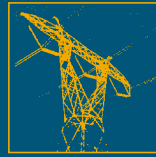




# Annual report 1998



**RED ELÉCTRICA**  
DE ESPAÑA





# Annual report 1998



**RED ELÉCTRICA**  
DE ESPAÑA

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Resolutions of the  
**Board of Directors**

# Auditors' Report on the Annual Accounts



## Auditores

Edificio Torre Europa  
Paseo de la Castellana, 95  
28046 Madrid

### Auditors' Report on the Annual Accounts

(Translation from the original in Spanish)

To the Shareholders of  
Red Eléctrica de España, S.A.

We have audited the annual accounts of Red Eléctrica de España, S.A. (the Company), which comprise the balance sheets at 31 December 1998 and 1997, the related statements of profit and loss for the years then ended and the notes thereto, the preparation of which is the responsibility of the directors of the Company. Our responsibility is to express an opinion on the annual accounts taken as a whole, based on our examination which was conducted in accordance with generally accepted auditing standards, which require examining, on a test basis, evidence supporting the amounts in the annual accounts and assessing the appropriateness of their presentation, of the accounting principles applied and of the estimates employed.

In our opinion, these annual accounts present fairly, in all material respects, the shareholders' equity and financial position of Red Eléctrica de España, S.A. at 31 December 1998 and 1997 and the results of its operations and source and application of funds for the years then ended, and contain sufficient information necessary for their adequate interpretation and understanding, in accordance with generally accepted accounting principles in Spain applied on a consistent basis.

The accompanying directors' report for 1998 contains such explanations as the directors consider relevant to the situation of the Company, the evolution of its business and other matters, but is not an integral part of the annual accounts. We have verified that the accounting information contained therein is consistent with that disclosed in the annual accounts for 1998. Our work as auditors is limited to the verification of the directors' report within the scope described in this paragraph and does not include a review of information other than that obtained from the Company's accounting records.

KPMG AUDITORES, S.L.

Valeriano Pérez Lozano

2 March 1999



KPMG Auditores S.L.  
KPMG Auditores S.L. es miembro de  
KPMG International, Sociedad Suiza.

Inscrita en el Registro Oficial de Auditores de Cuentas con el n.º 04782,  
y en el Registro de Sociedades del Instituto de Auditores-Censores  
Jenaro de Cuentas con el n.º 13.  
Reg. Merc. Madrid, T. 11.261, F. 04, Sec. 8, N.º M-188.007, 14/03/17  
N.I.C. 8-7837032



ASSETS	1998	1997
<b>INTANGIBLE ASSETS</b>	1,784,948,608	1,759,076,773
Research and development expenses	2,933,967,196	2,801,044,768
Software	832,074,598	595,010,383
Accumulated amortisation	-1,981,093,186	-1,636,978,378
<b>TANGIBLE ASSETS</b>	230,505,297,537	243,740,173,274
Land and buildings	5,878,911,140	5,814,631,753
Plant and machinery	346,104,334,614	335,425,047,354
Other installations, equipment and furniture	11,682,794,952	11,368,365,593
Plant and machinery under construction	12,786,946,915	20,709,903,896
Advances and other assets under construction	116,485,814	339,864,522
Provisions	-3,187,089,909	-2,956,799,447
Depreciation of plant and machinery	-133,644,096,970	-118,714,149,355
Other depreciation	-9,232,989,019	-8,246,691,042
<b>INVESTMENTS</b>	2,561,422,134	2,009,813,156
Long-term investment portfolio	5,658,553	5,658,553
Other loans	1,287,266,303	1,459,213,104
Long-term guarantee deposits	9,802,866	9,802,866
Long-term balances due from public entities	1,258,694,412	535,138,633
<b>LONG-TERM TRADE DEBTORS</b>	967,500,000	6,352,700,000
Long-term trade debtors	967,500,000	6,352,700,000
<b>TOTAL FIXED ASSETS</b>	235,819,168,279	253,861,763,203
<b>DEFERRED EXPENSES</b>	817,189,294	960,502,625
<b>STOCKS</b>	617,917,426	668,732,893
Raw materials and other supplies	1,164,820,644	1,258,246,586
Provisions for obsolescence	-546,903,218	-589,513,693
<b>DEBTORS</b>	25,311,981,314	17,372,515,009
Trade debtors	6,330,914,131	-2,805,731,250
Sundry debtors	18,726,042,727	18,829,797,556
Personnel	259,294,341	283,714,371
Public entities	142,212,263	1,064,734,332
Provisions	-146,482,148	—
<b>SHORT-TERM INVESTMENTS</b>	1,607,512,318	736,500,335
Interests in group companies	—	82,500,000
Short-term investment portfolio	215,000	347,500
Other loans	1,607,297,318	653,652,835
<b>CASH AND BANKS</b>	36,121,502	40,154,314
<b>PREPAID EXPENSES</b>	263,064,630	611,326,118
<b>TOTAL CURRENT ASSETS</b>	27,836,597,190	19,429,228,669
<b>TOTAL ASSETS</b>	264,472,954,763	274,251,494,497

SHAREHOLDERS' EQUITY AND LIABILITIES	1998	1997
<b>SHARE CAPITAL</b>	45,090,000,000	45,090,000,000
1996 REVALUATION RESERVE	41,100,991,320	41,100,991,320
<b>RESERVES</b>	18,339,144,296	14,272,165,885
Legal reserves	9,018,000,000	9,018,000,000
Other reserves	9,321,144,296	5,254,165,885
<b>PROFIT FOR THE YEAR</b>	11,535,705,431	9,539,777,762
<b>INTERIM DIVIDEND</b>	—	-3,000,000,000
<b>TOTAL SHAREHOLDER'S EQUITY</b>	116,065,841,047	107,002,934,967
Capital grants	10,822,795,579	9,278,186,765
Exchange gains	15,806,727	—
Other deferred income	21,565,199,142	22,507,065,450
<b>TOTAL DEFERRED INCOME</b>	32,403,801,448	31,785,252,215
Provisions for pensions and other liabilities	1,921,567,323	93,303,912
Provisions for taxes	38,983,301	38,983,301
Other provisions	628,400,004	621,000,000
<b>TOTAL PROVISIONS FOR LIABILITIES</b>	2,588,950,628	753,287,213
<b>BONDS ISSUED</b>	26,017,500,000	18,517,500,000
<b>LOANS</b>	41,277,346,979	36,675,919,386
<b>OTHER CREDITORS</b>	7,322,494,635	7,067,639,704
<b>TOTAL LONG-TERM LIABILITIES</b>	74,617,341,614	62,261,059,090
<b>BONDS ISSUED</b>	790,702,247	15,429,323,512
Non-convertible bonds	—	14,432,500,000
Interest payable	790,702,247	996,823,512
<b>LOANS</b>	14,985,438,675	30,686,390,515
Loans and other debt	13,331,250,246	28,632,273,406
Interest payable	1,654,188,429	2,054,117,109
<b>TRADE CREDITORS</b>	8,673,723,112	7,801,723,342
From purchases and services received	8,673,723,112	7,801,723,342
<b>OTHER CREDITORS</b>	9,056,964,566	11,687,391,840
Public entities	5,652,727,540	1,877,664,832
Other	3,126,598,209	9,342,054,551
Wages and salaries payable	2,742,728	1,323,826
Short-term guarantee deposits received	274,896,089	466,348,631
<b>ACCRUALS</b>	5,290,191,426	6,844,131,803
<b>TOTAL CURRENT LIABILITIES</b>	38,797,020,026	72,448,961,012
<b>TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES</b>	264,472,954,763	274,251,494,497

<b>EXPENSES</b>	<b>1998</b>	<b>1997</b>
<b>COST OF MATERIALS CONSUMED</b>	<b>35,173,173,409</b>	<b>11,742,544,810</b>
Purchase of energy and power	33,284,344,598	10,396,969,569
Maintenance and repair materials	1,888,828,811	1,345,575,241
<b>PERSONNEL EXPENSES</b>	<b>8,877,452,502</b>	<b>8,520,742,476</b>
Wages and salaries	6,563,906,592	6,220,788,611
Social benefits	2,313,545,910	2,299,953,865
<b>DEPRECIATION AND AMORTISATION</b>	<b>16,396,811,735</b>	<b>15,719,774,468</b>
<b>VARIATION IN TRADE PROVISIONS</b>	<b>101,181,191</b>	<b>133,050,272</b>
<b>OTHER OPERATING EXPENSES</b>	<b>7,202,272,136</b>	<b>9,276,198,368</b>
External services	6,813,577,698	8,790,722,842
Local taxes	205,526,621	80,548,900
Other administrative expenses	169,767,817	143,926,626
Provision for liabilities	13,400,000	261,000,000
<b>TOTAL OPERATING EXPENSES</b>	<b>67,750,890,973</b>	<b>45,392,310,394</b>
<b>OPERATING PROFIT</b>	<b>23,076,908,991</b>	<b>20,954,709,314</b>
<b>FINANCIAL AND RELATED EXPENSES</b>	<b>6,571,128,037</b>	<b>7,309,345,673</b>
On debt with third parties	6,571,128,037	7,309,345,673
<b>EXCHANGE LOSSES</b>	<b>38,193,536</b>	<b>1,268,263,219</b>
<b>TOTAL FINANCIAL EXPENSES</b>	<b>6,609,321,573</b>	<b>8,577,608,892</b>
<b>PROFIT ON ORDINARY ACTIVITIES</b>	<b>17,073,350,610</b>	<b>13,031,144,258</b>
<b>VARIATION IN PROVISIONS FOR TANGIBLE ASSETS</b>	<b>230,290,462</b>	<b>335,513,162</b>
<b>LOSSES ON TANGIBLE ASSETS</b>	<b>31,858,409</b>	<b>48,222,771</b>
<b>EXTRAORDINARY EXPENSES</b>	<b>1,816,345,223</b>	<b>3,880,869</b>
<b>PRIOR YEARS' EXPENSES</b>	<b>24,436,608</b>	<b>418,151,343</b>
<b>TOTAL EXTRAORDINARY EXPENSES</b>	<b>2,102,930,702</b>	<b>805,768,145</b>
<b>NET EXTRAORDINARY INCOME</b>	<b>320,412,616</b>	<b>971,602,763</b>
<b>PROFIT BEFORE TAX</b>	<b>17,393,763,226</b>	<b>14,002,747,021</b>
<b>INCOME TAX</b>	<b>5,858,057,795</b>	<b>4,462,969,259</b>
<b>PROFIT FOR THE YEAR</b>	<b>11,535,705,431</b>	<b>9,539,777,762</b>

<b>INCOME</b>	<b>1998</b>	<b>1997</b>
<b>NET SALES</b>	<b>89,246,655,748</b>	<b>63,107,043,171</b>
Sales of energy and power	34,348,747,844	11,173,487,067
Sale of by-products	32,668,396	44,692,898
Income on international power exchanges	-2,718,727	1,055,188,106
Services rendered	54,867,957,635	50,833,675,100
<b>SELF-CONSTRUCTED ASSETS</b>	<b>1,344,899,439</b>	<b>2,546,477,087</b>
<b>OTHER OPERATING INCOME</b>	<b>236,244,777</b>	<b>693,499,450</b>
Other income	125,341,441	527,089,998
Grants	36,903,336	60,445,914
Surplus provision for liabilities	74,000,000	105,963,538
<b>TOTAL OPERATING INCOME</b>	<b>90,827,799,964</b>	<b>66,347,019,708</b>
<b>INVESTMENT INCOME</b>	<b>405,989,177</b>	<b>130,248,428</b>
<b>OTHER INTEREST AND SIMILAR INCOME</b>	<b>139,327,621</b>	<b>456,294,718</b>
Other interest	139,327,621	356,846,024
Profit on investments	—	99,448,694
<b>EXCHANGE GAINS</b>	<b>60,446,394</b>	<b>67,500,690</b>
<b>TOTAL FINANCIAL INCOME</b>	<b>605,763,192</b>	<b>654,043,836</b>
<b>NET FINANCIAL EXPENSE</b>	<b>6,003,558,381</b>	<b>7,923,565,056</b>
<b>PROFIT ON TANGIBLE ASSETS</b>	<b>7,039,434</b>	<b>1,482,196</b>
<b>CAPITAL GRANTS TAKEN TO INCOME</b>	<b>728,023,483</b>	<b>512,118,508</b>
<b>EXTRAORDINARY INCOME</b>	<b>1,484,622,932</b>	<b>430,389,250</b>
<b>PRIOR YEARS' INCOME</b>	<b>203,657,469</b>	<b>833,380,954</b>
<b>TOTAL EXTRAORDINARY INCOME</b>	<b>2,423,343,318</b>	<b>1,777,370,908</b>

# Notes to the annual accounts

## 31 December 1998 and 1997

### (1) Nature and Principal Activities

Red Eléctrica de España, S.A. (hereinafter "the Company") was incorporated on 29 January 1985 as a result of the contribution of a part of the assets forming the high voltage grid in service at 15 February 1984. Immediately after, other assets in service at that date were transferred by the shareholders to the Company and recorded as debt arising from the acquisition of fixed assets upon incorporation (see note 12).

In 1997 and previous years the Company carried out activities related to the general administration of the electrical power system, the transmission of power and the international exchange of electrical power both in the short and long term, in accordance with Law 40 dated 30 December 1994 governing the Spanish electricity sector.

At the end of 1997 new legislation was enacted governing the electricity sector (Law 54 dated 27 November 1997), as a result of which Law 40/1994 was replaced. This legislation represented a significant step towards the deregulation of the sector as it provided for the creation of a free market for electricity generation. Law 54/1997 also established new arrangements for the management of the sector in the form of a Market Operator and System Operator to be responsible

for the financial and technical administration of the grid, respectively.

Accordingly for the first of these activities, a new trading company, Compañía Operadora del Mercado Español de Electricidad, S.A., has been created to match orders for the purchase and sale of power between generators, distributors, electricity traders and qualifying consumers. As required by the new Law, in 1997 Red Eléctrica de España, S.A. incorporated the new company and subscribed to 100% of its share capital. Pursuant to the ninth transitional provision of Law 54/1997, the Company sold 100% of the shares held in the new company to various entities in July 1998 through a bid process, thereby complying with all relevant legal requirements (see note 6).

In 1998 the Company carried out the functions assigned by the ninth transitional provision of Law 54/1997 to the System Operator, which is responsible for guaranteeing the quality and safety of power supplies and the co-ordination of the production and transmission systems. The System Operator is also required to act as the Manager of the Transmission Network. In this capacity, the Company is responsible for the development and extension of the high voltage grid and for ensuring that it is maintained and improved in accordance



with uniform and coherent criteria. The Manager of the Transmission Network is also responsible for the administration of power transmissions between external systems using the Spanish grid.

In addition to the above, the Company has continued to carry out its principal activity, which is the transmission of electricity.

The new electricity generating market is regulated by Royal Decree 2019 dated 26 December 1997, which came into force in 1998. This legislation defines the functions assigned to the Company in accordance with the principles of objectivity, transparency and competition established by Law 54/1997 and entrusts it with the responsibility of ensuring the proper functioning of the generating market. This objective requires close coordination with the activities of the Market Operator. As the System Operator the Company is responsible for ensuring that the basic daily market operations plan established by Compañía Operadora del Mercado Español de Electricidad, S.A. is viable in the context of the system's technical limitations, and for the results of the market for ancillary services required for the operation of the system.

The Company is also responsible for co-ordination with foreign operators, the information rela-

ting to international exchanges in progress, and measurement of energy flows through international electricity connections. The Company is also in charge of managing short-term exchanges designed to provide support to electricity systems in order to maintain the quality and safety of supply as required by the Ministry of Industry and Energy.

Access to the transmission network by third parties is guaranteed by Law. Accordingly, as Manager of the Transmission Network, the Company may only deny access for reasons of lack of system capacity with reference to safety, frequency or quality of supply. The terms of access to the grid, connection of new installations and restrictions on access will be regulated in subsidiary legislation to Law 54 of 1997. Royal Decree 2820 dated 23 December 1998 regulates the tariffs for access to transmission and distribution grids, which are applicable to qualifying consumers, electricity traders, distributors, generators, external agents and other exporters of electricity.

In accordance with Law 54/1997, remuneration for the transmission of power is based on the cost of investment, operation and maintenance of the installations, as well as other costs inherent in the activity. Remuneration of the System Operator is

based on recognised permanent operating costs of the system (see note 20).

Royal Decree 2819 dated 23 December 1998 regulates and defines the transmission activity, as well as the elements comprising the grid, which include the installations owned by the Company. This Royal Decree also establishes the financial framework for the transmission activity as from 1999. Accordingly, the remuneration of this activity will be determined on the basis of the transmission revenue received by the Company in 1998, adjusted annually on the basis of the consumer price index plus increments in consideration of new capital assets brought into operation. The calculation system incorporates efficiency indices and incentives for availability of installations.

Holdings in the share capital of the Company owned by individual shareholders have been brought into line with the requirements of the Law governing the electricity sector (see note 8a). At their general meeting held on 20 May 1998, the shareholders amended the articles of association to restrict the maximum permitted shareholding and modify the statutory activities of the Company.

In accordance with Law 54/1997 and the amended articles of association, the Company is authorised

to carry out activities of all kinds related to the transmission of electricity, which comprise principally the actual distribution of power; planning, construction, operation and maintenance or modification of the transmission installations, as well as activities related to the operation of the system and management of the transmission network. The Company may diversify activities both within Spain and internationally to generate revenues from its technological capabilities and know-how and from the utilisation of surplus capacity in its telecommunications networks. The Company will also continue to manage agreements for the long-term exchange of power with other EU and international electricity systems entered into prior to the enactment of the new Electricity Sector Law (see note 28).



## (2) Basis of Presentation

The accompanying annual accounts have been prepared by the board of directors of the Company in the format established by prevailing Spanish legislation to present fairly the shareholders' equity, financial position, results of operations and changes in financial position for 1997 and 1998, and the proposed distribution of profit for 1998.

The annual accounts have been prepared on the basis of the auxiliary records of the Company. The figures in the balance sheet and the profit and loss account are expressed in Pesetas, whereas the figures disclosed in the notes to the accounts are shown in millions of Pesetas. To facilitate comprehension of the information contained in the notes, a balance sheet and profit and loss account expressed in millions of Pesetas have been included as Appendices I and II, respectively, and referenced to the notes.

The annual accounts for 1998 have been prepared in accordance with the transitional rules for the adaptation of the Spanish Chart of Accounts to companies operating in the electricity sector, which came into force during the year. As a result, certain reclassifications have been made to the 1997 balance sheet for the purposes of harmonisation and to facilitate comparison. The effects of these

reclassifications are not significant to the annual accounts taken as a whole.

The directors consider that the 1998 annual accounts will be approved by the shareholders at their annual general meeting without significant changes. The 1997 annual accounts were approved at the annual general meeting held on 20 May 1998.

## (3) Distribution of Profits

The board of directors propose that the 1998 profit be distributed as follows:

	Millions of pesetas
<b>BASIS OF DISTRIBUTION</b>	
Profit for the year	11,536
<b>TOTAL</b>	<b>11,536</b>
<b>DISTRIBUTION</b>	
Voluntary reserves	4,614
Dividends	6,922
<b>TOTAL</b>	<b>11,536</b>

This proposal is pending approval by the shareholders at their annual general meeting.

#### **(4) Accounting Principles**

The accompanying annual accounts have been prepared in accordance with accounting principles established in the Spanish Chart of Accounts and transitional rules for its adaptation to the electricity sector. The most significant accounting principles applied are as follows:

##### **(a) Intangible assets**

Intangible assets principally comprise software and costs incurred in research and development projects which are expected to benefit the Company's operations over a number of years. Such assets are stated at cost of production or acquisition, less accumulated amortisation provided on a straight line basis over a period not exceeding five years, depending on the nature of the asset.

##### **(b) Tangible assets**

Tangible assets are stated at the value assigned on contribution, or at the cost of acquisition or production, less accumulated depreciation.

In 1996 the Company revalued its tangible fixed assets as permitted by Royal Decree 7 dated 7 June 1996 and Royal Decree 2607 dated 20 December 1996. The revaluation was carried out on the basis of the maximum rates established

by that legislation, reduced by 40% in order to take into consideration the structure of the Company's financing.

The cost of tangible assets directly constructed by the Company is recorded in accordance with the policy explained in section (c) below.

Repairs and maintenance costs of tangible assets are expensed when incurred.

Depreciation is provided on a straight line basis over the estimated useful lives of the relevant assets, applying the following annual rates:

	Annual rate
<b>BUILDINGS</b>	2%-10%
<b>PLANT AND MACHINERY:</b>	
- In operation when acquired by the Company:	
Power lines and substations	5%
Control and communication systems (supervisory control centres)	14.28%
- Built and put into operation by the Company:	
Power lines and substations	2.5%
Control and communication systems (supervisory control centres)	7.14%
<b>OTHER INSTALLATIONS, EQUIPMENT, FURNITURE AND OTHER TANGIBLE ASSETS</b>	4%-25%

Net increases in value arising from the revaluation of fixed assets will be depreciated over the remaining useful lives of the related assets.

In 1997 the Company re-estimated the useful lives of power lines and substations to bring them into line with those generally applied in the electricity sector and with applicable tax criteria. As a result, the net book values of these assets at 31 December 1996 are depreciated on a straight line basis over the new estimated useful lives.

### (c) Tangible assets under construction

The Company capitalises the following items during the period of construction of the related assets:

- Direct costs related to the construction of assets in projects directly controlled or supervised by the Company. In 1998 and 1997 the Company capitalised Ptas. 670 million and Ptas. 831 million in this regard, respectively.
- In 1997, financial expenses relating to specific and general financing obtained were capitalised. Interest charges on general financing were calculated by applying the average effective rate of interest to the average accumulated cost of investment for which no specific financing has been obtained.

In 1998 the Company has adapted its procedure for the capitalisation of financial expenses to the requirements of Royal Decree 437 dated 20 March 1998, which establishes the transitional rules for the adaptation of the Spanish General Chart of Accounts to companies operating in the electricity sector. Under the new criteria, financial expenses on specific borrowings arranged to fund projects are capitalised first. Self-financing is then assigned proportionally to the net book values of fixed assets under construction, less the amount of any specific borrowings in each case. The remaining cost of fixed assets under construction after deduction of specific borrowings and self-financing is considered to be funded out of general borrowings and the related



financial expenses are assigned on a proportional basis.

This change in criteria does not have a significant effect on the annual accounts for 1998 taken as a whole. In 1998 and 1997 the Company has capitalised financial expenses for Ptas. 542 million and Ptas. 1,497 million, respectively.

Costs capitalised in this respect are credited to the profit and loss account under the heading, self-constructed assets.

In 1996 the Company voluntarily revalued the cost of tangible assets under construction as permitted by Royal Decree 7 dated 7 June 1996 and Royal Decree 2607 dated 20 December 1996. This revaluation was carried out on the basis of the maximum rates established by that legislation, reduced by 40% in order to take into consideration the structure of the Company's financing.

Provision is made against the value of assets under construction when there is evidence that their net book value may be affected by circumstances other than use, obsolescence or normal service. Such circumstances mainly relate to the capitalisation of financial expenses when

the accumulated balance for a specific asset represents a significant portion of the total cost of a project as a consequence of delays in bringing the asset into operation, which are not attributable to the Company.

#### (d) Stocks

Stocks of spare parts and other consumables are stated at cost of acquisition.

Provision is made where cost exceeds market value or when it appears doubtful that items will be used.

#### (e) Foreign exchange transactions

Foreign exchange transactions are translated into Pesetas at the rates of exchange prevailing at the dates the transactions take place. Exchange gains or losses arising on settlement of these transactions are taken to income or expensed when incurred.

Unhedged balances receivable and payable in foreign currency at year end are expressed in Pesetas at the rates of exchange prevailing at 31 December. Unrealised foreign exchange losses, determined for groups of currencies with similar maturity or market trends, are charged to expenses while unrealised exchange gains, similarly determined, are deferred. In 1998, however, unrealised gains arising on EMU currencies have been taken to profit and loss as they are considered to be realised at 31 December 1998, in accordance with criteria regarding the introduction of the Euro established by Royal Decree 2814 dated 23

December 1998. The Company has recognised net exchange gains of Ptas. 22 million in respect of the implementation of the Euro, mainly relating to loans.

In 1997 the Company recognised net exchange losses of Ptas. 913 million, as the special accounting principles permitting the deferral of net unrealised exchange losses ceased to apply.

The Company has contracted exchange rate insurance in respect of certain operations. The related amounts are stated at the insured rates of exchange.

#### (f) Interest rate hedging operations

Profit or loss on over-the-counter operations to hedge interest rates on financial debt is calculated and taken to profit and loss simultaneously with the income and expense on the transactions covered. The income or expense recognised represents the net difference between the transactions covered and the corresponding hedging operations. The average interest rates on financial debt are calculated by applying this criteria (see note 24).

**(g) Bonds issued**

Bonds issued are stated at their face value. The redemption premium, representing the difference between face value and the value at which the bonds were issued, is deferred and charged to expenses over the period to maturity of the debt using the interest method.

When interest rate swaps are contracted to hedge the related interest rate risk and redemption premiums, where applicable, the amounts receivable by the Company in the long term in respect of the latter are recorded under deferred income and taken to income over the period to maturity using the interest method (see notes 7, 9 and 24).

**(h) Current/long-term**

Assets and liabilities are classified as current if maturing within twelve months and long-term if maturing more than twelve months from the balance sheet date.

**(i) Compensation for termination of employment**

In the absence of any foreseeable need for abnormal termination of employees' services and because indemnities are not payable to those employees who retire or voluntarily leave the Company, indemnities, if they arise, are

expensed when the decision to terminate employment is taken.

**(j) Income tax**

Income tax is calculated on the basis of the pre-tax accounting profit duly adjusted for permanent differences and taking into consideration any applicable credits and deductions. The effects of timing differences, where applicable, are included in deferred tax assets or liabilities.

As permitted by the transitional rules relating to the Spanish Chart of Accounts, the Company has not recorded the deferred tax liability related to timing differences which existed at 31 December 1989 (see note 8-e). The effect of these timing differences is recognised as an increase in the income tax expense in the year in which they crystallise.

#### (k) Deferred income

Capital grants, permanent transfers of non-returnable tangible assets and other deferred income are stated at the amounts originally received or awarded, or at the replacement cost of the relevant assets, where applicable.

Grants and deferred income obtained to finance fixed assets are recognised in proportion to the value of the assets funded over their estimated useful lives.

Deferred income generated on financial derivatives contracted for hedging purposes, agreements for the transfer of the rights to use fixed assets (see note 28-e) and, in general, on any agreement or commitment with a duration of more than one year are taken to income over the term of the related agreement or commitment.

#### (l) Pension plan

With effect from 2 November 1990, the voluntary defined contributions pension plan adopted by the Company on 31 December 1985 was integrated into a pension fund, in accordance with current legislation. Equal contributions are made by the Company and the participants by way of monthly instalments equivalent to 3% of the base salary established in the

fund. The Company's contributions are recorded on an accruals basis.

#### (m) Early retirement plan

The Company has opted to offer employees the possibility of taking early retirement under certain conditions and has made the necessary provisions, based on the preliminary studies and analyses carried out (see note 10).



**(5) Tangible Assets**

Tangible assets at 31 December 1998 and 1997 and movement during the years then ended are as follows:

Millions of pesetas	31.12.96	Additions and restatements	Disposals and write-downs	Transfers	31.12.97 (1)
<b>COST</b>					
Land and buildings	5,543	(12)	—	284	5,815
Plant and machinery	315,752	424	(135)	19,384	335,425
Other installations, equipment and furniture	9,516	309	(22)	1,565	11,368
Plant and machinery under construction	28,848	11,246	—	(19,384)	20,710
Advances and assets under construction	1,162	1,027	—	(1,849)	340
<b>TOTAL COST</b>	<b>360,821</b>	<b>12,994</b>	<b>(157)</b>	<b>—</b>	<b>373,658</b>
<b>ACCUMULATED DEPRECIATION</b>					
Buildings	(437)	(109)	—	—	(546)
Plant and machinery	(104,317)	(14,487)	90	—	(118,714)
Other installations, equipment and furniture	(6,861)	(859)	19	—	(7,701)
<b>ACCUMULATED DEPRECIATION</b>	<b>(111,615)</b>	<b>(15,455)</b>	<b>109</b>	<b>—</b>	<b>(126,961)</b>
<b>PROVISION FOR IMPAIRMENT (NOTE 4-C)</b>	<b>(2,621)</b>	<b>(336)</b>	<b>—</b>	<b>—</b>	<b>(2,957)</b>
<b>NET BOOK VALUE</b>	<b>246,585</b>	<b>(2,797)</b>	<b>(48)</b>	<b>—</b>	<b>243,740</b>

(1) See notes 4-b and 4-c

Transfers to plant and machinery during 1998 comprise three power lines, bays at four substations and communication and control systems amounting to Ptas. 10,749 million (Ptas. 19,384 million in 1997 relating to two lines, bays

at two substations and communication and control systems).

As a result of the revaluation of assets carried out as permitted by Royal Decree 7 of 7 June 1996



Millions of pesetas	31.12.97 (I)	Additions and resta- tements	Disposals and write -downs	Transfers	31.12.98 (I)
<b>COST</b>					
Land and buildings	5,815	—	—	64	5,879
Plant and machinery	335,425	8	(78)	10,749	346,104
Other installations, equipment and furniture	11,368	412	(115)	18	11,683
Plant and machinery under construction	20,710	2,826	—	(10,749)	12,787
Advances and assets under construction	340	180	(322)	(82)	116
<b>TOTAL COST</b>	<b>373,658</b>	<b>3,426</b>	<b>(515)</b>	<b>—</b>	<b>376,569</b>
<b>ACCUMULATED DEPRECIATION</b>					
Buildings	(546)	(113)	—	—	(659)
Plant and machinery	(118,714)	(14,970)	40	—	(133,644)
Other installations, equipment and furniture	(7,701)	(969)	96	—	(8,574)
<b>ACUMULATED DEPRECIATION</b>	<b>(126,961)</b>	<b>(16,052)</b>	<b>136</b>	<b>—</b>	<b>(142,877)</b>
<b>PROVISION FOR IMPAIRMENT (NOTE 4-C)</b>	<b>(2,957)</b>	<b>(281)</b>	<b>51</b>	<b>—</b>	<b>(3,187)</b>
<b>NET BOOK VALUE</b>	<b>243,740</b>	<b>(12,907)</b>	<b>(328)</b>	<b>—</b>	<b>230,505</b>

and Royal Decree 2607 of 20 December 1996, the depreciation charge for 1998 amounts to approximately Ptas. 3,809 million (approximately Ptas. 3,859 million in 1997). At 31 December 1998 the revaluation of tangible fixed assets, net

of depreciation, amounts to Ptas. 34,704 million (Ptas. 38,513 million in 1997).

The Company has contracted insurance policies to cover the replacement cost of tangible assets.

**(6) Investments**

Details at 31 December 1998 and 1997 are as follows:

	Millions of pesetas	
	1998	1997
Loans	1,287	1,460
Long-term, Public entities	1,259	535
Long-term guarantee deposits	10	10
Other long-term investments	5	5
<b>TOTAL LONG-TERM INVESTMENTS</b>	<b>2,561</b>	<b>2,010</b>
Investments in group companies	—	300
Uncalled portion of investments in group companies	—	(218)
Other short-term investments	1,608	654
<b>TOTAL SHORT-TERM INVESTMENTS</b>	<b>1,608</b>	<b>736</b>

Long-term loans have mainly been made to personnel and earn interest at market rates.

Long-term balances due from public entities reflect deferred tax assets (see note 19).

Investments in group companies at 31 December 1997 reflect the share capital of Compañía Operadora del Mercado Español de Electricidad, S.A., subscribed by the Company for Ptas. 300 million, of which Ptas. 218 million was unpaid at that date.

Compañía Operadora del Mercado Español de Electricidad, S.A. was incorporated pursuant to Law 54 dated 27 November 1997 governing the Spanish electricity sector, which required that the Company create a new entity to carry out the functions of Market Operator for the electricity market as defined by that legislation. The Company fully subscribed the initial share capital of Ptas. 300 million on the incorporation of Compañía Operadora del Mercado Español de Electricidad, S.A. In accordance with the provisions of Law 54/1997, the Company disposed of this investment in July 1998. The shares, which were fully paid in 1998, have been sold for Ptas. 1,450 million, less expenses inherent in the operation and the related gains have been recorded under extraordinary income.

Other short-term investments mainly comprise short-term deposits and interest receivable on operations involving financial derivatives. Interest accrues on these operations in line with the hedged operations (see note 24).

**(7) Debtors**

Details of debtors at December 31 are as follows:

	Millions of pesetas	
	1998	1997
Long-term trade debtors	968	6,353
<b>TOTAL (long-term)</b>	<b>968</b>	<b>6,353</b>
Debtors from the sale of energy:		
Domestic electricity companies	4,952	(8,255)
Foreign electricity companies	1,379	5,449
	<b>6,331</b>	<b>(2,806)</b>
Debtors from services rendered:		
Domestic electricity companies	12,508	12,588
Other debtors	6,218	6,242
	<b>18,726</b>	<b>18,830</b>
Personnel	259	284
Tax authorities:		
VAT receivable	—	821
Withholdings	2	4
Deferred tax assets (note 19)	140	240
	<b>142</b>	<b>1,065</b>
Provision for bad debts	(146)	—
<b>TOTAL (short-term)</b>	<b>25,312</b>	<b>17,373</b>

Long-term trade debtors at 31 December 1998 reflect the redemption premium on the swap operation contracted to hedge the bonds issued in September 1997. At 31 December 1997 long-term trade debtors mainly represented long-term receivables relating to an agreement to cede the use of surplus capacity in the Company's fibre optic network. These balances have been transferred to short term in 1998 (see note 28-e).

At 31 December 1998 and 1997 the net balance receivable from domestic electricity companies for sales of energy represents mainly electricity charges invoiced or pending billing to those companies in accordance with the power supply contract between Electricité de France (EDF) and the Company. At 31 December 1997 this item was also presented net of a Ptas. 8,974 million balance payable to various electricity sub-systems in respect of the distribution of the moneys received in compensation from EDF under the framework Agreement for the adaptation of contracts for the supply of electrical power (see note 28-a). The increase in this balance represents a rise in purchases and sales of power during the final months of 1998 as compared to the same period in 1997, and to certain adjustments to invoicing for the year due to changes in settlement processes in the generating market.

The balance receivable in respect of sales of energy to foreign electricity companies at 31 December 1998 and 1997 relates mainly to electricity charges invoiced or pending billing in accordance with the power supply export agreements entered into by the Company (see note 28). The decrease in this balance is principally due to invoicing of power supplies in accordance with different terms established in the contract with l'Office National de l'Electricité of Morocco (ONE) (see note 28-c).



At 31 December 1998 the balance receivable from domestic electricity companies for services rendered represents amounts invoiced and pending billing in respect of transmission and operation of the system. Royal Decree 2017 dated 26 December 1997 establishes, inter alia, the procedures and terms applicable in 1998 for settlement of transmission charges and permanent costs related to the operation of the system. At 31 December 1997 this item included amounts outstanding or pending billing in relation to the percentage attributable to the Company, of invoices issued to end users by electricity companies.

At 31 December 1998 and 1997 other debtors reflect mainly the short-term balance receivable in relation to the agreement to cede the use of surplus capacity from the Company's fibre optic network (see notes 9 and 28 e).

## (8) Shareholders' Equity

Details of movement in shareholders' equity during 1998 and 1997 are shown in Appendix III, which forms an integral part of this note.

### (a) Share capital

At 31 December 1998 and 1997 share capital comprises 45,090,000 shares of Ptas. 1,000 each, subscribed and fully paid. All shares have the same rights.

At 31 December 1998 and 1997 the share capital is held as follows:

SHAREHOLDERS	1998		1997	
	Millions of pesetas	Percentage ownership	Millions of pesetas	Percentage ownership
Sociedad Estatal de Participaciones Industriales (SEPI)	27,054	60.00	22,550	50.01
Iberdrola, S.A.	4,509	10.00	12,308	27.30
Unión Eléctrica Fenosa, S.A.	4,509	10.00	2,892	6.41
Hidroeléctrica del Cantábrico, S.A.	4,509	10.00	186	0.41
Empresa Nacional de Electricidad, S.A.	2,254	5.00	2,254	5.00
Compañía Sevillana de Electricidad, S.A.	1,812	4.02	1,812	4.02
Electra de Viesgo, S.A.	245	0.54	636	1.41
Eléctricas Reunidas de Zaragoza, S.A.	198	0.44	198	0.44
Empresa Nacional Hidroeléctrica del Ribagorzana, S.A.	—	—	2,254	5.00
<b>TOTAL SHARE CAPITAL</b>	<b>45,090</b>	<b>100.00</b>	<b>45,090</b>	<b>100.00</b>

The Company has brought the ownership of its share capital into line with the requirements of Law 54 of 27 November 1997, in accordance with which no single shareholder may own a total direct and indirect interest exceeding 10%. Also, the sum of the total interests held directly and indirectly by companies operating in the electricity sector does not exceed 40%. These shares may not be syndicated. The maximum limits for shareholdings are not applicable to Sociedad Estatal de Participaciones Industriales, which will hold an interest of at least 25% in the share capital of the Company until 31 December 2003, after which it will maintain a minimum interest of 10%.

#### **(b) Revaluation reserve**

Under Royal Decree 7 dated 7 June 1996 and Royal Decree 2607 dated 20 December 1996, the Company credited to the 1996 revaluation reserve the amount of the increase in the value of tangible assets arising from the revaluations carried out in accordance with that legislation.

The balance of this reserve (Ptas. 41,101 million) is presented net of a one-off tax charge on the revaluation and may not be disposed of until it has been inspected and agreed by the tax authorities or the inspection period, which com-

mences on 31 December 1996 and ends three years thereafter, has elapsed. Nevertheless, if a revalued asset is sold or disposed of at a loss, the revalued amount of the asset, to the extent it did not exceed the loss, would be released from the reserve into taxable income and, accordingly, become distributable. Once the revaluation has been agreed by the tax authorities, or after the inspection period has expired, the balance of the reserve may be applied to offset prior years' losses, to increase share capital or to increase distributable reserves after ten years have elapsed.

The balance of the revaluation reserve may not be distributed, either directly or indirectly, unless the related gain has been realised; that is when the related assets have been depreciated, to the limit thereof, sold or written off.

#### **(c) Legal reserve**

Companies are obliged to transfer 10% of the profits of each year to a legal reserve until this reserve reaches an amount equal to 20% of share capital. This reserve is not distributable to shareholders and may only be used to offset losses if no other reserves are available. Under certain conditions it may be used to increase share capital.

At 31 December 1998 and 1997 the legal reserve is equal to 20% of the share capital of the Company.

**(d) Investment reserve**

This reserve was established in accordance with the Spanish Energy Council ruling of 11 December 1987, which required the Company to set up a provision of Ptas. 1,352 million.

The investment reserve is not distributable without the express authorisation of the Energy Council.

**(e) Voluntary reserve**

Voluntary reserves are freely distributable, except where restricted by the Spanish Companies Act.

**(f) Reserve for accelerated depreciation**

As permitted by Royal Decree-Law 2/1985, prior to 1990 the Company provided accelerated depreciation for tax purposes of Ptas. 4,428 million in respect of acquisitions of tangible assets between 9 May and 31 December 1985, and set up the relevant reserve for accelerated depreciation, which at 31 December 1998 amounts to Ptas. 2,816 million (Ptas. 2,922 million in 1997). Each year the Company debits this reserve and credits extraordinary income in an

amount equal to the annual depreciation charge based on the useful lives of the assets subject to accelerated depreciation. The amount of tax, the payment of which has been deferred as a result of accelerated depreciation is estimated, using the standard tax rate of 35%, at approximately Ptas. 986 million at 31 December 1998 (Ptas. 1,023 million in 1997).

Subsequent to 1990 the Company made an adjustment of Ptas. 2,546 million to taxable income, as permitted by the aforementioned legislation, and recorded the related deferred tax liability. The timing difference arising in this regard at 31 December 1998 amounts to Ptas. 1,974 million (see note 19).

**(g) Own shares**

The Company carries out no operations involving own shares.

**(9) Deferred Income**

Details at 31 December are as follows

	Millions of pesetas	
	1998	1997
Capital grants	10,823	9,278
Exchange gains	16	—
Other deferred income	21,565	22,507
	<b>32,404</b>	<b>31,785</b>

At 31 December 1998 and 1997 other deferred income includes the contribution of non-returnable tangible assets, as well as the portion assigned to the Company of the compensation received from EDF pursuant to the agreement made on 8 January 1997 to amend electricity supply contracts (see note 28-a). This caption also reflects amounts arising from the agreement to cede the use of surplus capacity from the Company's fibre optic network (see note 28-e) and unrealised gains on operations involving financial derivatives contracted to hedge bonds issued in September 1997.

**(10) Provisions**

Details are as follows:

	Millions of pesetas	
	1998	1997
Provision for pensions and other commitments	1,922	93
Provision for taxes	39	39
Provision for other liabilities	628	621
	<b>2,589</b>	<b>753</b>

The provision for pensions and other commitments at 31 December 1998 reflects mainly the amount set aside with a charge to extraordinary expenses to cover future expenses which, in accordance with the studies and analyses carried out, will arise in respect of the early retirement plan the Company has decided to implement.

The provision for other liabilities mainly covers the possibility of unfavourable rulings in respect of claims from third parties.



**(11) Bonds Issued**

At 31 December 1998 and 1997 this balance represents bonds issued at fixed rates between 3.65% and 11.00% and at a variable rate based on MIBOR plus 0.135%. The bonds mature in periods of between 3 and 7 years.

In accordance with the terms of each bond issue, at 31 December 1998 and 1997 the debt matures as follows:

	Millions of pesetas	
	1998	1997
Three years	5,000	—
Four years	—	5,000
Five years	5,050	—
Thereafter	15,968	13,517
	<b>26,018</b>	<b>18,517</b>

During 1998 unhedged and hedged debts have accrued average annual interest of 7.37% and 7.46%, respectively (9.39% for hedged debts in 1997).

**(12) Long-Term Loans**

Details of long-term loans are as follows:

	Millions of pesetas	
	1998	1997
Debt transferred by electricity companies to banks relating to assets acquired on incorporation	8,817	13,084
Less, transfer to Other long-term creditors (note 13)	—	(2,556)
Less, current portion (note 15)	—	(1,711)
Less, repayments in advance	(8,817)	—
	<b>—</b>	<b>8,817</b>
Loans and credit facilities	44,175	30,013
Less, current portion (note 15)	(2,898)	(2,154)
	<b>41,277</b>	<b>36,676</b>

On 2 February 1998 the debt transferred by electricity companies to banks relating to assets acquired on incorporation was repaid in advance.

Loans and credit facilities bear interest at fixed annual rates of between 3.85% and 12.60% and at variable rates based on MIBOR and LIBOR plus differentials between 0.10% and 0.14%.

Details of foreign currency loans at 31 December are as follows:

Moneda	Millions of pesetas	
	1998	1997
ECU	3,624	5,695
Swiss Franc	1,733	1,949
German Mark	1,046	1,133
US Dollar	1,348	1,498
Dutch Guilder	1,000	1,000
	<b>8,751</b>	<b>11,275</b>

During 1998 unhedged and hedged Peseta loans have accrued average annual interest at rates of 6.47% and 6.01%, respectively (8.27% for hedged loans in 1997). Average interest on unhedged and hedged foreign currency loans has been 7.86% and 8.42%, respectively (9.12% for hedged loans in 1997).

Long-term maturities of the loans are as follows:

	Millions of pesetas	
	1998	1997
Two years	2,312	4,966
Three years	7,727	4,593
Four years	12,652	4,996
Five years	2,689	5,430
Thereafter	15,897	16,691
	<b>41,277</b>	<b>36,676</b>

At 31 December 1998 the Company has drawn down Ptas. 15,000 million on a syndicated credit

facility with a limit of Ptas. 20,000 million. No amounts had been drawn down at 31 December 1997. On 1 January 1999 this credit facility was converted into a loan of Ptas. 15,000 million.

### (13) Other Long-term Creditors

A detail of other long-term creditors at 31 December 1998 and 1997 is as follows:

	Millions of pesetas	
	1998	1997
Debt with electricity companies relating to assets acquired on incorporation	157	13,938
	<b>157</b>	<b>13,938</b>
Transfer from long-term bank loans (note 12)	—	2,556
Less, repayments in advance	(157)	(16,307)
Less, current portion	—	(30)
	<b>—</b>	<b>157</b>
Deferred tax liability (note 19)	7,314	6,906
Long-term deposits received	8	5
	<b>7,322</b>	<b>7,068</b>

On 30 December 1997 the Company repaid Ptas. 16,307 million in advance on the debt with electricity companies relating to assets acquired on incorporation. This repayment included Ptas. 2,556 million recovered by an electricity company from

banks (see note 12). On 27 February 1998 the remaining Ptas. 157 million of this debt was repaid in advance.

The long-term maturity of balances with other long-term creditors is as follows:

	Millions of pesetas	
	1998	1997
Two years	284	290
Three years	274	286
Four years	303	285
Five years	257	342
Thereafter	6,204	5,865
	<b>7,322</b>	<b>7,068</b>

#### (14) Bond Interest Payable

At 31 December 1998 this balance comprises accrued interest payable on the bonds issued by the Company (see note 11) (Ptas. 997 million in 1997).

At 31 December 1997 this caption comprised bond interest payable and bonds payable, which fell due in 1998.

#### (15) Short-term Loans

Details of short-term loans are as follows:

	Millions of pesetas	
	1998	1997
Debt transferred by electricity companies to banks relating to assets acquired on incorporation (note 12)	—	1,711
Loans (note 12)	2,898	2,154
Promissory notes and credit facilities	10,433	24,767
	<b>13,331</b>	<b>28,632</b>
Accrued interest payable	1,654	2,054
	<b>14,985</b>	<b>30,686</b>

In 1998 promissory notes bear interest at annual rates of between 3.09% and 5.60% (between 4.59% and 8.88% in 1997).

In both 1998 and 1997 credit facilities bear interest at MIBOR or LIBOR rates plus a differential of between 0.10% and 0.20%.

At 31 December 1998 and 1997 no promissory notes or draw-downs in foreign currency exist.

During 1998 unhedged and hedged promissory notes and short-term Peseta loans have accrued average annual interest at rates of 4.64% and 4.66%, respectively (5.93% on hedged operations in 1997). The average interest on foreign currency loans has been 4.41% (1.93% in 1997).



Promissory notes are issued by the Company through financial institutions and are recorded at their nominal value. The difference between this value and the amount actually received is recorded on the accruals basis and classified as prepaid expenses.

At 31 December 1998 and 1997 a programme to issue "highly liquid" promissory notes up to a maximum of Ptas. 28,000 million has been registered with the Spanish Stock Exchange Commission.

At 31 December 1998 the Company has unused credit facilities for Ptas. 10,067 million (Ptas. 8,282 million at 31 December 1997).

### (16) Trade Creditors

Details at 31 December are as follows:

	Millions of pesetas	
	1998	1997
Energy and power purchases	3,425	785
Services rendered	5,249	7,017
	<b>8,674</b>	<b>7,802</b>

Energy and power purchases mainly relate to the agreement with Electricité de France (EDF) to supply energy and power (see note 28-a). The increase in this balance represents higher purchases and sales of energy in the final months of 1998, as compared to the same period for 1997, and to certain adjustments in invoicing for the year due to changes in settlement processes in the generating market.

### (17) Other Creditors

At 31 December 1998 and 1997 other creditors are as follows:

	Millions of pesetas	
	1998	1997
Tax and Social Security authorities	5,653	1,878
Short-term guarantee deposits received	275	466
Other debts	3,129	9,344
	<b>9,057</b>	<b>11,688</b>

Balances due to the tax and Social Security authorities comprise the following:

	Millions of pesetas	
	1998	1997
<b>Taxes payable:</b>		
Withholding taxes	130	213
Income tax (nota 19)	4,239	1,272
VAT	848	—
Other taxes	3	3
<b>Social Security</b>	<b>141</b>	<b>143</b>
<b>Deferred tax liability (nota 19)</b>	<b>292</b>	<b>247</b>
	<b>5,653</b>	<b>1,878</b>

The increase in income tax payable is explained in note 19.

Other debts are as follows:

	Millions of pesetas	
	1998	1997
<b>Debts with electricity companies relating to assets</b>	—	37
<b>Creditors for purchases of assets and other items</b>	<b>2,599</b>	<b>6,732</b>
<b>Domestic electricity companies - international power exchanges (note 20)</b>	<b>530</b>	<b>2,575</b>
	<b>3,129</b>	<b>9,344</b>

### (18) Prepaid Expenses and Accruals

At 31 December 1998 prepaid expenses comprise Ptas. 263 million (Ptas. 611 million in 1997) relating mainly to financial expenses incurred in 1998 which will be recognised over the ensuing years, and prepayments on insurance policies contracted by the Company in respect of future years.

Accruals mainly reflect income of Ptas. 2,321 million (Ptas. 4,357 million in 1997) received in advance in respect of billings for guaranteed power supplies, in accordance with the power supply agreement between ONE and the Company (see note 28-c), and income of Ptas. 2,858 million (Ptas. 2,296 million in 1997) received in advance on the power supply agreement between EDF and the Company (see note 28-b).

### (19) Taxation

In 1998 and 1997 the Company has filed consolidated income tax returns as a part of the consolidated tax group nº 9/1986, which is formed by Sociedad Estatal de Participaciones Industriales and the companies in which it has a majority shareholding, in accordance with Law 5 of 10 January 1996.

In accordance with the consolidated tax regime, the individual income tax payable and



receivable of each company forming part of the consolidated group are integrated into the declaration of the parent company (Sociedad Estatal de Participaciones Industriales). As a result, the Company will be required to pay Ptas. 4,239 million to Sociedad Estatal de Participaciones Industriales in respect of income tax for 1998 (Ptas. 1,272 million in 1997). This amount represents the expected income tax charge for the year of Ptas. 6,025 million (Ptas. 4,153 million in 1997), less deductions of Ptas. 1,786 million (Ptas. 2,881 million in 1997) for payments on account made by the Company and withholdings at source of interest income. Payments on account and the balance due to the tax authorities have increased in 1998 because payments on account have been made through the consolidated tax group rather than directly as in 1997.

As a consequence of the treatment permitted by fiscal legislation for certain transactions, the accounting profit differs from taxable income. A reconciliation of the accounting profit for the year with the taxable income that the Company expects to declare after approval of the 1998 annual accounts, together with that for 1997, is as follows:

	Millions of pesetas	
	1998	1997
Profit before income tax	17,394	14,003
Permanent differences	(20)	146
<b>Taxable accounting income</b>	<b>17,374</b>	<b>14,149</b>
Timing differences:		
Generated during the year	1,876	(565)
Reversal of prior years	(1,388)	(1,147)
<b>TAXABLE INCOME</b>	<b>17,862</b>	<b>12,437</b>

Details of the 1998 and 1997 income tax charges are as follows:

	Millions of pesetas	
	1998	1997
Accounting income at 35%	6,081	4,952
Less, deductions	(226)	(199)
<b>Expense for the year</b>	<b>5,855</b>	<b>4,753</b>
Prior years' adjustment	3	(290)
<b>INCOME TAX CHARGE</b>	<b>5,858</b>	<b>4,463</b>

The Company is obliged to maintain fixed assets for which credits have been taken for a period of five years.

Details of timing differences in the recognition of expenses and income for accounting and tax purposes at 31 December 1998 and 1997 and the related accumulated deferred tax assets and liabilities are as follows:

	Millions of pesetas			
	1998		1997	
	Timing difference	Tax effect	Timing difference	Tax effect
<b>TAX DIFFERENCE:</b>				
– Long-term (note 6)				
Deferred income	3,154	1,104	1,020	357
Other	443	155	509	178
	<b>3,597</b>	<b>1,259</b>	<b>1,529</b>	<b>535</b>
– Short-term (note 7)				
Other	400	140	686	240
	<b>400</b>	<b>140</b>	<b>686</b>	<b>240</b>
	<b>3,997</b>	<b>1,399</b>	<b>2,215</b>	<b>775</b>
<b>DEFERRED TAX LIABILITIES:</b>				
– Long-term (note 13)				
1985 accelerated depreciation (1)	1,900	665	1,974	691
1975 accelerated depreciation (2)	7,517	2,631	7,768	2,719
1988 accelerated depreciation (3)	2,414	845	2,515	880
1993 accelerated depreciation (4)	7,740	2,709	6,117	2,141
1992 accelerated depreciation (5)	754	264	580	203
Accelerated amortisation of capitalised research and development costs	565	198	777	272
Reinvestment of extraordinary profit	6	2	—	—
	<b>20,896</b>	<b>7,314</b>	<b>19,731</b>	<b>6,906</b>
– Short-term (note 17)				
1985 accelerated depreciation (1)	74	26	76	27
1975 accelerated depreciation (2)	251	88	251	88
1988 accelerated depreciation (3)	100	35	101	35
Accelerated amortisation of capitalised research and development costs	267	93	278	97
1992 accelerated depreciation (5)	143	50	—	—
	<b>835</b>	<b>292</b>	<b>706</b>	<b>247</b>
	<b>21,731</b>	<b>7,606</b>	<b>20,437</b>	<b>7,153</b>

(1) Royal Decree 2/1985

(2) Royal Decree 175/1975

(3) Royal Decree 12/1988

(4) Royal Decree 3/1993

(5) Royal Decree 31/1992

At 31 December 1998 the Company has open to inspection by the tax authorities all applicable taxes since 1994, inclusive. The directors do not expect that significant additional liabilities would arise in the event of inspection.

## (20) Net Sales

Details are as follows:

	Millions of pesetas	
	1998	1997
Income from services rendered	52,611	49,624
Sales of energy and power	34,349	11,173
Income on international power exchanges	(3)	1,055
Other income from services rendered	2,257	1,210
Sales of by-products	33	45
	<b>89,247</b>	<b>63,107</b>

In 1998 income from services rendered relates to transmission activities and the operation of the system, the remuneration for which is established annually by the Ministry of Industry and Energy. In accordance with Royal Decree 2016 dated 26 December 1997, which establishes electricity tariffs for 1998, the remuneration of transmission activities was fixed at Ptas. 51,121 million, while revenues for the operation of the system were set at 0.053% of tariffs and 0.121% of power transmission tolls. In 1997 the remuneration received by the Company was set at 2.413% of the amounts invoiced to end users by the electricity generating companies for

power supplied (see note 1). Revenues earned over the year are recognised in line with energy actually supplied by the electricity companies.

Sales of energy and power represent income recognised in respect of energy and power contributed under the power supply contracts made by the Company with EDF (France), ONE (Morocco) and FEDA (Andorra). In 1997 this item reflected exclusively income generated under the power supply contract between EDF and the Company.

Income from international power exchanges in 1997 arose from the Company's interest in profits obtained from international electricity exchange operations. In 1998 this activity has ceased and has been replaced by the own activities of the members of the generating market.

Other income from services rendered includes revenues generated from the diversification of the Company's activities, comprising the cession of surplus capacity in its telecommunications networks, as well as consulting, engineering, construction and maintenance work performed for third parties.

**(21) Personnel Expenses**

Details are as follows:

	Millions of pesetas	
	1998	1997
Wages and salaries	6,563	6,221
Social Security	1,536	1,557
Pension fund and similar commitments	150	122
Other social costs	628	621
	<b>8,877</b>	<b>8,521</b>

The average number of employees, distributed by category, is as follows:

	1998	1997
Managers	22	22
Honours graduates	303	317
Graduates	324	327
Assistants	274	277
Administrative staff	156	159
	<b>1,079</b>	<b>1,102</b>

**(22) Prior Years' Income and Expense**

In 1997 prior years' income and expense reflected mainly amounts arising from annual modifications to the conditions of contracts with EDF, which affected previous years.

**(23) Remuneration of and Balances with Members of the Board of Directors**

In 1998 the members of the board of directors, including those who are employees of the Company, received Ptas. 45 million (Ptas. 55 million in 1997) in respect of salaries, allowances and other remuneration.

At 31 December 1998 and 1997 no loans or advances have been granted to members of the board of directors.

**(24) Financial Derivatives**

Hedging operations carried out by the Company using financial derivatives mainly comprise over-the-counter operations (specific bilateral transactions). For accounting purposes, these are classified as interest rate hedging operations (see note 4-f).

At 31 December 1998 the Company has contracted operations to hedge interest and/or exchange rates risks related to borrowings, as follows:

LIABILITY COVERED	TYPE OF COVER	TYPE OF OPERATION	AMOUNT COVERED (PTAS. M)	TERM
Bonds	Interest rate	Swap and collar	21,500	5 Months - 7 years
Long-term Peseta loans	Interest rate	Swap and collar	5,500	3 Months - 10 years
Long-term foreign currency loans:				2-4 years
• German Mark	• Interest rate	• Swap	255	
• US Dollar	• Interest and exchange rates	• Swap	1,498	
• Dutch Guilder	• Interest and exchange rates	• Swap and collar	1,000	

### (25) Environmental Issues

During 1998 the Company incurred expenses of Ptas. 133 million in respect of studies to determine the effect of transmission lines on the environment, protection of bird life, landscaping of installations, waste management, and the implementation of an environmental management system in accordance with the UNE-EN-ISO 14.001 standard, certification of which is expected to be obtained shortly. The Company has also incurred certain costs related to the creation of an environmental department to deal directly with these matters.

Studies have also been carried out in 1998 to determine the environmental impact of new electrical installations. These studies have cost approximately Ptas. 44 million and have been recorded as an increase in the value of the related tangible assets.

The Company has no litigation or contingencies relating to environmental protection or improvements.

### (26) Information by Activity

In accordance with Law 54 of 27 November 1997 governing the electricity sector and Royal Decree 437 dated 20 March 1998 approving transitional rules for the adaptation of the Spanish General Chart of Accounts to companies operating in the electricity sector, the Company has prepared separate information by activity for the first time in 1998.

As a result, income, expenses, assets and liabilities are now split for accounting purposes between transmission activities, operation of the system, other electricity activities and other non-electricity activities.



Law 54 of 1997, which defines and regulates transmission activities and the operation of the system, has led to a fundamental change in the Company's activities, as a result of which these are not comparable with the activities carried out in 1997. Thus, until 1998 the remuneration earned by the Company was approved by the Spanish Ministry of Industry and Energy on a global basis for the unified operation of the electricity system. Also, information relating to other activities was not significant in 1997. Accordingly, the accounting information for 1997 has not been split by activity.

The principal criteria used to prepare the accounting information by activity for 1998, which is disclosed in Appendices V and VI, are as follows:

- Direct expenses and income have been assigned to the relevant activity at source.
- Personnel expenses have been assigned proportionally on the basis of the time incurred by staff in each activity.
- Amortisation and depreciation charges have been allocated on the basis of the activity in which the related asset is used.

- Financial income and expenses are allocated in accordance with financing requirements for each period, except when borrowings relate directly to a specific activity.
- General and structural costs have been assigned on the basis of the use of services by each activity, applying objective allocation criteria such as the number of employees, services and materials consumed, etc.
- The income tax expense is allocated proportionally to activities on the basis of the profit generated by each.
- Fixed assets are assigned directly to activities. Assets used jointly by the various activities have been assigned in accordance with the estimated use by each, applying objective allocation criteria.
- Current assets have been allocated to the activities generating balances, except for cash and bank balances and short-term investments, which have been assigned to activities showing net cash surpluses.
- Shareholders' equity, net of profit for the year, has been allocated to the activities under the

assumption that they share the same financial structure.

- Deferred income has been allocated directly to the activities.
- Given their financial nature, bond issues, bank loans, long-term debtor balances and deferred expenses have been assigned on the basis of the net financing requirements of each activity.
- The remaining current liabilities have been allocated directly to the activities. Liabilities pertaining to more than one activity have been split by applying objective criteria.

### **(27) Year 2000 and Euro Issues**

The main applications and equipment related to the Company's management systems and the operation of the electricity systems are Year 2000 compliant and either have been adapted for the implementation of the Euro, or are capable of adaptation.

The Company has created a Co-ordination Committee for the implementation of the Euro. No significant expenses are expected to be incurred in this regard.

The Company has also established a Year 2000 Committee and has prepared various action plans, concentrating especially on the transmission network to ensure that all critical applications and equipment for this activity are fully Year 2000 compliant. These action plans are currently in the process of implementation and consist mainly of the following:

- Inventory of applications and equipment which could be affected by the Year 2000 issue, including an analysis of the impact on the various activities.
- Confirmation of Year 2000 compliance by suppliers or, where applicable, information regarding measures to achieve compliance.
- Adaptation or replacement, where necessary, of equipment and applications.
- Compliance testing of applications and equipment.
- Contingency plans.

The Company has no future commitments regarding investments or other operations relating to the Year 2000 issue. The net book value of IT



equipment and other installations whose useful lives could be affected in this respect is considered to be immaterial.

The Company estimates that total costs incurred in these actions plans, including the plans for the maintenance and renewal of installations in 1999, will not exceed Ptas. 600 million. Accordingly, these expenses will be recorded when incurred.

### **(28) Commitments**

At 31 December 1998 the Company is party to certain long-term agreements, as follows:

a) An agreement for the supply of electricity by Electricité de France (EDF) to the Company. Supply commenced in October 1994 for a period of 16 years. On 8 January 1997 the Company and EDF agreed to modify the supply agreement because the expected capacity of the international electricity connection with France had been significantly reduced as a result of the decision by French State not to authorise the construction of the Aragón-Cazaril line.

Under the revised agreement, the power to be supplied by EDF has been reduced to between 300 and 550 megawatts, depending on the year.

Also, the price of energy acquired in accordance with this contract and the power available had been reduced. Both parties undertake to extend the Pyrenees electricity connection by constructing a new electricity line.

- b) An agreement for the supply of energy by the Company to EDF during the winter peak period. This agreement commenced in November 1995 for a period of 15 years. Under the terms of the agreement, the Company undertakes to provide EDF with power equal to that stipulated in the supply agreement mentioned in section a) above for a maximum of 600 hours during the winter months, in accordance with the modifications agreed on 8 January 1997.
- c) An agreement for the supply of energy by the Company to the Office Nationale de l'Electricité de Maroc (ONE). In May 1998 a modification was agreed to reduce the power supplied to 90 MW during the period from May 1998 to December 2002.
- d) An energy supply agreement with Forces Electriques d'Andorra (FEDA), whereby EDF and the Company, either jointly or separately, will supply a maximum equivalent to a transit

capacity of 100 MVA until 31 December 1999 (see note 29).

- e) An agreement made in 1997 between the Company and Netco Redes, S.A. to cede the use and maintenance of the surplus capacity in the Company's fibre optic network for a period of 30 years. During 1997 the rights ceded under this agreement were transferred to Retevisión, S.A.

### **(29) Subsequent Events**

The contract for the supply of power to FEDA, which was scheduled to remain in force until 31 December 1999, was cancelled in advance on 15 January 1999.

In January 1999 the Company was awarded, as a member of a consortium, the concession for improving the electricity transmission system of southern Peru. This project consists of the construction and operation over 30 years of various lines and substations, as well as the operation of those installations. A company has been incorporated in Peru (Red Eléctrica del Sur, S.A.) to operate this concession, in which the Company is the principal shareholder and will carry out the functions of system operator. The concessionary company, in which the Company

expects to maintain a maximum interest of 35%, will make estimated investments of Ptas. 9,100 million. The earnings of the concessionary company are guaranteed through a long-term agreement with the Peruvian state.

### **(30) Statements of Source and Application of Funds**

The statements of source and application of funds for 1998 and 1997 are disclosed in Appendix IV, which forms an integral part of this note.

ASSETS	1998	1997
<b>FIXED ASSETS</b>		
Intangible assets	1,785	1,759
Tangible assets (note 5)	230,505	243,740
Investments (note 6)		
Long-term investment portfolio	5	5
Others loans	1,287	1,460
Guarantee deposits	10	10
Public entities (note 19)	1,259	535
	2,561	2,010
Long-term trade debtors (note 7)	968	6,353
<b>TOTAL FIXED ASSETS</b>	<b>235,819</b>	<b>253,862</b>
<b>DEFERRED EXPENSES</b>	<b>817</b>	<b>960</b>
<b>CURRENT ASSETS</b>		
Stocks	618	669
Debtors (note 7)	25,312	17,373
Short-term investments (note 6)	1,608	736
Cash and banks	36	40
Prepaid expenses (note 18)	263	611
<b>TOTAL CURRENT ASSETS</b>	<b>27,837</b>	<b>19,429</b>
<b>TOTAL ASSETS</b>	<b>264,473</b>	<b>274,251</b>

This Appendix forms an integral part of note 2 to the annual accounts.

SHAREHOLDERS' EQUITY AND LIABILITIES	1998	1997
<b>SHAREHOLDERS' EQUITY (note 8)</b>		
Share capital	45,090	45,090
Revaluation reserve	41,101	41,101
Reserves	18,339	14,272
Profit for the year	11,536	9,540
Interim dividend	—	(3,000)
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>116,066</b>	<b>107,003</b>
Capital grants	10,823	9,278
Exchange losses	16	—
Other deferred income	21,565	22,507
<b>TOTAL DEFERRED INCOME (note 9)</b>	<b>32,404</b>	<b>31,785</b>
<b>PROVISIONS FOR LIABILITIES (note 10)</b>	<b>2,589</b>	<b>753</b>
<b>LONG-TERM CREDITORS</b>		
Bond issued (note 11)	26,018	18,517
Loans (note 12)	41,277	36,676
Other creditors (note 13)	7,322	7,068
<b>TOTAL LONG-TERM CREDITORS</b>	<b>74,617</b>	<b>62,261</b>
<b>CURRENT LIABILITIES</b>		
Bonds issued (note 14)	791	15,429
Loans (note 15)	14,985	30,686
Trade creditors (note 16)	8,674	7,802
Other creditors (note 17)	9,057	11,688
Accruals (note 18)	5,290	6,844
<b>TOTAL CURRENT LIABILITIES</b>	<b>38,797</b>	<b>72,449</b>
<b>TOTAL SHAREHOLDER'S EQUITY AND LIABILITIES</b>	<b>264,473</b>	<b>274,251</b>

**RED ELÉCTRICA DE ESPAÑA, S.A.**  
Profit and Loss Accounts for the years  
ended 31 December 1998 and 1997 (Expressed in millions of Pesetas)

Exercise 98  
**Appendix II**

EXPENSES	1998	1997
<b>OPERATING EXPENSES</b>		
Purchases	35,173	11,742
Personnel expenses (note 21)	8,877	8,521
Depreciation and amortisation	16,397	15,720
Variation in trade provisions	101	133
<b>OTHER OPERATING EXPENSES</b>		
External services	6,814	8,791
Local taxes	206	80
Other overheads	170	144
Provision for liabilities (note 10)	13	261
<b>TOTAL OPERATING EXPENSES</b>	<b>67,751</b>	<b>45,392</b>
<b>OPERATING PROFIT</b>	<b>23,077</b>	<b>20,955</b>
<b>FINANCIAL EXPENSES</b>		
Interest and similar expenses	6,571	7,309
Exchanges losses	38	1,268
<b>TOTAL FINANCIAL EXPENSES</b>	<b>6,609</b>	<b>8,577</b>
<b>PROFIT ON ORDINARY ACTIVITIES</b>	<b>17,073</b>	<b>13,031</b>
<b>EXTRAORDINARY LOSSES AND EXPENSES</b>		
Variation in provision for tangible assets (note 5)	230	336
Losses on tangible assets	32	48
Extraordinary expenses (note 10)	1,816	3
Prior years' expenses (note 22)	25	418
<b>TOTAL EXTRAORDINARY EXPENSES</b>	<b>2,103</b>	<b>805</b>
<b>NET EXTRAORDINARY INCOME</b>	<b>321</b>	<b>972</b>
<b>PROFIT BEFORE TAX</b>	<b>17,394</b>	<b>14,003</b>
<b>INCOME TAX (note 19)</b>	<b>(5,858)</b>	<b>(4,463)</b>
<b>PROFIT FOR THE YEAR</b>	<b>11,536</b>	<b>9,540</b>

INCOME	1998	1997
<b>OPERATING INCOME</b>		
Net sales (note 20)	89,247	63,107
Self-constructed assets	1,345	2,546
Other operating income	236	694
<b>TOTAL OPERATING INCOME</b>	<b>90,828</b>	<b>66,347</b>
<b>FINANCIAL INCOME</b>		
Investment income	406	130
Other interest and similar income	139	456
Exchange gains	60	67
<b>TOTAL FINANCIAL INCOME</b>	<b>605</b>	<b>653</b>
<b>NET FINANCIAL EXPENSE</b>	<b>6,004</b>	<b>7,924</b>
<b>EXTRAORDINARY PROFIT AND INCOME</b>		
Profit on tangible assets	7	2
Capital grants taken to income	728	512
Extraordinary income (note 6)	1,485	430
Prior years' income (note 22)	204	833
<b>TOTAL EXTRAORDINARY INCOME</b>	<b>2,424</b>	<b>1,777</b>

This Appendix forms an integral part of note 2 to the annual accounts.

# RED ELÉCTRICA DE ESPAÑA, S.A.

## Movement in Shareholders' Equity

31 December 1998 and 1997 (Expressed in millions of Pesetas)

## Exercise 98 Appendix III

	Share capital	Revaluation reserve	Legal reserve	Investment reserve	Voluntary reserve	Reserve accelerated depreciation	Total reserves	Profit for the year	Interim dividend	Total
<b>BALANCES AT 31 DECEMBER 1996</b>	<b>45,090</b>	<b>41,101</b>	<b>8,312</b>	<b>1,352</b>	<b>17,873</b>	<b>3,028</b>	<b>30,565</b>	<b>10,547</b>	<b>(2,367)</b>	<b>124,936</b>
Distribution of 1996 profit:										
Legal reserve	—	—	706	—	—	—	706	(706)	—	—
Dividends	—	—	—	—	—	—	—	(4,734)	2,367	(2,367)
Voluntary reserves	—	—	—	—	5,107	—	5,107	(5,107)	—	—
Reversal of accelerated depreciation reserve	—	—	—	—	—	(106)	(106)	—	—	(106)
Profit for 1997	—	—	—	—	—	—	—	9,540	—	9,540
Interim dividend	—	—	—	—	—	—	—	—	(3,000)	(3,000)
Extraordinary dividend (30/06/1997)	—	—	—	—	(22,000)	—	(22,000)	—	—	(22,000)
<b>BALANCES AT 31 DECEMBER 1997</b>	<b>45,090</b>	<b>41,101</b>	<b>9,018</b>	<b>1,352</b>	<b>980</b>	<b>2,922</b>	<b>14,272</b>	<b>9,540</b>	<b>(3,000)</b>	<b>107,003</b>
Distribution of 1997 profit:										
Dividends	—	—	—	—	—	—	—	(5,367)	3,000	(2,367)
Voluntary reserves	—	—	—	—	4,173	—	4,173	(4,173)	—	—
Reversal of accelerated depreciation reserve	—	—	—	—	—	(106)	(106)	—	—	(106)
1998 profit	—	—	—	—	—	—	—	11,536	—	11,536
<b>BALANCES AT 31 DECEMBER 1998</b>	<b>45,090</b>	<b>41,101</b>	<b>9,018</b>	<b>1,352</b>	<b>5,153</b>	<b>2,816</b>	<b>18,339</b>	<b>11,536</b>	<b>—</b>	<b>116,066</b>

This Appendix forms an integral part of note 8 to the annual accounts.

# RED ELÉCTRICA DE ESPAÑA, S.A.

## Statements of Source and Application of Funds

31 December 1998 and 1997 (Expressed in millions of Pesetas)

## Exercise 98 Appendix IV

	1998	1997		
<b>APPLICATIONS</b>				
ACQUISITION OF FIXED ASSETS				
Intangible assets	457	429		
Tangible assets	3,426	12,994		
Investments	989	317		
	4,872	13,740		
LONG-TERM CREDITORS (*)	—	5,385		
DIVIDENDS	2,367	2,367		
INTERIM DIVIDEND	—	3,000		
EXTRAORDINARY DIVIDEND	—	22,000		
REPAYMENT OF TRANSFER TO SHORT TERM OF LONG-TERM DEBT	13,828	34,635		
PROVISION FOR LIABILITIES	—	50		
<b>TOTAL APPLICATIONS</b>	<b>21,067</b>	<b>81,177</b>		
INCREASE IN WORKING CAPITAL	42,060	—		
	<b>63,127</b>	<b>81,777</b>		
<b>SOURCES</b>				
FUNDS GENERATED ON OPERATIONS				
Profit for the year	11,536	9,540		
Reversal of provision for liabilities	(74)	(106)		
Depreciation and amortisation	16,397	15,720		
Reversal of accelerated depreciation reserve	(106)	(106)		
Provision for pensions and similar commitments	1,829	9		
Loss on disposal of fixed assets	111	56		
Provision for liabilities	81	328		
Exchange losses	(22)	1,251		
Deferred expenses recognised during the year	143	58		
Capital grants and other deferred income recognised during the year	(1,685)	(1,163)		
Provisions for impairment	281	336		
Reversal of provision for impairment	(51)	—		
	28,440	25,923		
DEFERRED INCOME (*)	2,304	22,563		
TRANSFER TO SHORT TERM OF LONG-TERM DEBT	5,385	—		
LONG-TERM LIABILITIES (*)	26,206	13,057		
DEFERRED EXPENSES (*)	—	(50)		
DISPOSAL OF FIXED ASSETS				
Tangible assets	354	3		
Investments	438	450		
	792	453		
<b>TOTAL SOURCES</b>	<b>63,127</b>	<b>61,946</b>		
DECREASE IN WORKING CAPITAL	—	19,231		
	<b>63,127</b>	<b>81,177</b>		
<b>CHANGES IN WORKING CAPITAL</b>				
	1998	1997		
	Increases	Decreases	Increases	Decreases
Stocks	—	51	—	157
Debtors	7,939	—	244	—
Current liabilities	33,652	—	—	19,231
Short-term investments	872	—	—	300
Cash and banks	—	4	—	66
Prepaid expenses	—	348	279	—
	42,463	403	523	19,754
Changes in working capital	—	42,060	19,231	—
	<b>42,463</b>	<b>42,463</b>	<b>19,754</b>	<b>19,754</b>

(\*) Figures for 1997 are shown net of the redemption premium relating to bonds issued in 1997, which was hedged through a swap operation (see note 24).

This Appendix forms an integral part of note 30 to the 1997 annual accounts.

ASSETS	Transmission	%	Operation of System	%	Other electricity activities	%	Other non-electricity activities	%	Total ACTIVITIES	%
<b>FIXED ASSETS</b>	<b>231,116</b>	<b>98</b>	<b>4,375</b>	<b>2</b>	<b>30</b>	<b>—</b>	<b>298</b>	<b>—</b>	<b>235,819</b>	<b>100</b>
INTANGIBLE ASSETS	912	51	867	49	1	—	5	—	1,785	100
TANGIBLE ASSETS	227,172	99	3,088	1	22	—	223	—	230,505	100
Plant and machinery	343,917	99	2,165	1	2	—	20	—	346,104	100
Plant and machinery under construction	12,786	100	1	—	—	—	—	—	12,787	100
Other tangible assets	12,917	74	4,282	24	38	—	325	2	17,562	100
Advances and other assets under construction	116	100	—	—	—	—	—	—	116	100
Depreciation of plant and machinery	(132,873)	99	(764)	1	(1)	—	(6)	—	(133,644)	100
Other depreciation	(6,504)	70	(2,596)	28	(17)	—	(116)	2	(9,233)	100
Provisions	(3,187)	100	—	—	—	—	—	—	(3,187)	100
INVESTMENTS	2,084	81	402	16	7	—	68	3	2,561	100
LONG-TERM LOANS	948	98	18	2	—	—	2	—	968	100
<b>DEFERRED EXPENSES</b>	<b>801</b>	<b>98</b>	<b>15</b>	<b>2</b>	<b>—</b>	<b>—</b>	<b>1</b>	<b>—</b>	<b>817</b>	<b>100</b>
<b>CURRENT ASSETS</b>	<b>13,733</b>	<b>50</b>	<b>92</b>	<b>—</b>	<b>8,039</b>	<b>29</b>	<b>5,973</b>	<b>21</b>	<b>27,837</b>	<b>100</b>
STOCKS	618	100	—	—	—	—	—	—	618	100
DEBTORS	13,013	52	88	—	6,333	25	5,878	23	25,312	100
OTHER CURRENT ASSETS	—	—	—	—	1,550	94	94	6	1,644	100
PREPAID EXPENSES	102	39	4	2	156	59	1	—	263	100
<b>TOTAL ASSETS</b>	<b>245,650</b>	<b>92</b>	<b>4,482</b>	<b>2</b>	<b>8,069</b>	<b>3</b>	<b>6,272</b>	<b>3</b>	<b>264,473</b>	<b>100</b>
<b>SHAREHOLDERS' EQUITY AND LIABILITIES</b>										
<b>SHAREHOLDERS' EQUITY</b>	<b>113,490</b>	<b>98</b>	<b>6</b>	<b>—</b>	<b>716</b>	<b>1</b>	<b>1,854</b>	<b>1</b>	<b>116,066</b>	<b>100</b>
SHARE CAPITAL AND RESERVES	102,446	98	1,938	2	13	—	133	—	104,530	100
PROFIT/(LOSS) FOR THE YEAR	11,044	96	(1,932)	(17)	703	6	1,721	15	11,536	100
<b>DEFERRED INCOME</b>	<b>14,574</b>	<b>45</b>	<b>1,259</b>	<b>4</b>	<b>1,222</b>	<b>4</b>	<b>15,349</b>	<b>47</b>	<b>32,404</b>	<b>100</b>
<b>PROVISIONS FOR LIABILITIES</b>	<b>1,685</b>	<b>65</b>	<b>795</b>	<b>31</b>	<b>46</b>	<b>2</b>	<b>63</b>	<b>2</b>	<b>2,589</b>	<b>100</b>
<b>LONG-TERM CREDITORS</b>	<b>74,460</b>	<b>100</b>	<b>152</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>5</b>	<b>—</b>	<b>74,617</b>	<b>100</b>
<b>CURRENT LIABILITIES</b>	<b>27,959</b>	<b>72</b>	<b>658</b>	<b>2</b>	<b>9,463</b>	<b>24</b>	<b>717</b>	<b>2</b>	<b>38,797</b>	<b>100</b>
CURRENT LIABILITIES, EXCLUDING ACCRUALS	27,936	83	626	2	4,284	13	661	2	33,507	100
ACCRUALS	23	—	32	1	5,179	98	56	1	5,290	100
<b>INTERACTIVITY FINANCING</b>	<b>13,482</b>	<b>—</b>	<b>1,612</b>	<b>—</b>	<b>(3,378)</b>	<b>—</b>	<b>(11,716)</b>	<b>—</b>	<b>—</b>	<b>—</b>
<b>TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES</b>	<b>245,650</b>	<b>92</b>	<b>4,482</b>	<b>2</b>	<b>8,069</b>	<b>3</b>	<b>6,272</b>	<b>3</b>	<b>264,473</b>	<b>100</b>

This Appendix forms an integral part of note 26 to the annual accounts.

**RED ELÉCTRICA DE ESPAÑA, S.A.**  
**Analytical Profit and Loss Account by Activity for the year**  
**ended 31 December 1998** (Expressed in millions of Pesetas)

**Exercise 98**  
**Appendix VI**

ITEMS	Transmission	%	Operation of System	%	Other electricity activities	%	Other non-electricity activities	%	Total ACTIVITIES (*)	%
Net sales and services rendered	51,569	58	1,046	1	34,346	38	2,257	3	89,218	100
+ Other operating income	1,251	91	104	7	10	1	19	1	1,384	100
+ Income assigned from other activities	138	72	33	17	2	1	20	10	193	100
<b>= VALUE OF PRODUCTION</b>	<b>52,958</b>	<b>58</b>	<b>1,183</b>	<b>1</b>	<b>34,358</b>	<b>38</b>	<b>2,296</b>	<b>3</b>	<b>90,795</b>	<b>100</b>
- Materials consumed	(1,485)	4	(13)	—	(33,285)	95	(221)	1	(35,004)	100
- External expenses	(4,335)	86	(334)	7	(1)	—	(370)	7	(5,040)	100
- Expenses assigned from other activities	(2,376)	79	(529)	18	(14)	—	(101)	3	(3,020)	100
<b>= VALUE ADDED BY THE COMPANY</b>	<b>44,762</b>	<b>94</b>	<b>307</b>	<b>1</b>	<b>1,058</b>	<b>2</b>	<b>1,604</b>	<b>3</b>	<b>47,731</b>	<b>100</b>
- Other expenses	(74)	100	—	—	—	—	—	—	(74)	100
- Personnel expenses	(6,742)	77	(1,630)	18	(39)	—	(415)	5	(8,826)	100
<b>= GROSS OPERATING PROFIT/(LOSS)</b>	<b>37,946</b>	<b>98</b>	<b>(1,323)</b>	<b>(3)</b>	<b>1,019</b>	<b>2</b>	<b>1,189</b>	<b>3</b>	<b>38,831</b>	<b>100</b>
- Amortisation and depreciation	(15,299)	97	(400)	3	—	—	—	—	(15,699)	100
- Bad debt write-offs and changes in trade provisions	43	(43)	—	—	—	—	(144)	143	(101)	100
<b>= NET OPERATING PROFIT/(LOSS)</b>	<b>22,690</b>	<b>98</b>	<b>(1,723)</b>	<b>(7)</b>	<b>1,019</b>	<b>4</b>	<b>1,045</b>	<b>5</b>	<b>23,031</b>	<b>100</b>
+ Financial income	220	36	2	—	12	2	371	62	605	100
- Financial expenses	(6,346)	96	(46)	1	(209)	3	(8)	—	(6,609)	100
<b>= PROFIT/(LOSS) ON ORDINARY ACTIVITIES</b>	<b>16,564</b>	<b>97</b>	<b>(1,767)</b>	<b>(10)</b>	<b>822</b>	<b>5</b>	<b>1,408</b>	<b>8</b>	<b>17,027</b>	<b>100</b>
+ Profit on fixed assets and extraordinary income	857	35	221	9	213	9	1,157	47	2,448	100
- Losses on fixed assets and extraordinary expenses	(1,347)	73	(424)	23	(14)	1	(66)	3	(1,851)	100
- Change in provisions for impairment	(268)	116	38	(16)	—	—	—	—	(230)	100
<b>= PROFIT/(LOSS) BEFORE TAX</b>	<b>15,806</b>	<b>91</b>	<b>(1,932)</b>	<b>(11)</b>	<b>1,021</b>	<b>6</b>	<b>2,499</b>	<b>14</b>	<b>17,394</b>	<b>100</b>
- Income tax	(4,762)	81	—	—	(318)	6	(778)	13	(5,858)	100
<b>= PROFIT/(LOSS) FOR THE YEAR</b>	<b>11,044</b>	<b>96</b>	<b>(1,932)</b>	<b>(17)</b>	<b>703</b>	<b>6</b>	<b>1,721</b>	<b>15</b>	<b>11,536</b>	<b>100</b>

(\*) These figures differ from those shown in the Profit and Loss Account (Appendix II) due to assignments of income and expenses between the activities.

This Appendix forms an integral part of note 26 to the annual accounts.

## Directors' report

During 1998 RED ELÉCTRICA has maintained balanced growth in key areas and has surpassed its business objectives, both with regard to profits on ordinary activities, the generation of funds and self-financing of investments.

Profit before tax for 1998 amounted to Ptas. 17,394 million compared to Ptas. 14,003 million in 1997. These results include profit on ordinary activities for Ptas. 17,073 million, representing an increase of Ptas. 4,042 million compared to 1997.

Profit after tax was Ptas. 11,536 million, which will permit the Company to raise dividends and continue to apply funds to reserves in order to maintain appropriate capitalisation.

In 1998 the ordinary income of RED ELÉCTRICA amounted to Ptas. 91,433 million, which is Ptas. 24,433 million more than in the prior year. This is mainly a consequence of the increase in income generated from higher imports of energy under the agreement made with Electricité de France (EDF) and changes in contractual conditions agreed between the Company and EDF in January 1997. Also, the energy export agreement with the l'Office National de l'Electricité de Maroc (ONE) took effect in May 1998 after an agreement had been reached to modify conditions relating to the power supplied and the term of the contract. Similarly, expenses incurred to purchase power and energy related to these contracts have also increased.

Revenues earned from the transmission activities of RED ELÉCTRICA and the operation of the system by the Company amounted to Ptas. 52,611 million, 6.0% up on 1997. Nevertheless, as explained in the prior year's directors' report and elsewhere, revenues from these activities declined in 1997 by almost Ptas. 2,600 million and, accordingly, the increase in 1998 compared to 1996 is only 0.7%.

Total expenses before tax amounted to Ptas. 76,463 million compared to Ptas. 54,774 million in 1997, mainly because of higher costs incurred in energy exchanges. Financial expenses have, however, declined by 22.9% compared to 1997 due to the fall in interest rates in the prior year and the reduction in the Company's indebtedness. Operating expenses, not including energy purchases and depreciation, have decreased by 6.3%, mainly as a consequence of the measures taken to optimise and cut costs. Total expenses before tax, without taking into consideration costs incurred under international energy contracts, have thus been reduced by 2.7% from Ptas. 44,378 million in 1997 to Ptas. 43,179 in 1998.



During 1998 RED ELÉCTRICA made total investments of Ptas. 3,883 million. Investment activity, which has been lower than initially forecast at the beginning of the year, has been influenced by the slow progress of work on the North Coast Axis (Asturias-Cantabria-Basque Country), and delays in the recommencement of work on the Lada-Velilla line and the international connection with France. Also, planned acquisitions of installations pertaining to the transmission grid from other electricity companies have not yet been completed.

Cash flow before income tax amounted to Ptas. 35,856 million, 18.6% up on the prior year. This represents 38.2% of the total income of RED ELÉCTRICA or 60.2% excluding income generated as a result of agreements for the import and export of energy. As a consequence of the funds generated, the Company has been able both to finance all of its investment activities and reduce indebtedness by Ptas. 17,819 million.

In 1998 the Company has completed the repayment in advance of debt with electricity companies for the acquisition of fixed assets. During the year debts totalling Ptas. 10,714 million, most of which had been ceded to banks by the electricity companies, have been cancelled.

The new installations incorporated into the transmission network during 1998 are as follows:

- In southern Andalusia, the 400 kV Pinar del Rey-Tajo de la Encantada line with a length of 109.5 km has become operational. This line, which closes the 400 kV transmission circuit in Andalusia, will increase the safety of supplies in the region and reduce losses on transmission. In western Andalusia, the 400 kV Litoral-Rocamora line (185.3 km) has been completed, connecting central and south eastern Spain, thereby strengthening the supply infrastructure to the latter region and to the East Coast area. A bay has been constructed at each of the Pinar del Rey, Tajo de la Encantada and Litoral 400 kV substations.
- In the East Coast region, the Rocamora substation has been extended with the new 400 kV Litoral bay. The central cell of the Auto 2 - Futuro Auto 1 route has been completed at the 400 kV Romica substation in the province of Albacete. This will make it possible to install a new transformer facility which will strengthen the infrastructure for the transmission of power throughout the region.
- In the Northern region, the 220 kV Sang, esa substation has been extended with the addition of a new transformer bay.

Maintenance work on transmission grid infrastructure has been designed to ensure that installations remain in service and reliable while optimising costs incurred. During 1998 the quality of the service measured in terms of global maintenance availability has risen to 98.71%, which represents an improvement on the average for recent years.

Work has been carried out in all of the regions to replace and improve installations. In particular, all protective installations have been renewed, communications have been upgraded and obsolete equipment has been replaced in Grijota, Villarino, Abrera, Penagos, Puente de San Miguel, Orcoyen, Siero, Rubía and other locations.

In 1998 the telecommunications network owned by RED ELÉCTRICA has been expanded by 182 km of fibre optic cable and 7 new links. As a result, the network now comprises 8,400 km of fibre optic cable and 137 links.

The most significant matters related to the electricity system in 1998 have been the rapid increase in demand for electricity with the highest growth rates seen in the last twenty years, the renewed drought since the middle of the year, the net imports resulting from international energy exchanges and the continuation of the steep upward trend in purchases of power from generators operating under the special regime, which covered 11% of total demand in 1998.

Monthly, daily and hourly demand for electricity repeatedly broke records throughout the year. The high spots were in December with monthly demand of 15,926 GWh, daily demand of 582 GWh and hourly demand of 29,484 MW. Total demand for the year was 172,673 GWh, representing growth of 6.5% compared to the prior year, or 5.9% if the effects of working days and the weather are discounted.

Since the summer, natural hydraulic contributions have declined steadily with the index of producible hydroelectric power reaching a low of 0.34 in the month of December. The index for the year was 0.91 with 27,153 GWh of power.

The generating structure of the system during the year was similar to 1997. The changeover to the market system does not seem to have affected generating, and thus hydroelectric production was very high in the early months of the year when reservoirs were full with a gradual decline thereafter as drought took hold. In



total, hydroelectric power stations produced close to 34,000 GWh, representing 21% of total production. Nuclear power stations produced a record total of almost 59,000 GWh, as well as breaking the historical monthly generating record in August. The contribution of nuclear energy to the sector was 37%. The performance of coal-fired power stations was a mirror image of the hydroelectric stations with low production at the start of the year rising to a record for monthly production in December. In total, coal-fired power stations generated 60,200 GWh, representing 38% of total production. Power generated from oil and gas was very low in the early months of the year, but gradually picked up to reach almost 2,400 and 3,300 GWh, respectively. Total production for the sector was 158,800 GWh.

International electricity exchanges resulted in net imports of 3,400 GWh, comprising imports of 4,604 GWh and exports of 1,204 GWh. Of the total imports, 4,504 GWh were supplied from France under the agreement entered into by RED ELÉCTRICA with EDF. This represents 95% of the maximum power permitted under the agreement and was matched by demand in the market. External agents also imported 85 GWh from Belgium. Exports comprised 484 GWh from RED ELÉCTRICA to ONE and 151 GWh from RED ELÉCTRICA to Forces Electriques d'Andorra (FEDA) under the relevant contracts, as well as 569 GWh exported by external agents to Portugal (277 GWh), Morocco (221 GWh) and France (71 GWh).

In accordance with the agreement made on 18 May 1998 to modify the conditions of the contract originally signed in 1994, exports by RED ELÉCTRICA to ONE commenced in the same month, after the international connection through the Straits of Gibraltar had become operational. Under the original contract, supplies of a basic 300 MW guaranteed for 8,160 hours per year were to have commenced in January 1996 and ended on 31 December 1998. The new agreement reduces the power contracted to 90 MW, extends the duration of supplies until the end of 2002, and limits guaranteed supplies to 7,260 hours per year.

In 1998 RED ELÉCTRICA has continued with environmental activities in relation to projects for new installations. Accordingly, one environmental impact study for a new line has been completed and studies for four lines and seven substations related to the high-speed train have commenced, as well as for three lines and three substations relating to wind parks.

The Company also carries out environmental activities to prevent or correct impacts related to the maintenance of installations in service. In 1998 these have included landscaping projects at five substations, two of which have been completed, as well as the preparation of an inventory of protected nature reserves in mainland Spain, including mapping, and an index of related legislation. The objective of this work is both to ensure appropriate maintenance of existing installations and to lay the groundwork for environmental viability studies in relation to new installations.

During 1998 RED ELÉCTRICA has progressed with the implementation of an Environmental Management System in accordance with the UNE-EN-ISO-14001 standard. It is expected that this system will be certified by AENOR in the first half of 1999. The new system, which encompasses a fully developed Environmental Policy, is a clear sign of the Company's commitment to carrying out its business and industrial activities within the context of maximum respect for the environment.

RED ELÉCTRICA has created an Internal Audit and Quality Department reporting directly to the Chairman in 1998, thus demonstrating the Company's interest in giving the highest level support to activities designed to safeguard quality.

Strategies and related action plans are in the process of development in order to obtain quality certification in all of the key activities carried out by RED ELÉCTRICA.

Relevant action has been taken to bring together all of the various certificates with regard to high voltage transmission lines since 1996 in a single ISO 9001 certification covering all related activities (i.e. engineering, construction and maintenance) and also including fibre optic cables. The requisite AENOR audit was successfully concluded in February 1999. The Company also intends to obtain a single certification for all activities related to high voltage substations, which would incorporate the certification related to the maintenance of the substations obtained in 1997 and engineering and construction activities.

Quality control in relation to the operation of the system has been affected by the changes in RED ELÉCTRICA's responsibilities brought about as a result of the Electricity Sector Law 54/1997. This has made it necessary to modify the scope of the certification in this area already requested from AENOR in accordance with the ISO 9002 standard. Certification is expected to be obtained during 1999.

During 1998 RED ELÉCTRICA has completed several long-term research and development projects, the total direct and indirect cost of which is approximately Ptas. 175 million. Key projects completed include a system for dynamic real time calculation of conductor temperatures (DITER), a system for very high speed fibre optic transmission (COSMOS) and the design of a prototype superconductor module for the storage of 1 MJ of energy (AMAS 500).

Research and development activities related to the environment include a major project undertaken in conjunction with the University of Valladolid to investigate the effects of electromagnetic fields. Laboratory experiments carried out on chicken and mammal embryos were completed during the year, and the project has been extended for a further four months to corroborate the results obtained using genetically modified animals. A project has been started in the same area in 1998 to research the mitigation of magnetic fields in collaboration with the Andalusia Research and Industrial Co-operation Association and the Engineering Faculty of the University of Seville. The dissemination of the latest findings in this area has been undertaken through the publication, in collaboration with UNESA, of a technical and informative work describing and analysing the fields generated by electrical installations and their possible physical and biological effects.

The average headcount in 1998 has been 1,070 employees, which is slightly less than in the prior year. This indicates that the workforce of RED ELÉCTRICA is appropriately sized.

During 1998 subsidiary legislation to the Electricity Sector Law has entered the statute books, which includes regulations having a direct effect on the Company's activities, as follows:

- A Royal Decree governing the activities of electricity transmission and distribution. These regulations precisely define the transmission activity and the elements which form a part thereof, as well as the remuneration system.
- Various resolutions approving operational procedures of a technical and instrumental nature necessary for the appropriate administration of the system.

In accordance with the ninth transitional provision of the Electricity Sector Law, Compañía Operadora del Mercado Español de Electricidad, S.A. was incorporated in December 1997 with a share capital of Ptas. 300 million. In order to bring the investments held by the Company into line with the limits established in the Law,



all of the shares owned by RED ELÉCTRICA were sold to institutional investors, companies operating in the electricity market and qualified consumers through a bid process. In accordance with the functions assigned to it by law, Sociedad Estatal de Participaciones (SEPI) was responsible for the privatisation process.

On 1 January 1998 RED ELÉCTRICA put into practice a new model for the management of the electricity system based on market criteria to coincide with the commencement of the new electricity market. This model implies the adaptation of the production programmes of generating plants resulting from the market for electricity to technical requirements relating to the quality and safety of the operation of the system. Adaptation includes the resolution of restrictions inherent in the system, the incorporation of complementary services regulated by secondary and tertiary legislation and measures to offset deviations between electricity generated and consumed, all in accordance with prices based on offers from agents in the market.

In order to accommodate the changes in production within the technical requirements for the operation of the electricity system, it has been necessary to develop a complex management information and communications system interfacing with both generators and the Market Operator. All transactions within operating markets and communication thereof to the market agents are based on this "System Operator Information System" (SIOS).

The Company has simultaneously developed Operational Procedures to guarantee the effectiveness and transparency of the various processes involved in the day-to-day running of the electricity system. As System Operator, RED ELÉCTRICA is required to submit technical and instrumental operating procedures designed to ensure appropriate technical management of the system to the Spanish Ministry of Industry and Energy for scrutiny. In 1998 various procedures were approved in accordance with Resolutions of the Ministry of Energy and Industry and a Circular of the National Electricity System Authority, including the procedures for the operation of the system, coverage forecasting, programming of operations, management of auxiliary services, operation of the transmission network, information and management of international exchanges.

In accordance with the fourth transitional provision of Royal Decree 2019 of 1997 governing the electricity generating market, RED ELÉCTRICA commenced the operation of the adjustment market for electricity in April 1998. The Company ceased this activity on 1 July 1998, the date the management of this market was taken over

by Compañía Operadora del Mercado Español de Electricidad, S.A. The adjustment market has increased the number of daily sessions during the year from the initial two in April to the current five sessions.

The Company has also collaborated with Compañía Operadora del Mercado Español de Electricidad, S.A. in the preparation of all of the information required for settlement purposes in the daily market and the other operating markets.

In order to guarantee adequate training of relevant employees both of RED ELÉCTRICA and other production and distribution companies, as well as the appropriateness of co-ordination and communications procedures for a major failure of the electricity system, a simulation has been successfully carried out during the year of a nation wide breakdown of supply and restart of the system. All of the control centres of RED ELÉCTRICA took part in conjunction with production and distribution companies.

Other work carried out during 1998 has included programming maintenance work for the transmission grid in order to ensure that minimum disruption is caused to the functioning of the electricity market and that the safety of the system is not compromised. The Company has also prepared daily demand forecasts for the use of distributors and retailers of electricity and an hourly calculation of power lost in transmission and ratios for losses at each node in the grid.

Accordingly, in 1998 RED ELÉCTRICA has continued to play a key role in the creation of the operational instruments necessary to start up the electricity market.

In 1998 RED ELÉCTRICA has restructured ownership in accordance with the restrictions on the interests which may be acquired or held by different entities. At the general meeting of the shareholders held in May the Company's articles of association were modified to include the aforementioned restrictions and modify the statutory activities. In addition to the activities prescribed by the new legislation governing the Company, the new object allows RED ELÉCTRICA to carry out any other activities, both within Spain and internationally, which may be permitted under the new legal framework in order to generate revenues from its technical capacity and know-how.

The Electricity Sector Law required that RED ELÉCTRICA restructure its ownership during the first half of 1998 to ensure that no single shareholder owned an interest exceeding 10% of the share capital and that the sum of all the interests held either directly or indirectly by entities operating in the electricity sector did not exceed 40% of share



capital. The shareholders owning interests in the share capital of RED ELÉCTRICA in excess of the aforementioned limits have proceeded to dispose of their holdings to bring them into line with the requirements of the Law.

Certain share swaps have also been carried out to enable shareholders with interests below the aforementioned limits to increase their holdings. SEPI acquired shares exceeding the 40% interest reserved for companies operating in the electricity market and, accordingly, it now owns 60% of the share capital of RED ELÉCTRICA.

Once again, 1998 has been an eventful year both from an economic and institutional point of view due to the key role played by the Company in the transcendental changes resulting from the deregulation of the Spanish electricity market. RED ELÉCTRICA's objectives for 1999 are to continue to respond efficiently and competitively to the new challenges raised by the Electricity Sector Law, the possibility of diversifying its activities internationally, and to maintain the profitability and efficiency achieved in prior years. In 1999 the Company expects to make investments of approximately Ptas. 15,000 million, which will be entirely self-financed, and to maintain the workforce at approximately current levels.

The outlook for RED ELÉCTRICA in 1999 is excellent and the Company has started the year with the successful completion of its efforts to develop international activities.

RED ELÉCTRICA has been awarded the concession to improve electricity transmission systems in southern Perú as a result of a public tender process held on 29 January 1999 within the context of the programme for the privatisation of the electricity sector currently underway in that country. The winning consortium was led by RED ELÉCTRICA and also included Abengoa, Cobra, BCH and Etecen.

The concession awarded comprises the construction and operation of three 220 kV lines with a total length of 444 km and four substations at Socabaya, Moquegua, Puno and Tacna. A company has been incorporated in Perú (Red Eléctrica del Sur, S.A.) to operate the concession awarded. RED ELÉCTRICA as Strategic Operator, will be the main shareholder of this company and will be responsible for management, as well as preparing and carrying out the engineering projects for the new installations. Meanwhile, Abengoa and Cobra will form a joint venture to carry out the construction work. Both of these companies have considerable experience in Peru and have had offices in that country for a number of years.

## Proposed Distribution of Profits

<b>1998</b>	<b>Pesetas</b>
<b>BASIS FOR DISTRIBUTION</b>	
Profit for the year	11,535,705,431
<b>TOTAL</b>	<b>11,535,705,431</b>
<b>DISTRIBUTION</b>	
Voluntary reserve	4,614,282,173
Dividends	6,921,423,258
<b>TOTAL</b>	<b>11,535,705,431</b>

Rafael García de Diego Barber, Secretary of the Board of Directors of Red Eléctrica de España, S.A., as entitled by Article 109 of the Regulations of the Mercantile Register,

HEREBY CERTIFIES:

That the annual accounts, directors' report and proposed distribution of profits, shown in this document, are a true and accurate copy of those which were inspected and approved during the meeting of the Board of Directors of Red Eléctrica de España S.A., held on March 2nd 1999. A copy of the annual accounts and the directors' report, signed by all the directors in accordance with Article 171.2 of the regulations pertaining to the Law on Companies, is kept in the Secretary's office.

With the object of declaring these matters and for required legal effects, this certificate is hereby issued in Madrid on April 6th 1999.





**RED ELÉCTRICA**  
DE ESPAÑA

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SOCIEDAD ESTATAL  
DE PARTICIPACIONES INDUSTRIALES