------------------	------------

---

(\*) The consolidated balance sheet at 31 December 2005 is presented for comparative purposes only.

The accompanying Notes 1 to 50 and the Appendix are an integral part of the consolidated balances sheets as at 31 December 2006 and 2005

**Table of Contents**

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with IFRS,  
as adopted by the European Union (see Note 50). In the event of a discrepancy, the Spanish-language version prevails.

**IBERDROLA, S.A. AND SUBSIDIARIES****Consolidated Income Statements for the years ended**

31 December 2006 and 2005

	Note	Thousands of Euros	
		2006	2005(*)
Revenue	29	<b>11,017,408</b>	11,738,228
Procurements	30	<b>(5,217,048)</b>	(6,791,567)
		<b>5,800,360</b>	4,946,661
Staff costs	31	<b>(1,173,721)</b>	(979,832)
Capitalised staff costs	31	<b>173,058</b>	174,255
Outside services		<b>(1,008,907)</b>	(862,934)
Other operating income		<b>235,171</b>	322,184
		<b>(1,774,399)</b>	(1,346,327)
Taxes other than income tax		<b>(136,311)</b>	(222,721)
		<b>3,889,650</b>	3,377,613
Depreciation and amortisation charge, allowances and provisions	33	<b>(1,235,200)</b>	(1,115,395)
<b>PROFIT FROM OPERATIONS</b>		<b>2,654,450</b>	2,262,218
Result of companies accounted for using the equity method		<b>69,085</b>	34,421
Finance income	35	<b>368,302</b>	266,719
Finance costs	36	<b>(887,250)</b>	(722,359)
Gains on disposal of non-current assets	34	<b>193,403</b>	157,712
Losses on disposal of non-current assets		<b>(11,814)</b>	(40,901)
<b>PROFIT BEFORE TAX</b>		<b>2,386,176</b>	1,957,810
Income tax	26	<b>(695,291)</b>	(553,250)
<b>NET PROFIT FOR THE YEAR</b>		<b>1,690,885</b>	1,404,560
Minority interests		<b>(30,629)</b>	(22,511)
<b>NET PROFIT FOR THE YEAR ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE PARENT</b>		<b>1,660,256</b>	1,382,049
<b>EARNINGS PER SHARE IN EUROS (BASIC AND DILUTED)</b>	48	<b>1.843</b>	1.534

(\*) The consolidated income statement at 31 December 2005 is presented for comparative purposes only.

The accompanying Notes 1 to 50 and the Appendix are an integral part of the consolidated income statement for the year ended 31 December 2006 and 2005



**Table of Contents****IBERDROLA, S.A. AND SUBSIDIARIES****Consolidated Statements of Recognised Income and Expense**

for the years ended 31 December 2006 and 2005

	Thousands of euros					
	2006 Of		Total	2005(*) Of		Total
	Of the Parent	Minority Interests		Of the Parent	Minority Interests	
<b>NET PROFIT RECOGNISED DIRECTLY IN EQUITY</b>						
<b>In other reserves</b>	(24,291)		(24,291)	(202,695)		(202,695)
Actuarial gains and losses on pension schemes	(8,796)		(8,796)	(311,838)		(311,838)
Adjustments for amendments to applicable tax rate	(13,801)		(13,801)			
Others	(7,307)		(7,307)			
Tax effect	5,613		5,613	109,143		109,143
<b>In unrealised asset and liability revaluation reserves</b>	<b>585,606</b>		<b>585,606</b>	172,290		172,290
Change in the value of available-for-sale investments	457,573		457,573	180,321		180,321
Change in the value of cash flow hedges	178,854		178,854	85,649		85,649
Tax effect	(50,821)		(50,821)	(93,680)		(93,680)
<b>In translation differences</b>	<b>(197,567)</b>	<b>(7,116)</b>	<b>(204,683)</b>	219,857	7,652	227,509
Change in translation differences	(297,722)	(10,715)	(308,437)	330,901	11,499	342,400
Tax effect	100,155	3,599	103,754	(111,044)	(3,847)	(114,891)
<b>NET PROFIT RECOGNISED DIRECTLY IN EQUITY</b>	<b>363,748</b>	<b>(7,116)</b>	<b>356,632</b>	189,452	7,652	197,104
<b>NET PROFIT FOR THE YEAR</b>	<b>1,660,256</b>	<b>30,629</b>	<b>1,690,885</b>	1,382,049	22,511	1,404,560
<b>TOTAL INCOME AND EXPENSES RECOGNISED IN THE YEAR</b>	<b>2,024,004</b>	<b>23,513</b>	<b>2,047,517</b>	1,571,501	30,163	1,601,664

(\*) The consolidated statement of recognised income and expense for 2005 is presented solely for information purposes.

The accompanying Notes 1 to 50 and the Appendix are an integral part of the consolidated statement of recognised income and expense for the year ended 31 December 2006 and 2005.

**Table of Contents****IBERDROLA, S.A. AND SUBSIDIARIES****Consolidated Cash Flow Statements**

for the years ended 31 December 2006 and 2005

	Note	Thousands of Euros	
		2006	2005(*)
<b>Cash flows from operating activities:</b>			
Profit before tax		2,386,176	1,957,810
Adjustments for			
Depreciation and amortisation charge and provisions	21,22,33	1,395,285	1,351,130
Net result of associates	11	(69,085)	(34,421)
Grants credited to income	20	(48,519)	(147,154)
Finance income and costs	35,36	518,948	455,639
Gains from disposal of noncurrent assets	34	(181,589)	(116,810)
Changes in working capital:			
Change in trade and other receivables		(465,917)	(277,643)
Change in inventories		(370,591)	38,182
Decrease in trade payables		(110,283)	569,614
Effect on working capital of changes in consolidation method and/or scope		28,786	(11,768)
Effect of translation differences on working capital of foreign companies		(28,561)	6,649
Change in non-current receivables and other payables		675,737	(1,379,903)
Provisions paid		(190,885)	(148,620)
Income taxes paid		(693,430)	(460,938)
Interest received		221,281	90,689
Dividends received		67,890	33,191
<b>Net cash flows from operating activities (I)</b>		<b>3,135,243</b>	<b>1,925,647</b>
<b>Cash flows from investing activities:</b>			
Investments in subsidiaries, net of the existing cash items			(97,870)
Investments in intangible assets	8	(53,167)	(64,745)
Investments in associates	11	(224,279)	(7,382)
Investments in equity investments	11	(331,812)	(248)
Other investments	11	(113,711)	64,022
Investments in treasury shares	19	(228,170)	(319,495)
Investments in investment property	9	(4,318)	(24,972)
Investments in property, plant and equipment	10	(2,435,701)	(2,041,996)
Changes in working capital due to current financial assets		380,339	(455,725)
Income taxes paid		(8,170)	(18,045)
Proceeds from disposals of non-financial assets		57,054	131,433
Proceeds from disposals of financial assets		79,900	155,312
Proceeds from disposals of treasury shares	19	227,427	322,681
<b>Net cash flows from investing activities (II)</b>		<b>(2,654,608)</b>	<b>(2,357,030)</b>
<b>Cash flows from financing activities:</b>			
Dividends paid	19	(872,699)	(729,384)
Change in working capital due to current borrowings		120,573	(931,990)
Grants related to assets	20	187,855	164,269
Cash inflows from non-current borrowings		3,007,716	3,510,878
Interest paid including capitalised interest		(751,767)	(697,535)
Repayment of borrowings		(1,665,412)	(844,839)
Non-current loans			(9,592)

Edgar Filing: - Form

Early settlement of derivatives		37,024
<b>Net cash flows from financing activities (III)</b>	<b>26,266</b>	498,831
<b>Effect of foreign exchange rate changes on cash and cash equivalents (IV)</b>	<b>(10,747)</b>	6,870
<b>Net increase in cash and cash equivalents (I+II+III+IV)</b>	<b>496,154</b>	74,318
Cash and cash equivalents at beginning of year	<b>208,420</b>	134,102
<b>Cash and cash equivalents at end of year</b>	<b>704,574</b>	208,420

(\*) The Consolidated Cash Flow Statement for 2005 is presented for comparative purposes only.

The accompanying Notes 1 to 50 and the Appendix are an integral part of the consolidated cash flow statements for the year ended 31 December 2006 and 2005

**Table of Contents**

**IBERDROLA, S.A. AND ITS SUBSIDIARIES**

**Notes to the Consolidated Accounts**

December 31, 2006

**1. Group activities**

Pursuant to Article 2 of its bylaws, the corporate purpose of IBERDROLA, incorporated in Spain with limited liability (Sociedad Anónima) ( IBERDROLA ) is as follows:

To carry out all manner of activities and construction work and provide services required for, or related to, the production, transmission, switching and distribution or retailing of electric power or electricity by-products and their applications, and involving the raw materials or primary energies required for electric power generation, energy, engineering, computer and telecommunications services, services relating to the Internet, the treatment and distribution of water, the integral provision of urban and gas retailing services, and other gas storage, regasification, transmission or distribution activities, which will be provided indirectly through the ownership of shares or other equity investments in companies that do not engage in the retailing of gas.

The distribution, representation and marketing of all manner of goods and services, products, articles, merchandise, computer programs, industrial equipment, machinery, machine and hand tools, spare parts and accessories.

To engage in the research, study and planning of investment and corporate organisation projects, and to promote, set up and develop industrial, commercial and service companies.

To provide assistance and support services to the Group companies and other investees, providing for them the guarantees and collateral required for this purpose.

IBERDROLA s registered address is at Calle Gardoqui 8, in Bilbao.

The aforementioned activities may be performed in Spain and abroad, and may be performed totally or partially either directly by IBERDROLA or through the ownership of shares or other equity investments in other companies, subject in all cases to the legislation applicable at any given time and, in particular, to the legislation applicable to the electricity industry (see Note 3).

In general, the corporate purpose of the subsidiaries consists of the production, switching, distribution and retailing of electricity and gas, the provision of telecommunications services and the performance of real estate and other related activities in Spain and abroad.

**2. Basis of presentation of the consolidated annual accounts**

**a) Applicable accounting legislation**

The IBERDROLA Group's 2006 Consolidated Annual Accounts were prepared by the directors on 20 February 2007 in accordance with International Financial Reporting Standards (IFRSs), as adopted by the European Union, in conformity with Regulation (EC) no. 1606/2002 of the European Parliament and of the Council. The directors of IBERDROLA expect these Consolidated Annual Accounts to be approved at the General Shareholders' Meeting without modification.

These Consolidated Annual Accounts have been prepared on a historical cost basis, except for available-for-sale financial assets and derivative financial instruments, which have been measured at fair value. The carrying amounts of assets and liabilities hedged by fair value hedges are restated to reflect variations in their fair value as a result of the risk hedged.

## **Table of Contents**

IBERDROLA has elected to implement the early application of the following standards, which have been endorsed by the European Union and do not have any impact on the Group's financial situation as they relate solely to additional disclosure:

IFRS 7: Financial instruments: disclosures (see Notes 5 and 24), which requires disclosure to enable readers to evaluate the significance of the Group's financial instruments, their nature and the extent of risks arising from them.

Amendments to IAS 1: Presentation of financial statements, which requires disclosure to enable readers to evaluate the policies and processes for managing capital (see Note 19).

The remaining standards issued by the corresponding bodies whose application is not mandatory in 2006 would not have a material impact on these Consolidated Annual Accounts.

The IFRSs provide for certain alternatives, including most notably the following:

- i) The IFRSs establish as an alternative the recording as an addition to the acquisition cost of assets the finance costs arising from the external financing allocated to property, plant and equipment in the course of construction and nuclear fuel stocks. The IBERDROLA Group opted to capitalise these finance costs.
- ii) Interests in joint ventures may be proportionately consolidated or accounted for by the equity method. The same method must be applied to all the Group's interests in joint ventures. The IBERDROLA proportionately consolidates all its investments in companies over which it shares control with the shareholders.
- iii) Intangible assets and assets recorded under Property, Plant and Equipment and Investment Property may be measured at market value or cost, less any accumulated amortisation and any accumulated impairment losses. The IBERDROLA Group decided to measure the aforementioned assets at adjusted cost.
- iv) Under IFRSs, actuarial differences exceeding the higher of 10% of the actuarial present value of guaranteed benefit or 10% of the market value of the plan assets, deferred over the average remaining life of the employees covered by the plan, may be allocated to income. Alternatively, the actuarial differences that arise in relation to its defined benefit obligations may be allocated to reserves.

The IBERDROLA Group decided to recognise the full amount of the actuarial variances when they are charged or credited, as appropriate, to reserves.

- v) Under IFRSs, grants related to assets can be treated in two ways: the amount of the grants related to assets received for the acquisition of the assets can be deducted from the carrying amount of the assets or they can be set up as deferred income on the liability side of the balance sheet. The IBERDROLA Group opted for the latter treatment.

The IBERDROLA Group's Consolidated Annual Accounts corresponding to the year 2005 were approved at the General Shareholders Meeting on 18 March 2006.

**b) Basis of consolidation**

The subsidiaries over which the IBERDROLA Group exercises control are generally fully consolidated, unless they are scanty material with respect to presenting fairly the accounts of the IBERDROLA Group.

The IBERDROLA Group considers that it has control over a company when it has the power to govern its financial and operating policies so as to obtain benefits from its activities.

## **Table of Contents**

The entities that the IBERDROLA Group manages jointly with other companies are proportionately consolidated.

The associates over which the IBERDROLA Group does not exercise control but does have a significant influence were accounted for in the consolidated balance sheet by the equity method. For the purposes of these Consolidated Annual Accounts, it is considered that a significant influence is exercised over companies in which the Group has an ownership of over 20%, except in specific cases in which, although the Group's ownership interest is lower, the existence of a significant influence can be clearly demonstrated.

The Appendix to these Consolidated Annual Accounts contains a detail of the subsidiaries, jointly controlled entities and associates of IBERDROLA, together with the consolidation or measurement basis used in preparing the accompanying Consolidated Annual Accounts and other disclosures relating thereto.

The closing date used of the financial statements of subsidiaries, jointly controlled entities and associates is 31 December. These companies' accounting policies are the same as or have been conformed to those used by the IBERDROLA Group in preparing these Consolidated Annual Accounts.

The financial statements of each of the foreign companies have been prepared in their respective functional currencies, defined as the currency of the economy in which each company operates and in which it generates and uses cash.

The operations of IBERDROLA and of the consolidated subsidiaries and jointly controlled entities are consolidated in accordance with the following basic principles:

1. On acquisition, the assets, liabilities and contingent liabilities of a subsidiary are measured at their market value. Any excess of the cost of acquisition of the subsidiary over the market value of its assets and liabilities, in proportion to the Parent's ownership interest, is recognised as goodwill.

Any deficiency of the cost of acquisition below the market value of the assets and liabilities is credited to the consolidated income statement.

The results of the subsidiaries acquired or disposed of during the year are included in the consolidated income statements from the effective date of acquisition or until the effective date of disposal.

2. Goodwill arising from business combinations has not been amortised since 1 January 2004, the date of transition to IFRSs, although it is reviewed at least once a year to ascertain whether any impairment loss should be recognised.
3. The result of accounting for investments using the equity method (after eliminating the results on intra-Group transactions) is classified under Other Reserves and Result of Companies Accounted for Using the Equity Method in the accompanying consolidated balance sheet and consolidated income statement, respectively.

## Edgar Filing: - Form

4. The interest of minority shareholders in the equity and results of the fully consolidated subsidiaries and of the subsidiaries of proportionately consolidated jointly owned entities is presented under Equity Of minority interests on the liability side of the consolidated balance sheet and Minority Interests in the consolidated income statement, respectively.
5. The financial statements of foreign companies were translated to euros using the year-end exchange rate method. This method consists of translating to euros all the assets, rights and obligations at the exchange rates prevailing at the date of the Consolidated Annual Accounts; the consolidated income statement items at the average exchange rates for the year; and equity at the

## **Table of Contents**

historical exchange rates at the date of acquisition (or in the case of retained earnings at the average exchange rates for the year in which they were generated provided that there are no significant transactions that make the use of the average exchange rate inappropriate), as appropriate.

6. All balances and transactions between the fully and proportionately consolidated companies were eliminated on consolidation.

### **3. Industry regulation and functioning of the electricity system**

Both IBERDROLA and certain of the fully and proportionately consolidated subsidiaries engage in electricity business activities in Spain and abroad (see the Appendix hereto). Following is a description of the main regulations affecting the IBERDROLA Group.

#### *Spain*

On 11 December 1996, the Ministry of Industry and Energy and the main electric utilities, including IBERDROLA, signed a protocol for the establishment of a new regulatory framework for the Spanish electricity system. On 27 November 1997, Electricity Industry Law 54/1997 was passed. This Law gave statutory force to the principles of this protocol and implemented in Spanish legislation the provisions set forth in Directive 96/92/EC concerning common rules for the internal market in electricity.

Electricity Industry Law 54/1997, of 27 November, and the subsequent implementing legislation established, inter alia, the following principles:

- 1) Introduction of competition in power generation through the following measures:

Since 1 January 1998, the producers of electricity, other than the special cases and exceptions provided for in the Law, have tendered hourly bids for the selling price of electricity of each of the production units owned by them. The operating order of the production units is established on the basis of the lowest bids made until demand is satisfied in each programming period. The power generated is remunerated in each programming period at the bid price tendered for the last facility whose start-up was required to satisfy demand. The generating facilities also receive remuneration for the supply guarantee that each of them effectively provides to the system and for the supplementary services required to guarantee adequate supply. The organisation and regulation of the electricity production market was defined and implemented by Royal Decree 2019/1997, of 26 December.

On 28 February 2006, Royal Decree-Law 3/2006 was passed amending the mechanism by which bids to sell and purchase energy are tendered simultaneously on the daily and intra-daily generation markets to the extent they are tendered by electricity sector companies belonging to the same corporate group. This Royal Decree-Law provides that bids to sell and purchase energy made simultaneously by members of the same corporate group in the daily and intra-daily generation markets shall be subject to bilateral contracts in the amounts in which sales and purchase bids match. The provisional price set for distributors for energy acquired in this manner in 2006 has been set at 42.35/MWh (see Note 4.z). The government shall set the definitive prices at which said energy purchases made by the aforementioned distributors are to be recognised throughout the course of this year. This had not happened by the date of preparation of these Consolidated Annual Accounts. These prices are to be based on pool prices and will be objective and transparent.

## Edgar Filing: - Form

Royal Decree 1634/2006, dated 29 December, setting the electricity tariff applicable from 1 January 2007, provided that the provisional price to be applied by the distributors during 2007 for energy subject to bilateral contracts shall be the matched price on the daily and intra-daily electricity generation markets plus the average acquisition cost to distributors for adjustment services, deviations and the capacity guarantee corresponding to the energy matched in each programming period.

## Table of Contents

In addition, on 30 May 2006, the resolution of 24 May 2006 issued by the General Secretary for Energy was passed, enacting the operating rules for the daily and intra-daily electricity generation markets.

The installation of new generating facilities is deemed to be liberalised, without prejudice to the obtainment of the necessary authorisations.

Producers are entitled to use in their generating facilities the primary energy sources that they deem most appropriate, subject to such restrictions in respect of the environment, etc. as might be provided for in current legislation.

The new Law envisages the possibility of giving operating priority to facilities which use Spanish energy sources (Spanish coal, etc.), up to a limit of 15% of the total amount of primary energy required for electricity production, provided that this is compatible with the free market.

The owners of the electricity production facilities with an installed capacity of less than 50 MW may opt to sell the power to the distributor that owns the network to which the related facilities are connected at the regulated tariff or to sell the power freely to the market through the system managed by the Market Operator at the price prevailing in the organised market supplemented by an incentive and, where applicable, by a premium.

Royal Decree 436/2004 establishes the economic regime for renewable energy powered generation facilities and sets the methodology for updating, standardising and revising the legal and economic regime applicable to renewables/CHP generation. The Royal Decree provides that renewables/CHP electricity generators can elect one of two remuneration schemes. The first entails the transfer of electricity to the distributor at a fixed price based on a percentage of the average electricity tariff as defined in Article 2 of Royal Decree 1432/2002. The second entails the sale of electricity at the pool price plus a premium calculated as a fixed percentage of the average tariff.

2) Guarantee of the proper functioning of the system, by means of the following measures:

Red Eléctrica de España, S.A. carries on the transmission management and system operation activities which, pursuant to the Law, have been unbundled for accounting purposes.

The Law also defines and assigns the responsibility for the economic management of the system to the Iberian Energy Market Operator, Polo Español, S.A., which is in charge of the mechanisms for receiving bids, matching demand to supply and making the notifications required to establish the production market.

3) Progressive liberalisation of electricity supply, and introduction of the retailing activity:

The Law provides for the progressive liberalisation of electricity supply by progressively allowing the various types of customer to choose their supplier (becoming eligible customers). On 1 January 2003, all levels of electricity consumption were liberalised.

The Law provides for the right of eligible customers and retailing companies to use transmission and distribution systems and establishes a single fee applicable to the whole of Spain for this purpose, without prejudice to the differing electricity prices based on voltage level, the use made of the systems or the features of consumption depending on whether transmission or distribution systems are involved. Royal Decree 1164/2001, which established the fees for access to the electricity transmission and distribution systems, was published on 26 October 2001.

## Edgar Filing: - Form

Under Electricity Industry Law 54/1997, the remuneration of the distribution activity for each utility must be based on the costs required to carry on this activity, using a model

---

**Table of Contents**

characterising the various distribution areas, and on other parameters. A Ministry of Industry and Energy Order dated 14 June 1999, established the remuneration of the electricity distribution activity and the means for determining it from 1998 onwards. This overall remuneration is calculated largely on the basis of the remuneration through 31 December 1997, adjusted from 1998 onwards on the basis of the variations in electricity demand and in the CPI and of certain efficiency parameters. The remuneration will initially be shared out among the electric utilities on the basis of the percentages of the total remuneration of the system corresponding to each utility under the former remuneration system. These percentages will be adapted progressively (over 16 years) to various parameters, including, inter alia, those resulting from the so-called reference system model, which defines the system based on the geographical areas in which each utility carries on its electricity distribution business.

Remuneration of the transmission activity, which includes the facilities with nominal operating voltage levels equal to or over 220 kV, will basically continue to be governed by the system in place through 1998, based on actual physical units and on standard investment, operating and maintenance costs, and the other costs required to carry on this activity.

On 1 December 2000, Royal Decree 1955/2000, regulating the transmission, distribution, retailing and supply activities and electricity facility authorisation procedures, was approved. The basic aim of this Royal Decree was to establish the measures required to guarantee the supply of power and the authorisation procedures relating to all electricity facilities that are the responsibility of the Spanish government.

- 4) Price formation and tariff structure applicable to customers which have not availed themselves of the entitlement to choose their power supply source.

Royal Decrees 2017/1997 and 1432/2002, of 27 December, establish, inter alia, the various cost components that must be taken into account when determining the annual average tariff, and an objective tariff calculation methodology that permits the full eligibility of all consumers, while simultaneously ensuring that the service is provided in adequate conditions and affords the utilities an element of predictability that enables them to make their investments under conditions of relative stability.

In this regard, Royal Decree 1432/2002 provided that the variation in the average electricity tariff cannot, in principle, exceed 1.4%, although it did set certain criteria for updating the tariff which, if applied, can give rise to an additional upward variation of 0.6% or to the corresponding downward variation. Also, it provided that the government may take into account when calculating the average or reference tariff variances in the amounts of costs derived from changes to the specific regulations governing the remuneration of electricity activities.

Royal Decree 1556/2005 establishing the electricity tariff for 2006 was published on 28 December 2005. This Royal Decree set the average increase in the average or reference tariff for the sale of electricity for 2006 at 4.48% with respect to the tariff that came into force on 1 January 2005. Subsequently, Royal Decree 809/2006 providing for an additional increase in the average or reference tariff of 1.38% effective from 1 July 2006 was published on 30 June 2006. Said Royal Decree further abolished the average electricity tariff increase ceilings established in Royal Decree 1432/2002.

In addition, Royal Decree 1634/2006 establishing the electricity tariff for 2007 was published on 30 December 2006. Among other measures, this Royal Decree set the average increase at 4.30%, providing additionally that on a quarterly basis from 1 July 2007, the Spanish government, by means of Royal Decree, will amend the tariffs applicable by electricity distributors to electricity sales, reviewing in each instance the costs accrued in undertaking the activities required to supply energy, the system's permanent costs, diversification costs as well as capacity guarantee compensation.

## **Table of Contents**

### 5) Unbundling of activities:

The corporate purpose of companies which carry on any of the activities regulated in the Law (economic and technical management of the system, transmission and distribution) must be confined exclusively to said activities and, accordingly, these companies may not carry on non-regulated activities (e.g. production, retailing to eligible customers, other non-electricity activities or activities abroad), without prejudice to the acknowledged entitlement of distributors to make sales to customers under the tariff system.

However, incompatible activities may be carried on within the same group of companies, provided that they are performed by different companies.

### 6) Emission allowances:

Royal Decree 1866/2004, of 6 September, amended by Royal Decree 60/2005, of 21 January, established a National Plan for the Assignment of Emission Allowances in compliance with the Kyoto Protocol approved on 11 December 1997, within the United Nations Framework Convention on Climate Change in order to reduce greenhouse gas emissions. This three-year Plan came into force on 1 January 2005. Emission allowances allocated free of charge to the Spanish electricity sector for the 2005-2007 period amounted to 268.98 million tonnes, of which 43.02 million tonnes corresponded to facilities of the IBERDROLA Group (14.17 and 14.24 million tonnes for 2006 and 2005, respectively) (see Note 8).

However, Article 2 of Royal Decree-Law 3/2006 establishes that from 2 March 2006, an amount equivalent to the value of the CO<sub>2</sub> emission allowances allocated free of charge to the electricity generators will be netted from remuneration for ordinary regime electricity generation. The value of the greenhouse gas emission allowances received by each of the companies owning facilities between 1 January and 2 March 2006 shall be used to compensate them for their share of the revenue deficit described in Note 4.z. Royal Decree-Law 3/2006 also empowers the Spanish government to develop the regulations to enact Article 2 thereof. These regulations had not been developed at the date of preparation of these Consolidated Annual Accounts.

### *Other countries*

The electricity distribution activity carried on by the proportionately consolidated subsidiaries Companhia de Eletricidade do Estado do Bahía, S.A., Companhia Energética do Rio Grande do Norte, S.A., Companhia Energética do Pernambuco, S.A. and Empresa Eléctrica de Guatemala, S.A. (see the Appendix to these Consolidated Annual Accounts) is subject to the legislation of the countries in which they operate.

Specifically, the Brazilian regulatory framework is based on which establishes ceilings that are revised every five years. Tariffs are updated annually by the Brazilian Energy Agency (ANEEL).

The tariffs have two components:

## Edgar Filing: - Form

Component A: corresponds to energy purchases and other costs that are extraneous to the distributor and are passed through to the end tariff.

Component B: costs related to the distributor's remuneration and which factor in operating and maintenance expenses, a return on investment (determined based on a rate of return to the value of the distribution assets) and an efficiency-related factor.

The aim of the annual revision is to ensure that component A costs are passed on and that component B costs perform in line with inflation adjusted for the defined efficiency factor.

## **Table of Contents**

### **4. Accounting policies**

The principal accounting policies used in preparing the Consolidated Annual Accounts were as follows:

#### **a) Revenue recognition**

Revenue from sales is measured at the fair value of the assets or rights received as consideration for the goods and services provided in the normal course of the Group companies' business, net of discounts and applicable taxes.

In the case of regulated tariff sales, as remuneration is based on a regulated margin, the IBERDROLA Group does not record separately its regulated energy purchases and sales, but instead recognises the remuneration fixed annually for these activities by Royal Decree (see Note 29).

The positive or negative adjustments to the future electricity tariff established by the regulator to compensate for variances between the estimated costs that served as the basis for calculating the tariff for the year and the costs actually borne by the Group companies in that period are recognised as an addition to or reduction of the income for future years. The additional cost arising from the aforementioned variances is recognised as income for the year only when local legislation and the government guarantee that the additional cost will be reimbursed, independently of future sales (Note 4.z).

Sales of goods are recognised when the goods and title thereto have been transferred.

Revenue from construction contracts is recognised in accordance with the IBERDROLA Group's accounting policy described in Note 4.e.

Interest income is accrued on a time proportional basis, by reference to the principal outstanding and the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the asset to that asset's carrying amount.

Dividend income is recognised when IBERDROLA Group companies are entitled to receive them.

#### **b) Associates**

Associates are companies over which the Group exercises significant influence but which cannot be classified as subsidiaries or jointly controlled companies. Therefore, the Group has the power to participate in the financial and operating decisions, but not to fully or jointly control them.

## Edgar Filing: - Form

In general, investments in associates are accounted for under the equity method of accounting. Accordingly, investments are measured initially at acquisition cost, subsequently adjusted for changes to each company's equity, taking into consideration the percentage ownership and impairments, if any.

Certain investments in associates that are not material in relation to these Consolidated Annual Accounts are recorded at acquisition cost under Non-current financial assets Non-current equities instruments in the accompanying consolidated balance sheets (see Note 11.b).

Gains or losses on transactions with associates are eliminated to the extent of the Group's interest in the associates.

### c) **Joint ventures**

A joint venture is a company in which various venturers perform an activity subject to joint control. This occurs when both the financial strategy and operating decisions require the unanimous consent of all the venturers.

## **Table of Contents**

The IBERDROLA Group companies that perform jointly controlled activities directly through joint property associations include in their financial statements the proportion of the assets and liabilities managed and their share of income and expenses. If joint control gives rise to the incorporation of a separate company, this company is proportionately consolidated.

Goodwill arising on the acquisition of interests in joint ventures is recognised in accordance with the Group's accounting policies described in Note 4.d.

### **d) Goodwill**

Goodwill arising on consolidation represents the difference between the price paid to acquire fully and proportionately consolidated subsidiaries and jointly controlled companies, as appropriate, and the IBERDROLA Group's interest in the fair value of the assets liabilities, and contingent liabilities of those companies at the date of acquisition. Goodwill arising from acquisitions of companies with a functional currency other than the euro is translated to euros at the exchange rates prevailing on the consolidated balance sheet date.

Goodwill acquired on or after 1 January 2004 is measured at acquisition cost and that acquired earlier is measured at the carrying amount at 31 December 2003 in accordance with Spanish GAAP and as provided for in IFRS 1: First-time adoption of international financial reporting standards. In neither instance is goodwill amortised, although at the end of each reporting period goodwill is reviewed for impairment to its recoverable value and any impairment is written down (see Note 4.m).

### **e) Construction contracts**

Where the income from a construction contract can be estimated reliably, the income is recognised according to the degree of completion of the construction project at each balance sheet date, by measuring the contract costs incurred to date as a proportion of the total estimated construction costs.

Where the income from a construction contract cannot be estimated reliably, it is recognised to the extent of contract costs incurred will be recoverable. Contract costs are recognised as expenses in the year in which they are incurred.

When total estimated costs exceed total contract revenue, the loss is recognised immediately in the consolidated income statement.

### **f) Electricity production capacity assignment contracts**

The IBERDROLA Group has electricity production capacity assignment and electricity purchase and sale contracts associated with the Mexican Federal Electricity Commission. These contracts have a term of 25 years from the scheduled date for the commencement of commercial operations of each facility.

Under these contracts, the IBERDROLA Group periodically receives fixed revenues from the assignment of power supply capacity and from the operation and maintenance of the plant over the contract term. IBERDROLA recognises these fixed revenues for each contract on a straight-line basis. The accounts receivable under these contracts are recognised at present value until they have been collected.

**g) Intangible assets**

*Concessions, patents, licences and other*

The amounts recognised by the IBERDROLA Group as *Concessions, Patents, Licences and Other* relate to the cost incurred in their acquisition.

## **Table of Contents**

A significant portion of the balance of this heading in the consolidated balance sheet relates to the price paid for the administrative concessions granted to certain IBERDROLA Group companies to carry on their business activities over periods ranging from 30 to 50 years. The IBERDROLA Group amortises the amounts incurred on a straight-line basis over the term of the related concessions, with a charge to Depreciation and amortisation charge, allowances and provisions in the consolidated income statement.

The costs incurred in relation to the other items included under this heading in the accompanying consolidated balance sheet are amortised on a straight-line basis over their useful lives, which range from five to ten years.

### *Emission allowances*

The IBERDROLA Group recognises emission allowances once it is the owner thereof. Allowances allocated free of charge to each facility as part of the National Emission Allowance Assignment Plan (see Notes 3 and 4.t) are initially measured at market value on their allocation date and are credited to Deferred income on the consolidated balance sheet. Allowances acquired from third parties are measured at acquisition cost.

The IBERDROLA Group has taken the stance that, as a result of the entry into force of Royal Decree-Law 3/2006 and the lack of enacting regulations, the greenhouse gas emissions allocated to its ordinary regime productive facilities as part of the aforementioned National Emission Allowance Assignment Plan for 2006 can no longer be considered to have been allocated for no compensation (see Notes 3 and 4.z).

These assets are measured at cost and are analysed at each balance sheet date for impairment.

Emission allowances are derecognised when they are sold to third parties, have been delivered or expire. When the allowances are delivered, they are derecognised with a charge to the provisions made when the CO<sub>2</sub> emissions were produced.

### *Computer software*

The acquisition and development costs incurred in relation to the basic computer systems used in the IBERDROLA Group's management are recorded with a charge to Other Intangible Assets in the consolidated balance sheet.

Computer system maintenance costs are recorded with a charge to the consolidated income statement for the year in which they are incurred.

Computer software is amortised on a straight-line basis over a period of between three and five years from the entry into service of each application.

*Research and development expenditure*

The IBERDROLA Group recognises as expenses research and development expenditure not relating to its basic computer systems, in view of the scant materiality thereof and of the difficulty involved in distinguishing research expenditure from development expenditure.

**h) Property, plant and equipment**

Property, plant and equipment are stated at cost of acquisition, modified, where appropriate, as follows:

Prior to the transition to IFRSs (1 January 2004), the IBERDROLA Group revalued certain assets under Property, Plant and Equipment in the consolidated balance sheet as permitted by the applicable legislation, including Royal Decree-Law 7/1996, and considered the amount of these revaluations as part of the cost of the assets, in accordance with IFRS 1.

---

**Table of Contents**

All the future costs that the IBERDROLA Group will have to incur in respect of the closure of its facilities are capitalised to the cost of the asset, at present value, when the related facilities come into service, with a credit to Provisions Other Provisions in the accompanying consolidated balance sheet. As a result of the start-up in 2006 of the Escobrerías CCGT, the IBERDROLA Group recorded EUR 5,592 thousand under the aforementioned heading with a charge to Property, Plant and Equipment in relation to the estimated present value of the cost of dismantling the plant (see Note 4.u). Similarly, in 2005, the IBERDROLA Group capitalised EUR 9,000 thousand from the start-up of the Aceca and Arcos I and II combined cycle plants.

The IBERDROLA Group periodically reviews its estimates of the aforementioned future costs and increases or reduces the carrying amount of the assets on the basis of the results obtained.

As a result of a 2006 update of the report on the estimated cost of dismantling its nuclear facilities, the IBERDROLA Group recognised a EUR 80,486 thousand increase in the provision for meeting these expenses. This increase was charged to Property, plant and equipment Property, plant and equipment in use on the consolidated balance sheet at 31 December 2006 (see Notes 10 and 22).

Cost of acquisition includes the following items:

1. Borrowing costs incurred during the construction period only.

The IBERDROLA Group determines the amount of the capitalisable borrowing costs as follows:

- a) The interest on specific-purpose sources of financing used to build certain of the companies' assets are capitalised in full.
- b) The interest on general-purpose borrowings is capitalised by applying the average effective interest rate on this financing to the average cumulative investment qualifying for capitalisation, after deducting the investment financed with specific-purpose borrowings, provided that it does not exceed the total borrowing costs incurred in the year.

The average capitalisation rates used to determine the interest costs to be capitalised in 2006 and 2005 were 4.18% and 3.62%, respectively.

In 2006 and 2005 the IBERDROLA Group capitalised to property, plant and equipment, applying the policy described above, borrowing costs totalling EUR 77,909 thousand and EUR 68,383 thousand, respectively, with a credit to Finance Income in the accompanying consolidated income statements (Note 35).

2. Staff costs relating directly or indirectly to construction in progress.

The amounts capitalised in this connection in 2006 and 2005 totalled EUR 164,917 thousand and EUR 165,501 thousand, respectively (Note 31).

The IBERDROLA Group transfers property, plant and equipment in the course of construction to property, plant and equipment in use at the end of the related trial period.

## Edgar Filing: - Form

The costs of expansion or improvements of items of property, plant and equipment leading to increased productivity or capacity or to a lengthening of the useful lives of the assets are capitalised.

When the IBERDROLA Group acquires a group of assets or of net assets that do not constitute a business (for example, in the case of companies that consist basically of a wind farm), the cost is allocated across the asset group's individually identifiable assets and liabilities, using fair values at the acquisition date.

**Table of Contents**

Replacements or renewals of complete items are recorded as additions to property, plant and equipment, and the items replaced or renewed are derecognised.

Gains or losses arising on the disposal of items of property, plant and equipment are calculated as the difference between the amount received on the sale and the carrying amount of the asset disposed of.

**i) Depreciation of property, plant and equipment in use**

The cost of property, plant and equipment in use is depreciated on a straight-line basis, less any material residual value, at annual rates based on the following years of estimated useful life:

	Average years of estimated useful life
Hydroelectric plants:	
Civil engineering work	65
Electromechanical equipment	30 35
Fossil-fuel plants	25
Combined cycle plants	25
Nuclear plants	40
Wind-powered facilities	20
Transmission facilities	40
Distribution facilities	30 40
Meters and measuring devices	15 27
Buildings	50 75
Dispatching centres and other facilities	4 50

Depreciation and amortisation charge, allowances and provisions in the 2006 and 2005 consolidated income statements include EUR 996,752 thousand and EUR 916,374 thousand, respectively, in relation to the period depreciation of property, plant and equipment in use (see Note 10).

**j) Investment property**

The investment property owned by the IBERDROLA Group relates primarily to properties earmarked for lease. The rental income earned in 2006 and 2005 from the lease of investment property amounted to EUR 49,556 and EUR 32,192 thousand, respectively. These amounts are presented under Revenue in the accompanying consolidated income statements (see Note 29). Direct operating expenses arising on both the investment property that gave rise to rental income and that which did not in 2006 and 2005 were not material.

The Group companies measure investment properties at acquisition cost. The market value of the IBERDROLA Group's investment properties is disclosed in Note 9. This market value is determined on the basis of valuations by independent valuers commissioned each year by the IBERDROLA Group, except when it is possible to obtain a value for the assets by reference to market information.

Investment properties are depreciated on a straight-line basis, less any material residual value, over the assets' estimated useful life. The average estimated useful life ranges between 50 and 75 years based on the features of the investment property concerned.

**k) Leases**

The IBERDROLA Group classifies leases as finance leases whenever the lessor transfers substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are presented in the appropriate non-current asset category based on their nature and purpose. Each asset is depreciated over its useful life, since IBERDROLA considers

## **Table of Contents**

that there is no doubt that title to the assets will be acquired when the finance lease term ends. These assets are measured at the lower of fair value of the leased asset and the present value of the future payments derived from the finance lease transaction

The expenses arising on operating leases are charged to the consolidated income statement over the term of the lease on an accrual basis.

### **l) Nuclear fuel**

The IBERDROLA Group measures its nuclear fuel stocks on the basis of the costs actually incurred in acquiring and subsequently processing the fuel.

The borrowing costs incurred on the external financing of the cost of acquisition of the nuclear fuel during the fuel production period until it is fit for loading into the reactor core are treated as an addition to the value of the nuclear fuel when this period exceeds one year. The method used by the IBERDROLA Group to capitalise these costs is described in Note 4.h. EUR 550 thousand and EUR 666 thousand of borrowing costs were capitalised in 2006 and 2005, respectively (see Note 35).

The nuclear fuel consumed is recognised under Procurements in the consolidated income statement from when the fuel loaded into the reactor starts to be used, based on the cost of the fuel in each reporting period. The nuclear fuel stocks consumed in 2006 and 2005 amounted to EUR 82,752 thousand and EUR 81,217 thousand, respectively (see Note 30).

### **m) Asset impairment**

At each balance sheet date, the IBERDROLA Group reviews the carrying amounts of its non-current assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). For this purpose, in the case of identifiable assets that, taken individually, do not generate cash flows, the IBERDROLA Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

In the case of goodwill and other intangible assets with indefinite useful lives or which have not yet come into use, the IBERDROLA Group performs the recoverability analysis systematically at the end of each year.

Recoverable amount is the higher of fair value less costs to sell and value in use, which is taken to be the present value of the estimated future cash flows. In assessing value in use, the assumptions used in making the estimates include discount rates, growth rates and expected changes in selling prices and direct costs. The pre-tax discount rates reflect the time value of money and the risks specific to the cash-generating unit. The growth rates and the changes in prices and direct costs are based on industry forecasts and experience and future expectations, respectively.

## Edgar Filing: - Form

The discount rates used by the IBERDROLA Group for this purpose range from 4.8% to 14.2% (2005: between 5.74% and 16%), depending on the risks specific to each asset.

If the recoverable amount of an asset is less than its carrying amount, an impairment loss is recognised for the difference with a charge to Depreciation and amortisation charge, allowances and provisions in the consolidated income statement. Impairment losses recognised for an asset are reversed with a credit to the aforementioned heading when there is a change in the estimates concerning the recoverable amount of the asset, increasing the carrying amount of the asset, but so the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised, except in the case of the impairment of goodwill, which is not reversible.

The 2006 and 2005 consolidated income statements include EUR 66,000 thousand and EUR 67,964 thousand, respectively, related to impairment losses.

## **Table of Contents**

### **n) Financial instruments**

#### *Financial assets*

The Group measures its current and non-current financial assets in accordance with the criteria described below:

1. Financial assets classified at fair value through profit or loss, which are assets that meet any of the following requirements:

They have been classified as held-for-trading financial assets, on the basis that the IBERDROLA Group intends to generate a profit from fluctuations in their prices.

They have been included in this asset category since initial recognition.

The assets included in this category are stated at fair value in the consolidated balance sheet, and changes in fair value are recognised as Finance Costs or Finance Income in the consolidated income statement, as appropriate.

The IBERDROLA Group classified in this category the derivative financial instruments which, although they are effective as hedges pursuant to its risk management policies, do not qualify for hedge accounting based on the requirements established for this purpose in IAS 39: Financial Instruments: Recognition and Measurement (see Note 24).

2. Loans and receivables: these are initially recognised in the balance sheet at fair value and are subsequently measured at amortised cost using the effective interest rate method.

The IBERDROLA Group records the related provisions for the difference between in the amount of the receivables considered recoverable and the carrying amount of the receivables.

3. Held-to-maturity investments, which are investments that the IBERDROLA Group has the intention and ability to hold to the date of maturity, which are also measured at amortised cost. At 31 December 2006 and 2005, the IBERDROLA Group had not classified any investments in this category.
4. Available-for-sale financial assets: these are the other financial assets that do not fall into any of three categories above and relate almost in full to equity investments (see Note 11.b). These investments are also recognised in the consolidated balance sheet at fair value at year-end which, in the case of companies that are not publicly listed, is obtained using a range of methods such as comparable company transactions or, if there is sufficient information, by discounting the expected cash flows. Changes in fair value are recognised with a charge or credit, as appropriate, to the Unrealised asset and liability revaluation reserve in the consolidated balance sheet (see Note 19) until these assets are disposed of, at which time the cumulative balance of this heading is recognised in full in the consolidated income statement.

## Edgar Filing: - Form

Investments in the share capital of companies that are not publicly listed the market value of which cannot be determined reliably are carried at cost of acquisition.

The IBERDROLA Group determines the most appropriate classification for each asset on acquisition and reviews the classification at each balance sheet date.

The IBERDROLA Group recognises conventional financial asset purchases and sales on the trading date.

### *Cash and cash equivalents*

This heading in the consolidated balance sheet includes cash, current accounts and other highly liquid short-term investments that can be realised in cash quickly and are not subject to a risk of change in value.

## **Table of Contents**

### *Financial liabilities and equity instruments*

Financial liabilities and equity instruments issued by the IBERDROLA Group are classified on the basis of their nature.

The IBERDROLA Group classifies as an equity instrument any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

### *Debentures, bonds and bank borrowings*

Loans, debentures and similar items are recorded initially at the amount received, net of transaction costs. In subsequent periods, these financial liabilities are measured at amortised cost, using the effective interest rate method, except for hedged transactions, which are measured using the method described below in relation to derivatives financial instruments and hedge accounting. Also, obligations under finance leases (see Note 4.k) are recognised at the present value of the lease payments under *Bank borrowings-loans* in the consolidated balance sheet.

### *Trade and other payables*

Trade payables are initially recognised at fair value and are subsequently measured at amortised cost using the effective interest rate method.

### *Derivative financial instruments and hedge accounting*

Financial derivatives are initially recognised at acquisition cost in the consolidated balance sheet and the required value adjustments are subsequently made to reflect their fair value at all times. Gains and losses arising from these changes are recognised in the consolidated income statement, unless the derivative has been designated as a cash flow hedge or a hedge of a net investment in a foreign operation.

For accounting purposes, hedges are classified as follows:

Fair value hedges: where the risk hedged is a change in the fair value of an asset or liability recognised on the consolidated balance sheet or a firm commitment (with the exception of exchange rate hedges in the latter instance).

Cash-flow hedges: where the risk hedged is the variation in cash flows attributable to a specific risk associated with a recorded asset or liability or a forecast transaction, or to exchange rate risk in a firm commitment.

Hedge of a net investment in a foreign operation

## Edgar Filing: - Form

Each time a hedge transaction is entered into the IBERDROLA Group formally documents the transaction to be treated under hedge accounting. This documentation includes its identification as a hedge instrument, the item hedged, the nature of the risk the hedge is designed to cover and the way the effectiveness of the hedge is to be measured. In addition, hedges are reviewed periodically to ensure they are highly effective (between 80% and 125%).

To the extent that transactions meet these hedge accounting requirements, they are treated as follows:

In the case of fair value hedges, changes in the fair value of the derivative financial instruments designated as a hedge and changes in the fair value of a hedged item due to the hedged risk are recognised with a charge or credit, as appropriate, to the consolidated income statement so that Finance Income and Finance Costs reflect the net gain or net loss, respectively, arising on the hedged item and the hedging instrument.

---

**Table of Contents**

In cash flow hedges and hedges of a net investment in a foreign operation, changes in the fair value of the hedging derivative are recognised, in respect of the ineffective portion of the hedges, in the consolidated income statement, while the effective portion is recognised under *Unrealised assets and liability revaluation reserve* and *Translation differences*, respectively, in the accompanying consolidated balance sheet. The cumulative gain or loss recognised in these headings is transferred to the relevant heading of the consolidated income statement as the hedged item affects net profit or loss or in the year in which the item is disposed of.

If a hedge of a forecasted transaction results in the recognition of a non-financial asset or a liability, this balance is taken into account in the initial measurement of the asset or liability arising from the hedged transaction. If a forecasted transaction does not result in recognition of an asset or a liability, the amounts credited or charged, to *Unrealised Asset and Liability Revaluation Reserve* in the consolidated balance sheet are recognised in the income statement in the same period in which the hedged item affects net profit or loss.

If a hedge of a forecasted transaction results in the recognition of a financial asset or liability, this balance is recognised in *Unrealised assets and liability revaluation reserve* until the hedged item affects net profit or loss.

When hedge accounting is discontinued, any cumulative gain or loss at that date recognised under *Unrealised Asset and Liability Revaluation Reserve* is retained under that heading until the hedged transaction occurs, at which time the gain or loss on the transaction will be adjusted. If a hedged transaction is no longer expected to occur, the gain or loss recognised under the aforementioned heading is transferred to the consolidated income statement.

Derivatives embedded in other financial instruments are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not carried at fair value with unrealised gains or losses reported in the consolidated income statement.

The fair value of the derivative financial instruments is calculated as follows:

Derivatives quoted on an organised market, at market price at year-end.

To measure derivatives not traded on an organised market, the IBERDROLA Group uses assumptions based on market conditions at year-end. Specifically, the fair value of interest rate swaps is calculated as the value discounted at market interest rates of the interest rate swap contract spread; currency futures are measured by discounting the future cash flows calculated using the forward exchange rates at year-end.

*Derecognition of financial assets and liabilities*

A financial asset is derecognised when:

The rights to receive cash flows from the asset have expired.

The IBERDROLA Group retains the rights to receive cash flows from the asset, but has assumed an obligation to pay them in full to a third party and has transferred substantially all the asset's benefits and risks or does not require them substantially.

## Edgar Filing: - Form

The IBERDROLA Group has transferred its rights to receive cash flows from the asset and either has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all risks and rewards of the asset, but has transferred control of the asset.

Financial liabilities are derecognised when the obligation under the liability is discharged or cancelled, or expires.

## **Table of Contents**

### **o) Inventories**

The measurement bases and accounting policies applied in recognising the items included under this heading in the consolidated balance sheet were as follows (see Note 15):

1. Fuel stocks are measured at the lower of acquisition cost or net realisable value. The acquisition cost of gas is determined using the FIFO method, whereas for the other fuel stocks (mainly coal and fuel-oil) the weighted average cost method is used, since it is considered that these methods are the most suitable for each type of inventories involved.
2. The real estate inventories of the Iberdrola Inmobiliaria Subgroup were measured at cost of acquisition, which encompasses both the acquisition cost of the land and the costs of urban infrastructures and construction of real estate developments incurred through year-end, which include the finance costs incurred until the land is ready to be used, calculated using the method described in Note 4.h. Finance income in the consolidated income statements for 2006 and 2005 includes EUR 7,777 thousand and EUR 8,104 thousand, respectively, in this connection (see Note 35).

### **p) Treasury shares**

At year end the IBERDROLA Group's treasury shares are deducted from Equity-Treasury shares on the consolidated balance sheet and are measured at acquisition cost.

The gains and losses obtained by the companies on disposal of these treasury shares are recognised in Other reserves in the consolidated balance sheet.

### **q) Deferred income**

Income recognised by virtue of the agreements entered into with the Ministry of Industry and Energy and autonomous community, provincial and municipal governments in connection with investments relating to rural electrification plans and service quality improvements is recognised under Deferred income on the liability side of the accompanying consolidated balance sheet when the related investments have been made and when the IBERDROLA Group is notified that the amounts have been officially granted.

This heading also includes all non-repayable grants aimed at financing investments in property, plant and equipment.

The emission allowances assigned for no consideration to the IBERDROLA Group in 2005 and 2006 under the National Emission Allowance Assignment Plan (in 2006 only the allowances corresponding to facilities that are not part of the ordinary generation regime, see Note 3) are recognised on the asset side of the consolidated balance sheet at market value with a credit to Deferred income. This deferred income is transferred to Other operating income on the consolidated income statement as the emissions which these allowances were granted are made.

Deferred income also includes amounts received from third parties in relation to the assignment of the right to use certain facilities which connect to the electricity grid, the IBERDROLA Group's fibre optic network and other owned assets. These amounts are recognised in income on a straight-line basis over the term of the related contract.

**r) Post-employment and other employee benefits**

The contributions to be made to the defined contribution post-employment benefit plans are expensed under Staff costs on an accrual basis.

## **Table of Contents**

In the case of the defined benefit plans, the IBERDROLA Group recognises the expenditure relating to these obligations on an accrual basis over the working life of the employees by commissioning the appropriate independent actuarial studies using the projected unit credit method to measure the obligation accrued at year-end, and the positive or negative actuarial differences are recognised as Other reserves when they arise (Note 2.a). The provision recognised in this connection represents the present value of the defined benefit obligation reduced by the market value of the related plans.

If the market value of the assets exceeds the present value of the obligation, the net asset is not recognised in the consolidated balance sheet unless it is practically certain that it will be recovered.

### **s) Collective redundancy procedure and other early retirement plans for employees**

The IBERDROLA Group recognises termination benefits when there is an agreement with the employees or a certain expectation that such an agreement will be reached that will enable the employees to be terminated in exchange for indemnity payment.

The Group has labour force reduction plans in progress, mainly in Spain, within the framework of the related collective redundancy procedures approved by the government, which guarantee that benefits will be received throughout the pre-retirement period.

The IBERDROLA Group recognises the full amount of the expenditure relating to these plans when the obligation arises by performing the appropriate actuarial studies to calculate the present value of the actuarial obligation at year-end. The actuarial gains and losses disclosed each year are recognised in the consolidated income statement for that year.

### **t) Provision for emission allowances**

The IBERDROLA Group records a provision for contingencies and expenses in order to recognise the obligation to deliver CO<sub>2</sub> emission allowances in accordance with the methods provided for in the National Emission Allowance Assignment Plan and in Royal Decree-Law 3/2006 (see Note 3).

The amount of the provision is determined on the assumption that the obligation will be settled:

Through the emission allowances transferred for no consideration to the Group companies under the National Emission Allowance Assignment Plan.

Through other emission allowances in the consolidated balance sheet that were acquired subsequently.

## Edgar Filing: - Form

For the portion of emissions covered by the allowances granted under the National Emission Allowance Assignment Plan or by allowances acquired or generated by the Group, the provision recognises the value at which these allowances were initially recognised on the balance sheet. If it is estimated that it will be necessary to deliver more emission allowances than recorded on the balance sheet, the provision for this shortfall is calculated based on the market price of the allowances at the balance sheet date.

At 31 December 2006 and 2005, the IBERDROLA Group had recorded provisions of EUR 255,769 thousand and EUR 168,602 thousand (see Note 22), respectively, in connection with allowance consumptions. These amounts were charged in full to Procurements in the consolidated income statements for the years then ended (see Note 30). Of these amounts, EUR 220,236 thousand and EUR 19,225 thousand relate to the aforementioned shortfall, i.e., emissions not allocated free of charge (including in 2006 the impact of Royal Decree-Law 3/2006 as described in Notes 3 and 4.z).

### **u) Production facility closure costs**

The IBERDROLA Group incurs certain costs to undertake the preliminary work required to decommission its nuclear plants (see Notes 4.h and 22), and to dismantle its fossil-fuel plants and

## **Table of Contents**

restore the land at the sites where these have been located. Additionally, in the case of nuclear plants, part of the fuel remains within the reactor without having been burnt. The Group recognises as an addition to the value of the related asset the present value of the estimated expenses in this connection and records a provision under Provisions Other Provisions at the beginning of the facility's useful life. This estimate is subject to annual revision so that the provision reflects the present value of the full amount of the estimated future costs. The value of the asset is only adjusted for variances with respect to initial cost.

Any change in the provision as a result of its discounting is recognised in Finance costs in the consolidated income statement.

### **v) Other provisions**

The IBERDROLA Group recognises provisions to cover present obligations, whether these be legal or constructive, which arise as a result of past events, provided that it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and reliable estimate can be made of the amount of the obligation. A provision is recognised when the liability or obligation (see Note 22) arises, with a charge to the relevant heading in the consolidated income statement depending upon the nature of the obligation, for the present value of the provision when the effect of discounting the value of the obligation to present value is material. The change in the provision due to its discounting each year is recognised under Finance costs in the consolidated income statement.

These provisions include those recorded to cover environmental damage, which were determined on the basis of a case-by-case analysis of the situation of the polluted assets and the cost of cleaning them.

### **w) Onerous contracts**

The IBERDROLA Group defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations thereunder exceed the economic benefits expected to be received under the contract.

The IBERDROLA Group records a provision for the present value of the abovementioned difference between the costs and the economic benefits of the contract.

Procurements in the 2005 consolidated income statement includes EUR 47,900 thousand related to the provision made for the present value, at year end, of the obligations arising under certain onerous contracts for the supply of electricity on the free market. In 2006, no provision was required in this connection.

### **x) Transactions in currencies other than the euro**

## Edgar Filing: - Form

Transactions carried out in currencies other than the functional currency of the Group companies are translated to the appropriate functional currency at the exchange rates prevailing at the transaction date. During the year, the differences arising between the exchange rates at which the transactions were recorded and those in force at the date on which the related collections or payments are made are charged or credited, as appropriate, to income.

Fixed-income securities and receivables and payables denominated in currencies other than those in which the financial statements of the Group companies are denominated are translated at the year-end exchange rates at 31 December of each year. Exchange differences are charged to Finance costs or credited to Finance income in the consolidated income statement, as appropriate.

The foreign currency transactions in which the IBERDROLA Group has decided to mitigate foreign currency risk through the use of financial derivatives or other hedging instruments are recorded as described in Note 4.n.

---

**Table of Contents**

**y) Current/non-current classification**

In the accompanying consolidated balance sheet debts due to be settled within 12 months are classified as current items and those due to be settled within more than 12 months as non-current items.

**z) Settlements relating to regulated activities and shortfall in revenue**

In 1998, basically as a result of the entry into force of Spanish Electricity Industry Law 54/1997 and the related implementing regulations, inter-company settlements were created. These settlements are made by the Spanish National Energy Commission and take the form of collections from or payments to other electric utilities in order to redistribute tariff revenue, net of energy purchases made to cover demand from customers supplied under the tariff system. Accordingly, each utility receives the revenue corresponding to its regulated activities, including distribution and transmission activities. Tariffs are set annually by Royal Decree (see Note 3).

Regarding regulated distribution activity, in 2006 and 2005 the IBERDROLA Group recognised under Revenue in the consolidated income statement remuneration amounting to EUR 1,230,351 thousand and EUR 1,200,209 thousand, respectively, assigned to the Group by virtue of the remuneration allocated to the Group under Royal Decree 1556/2005 of 28 December and Royal Decree 2892/2004 of 30 December, which established the electricity tariffs for 2006 and 2005, respectively (see Note 29).

As detailed in Note 3, Royal Decree-Law 3/2006 provided that bids to sell and purchase energy made simultaneously by members of the same corporate group in the daily and intra-daily generation markets and in the same programming period shall be subject to physical bilateral contracts with the market operator in the amounts in which the sales and purchase bids match. As a result, a group may only participate in the resulting matching program to the extent of its net position as either a net buyer or seller. This Royal Decree-Law also stipulated that for inter-company settlement purposes, the provisional price for distributors would be EUR 42.35/MWh, including adjustment services and the capacity guarantee. It further stipulated that the government would set the definitive price for remunerating the distribution companies for energy purchases made throughout the year in question. At the date of preparation of these Consolidated Annual Accounts, there has been no modification to the provisional price referred to above. Accordingly, Revenue in the 2006 consolidated income statement was reduced by EUR 161,369 thousand in connection with the difference between the cost of purchases which were made through bilateral contracts and the value at which these purchases were recognised in the National Energy Commission regulated activity settlements, based on the aforementioned price of EUR 42.35/MWh (see Note 29).

Further, Article 2 of Royal Decree-Law 3/2006 provided that from 2 March 2006, an amount equivalent to the value of the CO<sub>2</sub> emission allowances allocated free of charge to the electricity generators will be netted from remuneration for ordinary regime electricity generation. It additionally stipulated that emission rights allocated for the period between 1 January and 2 March 2006 will be deducted from the 2006 tariff revenue deficit (see below). Royal Decree-Law 3/2006 empowers the Government of Industry, Tourism and Commerce to develop the regulations to enact this article. These regulations have not been developed at the time of preparing these consolidation annual accounts.

As a result of the above, specifically the lack of implementing regulations to date, the IBERDROLA Group has interpreted that Royal Decree-Law 3/2006 implies that all the CO<sub>2</sub> emissions rights corresponding to its ordinary regime electricity generation facilities granted to it for 2006 under the National Emission Allowance Assignment Plan, described in Note 3, will entail a cost. As a result, Other operating income in the 2006 consolidated income statement does not include the EUR 218,709 thousand that would have been credited to the account had the allocated emission allowances actually been assigned free of charge.

## Edgar Filing: - Form

Because in 2006 and 2005 the income received by utilities for regulated sales to their customers was not sufficient to remunerate the system's various activities and costs, the utilities themselves were forced to finance the resulting tariff shortfall.

---

**Table of Contents**

In 2005, Royal Decree-Law 5/2005, of 11 March, ruled provisionally that IBERDROLA must finance 35.01% of the tariff deficit. Subsequently, Royal Decree 1556/2005, of 28 December, established that the amounts contributed by each utility to finance the shortfall in revenue for 2005 would be reimbursed through settlements for regulated activities in later years, including accrued financing costs.

As a consequence of this recognition by the Spanish government to reimburse the tariff deficit independent of future billings, in 2005 the IBERDROLA Group recognised a receivable for said amount of EUR 1,259,115 thousand under Non-current trade and other receivables in the accompanying consolidated balance sheet at 31 December 2005 (see Note 12).

Later, Royal Decree 809/2006, passed to revise the electricity tariff applicable from 1 July 2006, ruled that the 2005 tariff deficit could be securitised. Accordingly, prior to year-end 2006, the IBERDROLA Group entered into a securitisation agreement with a group of financial entities by virtue of which it transferred the right to collect the 2005 tariff deficit receivable to said entities, along with substantially all the associated risks and rewards. Non-current trade and other receivables in the consolidated balance sheet at 31 December 2006 includes EUR 6,977 thousand corresponding to the difference between the amount securitised and IBERDROLA's best estimate of the percentage corresponding to it of the shortfall generated in 2005, in accordance with the most recent settlements by the National Energy Commission (see Note 12).

Finally, Royal Decree 1634/2006, which establishes the electricity tariff applicable from 1 January 2007, guarantees the recovery of the 2006 tariff deficit independent of future billings, as happened with the 2005 tariff deficit. As a result, Non-current trade and other receivables in the consolidated balance sheet at 31 December 2006 includes a receivable amounting to EUR 579,670 thousand, corresponding to the best estimate of the portion of the 2006 tariff deficit that corresponds to the IBERDROLA Group, net of the value of the emission allowances described herein, and assuming the same deficit allocation percentage of 35.01% (see Note 12).

**aa) Income tax**

Since 1986 IBERDROLA has filed consolidated tax returns with certain Group companies.

Income tax is accounted for using the balance sheet liability method, which consists of determining deferred tax assets and liabilities on the basis of the carrying amounts of assets and liabilities and their tax base, using the tax rates that can objectively be expected to be in force when the assets or liabilities are realised or settled. Deferred tax assets and liabilities arising as a result of direct charges or credits to equity accounts are also accounted for with a charge or credit to equity.

The IBERDROLA Group recognises deferred tax assets provided future taxable profits are expected against which said assets can be recovered.

Double taxation tax credits and other tax credits and tax relief earned as a result of economic events occurring in the year are deducted from the income tax expense, unless there are doubts as to whether they can be realised.

**ab) Administrative concessions for hydroelectric plants**

## Edgar Filing: - Form

Pursuant to Law 29/1985, of 2 August, partially amended by Law 46/1999, of 13 December, all the Spanish hydroelectric plants, the total carrying amounts of which are disclosed in Note 10, are operated under the temporary administrative concession system, whereby at the end of the concession period title to the facilities is returned to the State, at which time the facilities have to be in good working order. The Group's administrative concessions expire in the period from 2000 to 2067. However, the facilities the concessions for which had expired at 31 December 2006 are scanty material in terms of installed capacity, and had been fully amortised at 31 December 2006, although they continued to be operated by the IBERDROLA Group.

## **Table of Contents**

IBERDROLA considers that it is not necessary to record a provision to a reversion reserve since the maintenance programmes ensure the good working condition of the facilities at all times.

### **ac) Final radioactive waste management costs**

Royal Decree 1349/2003, of 31 October, regulating activities in the nuclear fuel cycle and the percentages of collections from electricity sales to end customers to be paid to Empresa Nacional de Residuos Radiactivos, S.A. (ENRESA) to cover the costs incurred in the work relating to the second part of the nuclear fuel cycle (dry storage, reprocessing and definitive storage of nuclear waste), was published on 8 November 2003. This Royal Decree grouped together the previous legislation regulating the activities of the aforementioned company and its financing and repealed, inter alia, Royal Decree 1899/1984, of 1 August.

Royal Decree-Law 5/2005, of 11 March, on urgent reforms to boost productivity, and Law 24/2005, of 18 November, established that the costs relating to the management of radioactive waste and spent fuel from nuclear plants, and to the decommissioning and shut-down of the plants, attributable to their operation and incurred after 31 March 2005, will be financed by the owners of the nuclear plants in question.

The amounts financed by IBERDROLA in 2006 and 2005 in this connection totalled EUR 60,615 thousand and EUR 33,909 thousand, respectively, which were classified under *Outside services* in the accompanying consolidated income statement. These amounts are the result of multiplying the output in GWh of each plant by the unit value specified in the aforementioned Royal Decree-Law (see Note 6.b).

The above-mentioned costs incurred prior to that date are considered to be diversification and security of supply costs and, therefore, they are included among the items established in the methodology for setting the electricity tariff (see Note 4.z). Accordingly, the financing of radioactive waste management and processing is not the responsibility of the owners of the facilities.

### **ad) Earnings per share**

Basic earnings per share are calculated by dividing the net profit for the year attributable to the Parent by the weighted average number of ordinary shares outstanding during the year, excluding the average number of shares of the Parent IBERDROLA, S.A. held by the IBERDROLA Group companies (see Note 19).

Diluted earnings per share are calculated by dividing the net profit for the year attributable to ordinary shareholders by the weighted number of ordinary shares outstanding during the year, adjusted by the weighted average number of ordinary shares that would have been outstanding assuming the conversion of all the potential ordinary shares into ordinary shares of IBERDROLA, S.A. For these purposes, it is considered that shares are converted at the beginning of the year or at the date of issue of the potential ordinary shares, if the latter were issued during the current period.

In the Consolidated Annual Accounts of the IBERDROLA Group for the years ended 31 December 2006 and 2005, basic earnings per share coincide with diluted earnings per share, since there were no potential shares outstanding during these years that could be converted into

ordinary shares (see Note 48).

**ae) Dividends**

The interim dividend approved by the Board of Directors in 2006 is presented as a deduction from the IBERDROLA Group's equity. However, the final dividend proposed by the Board of Directors of IBERDROLA to the shareholders at the Annual General Meeting is not deducted from equity until it has been approved by the latter.

## **Table of Contents**

### **af) Discontinued operations**

A discontinued operation is a line of business that it has been decided to abandon and/or sell whose assets, liabilities and net profit or loss can be distinguished physically, operationally and for financial reporting purposes.

Income and expenses of discontinued operations are presented separately in the income statement.

No line of business or material business segment was discontinued in either 2006 or 2005.

### **ag) Consolidated cash flow statements**

The following terms are used in the consolidated cash flow statements, which were prepared using the indirect method, with the meanings specified:

Cash flows: inflows and outflows of cash and cash equivalents, which are short-term, highly liquid investments that are subject to an insignificant risk of changes in value.

Operating activities: the principal revenue-producing activities of the Group companies, as well as other activities that are not investing or financing activities.

Investing activities: the acquisition and disposal of long-term assets and other investments not included in cash and cash equivalents.

Financing activities: activities that result in changes in the size and composition of the equity and borrowings of the Company that are not operating activities.

## **5. Financial risk management policy**

Under the General Risk Policy, which was approved in November 2004 by the Board of Directors of IBERDROLA, the Group undertakes to use its capabilities to the full in order to ensure that all the significant risks of all kinds are adequately identified, measured, managed and controlled, applying the following basic action guidelines :

Incorporation of the risk-opportunity approach into the Group s management.

## Edgar Filing: - Form

Separation, at operating level, of functions between the risk-taking areas and the areas responsible for analysing, controlling and supervising the risks.

Assurance of short and long-term business and financial stability, maintaining an appropriate balance between risk, value and benefit.

Correct use of financial risk hedging instruments and their recognition in accordance with the applicable accounting and financial standards.

Transparency in reporting on the Group's risks and the functioning of the systems developed to control them.

Development of a risk-opportunity control and management culture within the IBERDROLA Group.

Bring into line with general policy all the specific risk-related policies that have to be implemented.

Compliance with current regulations and legislation in relation to risk control, management and oversight.

**Table of Contents**

Continuous improvement on the basis of international best practices in Transparency and Good Corporate Governance in relation to risk control, management and oversight.

In order to implement this policy and respect these principles, IBERDROLA has developed an Integral Risk Control and Management System based on a suitable definition, separation and assignment of functions and responsibilities, and of the required procedures, methodologies and support tools.

The System, which in November 2005 received quality certification from AENOR under the ISO 9001:2000 standard, is based on three fundamental cornerstones:

A risk policy and limit structure, developed in 2005, that guarantees that risks are managed by the businesses in a controlled fashion.

Monitoring and control of the risks in the income statement.

Analysis and control of risks associated with new investments.

In this context, IBERDROLA has certain risk policies and limits approved by the Operating Committee that cover, among others, the following risks:

*Interest rate risk*

Several items in the balance sheet and the associated financial derivatives bear interest at fixed rates and, therefore, are exposed to fair value interest rate risk as a result of changes in market interest rates. Also, the IBERDROLA Group is exposed to cash flow interest rate risk in respect of items in the balance sheet and derivatives that bear interest at floating rates.

IBERDROLA mitigates this risk by managing the proportion of its debt that bears fixed interest to that which bears floating interest on the basis of the situation of the markets, through new sources of financing and the use of interest rate derivatives, all within the approved risk limits.

The debt structure at 31 December 2006 and 2005, after taking into account hedges via derivatives, was the following:

	<b>Thousands of euros</b>	
	<b>2006</b>	2005
Fixed interest rate	<b>8,266,490</b>	7,873,723
Floating interest rate	<b>4,660,200</b>	3,445,328
Floating interest rate with cap and floor(*)	<b>1,313,880</b>	1,615,973
	<b>14,240,570</b>	12,935,024

(\*) Relating to certain borrowing agreements whose exposure to interest rate fluctuations is limited by caps and floors.

The reference interest rates for the floating rate borrowings are basically Euribor and US dollar-Libor and are the most liquid local reference rates in the case of the borrowings of the Latin American subsidiaries.

The sensitivity earnings and equity to changes in interest rates is the following:

	Increase/decrease in interest rate (basis points)	Thousands of euros	
		Impact on profit before taxes	Impact on equity before taxes
2006	+10	(7,000)	10,000
	-10	7,000	(10,000)
2005	+10	(6,000)	15,000
	-10	6,000	(15,000)

**Table of Contents***Foreign currency risk*

Fluctuations in the value of the currencies in which borrowings are instrumented and purchases and sales are made with respect to the presentation currency may have an adverse effect on the finance costs and profit for the year.

The following items could be affected by foreign currency risk:

Debt denominated in currencies other than the local or functional currency arranged by the IBERDROLA Group companies.

Collections and payments for supplies, services or investments in currencies other than the functional currency.

Income and expenses of certain foreign subsidiaries indexed to currencies other than the functional currency.

Taxes derived from the accounting for tax purposes in local currencies other than the functional currency.

Profit or loss on consolidation of the foreign subsidiaries.

Consolidated carrying amount of investments in foreign subsidiaries.

IBERDROLA reduces this risk by ensuring that all its economic flows are denominated in the presentation currency of each Group company, provided that this is possible and economically practicable. The resulting open positions are integrated and managed through the use of derivatives, within the approved limits.

As highlighted in Note 23, other than the euro, the currency in which the IBERDROLA Group operates most is the US dollar. The sensitivity of earnings and consolidated equity to changes in the \$ / exchange rate is as follows:

	Change in the \$/ exchange rate	Thousands of euros	
		Impact on profit before taxes	Impact on equity before taxes
2006	+5%	9,655	(9,423)
	-5%	(9,655)	10,416
2005	+5%	16,226	(4,819)
	-5%	(16,226)	5,326

## Edgar Filing: - Form

The sensitivity of the market value of the IBERDROLA Group's financial borrowings, bearing in mind hedges entered into, to changes in the \$/ exchange rate is as follows (in thousands of euros):

	2006		2005	
Changes in the \$/ exchange rate	+2.5%	-2.5%	+2.5%	-2.5%
Change in the market value of the borrowings	(37,270)	29,377	(22,776)	23,944

### *Commodity price risk*

The power purchase and sale transactions performed by the IBERDROLA Group in Spanish and international markets are exposed to various risks arising from fuel prices (primarily gas), the price of CO<sub>2</sub> emission allowances, the price of electricity and other traded underlying assets.

In the case of the Spanish market, in which IBERDROLA carries on its principal business, the current production mix provides a significant level of natural hedging among the various production technologies which makes it possible to mitigate these risks.

## **Table of Contents**

The remaining risk arising from fluctuations in prices of products to which fuel prices are indexed and in exchange rates is mitigated through the appropriate diversification and management of the supply contracts, which provide for:

Prices tied, to the extent possible, to indexes that replicate the changes in income that arise on the demand side (retailing and production markets).

Revision and re-opening clauses that make it possible to adjust prices in the event of changes in the market.

Lastly, the hedging transactions considered necessary at any given time are carried out in order to keep risk levels within the established limits.

In the case of the Mexican market, the Group does not have a significant commodity price risk, since its main contracts are pass-through contracts.

In the case of the electricity trading transactions that IBERDROLA performs in international markets, the risk is scanty material due to the small volume of transactions and the limits established for the open positions, in terms of both the amounts and time horizons involved.

### *Liquidity risk*

Exposure to adverse situations in the debt or capital markets can hinder or prevent the IBERDROLA Group from obtaining the financing required to properly carry on its business activities and implement its Strategic Plan.

IBERDROLA's liquidity policy ensures that it can meet its payment obligations without having to obtain financing under unfavourable terms. For this purpose, it uses various management measures such as the arrangement of committed credit facilities of sufficient amount and flexibility, diversification of the coverage of financing needs through access to different markets and geographical areas, and diversification of the maturities of the debt issued (see Note 45).

### *Credit risk*

The credit risk arising from the default of a counterparty (customer, supplier, shareholder or financial institution) is duly controlled at the IBERDROLA Group through various policies and risk limits in which requirements relating to the following are established:

Contracts tailored to the transaction performed.

## Edgar Filing: - Form

Sufficient internal or external creditworthiness of the counterparty.

Additional guarantees whenever necessary.

Time limit on open positions.

Limits on the costs of doubtful debts and on the finance costs arising from debtor defaults.

In particular, in the case of financial creditor positions, IBERDROLA follows a prudent policy of arranging derivatives and placing cash surpluses with highly solvent counterparties based on the credit ratings of Moody's and S&P.

In addition, there is an action protocol detailing corrective measures when a counterparty's credit rating drops to below its investment rating, and the market value of derivatives and credit risk are measured regularly in order to ensure that the risk limits established are being observed at all times.

**Table of Contents**

At 31 December 2006 and 2005, there was no material concentration of credit risk at the IBERDROLA Group.

The age at 31 December 2006 and 2005 of financial assets that are past due but not considered impaired is the following:

	Thousands of euros	
	2006	2005
Less than 90 days	129,644	105,626
90-180 days	31,876	25,941
Over 180 days	44,011	35,858
	<b>205,531</b>	<b>167,455</b>

**6. Use of estimates and sources of uncertainty****a) Accounting estimates**

The preparation of these Consolidated Annual Accounts made it necessary for IBERDROLA to make assumptions and estimates. The estimates with a significant effect on the accompanying consolidated annual accounts are as follows:

## Unbilled power supplied:

The revenue figure for each year includes an estimate of the power supplied to customers in the liberalised market and abroad but not billed because it had not been metered at year-end for reasons relating to the regular meter-reading period. The estimated unbilled power at 31 December 2006 and 2005, amounted to EUR 93,626 and 195,762 thousand. This amount is included under Current trade and other receivables on the asset side of the consolidated balance sheets at 31 December 2006 and 2005.

## Settlements relating to regulated activities:

At the end of each year the IBERDROLA Group estimates the definitive settlements relating to regulated activities for that year, establishing the shortfall in revenue from regulated activities, if any, that corresponds to IBERDROLA, together with the amount that will be recovered in the future on the basis of the announcements made by the authorities in this connection (see Note 4.z).

The estimates are made on the basis of the provisional settlements published up to the date of preparation of the Consolidated Annual Accounts and other industry information.

## Edgar Filing: - Form

Cost incurred in dismantling electricity production and distribution facilities:

The IBERDROLA Group periodically revises the estimates made concerning the costs to be incurred in the dismantling and definitive shut-down of its electricity production facilities (see Note 22), and in the dismantling work that will have to be performed on the basis on agreements entered into for the disposal of land on which distribution facilities are located. At 31 December 2006 and 2005, the present value of the aforementioned costs amounted to EUR 456,105 thousand and EUR 354,161 thousand, respectively.

Provision for pensions and similar obligations and restructuring costs:

At each year-end the IBERDROLA Group estimates the current actuarial provision required to cover obligations relating to restructuring plans, pensions and other similar obligations to its employees. In making these estimates, the IBERDROLA Group receives advice from independent actuaries (see Notes 4.r and 4.s).

---

## **Table of Contents**

Although these estimates were made on the basis of the best information available at the date on which these Consolidated Annual Accounts were prepared on the events analysed, events that take place in the future might make it necessary to change these estimates (upwards or downwards) in coming years. Changes in accounting estimates would be applied prospectively, recognising the effects of the change in estimates in the related future Consolidated Annual Accounts.

### **b) Sources of uncertainty**

There are certain aspects that, at the date of issue of these Consolidated Annual Accounts constitute a source of uncertainty concerning the accounting effect that they might have in future years. These uncertainties are as follows:

Under Royal Decree 1432/2002, of 27 December, the financing of the costs to be incurred by ENRESA in the second part of the nuclear fuel cycle forms part of the diversification and security of supply costs and, accordingly, a percentage of the revenue from the sale of electricity under the tariff system in the industry has been earmarked for this purpose. Royal Decree 2392/2004, of 30 December, which approved the tariff for 2005, included a percentage earmarked for this purpose that is lower than that required on the basis of Report 7/2004 of the Spanish National Energy Commission. In this regard, Royal Decree-Law 5/2005, of 11 March, establishes that the amounts earmarked for recognising the portion of the provision for the financing of costs relating to the management of radioactive waste and spent fuel generated in nuclear plants and to the decommissioning and shut-down attributable to the operation of the nuclear plants incurred after 31 March 2005, are not treated as diversification and security of supply costs and will be financed by the owners of the nuclear plants during their operating life (see Note 4.ac).

In order to finance these costs, ENRESA bills the owners of the nuclear plants for the amounts resulting from multiplying the gross number of kWh generated by each plant in each calendar month, from 1 April 2005 onwards, by a unit value specific to each plant expressed in euro cents. These unit values are revised annually by Royal Decree on the basis of an updated economic and financial report on the cost of the related activities.

At the date of preparation of these Consolidated Annual Accounts, the Ministry for Industry, Tourism and Trade had not published the aforementioned economic and financial report and, therefore, it is not possible to determine accurately whether the amount paid by the Group in the period from 1 April 2005 to 31 December 2006 in this connection is in line with the obligation calculated by the accrual method. The IBERDROLA Group, based on the related information included in the General Radioactive Waste Plan published by ENRESA in June 2006, considers that any difference between the amount paid and the amount accrued would not be material.

As detailed in Note 4.i, the IBERDROLA Group is depreciating its nuclear generation facilities over a useful life of 40 years. This is the minimum period over which these facilities are considered to generate an optimum return. However, the operating licence in effect for the majority of the IBERDROLA Group's nuclear facilities span a 30-year period once they become operational. Renewal of these licences cannot be applied for until a few years before they expire. In light of the investment and maintenance policies undertaken at these plants as well as certain information in the public domain, the IBERDROLA Group believes that the corresponding operating licences will be renewed for at least an additional ten years, thus giving rise to the application of the aforementioned useful life of 40 years.

As indicated in Note 4.z, the passing of Royal Decree-Law 3/2006 last year has resulted in the modification of part of the electricity sector's economic regime in Spain, notably in relation to the following two aspects:

## Edgar Filing: - Form

The regulated settlement price for purchases by the distributors of electricity deemed bilateral, set provisionally at 42.35/MWh and still in effect at the time of preparing these

---

**Table of Contents**

Consolidation Annual Accounts. Accordingly this is the price used by the IBERDROLA Group to estimate the 2006 settlements from the Spanish National Energy Commission (see Note 6.a).

Consideration for CO<sub>2</sub> emission allowances which in theory were allocated free of charge to ordinary regime electricity production facilities for 2006. Following the publication of the aforementioned Royal Decree-Law, and the lack of related enacting regulations, it is the interpretation of the IBERDROLA Group that it will have to return the amount corresponding to said allowances; this amount will be netted from the 2006 tariff revenue shortfall.

The IBERDROLA Group therefore believes that the estimates used are in keeping with prevailing legislation and updated information at the date of preparation of these Consolidated Annual Accounts.

In 2006, an injunction was imposed on part of Bizkaia corporate tax legislation (Provincial Regulatory Decree 1/2005 of 30 December). The ruling is not final as official appeals have been filed and as it has not been published in the Official Gazette of Bizkaia.

The IBERDROLA Group has calculated the amounts corresponding to this tax for 2006 and for those years open for inspection in accordance with provincial regulations in effect at the end of each year given that they consider that the final resolution of the appeals filed will not have a material effect on the Consolidated Annual Accounts taken as a whole.

**7. Geographical and business segment reporting**

Described below are the main bases used in defining the IBERDROLA Group's segment information included in the accompanying Consolidated Annual Accounts:

The primary segments were taken to be geographical segments, unbundling the activities carried on in Europe and North America and in Latin America. In view of the nature of the business activities of the IBERDROLA Group, the geographical location of its customers coincides basically with the geographical location of the assets.

The secondary segments for Spain are business segments, in view of the importance thereof within the IBERDROLA Group. Therefore, complete information is also provided on the following business segments as if they were primary segments:

Electricity generation (nuclear, fossil-fuel and hydroelectric).

Electricity distribution and retailing to customers under the tariff system, as well as regulated gas supply activities.

Electricity and gas retailing to eligible customers.

Other non-energy businesses, which include other activities carried on by the IBERDROLA Group, mainly in the industrial and telecommunications sectors. This segment includes, in general, operations relating to investments in companies in the industrial and services sectors corresponding to other diversification activities carried on in Spain. This activity is also deemed to

## Edgar Filing: - Form

encompass:

- i) The provision of engineering, consulting and IT services.
- ii) The sale of real estate products and services.

248

**Table of Contents**

- iii) The ownership and management of meter-reading equipment (installation and coupling revenue from the distribution activity, rental and sale of this equipment and the associated costs).
- iv) Ownership and management of the assets associated with telecommunications networks not used exclusively for electricity activities (generation and transmission and distribution); otherwise, they are assigned to those activities.

The secondary segment includes a renewable energies business (wind energy and mini-hydro stations) that is carried out in Spain and in the rest of Europe and North America.

The assets and liabilities for general use and the profit or loss generated thereby were not allocated to the other segments.

The information on the primary and secondary segments is as follows:

**Geographical primary segment reporting for 2006**

	Thousands of euros					Total
	Europe & Northamerica	Southamerica	Mexico- Guatemala	Other	Overhead	
<b>REVENUE</b>						
External sales	8,718,827	932,220	1,344,768	21,593		11,017,408
Inter-segment sales						
<b>Total sales</b>						11,017,408
<b>INCOME STATEMENT</b>						
Segment operating profit (loss)	2,178,483	333,533	207,939	19,082	(84,587)	2,654,450
Share in net profit of companies accounted for using the equity method	66,780	2,120	(834)	1,019		69,085
Finance income						368,302
Finance costs						(887,250)
Gains on disposal of non-current assets						193,403
Losses on disposal of non-current assets						(11,814)
<b>Profit before tax</b>						2,386,176
Income tax						(695,291)
<b>Net profit for the year</b>						1,690,885
Minority interests						(30,629)
<b>Profit attributable to the Parent</b>						1,660,256
<b>ASSETS</b>						
Segment assets	22,020,159	1,575,991	2,171,263	72,387	777,005	26,616,805
Investments in companies accounted for using the equity method	587,537	29,353	94,346	50,174		761,410
Other non-current financial assets						377,902
Current financial assets and cash and cash equivalents						993,429
Deferred tax assets						1,221,965
Other unallocated assets						3,089,332
<b>Total assets</b>						33,060,843
<b>LIABILITIES</b>						
Segment liabilities	5,145,948	351,323	257,097	16,922	1,371,505	7,142,795
Financial liabilities						14,240,570
Derivative financial instruments						111,676
Deferred tax liabilities						605,282
Other unallocated liabilities						393,517
<b>Total liabilities</b>						22,493,840

**OTHER INFORMATION**

## Edgar Filing: - Form

Total cost incurred during the year in the acquisition of property, plant and equipment and non-current intangible assets	2,290,610	268,277	163,512		157,135	2,879,534
Depreciation and amortisation charge, allowances and provisions	1,023,142	77,036	67,321	4,743	62,958	1,235,200
Expenses for the year other than depreciation and amortisation that did not result in cash outflows	140,744	3,590		1,409	61,028	206,771

**Table of Contents****Secondary business segment reporting for 2006**

	Thousands of euros							
	Spain							TOTAL
	Generation	Distribution	Retailing and Gas	Non-Energy Activities	Renewable Energies	Latin America	Overhead	
<b>REVENUE</b>								
External sales	4,308,644	991,144	1,463,981	1,497,132	457,926	2,298,581		11,017,408
Inter-segment sales	277,336	25,372	877,641	11,828	237,710			1,429,887
Intra-Group eliminations								(1,429,887)
<b>Total sales</b>								<b>11,017,408</b>
<b>INCOME STATEMENT</b>								
Segment operating profit (loss)	1,524,233	(68,012)	(4,158)	350,213	376,207	560,554	(84,587)	2,654,450
Share in net profit of companies accounted for using the equity method	(1,468)	2,277	(224)	66,195		2,305		69,085
<b>ASSETS</b>								
Segment assets	8,914,195	6,349,802	346,300	2,224,517	4,185,345	3,819,641	777,005	26,616,805
Investments in companies accounted for using the equity method	(1,306)	24,772	3,746	560,180	143	173,875		761,410
<b>LIABILITIES</b>								
Segment liabilities	1,694,728	1,962,443	290,318	817,783	380,676	625,342	1,371,505	7,142,795
<b>OTHER INFORMATION</b>								
Total cost incurred during the year in the acquisition of property, plant and equipment and non-current intangible assets	878,203	508,964	84	50,108	853,251	431,789	157,135	2,879,534
Depreciation and amortisation charge, allowances and provisions	510,796	268,827	12,542	50,589	180,388	149,100	62,958	1,235,200
Expenses for the year other than depreciation and amortisation that did not result in cash outflows	39,356	88,109	12,390	588	301	4,999	61,028	206,771

The transactions between secondary segments were carried out on an arm's length basis.

**Table of Contents****Geographical primary segment reporting for 2005**

	Thousands of euros					Total
	Europe & Northamerica	Brazil	Mexico-Guatemala	Other	Overhead	
<b>REVENUE</b>						
External sales	9,707,041	729,289	1,284,928	16,970		11,738,228
Inter-segment sales						
<b>Total sales</b>						11,738,228
<b>INCOME STATEMENT</b>						
Segment operating profit (loss)	1,886,123	184,664	180,733	6,059	4,639	2,262,218
Share in net profit of companies accounted for using the equity method	33,357	3,021	1,993	(3,950)		34,421
Finance income						266,719
Finance costs						(722,359)
Gains on disposal of non-current assets						157,712
Losses on disposal of non-current assets						(40,901)
<b>Profit before tax</b>						1,957,810
Income tax						(553,250)
<b>Net profit for the year</b>						1,404,560
Minority interests						(22,511)
<b>Profit attributable to the Parent</b>						1,382,049
<b>ASSETS</b>						
Segment assets	20,285,294	1,512,551	2,295,893	88,878	541,395	24,724,011
Investments in companies accounted for using the equity method	244,586	34,297	100,042	82,192	14,723	475,840
Other non-current financial assets						240,549
Current financial assets and cash and cash equivalents						851,285
Deferred tax assets						1,356,456
Other unallocated assets						2,830,519
<b>Total assets</b>						30,478,660
<b>LIABILITIES</b>						
Segment liabilities	4,373,419	335,562	297,014	506	1,649,982	6,656,483
Financial liabilities						12,935,024
Derivative financial instruments						176,027
Deferred tax liabilities						719,715
Other unallocated liabilities						576,756
<b>Total liabilities</b>						21,064,005
<b>OTHER INFORMATION</b>						
Total cost incurred during the year in the acquisition of property, plant and equipment and non-current intangible assets	1,877,167	144,196	362,130	1,297	140,177	2,524,967
Depreciation and amortisation charge, allowances and provisions	898,258	119,648	59,833	4,909	32,747	1,115,395
Expenses for the year other than depreciation and amortisation that did not result in cash outflows	31,934	10,906		135	28,589	71,564

**Table of Contents****Secondary business segment reporting for 2005**

	Thousands of euros							TOTAL
	Spain							
	Generation	Distribution	Retailing and Gas	Non-Energy Activities	Renewable Energies	Latin America	Overhead	
<b>REVENUE</b>								
External sales	4,236,265	1,257,280	2,576,012	1,269,296	368,188	2,031,187		11,738,228
Inter-segment sales	(594,580)	(42,182)	543,802	105,669	189,068			201,777
Intra-Group eliminations								(201,777)
Total sales								11,738,228
<b>INCOME STATEMENT</b>								
Segment operating profit (loss)	1,054,133	430,287	(245,265)	329,255	317,713	371,456	4,639	2,262,218
Share in net profit of companies accounted for using the equity method	(7,991)	1,630	(80)	39,762	36	1,064		34,421
<b>ASSETS</b>								
Segment assets	8,690,789	5,410,264	775,178	1,900,031	3,509,031	3,897,323	541,395	24,724,011
Investments in companies accounted for using the equity method	4,220	23,200	4,046	212,977	143	216,531	14,723	475,840
<b>LIABILITIES</b>								
Segment liabilities	1,441,134	1,619,675	471,528	559,932	281,150	633,082	1,649,982	6,656,483
<b>OTHER INFORMATION</b>								
Total cost incurred during the year in the acquisition of property, plant and equipment and non-current intangible assets	761,023	363,690	42,913	67,210	642,331	507,623	140,177	2,524,967
Depreciation and amortisation charge, allowances and provisions	394,399	238,132	66,758	50,958	148,011	184,390	32,747	1,115,395
Expenses for the year other than depreciation and amortisation that did not result in cash outflows	6,660	21,776	2,622	656	220	11,041	28,589	71,564

The transactions between secondary segments were carried out on an arm's length basis.

**Table of Contents****8. Intangible assets**

The changes in 2006 and 2005 in intangible assets accounts and in the related accumulated amortisation and allowances were as follows:

Balance at 12.31.05	Thousands of euros											
	Changes in the consolidation method and/or scope	Translation differences	Additions and charges for the year	Capitalised staff costs (Note 31)	Disposals, derecognition, reductions and write-offs	Transfers	Balance at 12.31.05	Changes in the consolidation method and/or scope	Translation differences	Additions and charges for the year	Capitalised staff costs (Note 31)	Disposals, derecognition, reductions and write-offs
443	27,786	2,318	2,486				50,033	(3,464)	(191)	9,266		
447		138,121	104		(78,437)	(2,025)	600,210	543	(46,556)	2,504		(17)
537	3,856	13,065	33,907	5,780	(5,450)	143	320,838	(11,517)	(1,209)	25,674	4,587	(1,972)
			147,178				147,178			312,729		(214,779)
688	21,908	(3,942)	7,590	2,974	(919)	(803)	88,496	(105)	(1,140)	7,582	3,554	(2,028)
115	53,550	149,562	191,265	8,754	(84,806)	(2,685)	1,206,755	(14,543)	(49,096)	357,755	8,141	(218,796)
462		21,359	14,869		(54,017)	(1,051)	93,622		(5,093)	11,248		(17)
717	18	7,523	35,651		(5,102)		230,807	(11,517)	(4,760)	33,629		(1,808)
780	10,794	(2,576)	13,619		(177)	(114)	29,326	(92)	(418)	10,778		(41)
959	10,812	26,306	64,139		(59,296)	(1,165)	353,755	(11,609)	(10,271)	55,655		(1,866)
761			193		(8,549)		4,405	27	(6)	1		
720	10,812	26,306	64,332		(67,845)	(1,165)	358,160	(11,582)	(10,277)	55,656		(1,866)
395	42,738	123,256	126,933	8,754	(16,961)	(1,520)	848,595	(2,961)	(38,819)	302,099	8,141	(216,930)



---

**Table of Contents**

The fully amortised intangible assets in use at 31 December 2006 and 2005, amounted to EUR 160,087 thousand and EUR 215,041 thousand, respectively.

The detail of goodwill by company is as follows:

	<b>Thousands of euros</b>	
	<b>2006</b>	2005
C. Rokas, S.A.	<b>25,468</b>	27,786
Capuava Energy	<b>6,508</b>	6,634
Others	<b>23,668</b>	15,613
	<b>55,644</b>	50,033

---