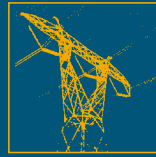




Annual
report 1998



RED ELÉCTRICA
DE ESPAÑA



Annual report 1998



RED ELÉCTRICA
DE ESPAÑA

Contents

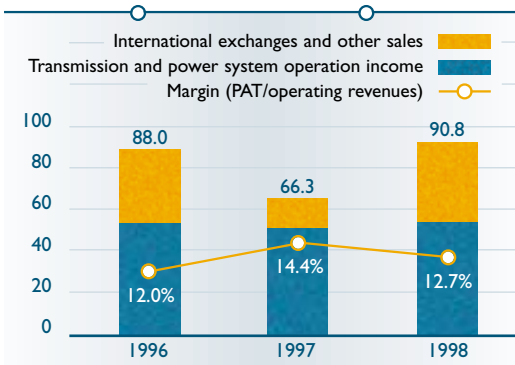
		2	Key Indicators
		4	The Chairman's letter
		9	The Board of Directors and Senior Management
		11	Business activities
		12	Development of the Transmission Network
		22	Maintenance of Transmission Facilities
		26	Operation of the Power System
		36	Other activities
		38	International development
		42	Human resources
		46	Administration and finance
		54	International cooperation and sponsorship
		59	Research and development
		62	Quality
		63	The Environment
		66	Year 2000 Effect
		69	Resolutions of the Board of Directors
		72	Annual accounts for 1998
		118	Directors' report
		127	Proposed distribution of profits

Key indicators

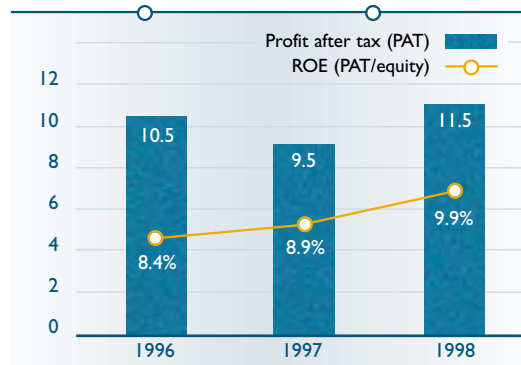
“In this constantly shifting environment...
RED ELÉCTRICA
has continued
to improve its
key financial
indicators”



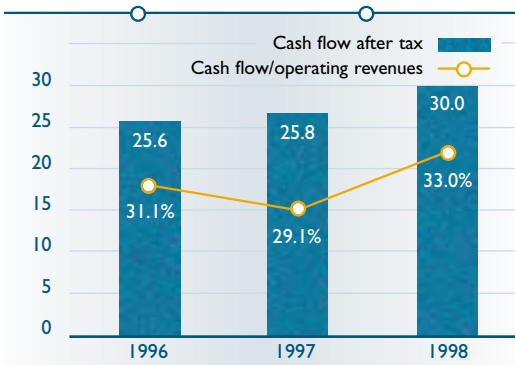
Operating revenues (billions of pesetas)



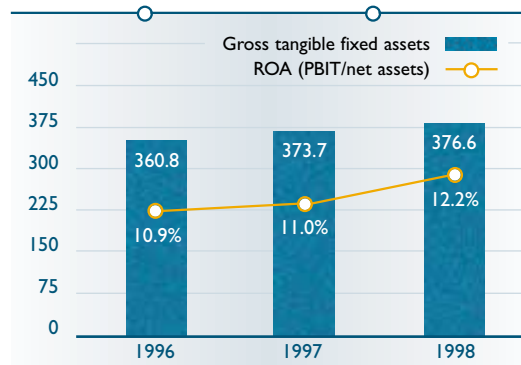
Profit after tax (billions of pesetas)



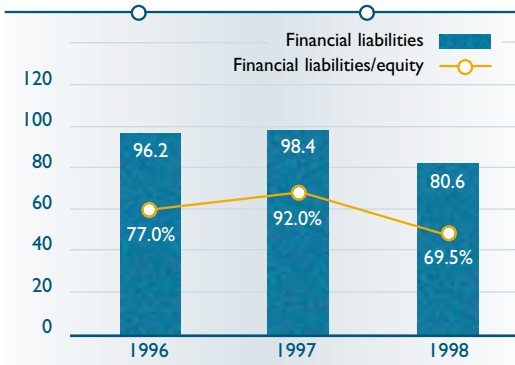
Cash flow after tax (billions of pesetas)



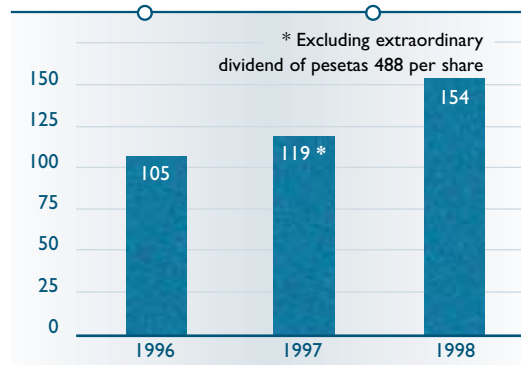
Tangible fixed assets (billions of pesetas)



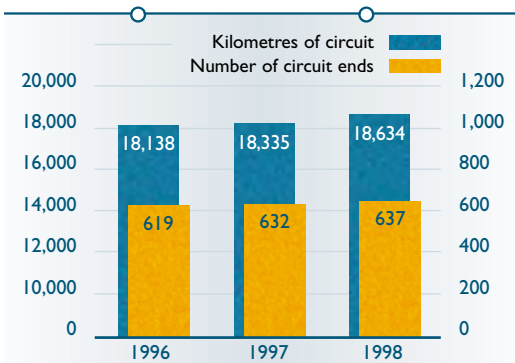
Financial liabilities (billions of pesetas)



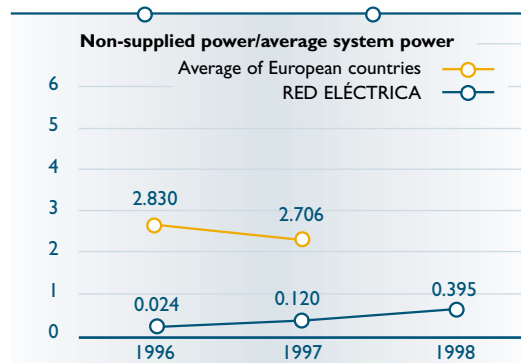
Dividends per share (pesetas)



Size of the grid (lines and substations)



Quality of service Average interruption time (minutes)





The Chairman's letter



Pedro Mielgo Álvarez
Chairman of Red Eléctrica de España

TO THE SHAREHOLDERS:

For RED ELÉCTRICA and the rest of the Spanish power sector, 1998 has been a year brimming with truly important and decisive events. The implementation of the injunctions in the Law on the Power Sector plus the commencement of a wholesale power market and its associated competitive framework, and the European Union Directive on common standards for domestic power markets, heralded the start of a new chapter which will be characterised by processes of integration and deregulation and whose development and evolution are to bring even greater changes for long to come.

In this constantly shifting environment, which continuously demands ever greater efficiency and flexibility, RED ELÉCTRICA has continued to improve its key financial indicators. Profit before tax rose by 20.9% to Ptas. 11,536 million, a substantial increase over the previous year. This will permit the Company to maintain appropriate capitalisation and to attend to finance needs.

Cash flow improved 18.6% with regard to 1997 and amounted to Ptas. 35,856 million. The funds thus generated were sufficient to finance the Company's investments, to reduce indebtedness by approximately Ptas.

18,000 million and to complete the early retirement of the Ptas. 10,174 million debt, acquired with the utility companies during incorporation.

In 1998, sales revenue grew by 36.9% compared to the prior year, increasing from Ptas. 66,347 million to Ptas. 90,828 million. This was mainly due to the increase in international power transactions. Regulatory revenues, that is, remuneration for transmission activities and operation of the Power System, grew by 6.0% in 1998, and recovered to a level similar to 1996 after absorbing the significant drop experienced in 1997. Despite this, these revenues were less than those of 1996 in real terms.



The improvement in profits has been possible thanks to the efforts made in reducing and controlling operating expenses, which fell by 6.3% (excluding purchases of electric power and depreciation).

In the light of these main indicators, it may be concluded that 1998 has been a satisfactory year. Shareholder value was increased and this has helped to increase the capital value of the Company and improve its financial position. Investments made during the year came to Ptas. 3,883 million of which 77.3% was for investments related to the transmission grid.

Several new installations were added to the transmission grid during 1998. These included the transmission lines and substations needed to close the 400 kV circuit in Andalusia and the power interconnection with Morocco. Some 182 km of fibre optic cable and seven new links were added to the telecommunications network.

In 1998, the quality of service – measured in terms of the overall availability of the transmission facilities – has surpassed the average levels recorded in recent years, thanks to the constant efforts expended in maintenance of the installations and the modifications made to the communication systems. International power transactions amounted to 4,604 GWh of imports and 1,204 GWh of exports, resulting in an import balance of 3,400 GWh. The commissioning of the interconnection with neighbouring Morocco in May signalled the start of exports to that country under the original agreement with the l'Office National de l'Electricité, which has been extended until the year 2002.

In 1998, environmental activities received an important boost. Environmental impact studies were carried out on new projects and existing installations were modified to respond to the more demanding criteria for the preservation of the natural environment.

The fruit of these activities was the implementation of an Environmental Management System in accordance with the UNE-EN-ISO 14001 standard and whose certification by AENOR is in its final stages. This system underlines RED ELÉCTRICA's commitment to reconcile the demands of its business activities with maximum respect for nature.

In the area of research and development, activities during the past year have been mainly focussed on projects involving conductivity, fibre optic communications and superconducting devices.

Accelerating change in the international sector, especially in the European Union, has persuaded RED ELÉCTRICA to reconsider its participation in international organisations in order to vest this with appropriate meaning and strategic value. Advantage will be taken of the opportunities which exist to help in shaping the future internal power market in all its aspects, based on our experience as a Company which specialises in transmission activities and the management of power systems and our experience in the development of the Spanish sector:

The number of employees has stabilised at 1,070. This figure is slightly less than the previous year but it has been sufficient to handle the needs of the organisation with minor adjustments. The priorities in the area of human resources are focussed on training, especially with regard to RED ELÉCTRICA's needs during its new stage of development. Adaptability, technological skills and the capability of management will be the keys to success in the future.

With regard to institutional matters, 1998 was a milestone in the reorganisation of the sector. The effect of the Law on the Power Sector has been felt in various areas. The most apparent of these has been, without doubt, the commencement of trading on the power market. The Law entrusted RED ELÉCTRICA with the task of incorporating Compañía Operadora del Mercado Español de Electricidad (the power market operating company) and with its privatisation.

The first part of this task was completed at the end of 1997 when the above company was provided with the necessary means to operate the market and started to function on 1st January 1998. The market has been operating continuously and without incident since that date. It enables a constant dialogue to be maintained between the market trader, the Ministry of Industry and Energy and the National Power System Commission. This dialogue has allowed the questions which arose during the implementation of the new system to be resolved in a satisfactory manner.

In July of last year, all the share capital of this company was sold and SEPI was responsible for the privatising process, as provided by legislation. This concluded the legal responsibilities of RED ELÉCTRICA, as defined in the Law. All the parties involved, especially RED ELÉCTRICA, can be satisfied with their efforts and the results obtained.

RED ELÉCTRICA, as operator of the Spanish Power System, played a basic role in providing the necessary support for the operation of the market and in ensuring that the safety of the system was not compromised at any time.

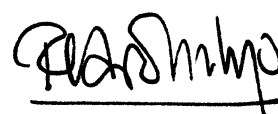
Appropriate management of the system and the handling of deviations were instrumental, not only in achieving this objective but in maintaining costs within the limits established when the law came into force. The new legal framework has also created important technological and organisational challenges such as the development and implementation of a computerised system for management of operations and communications with the market agents and the adaptation of operating procedures to ensure objectivity and the transparency required by the legislation.

At the end of the year, a simulation for restoring power at national level was carried out for the first time, with complete success. This trial consisted in handling an imaginary situation involving the failure of power supply in the whole of mainland Spain and the corresponding restoration of supply, from RED ELÉCTRICA's control centre. The control centres of all the power producers and the distributors participated in this exercise. This operation tested the existing simulation systems and the present level of co-ordination and communication in the sector. The results reflected the abilities and professional capacity of all the participating companies as well as the readiness of the restoration procedures and communications systems, to handle any type of incident of this nature.

At the General Shareholders' Assembly, held in May, the Company's Statutes were modified, changing the expressed purpose of the Company to agree with the provisions of the Law on the Power Sector. Limitations were also incorporated on maximum shareholdings as provided in the Law. These modifications were yet another step in the preparation of the Company for a possible listing on the stock exchange in the future.

At the end of the year, the Company unveiled a new logo which embodies its new corporate culture, focussed on creating value, on service, on efficiency and on profit.

Thanks to the efforts of the whole organisation in achieving the Company's objectives and in satisfying the demands of society, RED ELÉCTRICA is today a company which is more flexible and efficient in carrying out its functions – accessible to its shareholders and employees and responsible to society.



The Board of **Directors and Senior Management**

RED ELÉCTRICA DE ESPAÑA, S.A.

Members of the Board of Directors at 31 December 1998

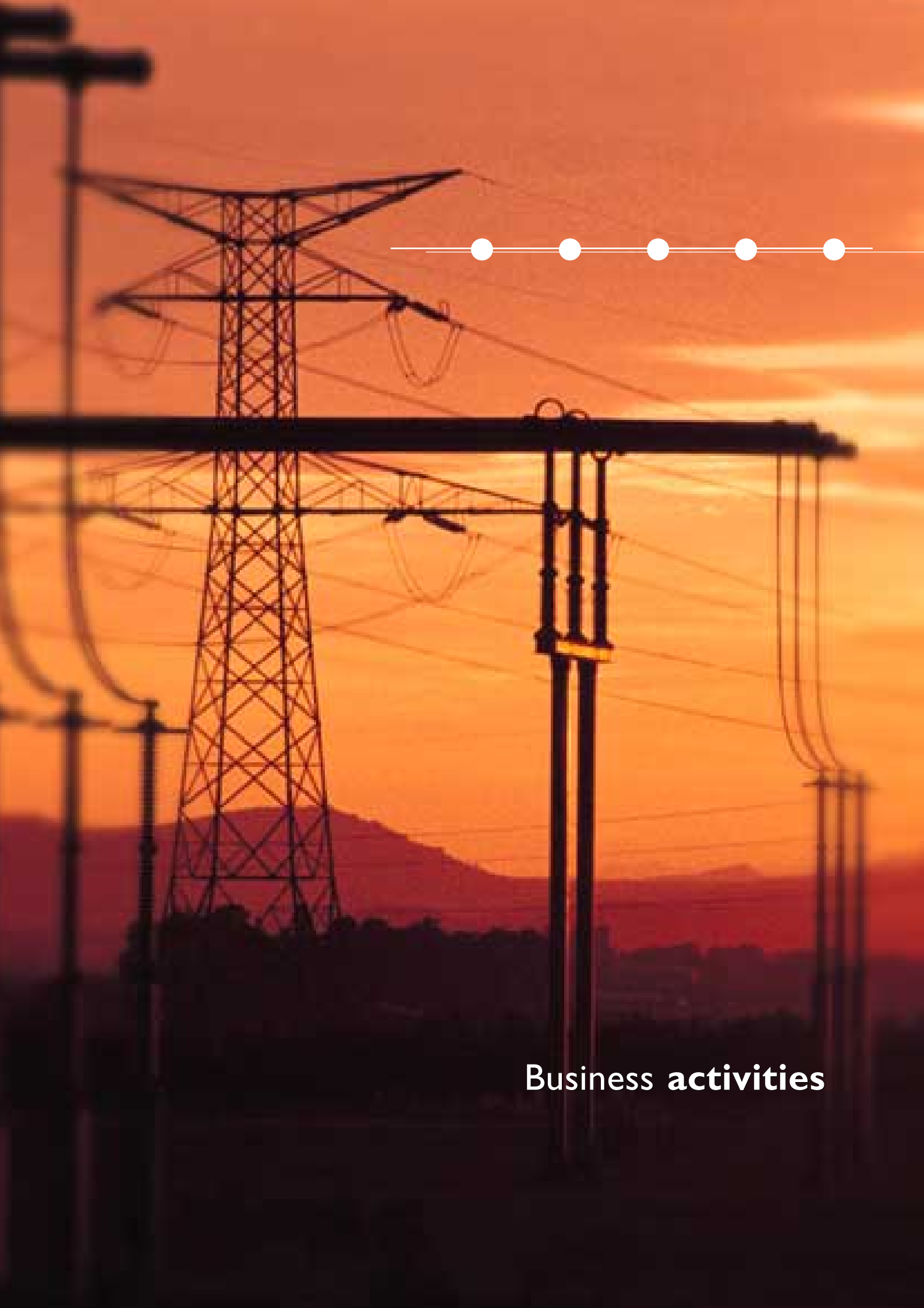
Chairman	D. Pedro Mielgo Álvarez
Members	D. Pedro Rivero Torre
	D. Rafael Miranda Robredo
	D. ^a María Luisa Huidobro y Arreba
	D. Victoriano Reinoso y Reino
	D. Luis Felipe Castresana Sánchez
	D. Luis Daniel Sanz Suárez
	D. Javier Herrero Sorriqueta
	D. ^a Carmen Becerril Martínez
	D. Antonio Tuñón Álvarez
	D. Antonio Gomis Sáez
	D. Juan Gurbindo Gutiérrez
	D. Francisco José Escat Cortés

Secretary (non-Board Member)	D. Rafael García de Diego Barber
---	----------------------------------

At their general meeting held on 20 May 1998, the shareholders passed a resolution to fix the number of Directors at thirteen.

Senior Management

Chief Executive	D. Pedro Mielgo Álvarez
General Managers	D. Victoriano Casajús Díaz
	D. Ángel Landa López de Ocariz
	D. Francisco Pedrosa Ortega



Business activities



Development of the **Transmission Network**





THE PROGRAMMES RELATED TO THE EXPANSION AND IMPROVEMENT OF THE POWER TRANSMISSION NETWORK RESULTED IN the completion of the Pinar del Rey – Tajo de la Encantada and the Litoral – Rocamora power lines plus modifications to the substations at Litoral, Pinar del Rey, Rocamora and Tajo de la Encantada. This work strengthened the grid in the south-east region of the Spanish mainland.

In 1998, various activities contributed significantly to improving and strengthening the Spanish power transmission system. These included the commissioning of 298 km of overhead power lines, 5 new circuit ends at existing substations, 182 km of fibre optic cable and renewals and improvements to switchgear, protections and control systems in the circuit bays at 20 substations.

Transmission network planning

In 1998, activities related to the transmission grid included the following items:

- An evaluation was made of the capacity of the power interconnections with France and Portugal with the object of publishing the available capacity for commercial purposes. A procedure was developed for determining various key indicators related to annual goals.
- An evaluation was made of the access capacity available to new entities and the need to develop the grid. In this regard, applications amounting to approximately 20,000 MW of new generation were evaluated (including wind generators and fuel-fired generators related to the new combined-cycle gas generators). Other activities included the definition of conditions for the supply and connection of power to the newly planned sections of high velocity train track.
- Studies were carried out for developing the grid in certain regions. The existing plans were reconsidered in the light of anticipated new sources of generation from the areas of Navarre, Aragón and the Basque Country (where access applications of considerable size have been received).

Network studies

- A study was made of the need to compensate reactive power in the RED ELÉCTRICA network and ensure suitable voltage levels in the grid.
- A study was made of the problems related to connecting power from wind farms to the transmission grid in view of the important volume of this type of power which might be installed in the near future.

Transmission facilities under construction

- Work continues in the Northern Region to improve the infrastructure in Asturias, Cantabria, the Basque Country and Navarre. This includes planning and construction of the northern trunk line which is needed for transmission and the transfer of excess power arising from an expected increase in generation.
- In Aragón and Catalonia, design work continues on the connection of the Aragón – Graus line with the



Sallente – Sentmenat line and on other links between lines of the transmission grid in this area to improve the supply of power in both communities.

- Work continues in Galicia on the location and prior studies for the future substation at Boimente and its connection to the Aluminio – Puentes de García Rodríguez line, which will improve the transfer of power from the wind farms in the area.
- In the Central Region design work is being finalised for the construction of the future 400 kV

1a Facilities under construction-transmission lines

	No. of circuits	Length (km)
400 kV LINES		
Fuencarral – the Galapagar – San Sebastián de los Reyes line	2	9
La Secuita – the Vandellós – Begues line	2	1
Penedés – the Vandellós – Begues line	2	0.8
Lada – Velilla	1	96
Soto – Penagos	1	175
Boimente – Aluminio – Puentes García Rodríguez line	2	14
Sentmenat – Bescanó	2	77
Penagos – Güeñes	2	70
Aragón – Lérida main trunk	2	42
Madrid – Aragón main trunk	2	220
Graus – Isona	2	53
Magallón – the Serna – Peñaflor line	2	33
Balboa – Portuguesa frontier	1	40
TOTAL km OF CIRCUIT		1,350.6

	No of circuits	Length (km)
220 kV LINES		
Cartelle – the Pazos – Castrelo line	2	10
La Mudarra – La Olma	1	17.5
Bolarque – Trillo	2	60
TOTAL km OF CIRCUITS		157.5

1b Facilities under construction-substations

FACILITY	PROJECT
Balboa	Enlargement of the 400 kV compound, new 220 kV compound and 400/220 kV transformer unit
Cartelle	Enlargement of the 400 kV compound, new 220 kV compound and 400/220 kV transformer unit
Aguayo	New 400 kV circuit ends at Velilla and Penagos
Fuencarral	New 400 kV compound and 400/132 kV transformer unit
Penedés	New 400 kV substation with circuit ends for Vandellós, Begues and auto-transformer I
Boimente	New 400 kV substation with circuit ends for Puentes García Rodríguez I and 2, Aluminio I and 2 and 400/132 kV transformer unit
Magallón	New 400 kV substation with circuit ends for La Serna, Peñaflor, auto-transformer I and 400/220 kV transformer unit
Various substations	Aragón – Lérida Trunk: new 400 kV substation (Peñaalba) and extension of the one at Aragon
Penagos	New 400 kV circuit ends for Soto, Aguayo, Güeñes and auto-transformer I
Various substations	Madrid – Aragón Trunk: five new 400 kV substations, Anchuelo, Torija, Medinaceli, Terrer and Épila and an extension at Trillo.



2 Facilities in use (31 December 1998)

LÍNEAS (km)	
400 kV	14,264
220 kV	4,280
110 kV and less	75
TOTAL	18,619
400 kV submarine line (km)	13
400 kV underground line (km)	2
CIRCUIT ENDS	
400 kV	459
220 kV	175
110 kV and less	3
TOTAL	637
SUBSTATIONS	
TOTAL	127
TRANSFORMERS	
Number	34
Total Power (MVA)	17,051
REACTOR UNITS	
Number	28
Total Power (MVA)	3,410

compound at the Fuencarral substation and its connection to the Galapagar – San Sebastián de los Reyes line to improve the supply of power in the north area of Madrid.

- In Extremadura, design work is underway on the extension of the Balboa substation involving a new 400/220 kV transformer module and the construction of a new 220 kV compound and its connection to the Balboa – Badajoz line. This will increase the reliability of power supply in the southern part of Badajoz.

- Lastly, work has commenced on the pre-design studies for the facilities required to feed the future main trunk line, Madrid – Aragón – Lérida.

Tables 1a and 1b show the details of the facilities under construction at 31 December 1998.

Facilities completed

During 1998, construction of the following facilities was completed:

Lines

- Pinar del Rey – Tajo de la Encantada: a single circuit 400 kV line, 109.5 km long with structures prepared for double circuit. This will complete the 400 kV circuit in Andalusia and reduce transmission losses.
- Litoral – Rocamora: a single circuit 400 kV line, 185.3 km long with structures prepared for double circuit.



This line will increase the degree of meshing (interconnection) of the grid in the south-east mainland and strengthen supply flows between this area and Levante.

New facilities at existing substations

- Tajo de la Encantada: a new 400 kV circuit end for Pinar del Rey. This will improve power supply to the Malaga area.
- Pinar del Rey: a new 400 kV circuit end for Tajo de la Encantada. This will allow surplus power generated in the Algeciras area to be transferred to eastern Andalusia.
- Litoral: a new 400 kV circuit end for Rocamora. This will increase the reliability of power supply in the area.
- Rocamora: an extension involving a new 400 kV circuit end for the exit of the Litoral line. This will improve power supply in the Levante area.
- Romica: a new central bay for the Auto2 – Future Auto1 circuit end. This will allow a new pedestal to be built for a 400/132 kV transformer (of 300 MVA) to strengthen power supply to the Albacete area.
- Sangüesa: a 220 kV substation which has been extended by the construction a new circuit end involving a 220/66 kV transformer of 150 MVA.





- Orcoyen: the construction of a circuit relay room at the Cordovilla 2 circuit end.
- Mesón do Vento: a new facility for auxiliary services.

Table 2 shows the facilities in use at 31 December 1998.

Communication systems

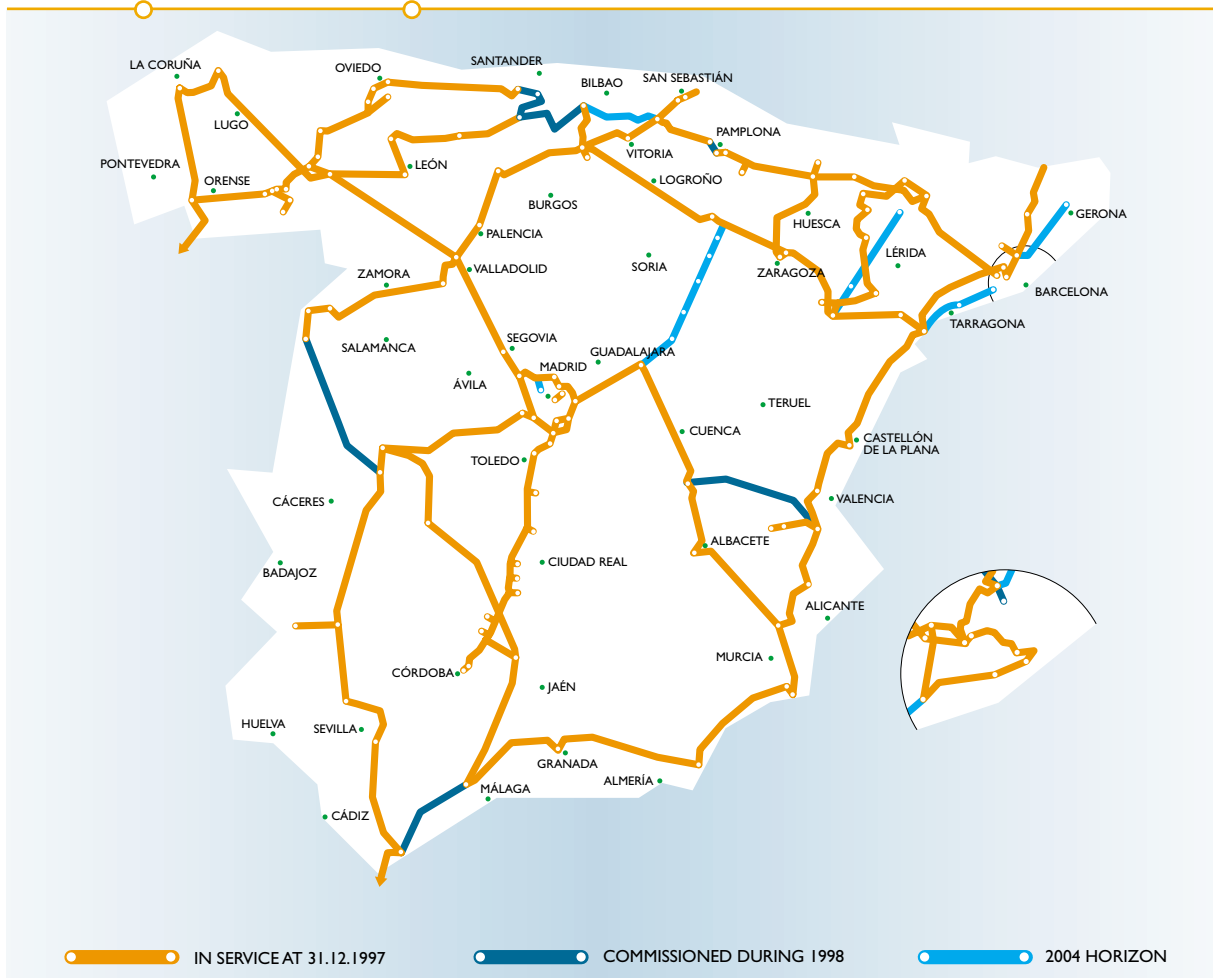
During 1998, the following activities were carried out:

- Communication circuits: the commissioning of 365 circuits for telephone, remote control, remote

te protection, management, etc, bringing the total number of circuits used by RED ELÉCTRICA to 4,683.

- Mobile radio systems: the installation of a new repeater station under the Adjustment and Improvement Plan for mobile communications, bringing the total at the end of the year to 107 mobile radio repeater stations.
- Fibre optic systems: the installation of compound earth-optic cable (a fibre optic cable attached to the earth wire), underground cable on 182 km of existing lines and the commissioning of nine new links (two links were retired during the year). This brings the total cable laid to 8,400 km and the fibre optic links to 137.
- Carrier and remote protection systems: the installation and commissioning of 30 carrier wave units and 50 remote protection units. Eight high frequency remote protection links have been disconnected and this means that there are 536 carrier wave units and 767 remote protection units in total at the end of the year.

RED ELÉCTRICA's fibre optic network (31 December 1998)



- Switching systems: the installation and commissioning of one digital exchange and nine remote exchange modules thus improving the quality of connection at 10 network exchanges. This brings the total number of digital exchanges and remote modules to 53 and 41, respectively.



Renewal and improvement of facilities

The renewal and improvement programs are aimed at achieving a suitable level of availability and reliability for the installations, which is in accordance with the level of service to be provided by the transmission grid. The activities in 1998 were as follows:

Lines

This included the installation of compound cable, the replacement of support structures, action taken to increase the transmission capacity of the lines, the replacement of earthing conductors and cables and the replacement of glass insulation by compound insulation, on 17 lines and in accordance with the detailed program for each one, plus other activities of a diverse nature involving another 21 lines.

Substations

This involved the replacement of 91 high voltage items at 25 substations. Digital control systems were fitted to 13 circuit ends at these substations.

In other areas, low voltage equipment has been replaced, auxiliary service facilities have been renewed and Megaphasor units have been installed at other substations in the grid.

Protections

Protection systems have been completely renewed at 31 circuit ends and partially renewed at 41 circuit ends of the transmission grid. The corresponding protections for the new Pinar del Rey – Tajo de la Encantada line and the Litoral – Rocamora line were commissioned.

Equipment for measuring active and reactive energy has been installed on all the international interconnection lines, in accordance with the requirements of the new Points of Measurement Regulations (RPM).

A real-time digital simulator for testing protection equipment and systems in the laboratory and a prototype control and protection monitoring system, have been installed, tested and commissioned. Communication links have been installed between 73 new units and the control centre for the transmission of information from the protection units and disturbance recorders. Phase I of the Event Analysis Software for handling information from the protection systems has been commissioned.

Control systems

Two new digital control systems and 1 telecontrol remote station were installed, 39 systems were extended and terminals for local operation were installed at 5 remote telecontrol stations.

Remote supervision and remote data loading functions have been added to the control system equipment, bringing the units fitted with such equipment to 93% and 84% of total, respectively.

Two complete digital control systems and hardware at 18 remote telecontrol stations, have been renewed.

Maintenance of the Transmission Facilities





CONSTANT EFFORTS TO IMPROVE THE SCHEDULING OF MAINTENANCE ACTIVITIES INVOLVING SHUT-DOWNS AND THE USE OF live-line maintenance techniques has meant that the unavailability rate of the installations was improved. In addition, predictive maintenance techniques continue to be applied in order to increase reliability and reduce maintenance costs.

Line maintenance

As part of the predictive, preventive and corrective maintenance programmes and the official inspections of earth wires and earth resistance, periodic inspections have been made on foot and by helicopter. A large number of towers has been inspected and work was carried out on the trees under the overhead lines. Other programmed activities included the cleaning of insulator strings, the application of corrosion protection to steel transmission towers, re-tensioning of wires and the replacement of insulator strings and support structures due to problems involving the terrain. The corresponding studies were carried out for a large number of applications by official and private organisations regarding alignment and areas of influence of the lines. Modifications were made at the request of third parties and these included the conversion of the two existing Cordovilla – Orcoyen circuits into a single line with an increase of 3.8 km in the total length of the two circuits.

Substation maintenance

With regard to power equipment (transformers and reactors), the analysis of oil and its evaluation, the measurement of insulation and other diagnostic techniques, such as frequency response analysis, were used to analyse their condition and correct the faults encountered.

The preventive program for breakage failures in current transformers, involving partial discharge measurements and oil analysis, together with thermovision inspections, helped to detect defective units and to arrange for their replacement.



With the object of organising maintenance work more efficiently through remote diagnosis of circuit breakers and the thermovision inspection of substations, together with the routine preventive inspections of all facilities, the faults encountered were corrected.

The accuracy of the measurement transformers was monitored and the results analysed. The integrated measurement equipment at the circuit ends of the international interconnections were verified and their hourly readings were downloaded to the Measurement Integrator of the System Operator. With regard to protection and measurement units, checking was carried out as programmed, according to established procedures. Units at new circuit ends, plus those involving complete or partial renewals, were scheduled, tested and commissioned. The remote management of protection units was increased and a large number of units is now connected to the control centre.

Maintenance of remote control systems

With regard to preventive and corrective maintenance, the records of both the remote telecontrol stations and the digital control systems were adapted to match the current configuration of the units and some updating

was necessary. Specialised maintenance generated more than 100 databases – most of them by means of remote downloading.

Performance of the transmission network

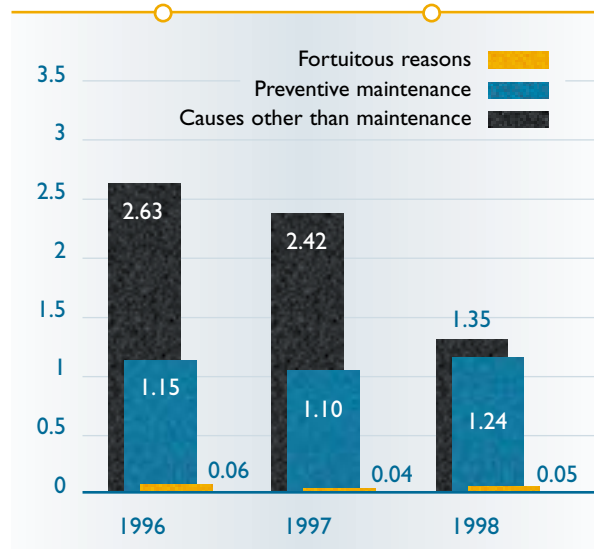
Coordination of outages for construction work and maintenance work together with the use of predictive maintenance techniques and live-line working have meant that the quality indicators of the transmission service were once again very satisfactory in terms of safety and continuity of supply.

The overall availability in 1998 was 97.36% – a slight improvement on the previous figure of 96.44%.

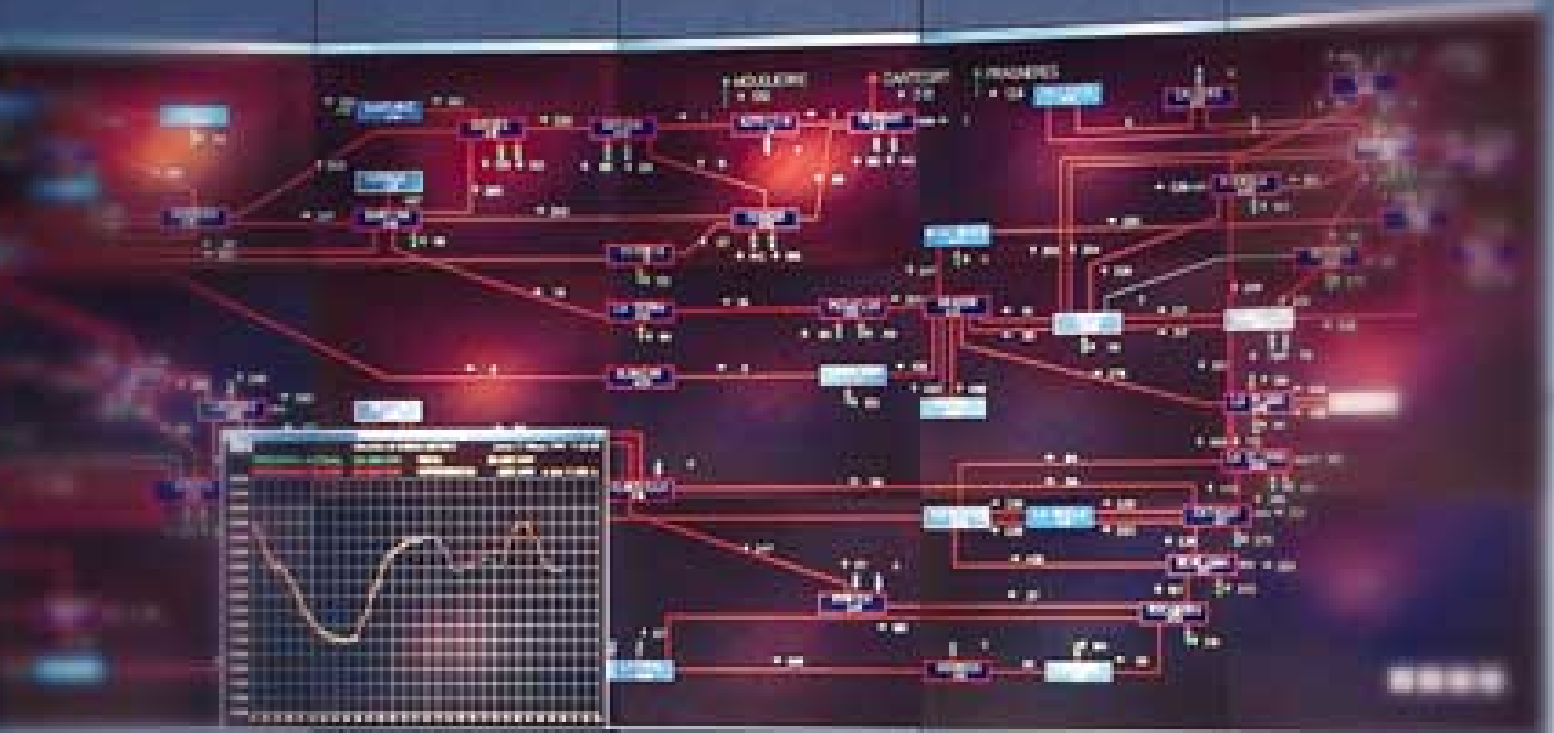
The performance of substation equipment and protections continued at the high levels recorded in previous years and the performance of remote control systems was very satisfactory.

The attached chart of Unavailability Rates reflects the positive evolution of this indicator. The average interrupt time is shown in the chart, included in the key indicators.

Evolution of the Unavailability Rate (%)



Operation of the Power System





JANUARY 1ST 1998 WITNESSED A HISTORIC CHANGE IN THE SPANISH POWER SYSTEM WHEN THE WHOLESALE POWER MARKET came into being. The switch from a central optimising model to one based on competitive offer prices was a definitive step in the deregulation process defined by the Law on the Power Sector and it will have important consequences in the long term. By virtue of the instructions contained in this law, RED ELÉCTRICA was made responsible for putting this market in operation through the creation of the company, Compañía Operadora del Mercado Español de Electricidad (the power market operating company), and for providing it with the technical and human resources within the time frame established by the law.

The successful operation of the market required a profound and rapid adaptation on the part of the various entities and institutions involved. The results were satisfactory, thanks to the combined effect of the efforts made by individuals and utility companies, the National Power Commission, the Ministry of Industry and Energy and, above all, by RED ELÉCTRICA itself. Our Company has dedicated important resources to the creation of the market at the same time as it was training the operators who, from the beginning of the year, were obliged to work in a way which was quite different to the one they had been using for years.

RED ELÉCTRICA, the power generation companies and the distributors conducted a simulation of a power restore at national level, with complete success, to verify the level of training of the operators and to check the co-ordination procedures and communication systems in the event of a large-scale incident in the Power System. This simulation was based on an imaginary total failure of power supply in the whole of the Spanish mainland. Apart from the sections of RED ELÉCTRICA which are responsible for operations, the power generation and other utility companies participated in this simulation.

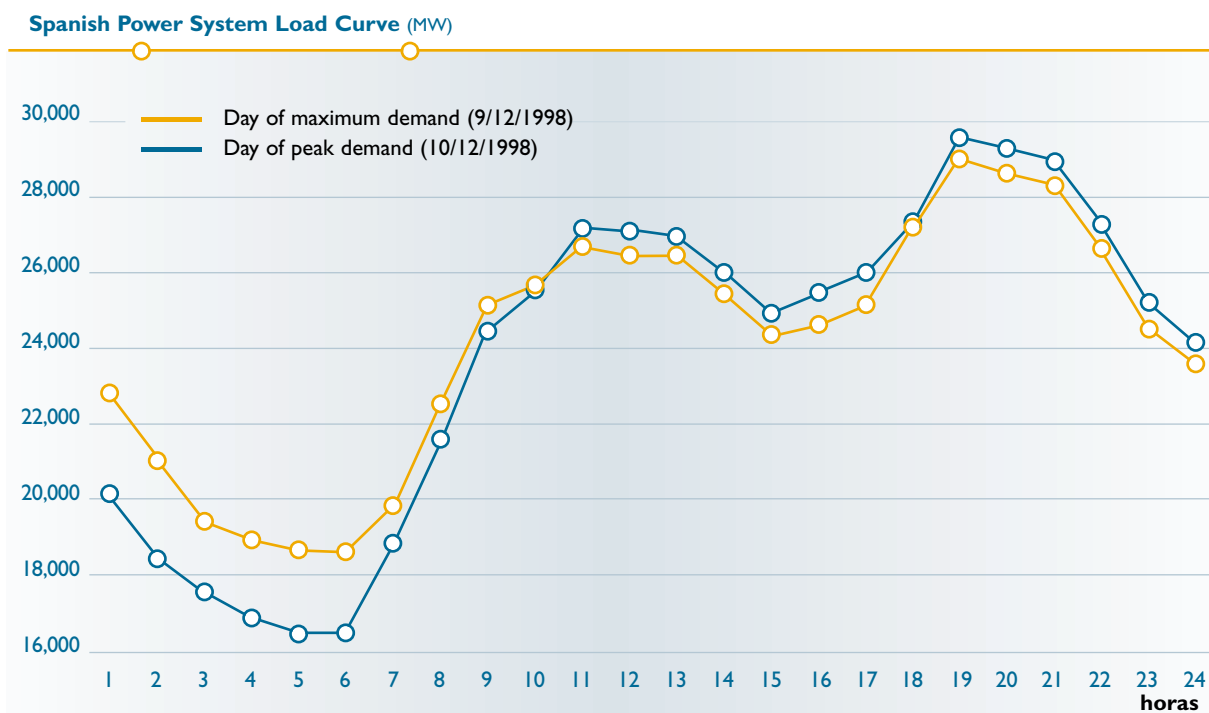
Evolution of the key system indicators

In 1998, the operation of the system was characterised by a high rate of growth of power demand which reached the highest levels recorded for 20 years, the reappearance of drought conditions halfway through the year,

the import balance of international power trading and the continuation of the strong growth in power acquired from generation companies operating under the special regime – which supplied 11% of total demand.

Demand

Monthly, daily and hourly figures for power demand broke their respective records on several occasions. The year's highs were recorded in December with 15,926 GWh of monthly demand, 582 GWh of daily demand and 29,484 MW of hourly demand. The total demand for the year came to 172,673 GWh which was an increase of 6.5% compared to the previous year. However, after correction for the year's labour effects and temperatures, the adjusted percentage increase was calculated as 5.9%.





Generation

The structure of power generated in the system during the year was similar to 1997. The switch to a market trading system does not appear to have significantly affected the behaviour of the power generation sector: The hydroelectric power stations supplied approximately 34,000 GWh, which was 21%

of total production. The nuclear power stations produced nearly 59,000 GWh, which was an all time record and represented 37% of total. The coal-fired power stations produced approximately 60,200 GWh, 38% of total output. Oil-fired and natural gas power stations finished the year with outputs that were close to 2,400 GWh and 3,300 GWh, respectively. The total output of the entire sector was 158,800 GWh.

Breakdown of generation in 1998	GWh	% of total
POWER		
Hydroelectric	33,992	21
Nuclear	59,003	37
Coal	60,190	38
Oil+Gas	5,659	4
TOTAL	158,844	100



International Power Exchanges

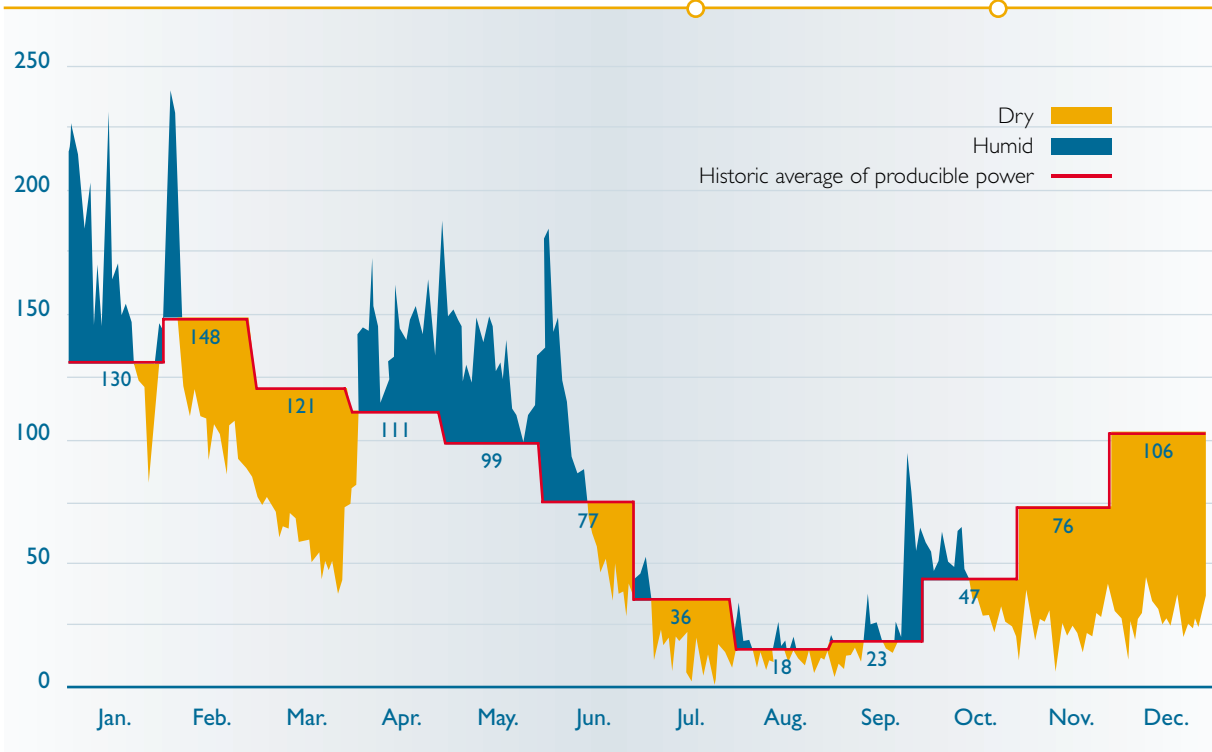
During the year 4,604 GWh were imported and 1,204 GWh were exported, resulting in an import balance of 3,400 GWh. The imports included 4,504 GWh from France under the agreement between RED ELÉCTRICA and Electricité de France and this figure represents 95% of the maximum power that can be imported under this contract (this power was traded in the daily market.). External entities imported 85 GWh from Belgium. The exports consisted of 483 GWh to Morocco and 151 GWh to Andorra (exported by RED ELÉCTRICA under existing agreements) and 569 GWh exported by external entities to Portugal (277 GWh), Morocco (221 GWh) and France (71 GWh).

Ancillary services and the management of deviations

The incorporation of the ancillary service for secondary regulation in the new regulatory framework meant an average power range of 1,014 MW with a cost of Ptas. 27,542 million. A total of 2,336 GWh of power was used and its cost was Ptas. 5,943 million.



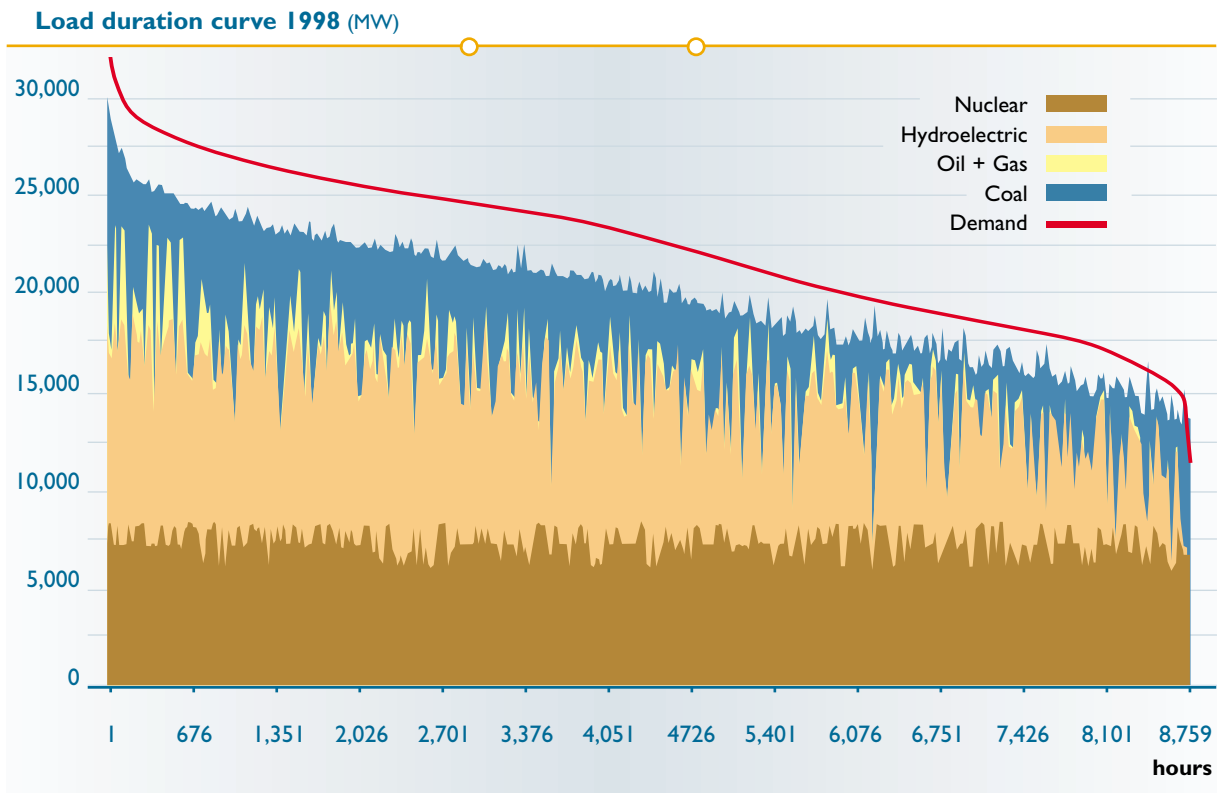
Daily producible hydroelectric power in 1998 compared to the historic average (GWh)



The ancillary service for tertiary regulation involved the procurement of 1,277 GWh at a cost of Ptas. 3,710 million. RED ELÉCTRICA acquired a total of 2,168 kWh, whose cost to the system was Ptas. 6,243 million, to ensure coverage of demand through the management of generation – consumption deviations.

These processes, which are managed by RED ELÉCTRICA, have a repercussion on the final price of power. To the average price of 4.27 Ptas./kWh in the daily market over the year, 0.04 Ptas./kWh must be added for technical restrictions, 0.17 Ptas./kWh for the cost of the range of secondary regulation and 0.07 Ptas./kWh for the cost of regulation and the management of deviations. These figures, plus those corresponding to the





intra-day market (-0.01 Ptas./kWh) and the guarantee of power (1.27 Ptas./kWh), determine the final price of 5.81 Ptas./kWh.

Regional reorganisation

In 1998, the organisation of the power control centres has been rearranged. Current technology allows operations to be conducted with greater efficiency and at ever-increasing levels of quality and safety. The greater operational complexity also demands that these goals should be compatible and that the systems should be

permanently improved. Over the next four years it is planned progressively to group the functions, currently handled by the six existing control centres, at two centres. One of these will be a twin of the other and this will ensure operations in the event of a failure at either centre.

New tools for the operation of the system

Following deregulation of the Power System, it was necessary to develop new software tools which reflect the operation of the markets which form part of RED ELÉCTRICA's responsibilities. Such tools must handle the reception, storage and preparation of power transactions measurements.

Information System for the System Operator (SIOS)

RED ELÉCTRICA has adopted a new software tool for information tasks and for handling the processes related to the power market. This system handles information through two interfaces. The first involves the market traders; it records the offers and fixes the assignments in each market. The second interface is for the market management company; it co-ordinates the activities of each company (the market manager and the system operator).

Contribution of each market to the final price of power

	Jan.	Feb.	Mar.	Apr.	May.	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.	Ave. for year
Average price in the daily market	4.53	4.03	4.28	4.39	3.78	3.77	4.41	4.63	4.1	4.21	4.81	4.2	4.27
Average price of the intra-day market				0	-0.01	-0.01	-0.01	-0.01	-0.01	-0.02	-0.03	-0.01	-0.01
Technical restrictions	0.02	0	0.01	0	0.01	0.07	0.1	0.11	0.1	0.02	0.01	0.03	0.04
Ancillary services and deviation management	0.18	0.15	0.09	0.2	0.24	0.16	0.24	0.49	0.16	0.12	0.19	0.54	0.24
Power supply guarantee	1.27	1.28	1.28	1.27	1.27	1.28	1.28	1.27	1.28	1.28	1.28	1.26	1.27
FINAL AVERAGE PRICES	5.98	5.46	5.67	5.86	5.29	5.27	6.03	6.49	5.65	5.61	6.26	6.02	5.81

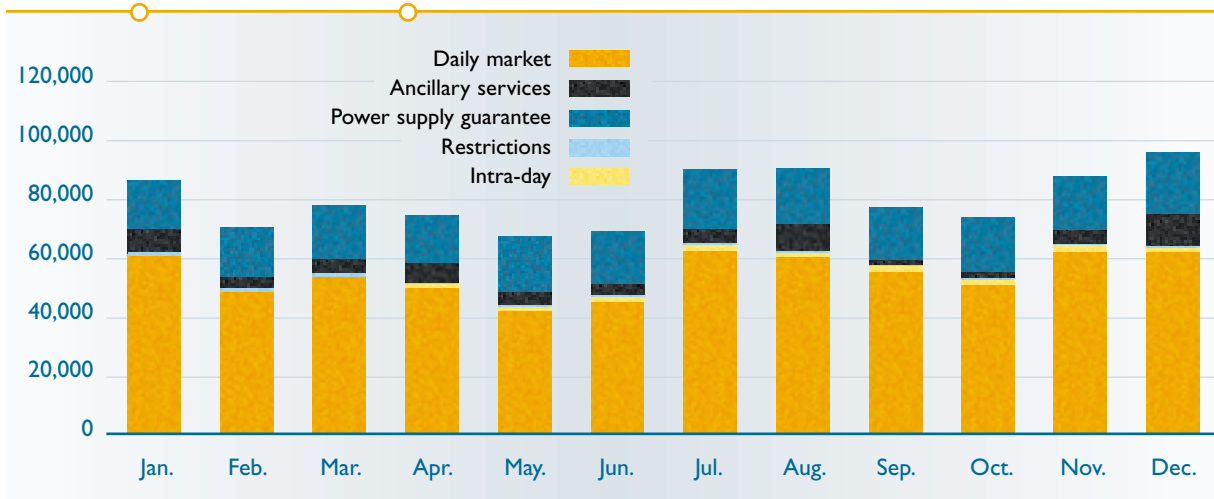


The Power Measurement Information System (SIMEL)

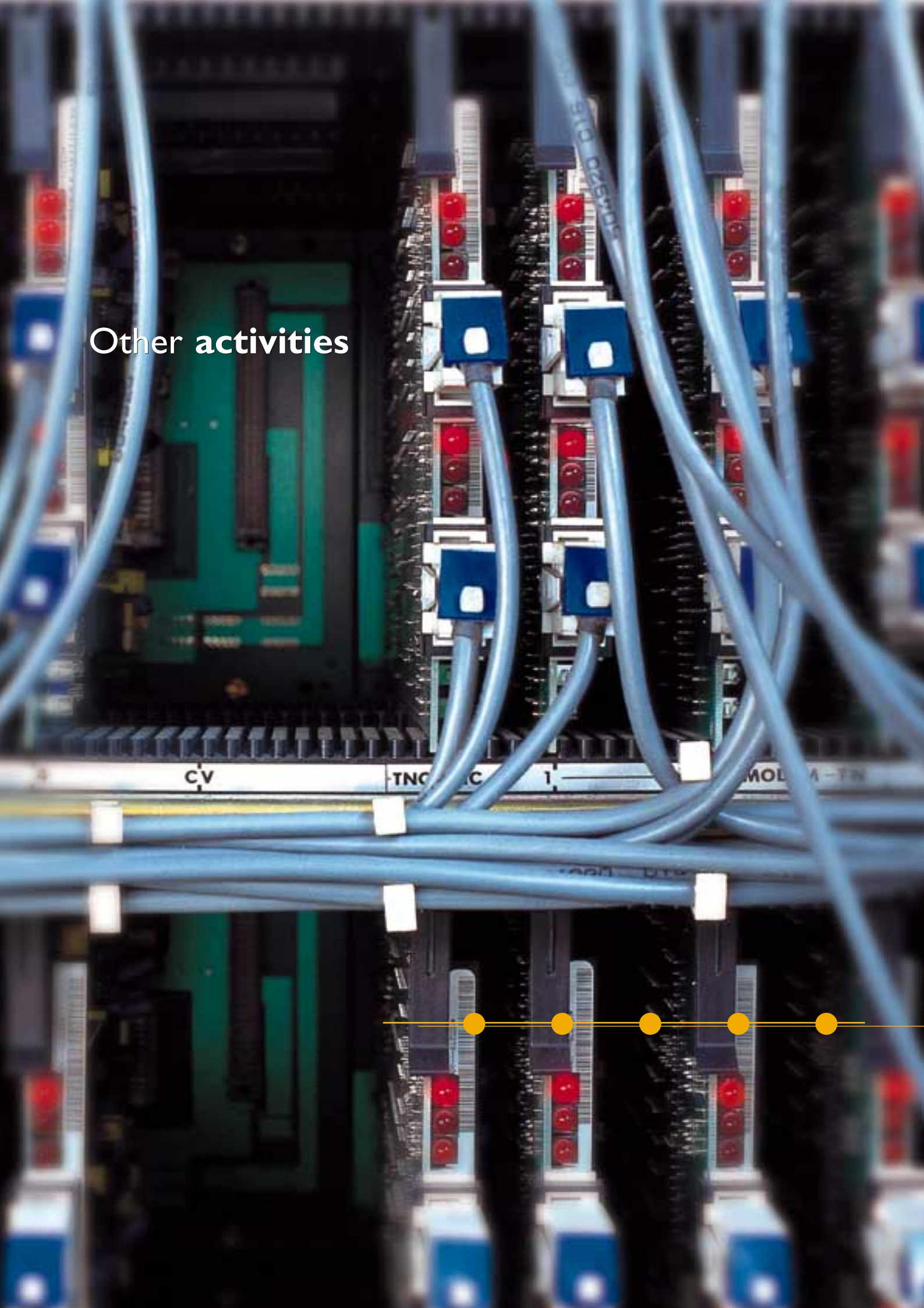
In 1998, RED ELÉCTRICA developed software to record and process information related to the power which is exchanged hourly between the traders which operate in the market and the power which flows through the international interconnections or the connection points of qualifying consumers.

This project involved the definition of 2000 border points, new metering equipment or recorders of active and reactive energy operating on an hourly basis with great precision, as well as the development of the Main Measurement Integrator system which is used for the reception, storage and processing of information and for making it available to the various authorities.

Participation of the different market segments in the final cost (millions of pesetas)



Other activities





Telecommunication services

In 1997, RED ELÉCTRICA possessed excess capacity in its fibre optic network which it could not employ directly as it did not possess a licence as a telecommunications operator. In view of these circumstances, it transferred the use of the excess capacity to the company, Netco Redes, S.A. This excess capacity depends on the maintenance services provided by RED ELÉCTRICA. The telecommunications network owned by the Company has been the object of a general authorisation granted by the General Secretary for Communications on 3rd August 1998. This authorisation covers its use as a private telecommunications network under article 14 of the General Telecommunications Law no. 11 of 24 April 1998.

Engineering and consulting services

In 1998, a survey of the existing market in this area was commenced and the analysis of potential offers has been completed. As a conclusion of this analysis only the offer of one consulting engineer was adopted for the project involving the electrical connection of the wind farm at Lubián to the transmission system. This project was completed and delivered in the second half of the year.

International development





THE CREATION OF VALUE BY RED ELÉCTRICA MUST BE AIMED AT WIDENING THE BASIS OF THE BUSINESS TO neutralise the long-term significant threat posed by the Company's dependence on regulatory income. This widening of activities can be made in two ways: through diversification (the incorporation of activities other than the principal or regulatory activities) or through greater international activity (extending current activities in the Spanish market to other countries).

The international strategy of RED ELÉCTRICA is, therefore, a requirement which requires an explicit and precise definition to guide the efforts of the organisation towards the aforementioned objective – the creation of value. RED ELÉCTRICA plans to promote those activities which are based on its skills and demonstrated ability in the Spanish market, within the limitations which current legislation imposes with regard to the compatibility of activities. The development and management of networks and power systems, together with the complementary or related activities such as advising and consulting, development engineering and the basic design of power systems and the planning of maintenance and other services, are the relevant activities which it can contribute in this area. The selection of the target markets must be based on criteria which include profitability and risk. And when both of these conditions are met, additional aspects must be considered such as the degree of affinity or compatibility, the relative absence of barriers to entry or the greater possibility of market penetration.

At the current time, a close watch is being kept on the legislative and regulatory developments in the principal Latin-American countries and other regions where the possibility of participation is emerging. This applies to the field of consulting work as well as to direct investments in the privatisation processes or in management contracts. Special attention is being paid to the deregulation processes of the electric power sector in Latin America and the possibility of consulting work within the framework of the multilateral cooperation programs.

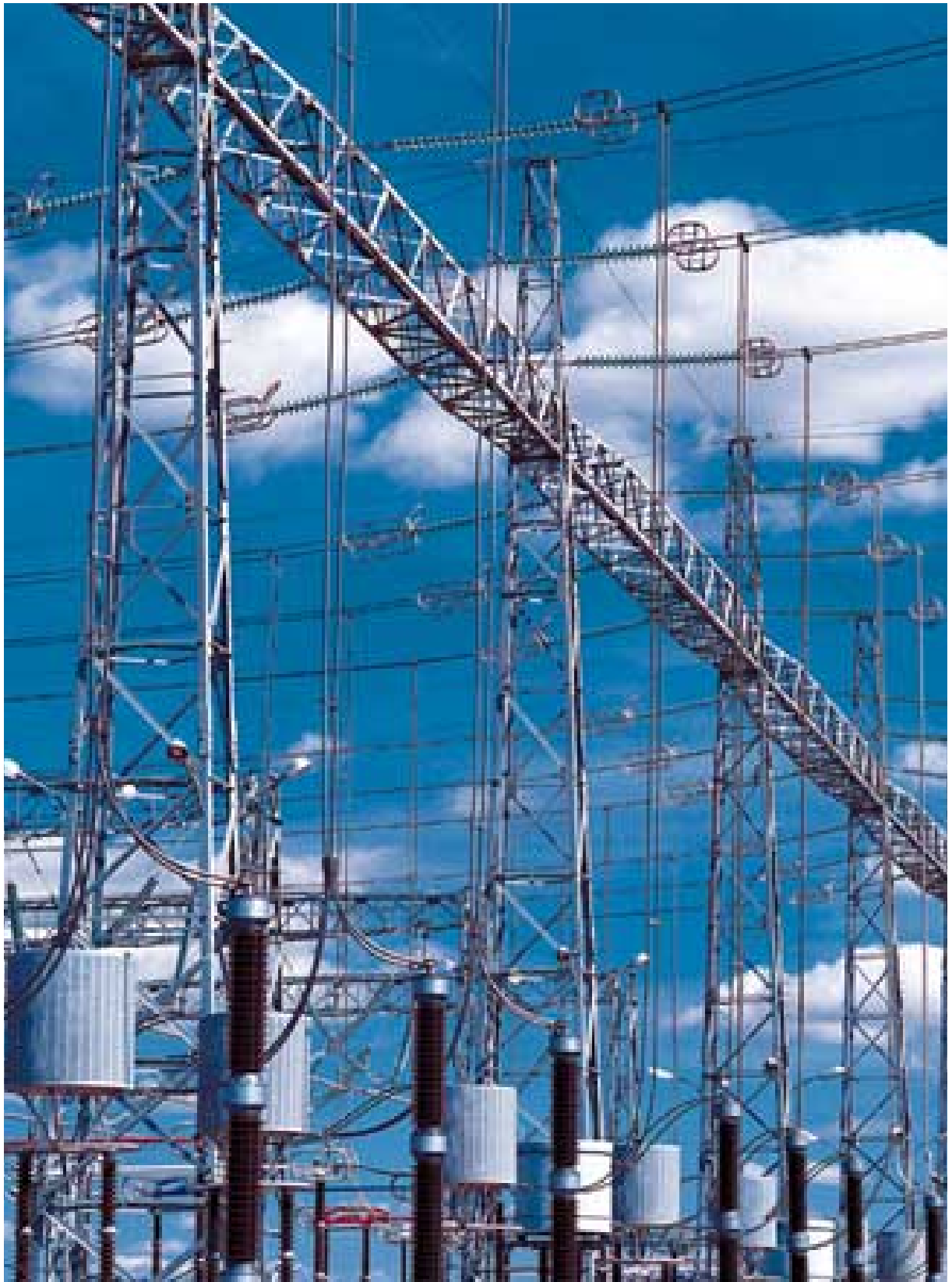
So far, RED ELÉCTRICA's advisory and consulting activities have resulted in various projects in South America, North Africa and the Ukraine. All of these can be considered to be satisfactory in all aspects.



In January 1999, as a result of a competitive tender process, RED ELÉCTRICA was awarded a concession to improve the power transmission systems in Southern Perú – leading a consortium of Spanish companies. The activity related to the concession will be carried out by Red Eléctrica del Sur (Redesur), a new company in which RED ELÉCTRICA is the major shareholder and strategic operator. The forecast profitability of the investment is within the range of values which was set as an initial target.

The concession involves the construction of 444 km of 220 kV transmission lines and three new substations plus an extension to an existing substation and the operation of the resulting system for a period of 30 years. This is the first international investment made by RED ELÉCTRICA and it will allow the Company's capacity and skills to be put to the test and its competitive advantages in the specialised power transmission segment of the market, to be verified.





Human resources





THE TREND TOWARDS AN INCREASINGLY COMPETITIVE BUSINESS ENVIRONMENT AND THE CONSEQUENT REDEFINITION OF RED ELÉCTRICA's business strategies can only be successfully managed from within a corporate culture whose essential values lie in teamwork, flexibility, adaptability, the development of individual abilities and especially in the development of management and man-management skills. These values must also be applied in manner which will support the achievement of the defined goals.

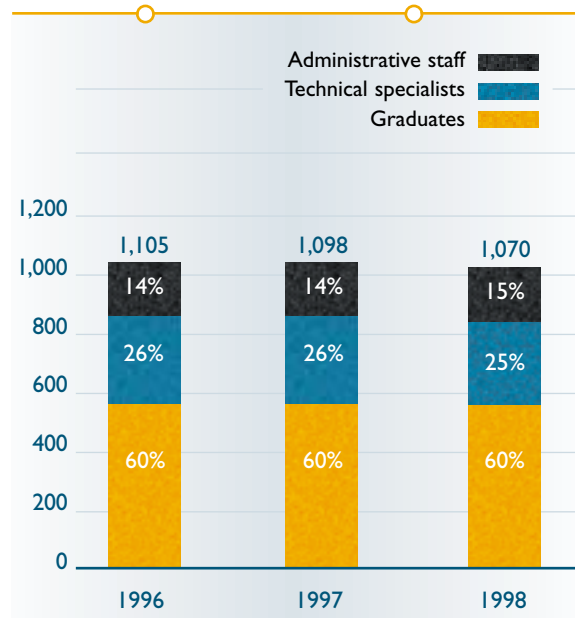
During the year the adjustment of the Company's structure has commenced and the management team has been renewed.

At the end of 1998, there were 1,070 employees at RED ELÉCTRICA. This figure is slightly less than at the end of the previous year. This marks the end of a phase of strong growth in the workforce and it confirms the capacity of current resources to handle the

Company's needs with minor adjustments.

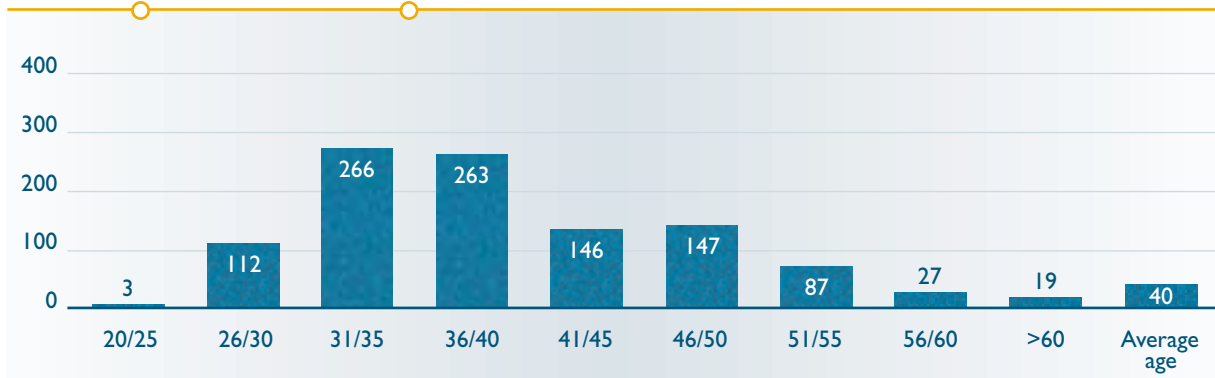
In 1998, training was focussed on the implementation and consolidation of the management information systems, on specific job training, on the development of management skills and on the distribution of information related to the new legislation and regulations for the power sector. Investment in training in 1998 was 4% of total personnel costs. It represented 63,000 hours of training involving 87% of employees with an average of 59 hours per employee. Of these hours, only 46% were normal working hours and this indicates the interest of the employees in improving their skills.

Evolution of the workforce by academic level





Distribution of the workforce by age group (31/12/98)



For more than a decade, RED ELÉCTRICA has been engaged in a program of educational cooperation with various universities and other institutions related to its business activities and, in particular, with engineering colleges and industrial engineering faculties. These accounted for 76% of the 127 people who participated in these programs during the year.

With regard to safety and health, the most important event during the year was the new Law on the Prevention of Risk in the Workplace. With the aim of applying the provisions of this legislation, a risk evaluation system was implemented for all the tasks in the Company and a safety control system was established for persons involved in construction works.

Administration and finance





Results

Profit after tax for the year came to Ptas. 11,536 million which was 20.9% greater than 1997. The figures for the last three years are shown in Table 3.

3 Profits (millions of pesetas)	1998	1997	1996	% 98/97
Profit before tax	17,394	14,003	14,434	24.2
Profit after tax	11,536	9,540	10,547	20.9

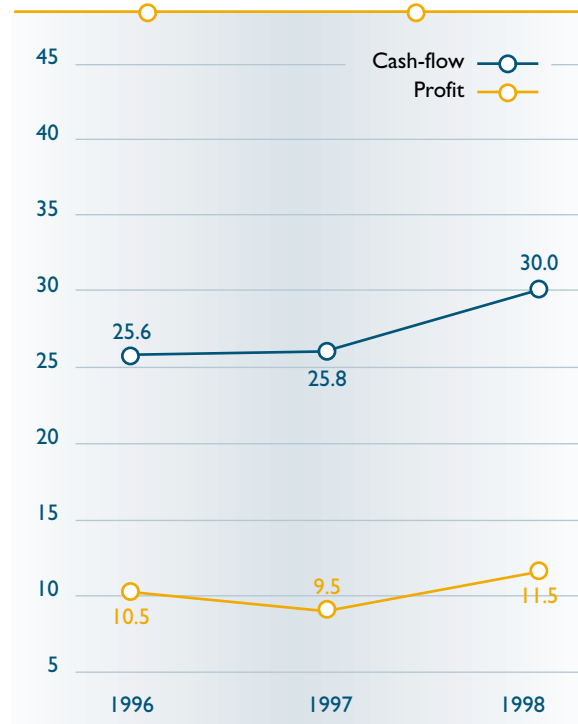
Revenues

Turnover in 1998 came to Ptas. 89,247 million.

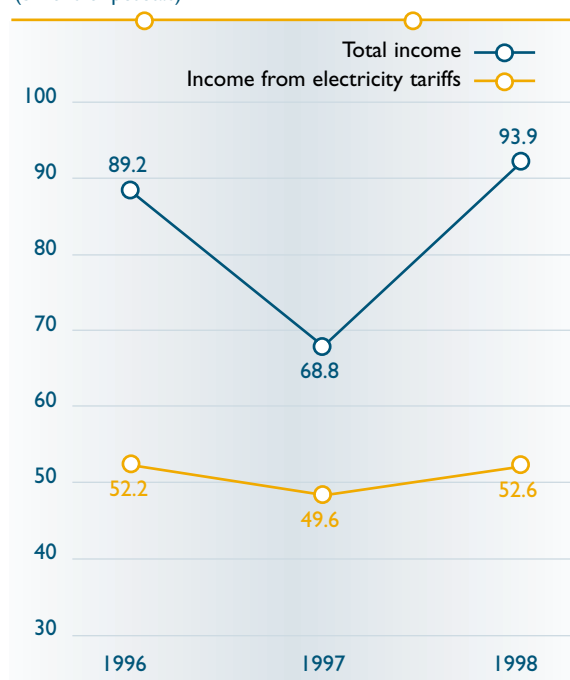
The increase compared to the preceding year was essentially due to the greater volume of international power trading under the agreements with RED ELÉCTRICA. The principal items were as follows:

- Income from services related to transmission and operation of the system came to Ptas. 52,611 million. The level of remuneration for these services is fixed annually by the Ministry of Industry and Energy.
- Income from the sale of power was Ptas. 34,349 million. This revenue was mainly related to the export and import

Evolution of profit and cash-flow after tax (billions of pesetas)



Evolution of income (billions of pesetas)



agreements with EDF (France) and ONE (Morocco).

- Income from other activities was Ptas. 2,290 million – an increase of 82% over the previous year. This figure includes income from diversified activities such as consulting work, engineering designs and other activities carried out for third parties.

Other income, which came to Ptas. 1,581 million, included the following:

- The work carried out by the Company on its fixed assets, which came to Ptas. 1,212 million.
- R&D expense of Ptas. 133 million capitalised as intangible fixed assets.

4 Total income (millions of pesetas)	1998	1997	1996	% 98/97
TURNOVER	89,247	63,107	84,401	41.4
Other income	1,581	3,240	3,607	(51.2)
INCOME FROM OPERATIONS	90,828	66,347	88,008	36.9
Financial income	605	653	350	(7.4)
ORDINARY INCOME	91,433	67,000	88,358	36.5
Extraordinary income	2,424	1,777	842	36.4
TOTAL INCOME	93,857	68,777	89,200	36.5



- Additional operating income, which came to Ptas. 236 million.

The above income was supplemented by Ptas. 605 million of financial income and Ptas. 2,424 million of extraordinary income.

Table 4 shows the evolution of income in recent years.

Expenses

Total expenses before tax came to Ptas. 76,463 million. The breakdown of expenses is as follows:

- Salaries and wages in 1998 came to Ptas. 8,877 million.
- Purchases and external services came to Ptas. 42,088 million. This includes Ptas. 33,284 million for power purchases under the international power exchange agreements.
- Provision for depreciation came to Ptas. 16,397 million in 1998.
- Financial expenses related to external sources of finance came to Ptas. 6,609 million for all concepts and this includes capitalised interest related to investments in assets under construction.

The above figures do not include Ptas. 389 million for other operating expenses and Ptas. 2,103 million for extraordinary expenses.

Table 5 shows the details of expenses.

5 Expenses (millions of pesetas)	1998	1997	1996	% 98/97
Salaries and wages	8,877	8,521	8,141	4.2
Purchases	35,274	11,875	31,363	197.0
Outside services *	6,814	8,791	9,835	(22.5)
Depreciation	16,397	15,720	13,676	4.3
Other expenses	389	485	341	(19.8)
OPERATING EXPENSES	67,751	45,392	63,356	49.3
Financial expenses	6,609	8,577	9,600	(22.9)
ORDINARY EXPENSES	74,360	53,969	72,956	37.8
Extraordinary expenses	2,103	805	1,810	161.2
TOTAL EXPENSES	76,463	54,774	74,766	39.6

* Includes variations in trading provisions

Financing

Cash-flow after tax was Ptas. 29,998 million which was 16.4% greater than the previous year and represented 32.0% of RED ELÉCTRICA's revenues. The year 1998 witnessed a change in the normal trends when total debt was reduced by Ptas. 17,819 million.

This important reduction was achieved through the flexibility of the Company's financial structure and the due dates established for certain operations. Advantage was taken of market developments, especially the reduction in the cost of funds. Following moderate utilisation of long-term financing (bond issues, facilities with the European Investment Bank and the syndicated credit line), the significant cash requirements at the beginning of the year (which were absorbed in the second half) were covered by short-term financing (promissory notes and short-term loans).

Outside financing (millions of pesetas)	1998	1997	1996	% 98/97
Debt on acquisition of fixed assets	0	8,974	27,022	—
Credit facilities and loans	41,277	27,859	24,696	48.2
Bond issues	26,018	18,517	24,432	40.5
LONG-TERM FUNDS	67,295	55,350	76,150	21.6
SHORT-TERM FUNDS	13,331	43,094	20,036	(69.1)
TOTAL FUNDS	80,626	98,444	96,186	(18.1)
LONG-TERM CREDITORS	7,322	6,911	6,404	5.9
SHORT-TERM CREDITORS	25,466	29,355	33,182	(13.2)
TOTAL EXTERNAL FUNDS	113,414	134,710	135,772	(15.8)

Shareholders' equity (millions of pesetas)	1998	1997	1996	% 98/97
Share capital	45,090	45,090	45,090	—
Revaluation reserve	41,101	41,101	41,101	—
Reserves	18,339	14,272	30,565	28.5
Net profit for year	11,536	9,540	10,547	20.9
Interim dividend	0	(3,000)	(2,367)	(100.0)
TOTAL	116,066	107,003	124,936	8.5

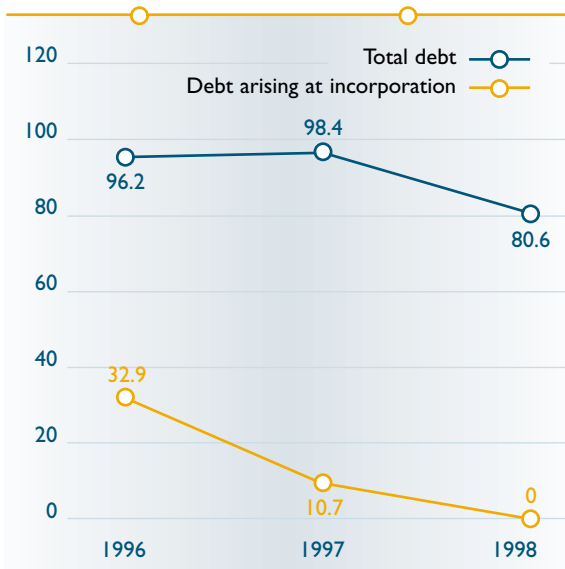
With regard to bond issues, Ptas. 14,433 million were redeemed in 1998 and a single issue was made in July for Ptas. 7,500 million.

Use of the credit line with the European Investment Bank for the Spain – Portugal interconnections was completed with a final withdrawal of Ptas. 3,000 million.





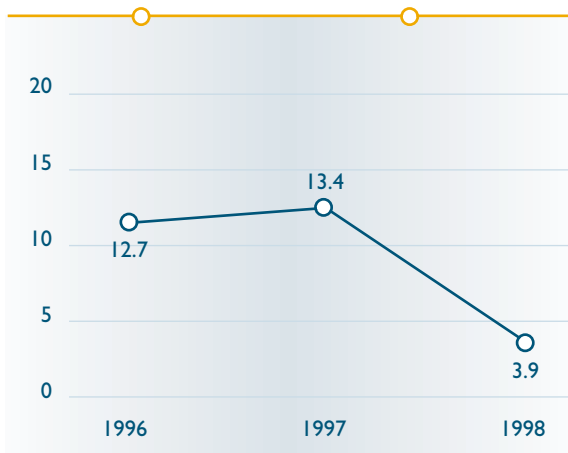
Evolution of financial liabilities
(billions of pesetas)



The average balance of the syndicated credit during the year was Ptas. 8,825 million. The total value of this line is Ptas. 20,000 million and at 31 December Ptas. 15,000 million were available.

As in other years, the short-term promissory note program, together with other short-term finance, was used to introduce changes in funding requirements. The average use of this program during the year was Ptas. 22,689 million and the maximum limit of the program is Ptas. 28,000 million.

Investments (billions of pesetas)



6 Investments

(millions of pesetas)

	1998	1997	1996
Lines	1,725	10,140	6,785
Substations	1,278	1,974	4,610
SUBTOTAL, GRID INVESTMENTS	3,003	12,114	11,395
R&D projects	133	219	288
Other projects	747	1,090	1,004
	880	1,309	1,292
TOTAL	3,883	13,423	12,687

Investments

Investments by RED ELÉCTRICA during 1998 came to Ptas. 3,883 million. Of this amount, 77.3% corresponds to investments in transmission facilities.

The investment in power lines came to Ptas. 1,725 million and Ptas. 1,278 million for substations. The remaining investment, Ptas. 880 million was used for miscellaneous infrastructure projects, equipment and R&D projects.

The breakdown of these investments and their principal components is shown in Table 6.

A photograph of high-voltage electrical equipment, likely a circuit breaker or switchgear, featuring multiple vertical insulator strings and red handwheels. The equipment is set against a clear blue sky with light clouds. The text "International cooperation and sponsorship" is overlaid in white on the left side of the image.

International cooperation and sponsorship





Participation in international organisations

The growing and inevitable technical and institutional integration of power systems and markets renders the need to participate in international organisations increasingly evident. This is especially true in the European context. It is also essential to contribute in a significant way to this integration through the development of proposals and activities which involve the experience and skills of the more capable companies. In this regard, RED ELÉCTRICA has continued to participate in the most important organisations. Activity in 1998 has been intense:

- **EURELECTRIC (European Grouping of the Electricity Supply Industry) / UNIPEDE (International Union of Producers and Distributors of Electrical Energy)**

RED ELÉCTRICA is a founder member and a member of the Executive Committee of EURELECTRIC. It chairs the Industry Observatory. This organisation has developed various initiatives related to the evolution of the internal power market.

- **UCPTE (Union for the Coordination of Production and Transmission of Electricity)**

This organisation, whose basic mission is focussed on the preparation of technical rules and recommendations for the operation of the interconnected European power system, represents 46 companies of 18 countries of continental Europe. In 1998, RED ELÉCTRICA participated as one of the representatives of UCPTE in the creation of the future System Operator Association at European level. RED ELÉCTRICA also holds the office of chairman and secretary of the Spanish Committee.

- **IESOE (South-east European Power Interconnection)**

This organisation consists of the following companies: Electricité de France, Rede Eléctrica Nacional de Portugal and the Spanish utilities companies. Its objective is to examine the operation of the network of interconnections between the member countries and to prepare common recommendations to improve its operations. RED ELÉCTRICA is the secretary and chairs the Spanish Delegation.

- **CIGRE (International Conference on Large Power Networks)**

The goal of this organisation is to facilitate the exchange of technical know-how between all the countries in the field of generation and transmission of high-voltage electric power. It consists of utility companies and manufacturers of electrical capital goods world-wide. RED ELÉCTRICA holds the post of permanent secretary of the Spanish Committee.

- **OME (Observatoire Méditerranéen de l'Energie)**

This organisation was created in 1991 and comprises utility companies and gas and oil companies from the Mediterranean rim. It sponsors and promotes cooperation in questions of power between these countries.



Cooperation and Sponsorship

Sponsorship activities in the fields of education and culture and in projects of general interest, contribute to the maintenance of excellent relations and to improving mutual knowledge of institutions and society in general. In the field of environmental protection, RED ELÉCTRICA's experience – related to its activities – enables it to make positive contributions in various areas. Cooperation with academic institutions through programs related to electrical activities (involving training for the power business and specific research and development programs and projects) is the best way to improve the level of expertise of these institutions in those fields where the accumulated knowledge of RED ELÉCTRICA is most relevant. In this regard, attention is drawn to the cooperation agreements which RED ELÉCTRICA has made with government authorities for the protection of the environment and with various universities for educational, scientific and technological matters, pursuant to Law 30/1994 which covers foundations and tax incentives for private participation in activities of general interest.

The activities related to environmental matters include an agreement with the School of Ecology at the Menéndez Pelayo International University.

The activities related to cooperation and development in the academic area include the Chair of Social Research in the Power Sector which RED ELÉCTRICA sponsors at the Universidad Autónoma of Madrid and the support which it provides to the Foundation and Board of Carlos III University.







Technological research and development

The research and development activities carried out by RED ELÉCTRICA during 1998 include the following:

Projects completed

- **Dynamic monitoring (DITER)**

The objective of this project is to develop a methodology for applying thermal and dynamic real-time limitations to the transmission capacity of overhead 400/220/132 kV power lines. IBERDROLA and RED ELÉCTRICA participate in this project which receives finance from the Electrotechnical Research and Development Program.

- **EFICOM project**

The objective of this project is to increase our knowledge of power consumption in two specific segments of the service sector: restaurants and self-service stores. This project is subsidised by SAVE funds. Results include records and analysis of the consumption of various items of equipment under real conditions of use, together with an evaluation of the degree of efficiency of these consumers. All the results are contained in the final project report which was delivered to the European Commission. The participants were CCE, JRC/ISPRA (Joint Research Centre) and RED ELÉCTRICA as project leader.

Projects underway

- **Inter-area fluctuations in the interconnected system UCPTE/CENTREL**

This project is financed by the European Union. Apart from RED ELÉCTRICA, the following utility companies participate: RWEE (Germany), EDF (France), MVM Rt (Hungary) and PSE S.A. (Poland). The goal of this project is to study the fluctuations which appear in the synchronous UCPTE/CENTREL system and propose suitable control measures as well as the construction of a detailed model of the power system for simulation purposes.

- **Superconductor fault current limiting device for high voltage “ByFault” systems**

This project comes under the BRITE/EURAM program and its objective is to build and install a fault current limiting superconducting device of 17 MVA suitable for high voltage networks.

- **Reduction of transmission losses in regional power systems**

This project is part of the THERMIE program. ENDESA, ENEL and the Strathclyde University participate together with RED ELÉCTRICA, which is the project leader. The project consists in demonstrating the industrial feasibility of an automatic and distributed system for voltage control and the handling of reactive power, which will significantly reduce energy losses in the transmission network and improve the system's safety conditions.

- **Research project on power demand (INDEL)**

In 1998 this project has produced a compendium of Spanish power demand covering the work done in the first phase of the project. It has also extended the NOE database of power usage and completed the final campaign of installations of ARPO recorders at consumers from the commercial panel. Finally, the last phase of the project has been reorganised: it will include a methodology for the analysis of long-term demand, taking into account the new requirements of the participating companies and the new market situation.

- **FOTORED project**

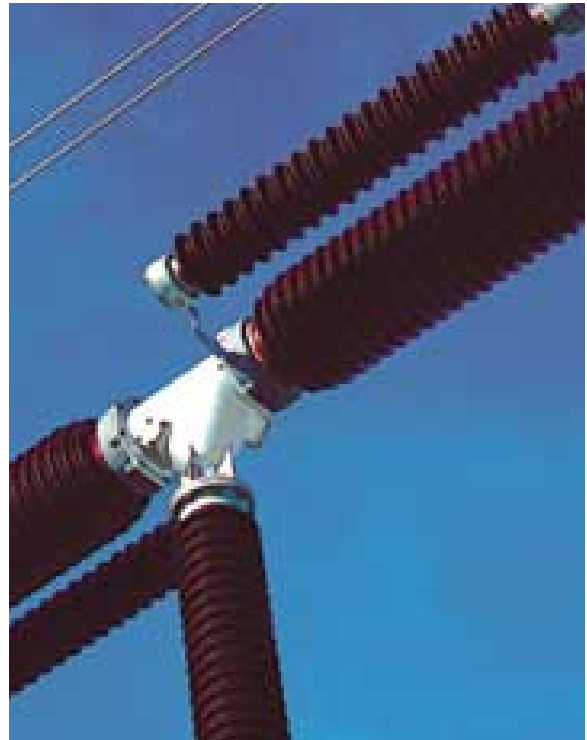
The goal of this project is to analyse the advantages and disadvantages (and to propose solutions) of the large-scale use of photovoltaic power, especially for systems installed in office buildings. The participants are: ENDESA, IBERDROLA, RED ELÉCTRICA and UNED – FUE. This is a project financed by the Electrotechnical Research and Development Program. The activities in 1998 included the following tasks: an analysis of the aggregate load curve, a study of the buildings in the sample whose consumption will be recorded and their installations and a study of photovoltaic buildings connected to the power supply.

- **Demand management project in cooperation with the International Energy Agency**

RED ELÉCTRICA, represents Spain, and is cooperating with other participants from England, the Netherlands, Denmark and Finland, on the design of the new VIII project which will develop mechanisms to present demand management offers in competitive power and operation markets. It has also participated in the creation of a database of international demand management programs and the preparation needed to make them accessible through the Internet.

- **The SACPA project (under the BRITE/EURAM program of the European Union)**

The goal is to evaluate the potential applications of superconductivity in power systems and, specifically, in transmission networks. In the second phase now underway, typical cases have been analysed involving the use of this technology in the development of the power network for supporting urban systems.





Quality

THE PRINCIPAL LINES OF ACTION ARE AIMED AT ACHIEVING THE APPROPRIATE CERTIFICATION OF ALL RED ELÉCTRICA'S basic activities. Tasks which are related to the transmission network and which are currently in progress,

are listed below:

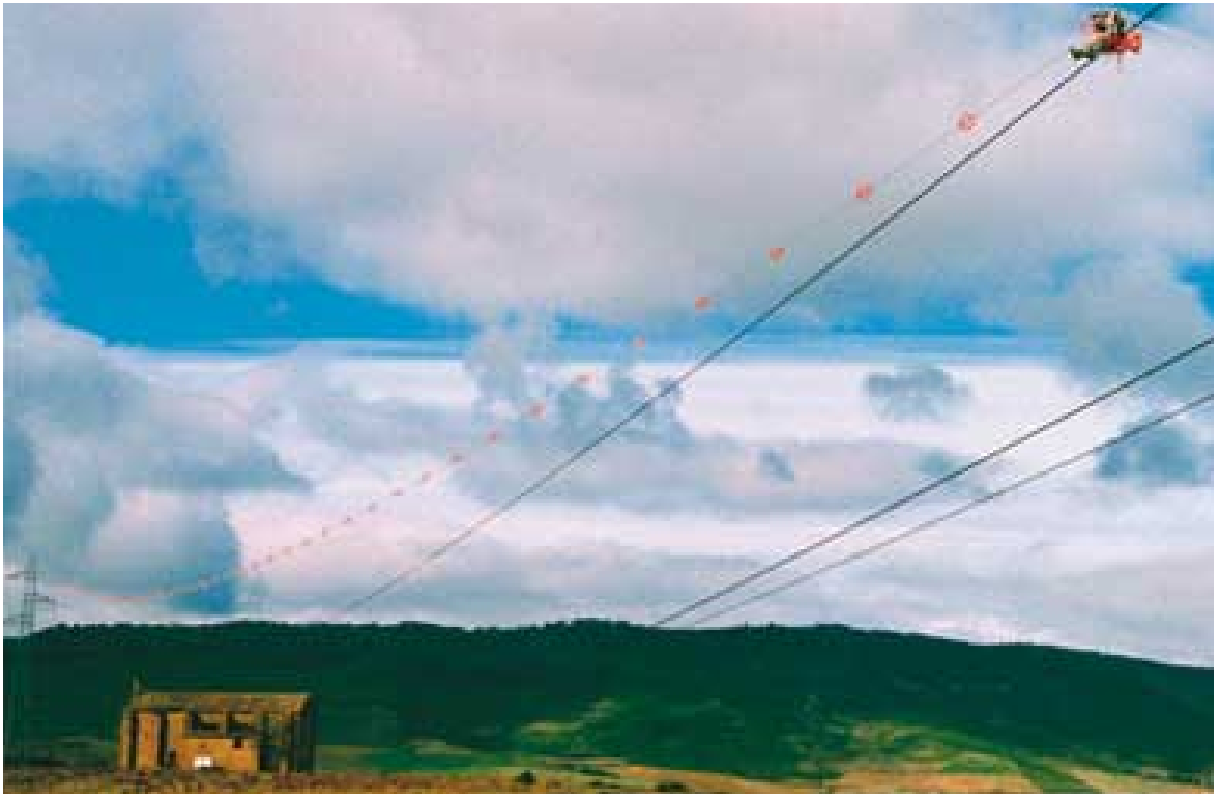
Half way through the year, work was started on grouping the certificates which relate to high voltage lines and which have been issued since 1996, in a single certificate under the ISO 9001 standard. This new certificate will cover all the related activities: engineering, construction and maintenance and will include fibre optic cables. It is also planned to collect all the activities related to high voltage substations in a single certificate by incorporating the engineering and construction aspects in the existing substation maintenance certificate which was issued in 1997.

In addition, an Operation Quality Plan has been developed to ensure that all the activities involved comply with the applicable legal procedures and standards and to guarantee maximum transparency and objectivity of the actions performed by the personnel in charge of operations.





The environment



SINCE ITS INCEPTION, RED ELÉCTRICA HAS BEEN ENGAGED IN ACTIVITIES RELATED TO THE PROTECTION OF THE environment and respect for natural surroundings.

The Environmental Conduct Code of 1992, which expressed RED ELÉCTRICA's voluntary and public commitment to comply with a series of principles of respect for the environment in all its aspects, was complemented by the introduction of the Environmental Policy (1998).



In 1998, the environmental impact study for the 220 kV Bolarque – Trillo Nuclear Power Station line was completed and studies for four new lines and seven substations associated with the Madrid – Aragon – Lérida Main Trunk Line, were commenced. Further studies were started for five lines and two substations which will help to transfer power away from the wind farms in the autonomous regions of Galicia, Aragon and Navarre. The implementation of the Environmental Management System in accordance with the UNE-EN-ISO 14001 standard, was also completed and the corresponding certificate is expected from AENOR in the second half of 1999. During the implementation process, 31 environmental audits were conducted at 18 facilities.

In 1998, as part of the project entitled “Design and testing of methods of discouraging the nesting of storks in the towers of power lines”, the first prototypes have been installed. The results will be used to prevent storks nesting in those parts of the towers which pose a risk to the installation or the birds themselves but without preventing the

The environment

birds from nesting in other parts of the tower which are risk-free. This work is being carried in conjunction with the Doñana Biological Station (CSIC).

Work has continued on the installation of birdsavers on spans which are potentially dangerous, to avoid collisions involving birds. This mainly affects Catalonia and Navarre.

Under the project entitled "Proposal for the environmental management of the rights of way for RED ELÉCTRICA's lines", in cooperation with the Universidad Politécnica of Madrid, the different types of vegetation which exist in the central and southern regions of the Spanish mainland have been identified. This will help in designing the most suitable procedures which will allow the lines and the vegetation to co-exist.

During 1998, projects were prepared for improving or adjusting the landscape aspects at five substations and this work included the generation of the corresponding graphical simulations. Other activities included the updating of the database of all the nature reserves on the Spanish mainland, including the legislation applicable at each and digitised maps.



Year 2000 Effect





IN 1998, AFTER CARRYING OUT AN ANALYSIS OF THE SITUATION AT EACH OF ITS RELEVANT INFORMATION AND control systems, RED ELÉCTRICA commenced a series of renewal and improvement projects to prevent the possible negative consequences of the so-called "Y2K Effect" and to ensure proper operation at the change of the millennium.

The computer systems which support the Company's management systems have been completely replaced using SAP R/3. Work was also started on bringing certain modules of the power management system up to date, to ensure that the change of the millennium will take place without problem. This works affects both the power control centre and the regional installations. It is expected to be completed in the first half of 1999.

This work has been coordinated with the utility companies and the government. RED ELÉCTRICA is also represented in the specialised working groups of the more important international organisations. This will ensure uniformity of criteria – in terms of safety and operations.



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
Jenabos de Cuentas con el n.º 13.
Reg. Merc. Madrid, T. 11.261, F. 04, Sec. 8, N. 14-188.007, 14/03/17
N.I.C. 8-7837032



ASSETS	1998	1997
INTANGIBLE ASSETS	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
TANGIBLE ASSETS	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
INVESTMENTS	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
LONG-TERM TRADE DEBTORS	967,500,000	6,352,700,000
Long-term trade debtors	967,500,000	6,352,700,000
TOTAL FIXED ASSETS	235,819,168,279	253,861,763,203
DEFERRED EXPENSES	817,189,294	960,502,625
STOCKS	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
DEBTORS	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	—
SHORT-TERM INVESTMENTS	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
CASH AND BANKS	36,121,502	40,154,314
PREPAID EXPENSES	263,064,630	611,326,118
TOTAL CURRENT ASSETS	27,836,597,190	19,429,228,669
TOTAL ASSETS	264,472,954,763	274,251,494,497

SHAREHOLDERS' EQUITY AND LIABILITIES	1998	1997
SHARE CAPITAL	45,090,000,000	45,090,000,000
1996 REVALUATION RESERVE	41,100,991,320	41,100,991,320
RESERVES	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
PROFIT FOR THE YEAR	11,535,705,431	9,539,777,762
INTERIM DIVIDEND	—	-3,000,000,000
TOTAL SHAREHOLDER'S EQUITY	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
TOTAL DEFERRED INCOME	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
TOTAL PROVISIONS FOR LIABILITIES	2,588,950,628	753,287,213
BONDS ISSUED	26,017,500,000	18,517,500,000
LOANS	41,277,346,979	36,675,919,386
OTHER CREDITORS	7,322,494,635	7,067,639,704
TOTAL LONG-TERM LIABILITIES	74,617,341,614	62,261,059,090
BONDS ISSUED	790,702,247	15,429,323,512
Non-convertible bonds	—	14,432,500,000
Interest payable	790,702,247	996,823,512
LOANS	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
TRADE CREDITORS	8,673,723,112	7,801,723,342
From purchases and services received	8,673,723,112	7,801,723,342
OTHER CREDITORS	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
ACCRUALS	5,290,191,426	6,844,131,803
TOTAL CURRENT LIABILITIES	38,797,020,026	72,448,961,012
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES	264,472,954,763	274,251,494,497

EXPENSES	1998	1997
COST OF MATERIALS CONSUMED	35,173,173,409	11,742,544,810
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
PERSONNEL EXPENSES	8,877,452,502	8,520,742,476
Wages and salaries	6,563,906,592	6,220,788,611
Social benefits	2,313,545,910	2,299,953,865
DEPRECIATION AND AMORTISATION	16,396,811,735	15,719,774,468
VARIATION IN TRADE PROVISIONS	101,181,191	133,050,272
OTHER OPERATING EXPENSES	7,202,272,136	9,276,198,368
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
TOTAL OPERATING EXPENSES	67,750,890,973	45,392,310,394
OPERATING PROFIT	23,076,908,991	20,954,709,314
FINANCIAL AND RELATED EXPENSES	6,571,128,037	7,309,345,673
On debt with third parties	6,571,128,037	7,309,345,673
EXCHANGE LOSSES	38,193,536	1,268,263,219
TOTAL FINANCIAL EXPENSES	6,609,321,573	8,577,608,892
PROFIT ON ORDINARY ACTIVITIES	17,073,350,610	13,031,144,258
VARIATION IN PROVISIONS FOR TANGIBLE ASSETS	230,290,462	335,513,162
LOSSES ON TANGIBLE ASSETS	31,858,409	48,222,771
EXTRAORDINARY EXPENSES	1,816,345,223	3,880,869
PRIOR YEARS' EXPENSES	24,436,608	418,151,343
TOTAL EXTRAORDINARY EXPENSES	2,102,930,702	805,768,145
NET EXTRAORDINARY INCOME	320,412,616	971,602,763
PROFIT BEFORE TAX	17,393,763,226	14,002,747,021
INCOME TAX	5,858,057,795	4,462,969,259
PROFIT FOR THE YEAR	11,535,705,431	9,539,777,762

INCOME	1998	1997
NET SALES	89,246,655,748	63,107,043,171
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
SELF-CONSTRUCTED ASSETS	1,344,899,439	2,546,477,087
OTHER OPERATING INCOME	236,244,777	693,499,450
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
TOTAL OPERATING INCOME	90,827,799,964	66,347,019,708
INVESTMENT INCOME	405,989,177	130,248,428
OTHER INTEREST AND SIMILAR INCOME	139,327,621	456,294,718
Other interest	139,327,621	356,846,024
Profit on investments	—	99,448,694
EXCHANGE GAINS	60,446,394	67,500,690
TOTAL FINANCIAL INCOME	605,763,192	654,043,836
NET FINANCIAL EXPENSE	6,003,558,381	7,923,565,056
PROFIT ON TANGIBLE ASSETS	7,039,434	1,482,196
CAPITAL GRANTS TAKEN TO INCOME	728,023,483	512,118,508
EXTRAORDINARY INCOME	1,484,622,932	430,389,250
PRIOR YEARS' INCOME	203,657,469	833,380,954
TOTAL EXTRAORDINARY INCOME	2,423,343,318	1,777,370,908

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
BASIS OF DISTRIBUTION	
Profit for the year	11,536
TOTAL	11,536
DISTRIBUTION	
Voluntary reserves	4,614
Dividends	6,922
TOTAL	11,536

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
BUILDINGS	2%-10%
PLANT AND MACHINERY:	
- 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%
OTHER INSTALLATIONS, EQUIPMENT, FURNITURE AND OTHER TANGIBLE ASSETS	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)
COST					
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
TOTAL COST	360,821	12,994	(157)	—	373,658
ACCUMULATED DEPRECIATION					
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)
ACCUMULATED DEPRECIATION	(111,615)	(15,455)	109	—	(126,961)
PROVISION FOR IMPAIRMENT (NOTE 4-C)	(2,621)	(336)	—	—	(2,957)
NET BOOK VALUE	246,585	(2,797)	(48)	—	243,740

(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)
COST					
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
TOTAL COST	373,658	3,426	(515)	—	376,569
ACCUMULATED DEPRECIATION					
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)
ACCUMULATED DEPRECIATION	(126,961)	(16,052)	136	—	(142,877)
PROVISION FOR IMPAIRMENT (NOTE 4-C)	(2,957)	(281)	51	—	(3,187)
NET BOOK VALUE	243,740	(12,907)	(328)	—	230,505

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
TOTAL LONG-TERM INVESTMENTS	2,561	2,010
Investments in group companies	—	300
Uncalled portion of investments in group companies	—	(218)
Other short-term investments	1,608	654
TOTAL SHORT-TERM INVESTMENTS	1,608	736

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

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
TOTAL SHARE CAPITAL	45,090	100.00	45,090	100.00

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
	32,404	31,785

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
	2,589	753

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
	26,018	18,517

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)	—
	—	8,817
Loans and credit facilities	44,175	30,013
Less, current portion (note 15)	(2,898)	(2,154)
	41,277	36,676

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
	8,751	11,275

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
	41,277	36,676

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
	157	13,938
Transfer from long-term bank loans (note 12)	—	2,556
Less, repayments in advance	(157)	(16,307)
Less, current portion	—	(30)
	—	157
Deferred tax liability (note 19)	7,314	6,906
Long-term deposits received	8	5
	7,322	7,068

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
	7,322	7,068

(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
	13,331	28,632
Accrued interest payable	1,654	2,054
	14,985	30,686

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
	8,674	7,802

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
	9,057	11,688

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

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

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

Other debts are as follows:

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

(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
Taxable accounting income	17,374	14,149
Timing differences:		
Generated during the year	1,876	(565)
Reversal of prior years	(1,388)	(1,147)
TAXABLE INCOME	17,862	12,437

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)
Expense for the year	5,855	4,753
Prior years' adjustment	3	(290)
INCOME TAX CHARGE	5,858	4,463

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
TAX DIFFERENCE:				
– Long-term (note 6)				
Deferred income	3,154	1,104	1,020	357
Other	443	155	509	178
	3,597	1,259	1,529	535
– Short-term (note 7)				
Other	400	140	686	240
	400	140	686	240
	3,997	1,399	2,215	775
DEFERRED TAX LIABILITIES:				
– 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	—	—
	20,896	7,314	19,731	6,906
– 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	—	—
	835	292	706	247
	21,731	7,606	20,437	7,153

(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
	89,247	63,107

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 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
	8,877	8,521

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
	1,079	1,102

(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
FIXED ASSETS		
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
TOTAL FIXED ASSETS	235,819	253,862
DEFERRED EXPENSES	817	960
CURRENT ASSETS		
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
TOTAL CURRENT ASSETS	27,837	19,429
TOTAL ASSETS	264,473	274,251

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

SHAREHOLDERS' EQUITY AND LIABILITIES	1998	1997
SHAREHOLDERS' EQUITY (note 8)		
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)
TOTAL SHAREHOLDERS' EQUITY	116,066	107,003
Capital grants	10,823	9,278
Exchange losses	16	—
Other deferred income	21,565	22,507
TOTAL DEFERRED INCOME (note 9)	32,404	31,785
PROVISIONS FOR LIABILITIES (note 10)	2,589	753
LONG-TERM CREDITORS		
Bond issued (note 11)	26,018	18,517
Loans (note 12)	41,277	36,676
Other creditors (note 13)	7,322	7,068
TOTAL LONG-TERM CREDITORS	74,617	62,261
CURRENT LIABILITIES		
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
TOTAL CURRENT LIABILITIES	38,797	72,449
TOTAL SHAREHOLDER'S EQUITY AND LIABILITIES	264,473	274,251

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
OPERATING EXPENSES		
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
OTHER OPERATING EXPENSES		
External services	6,814	8,791
Local taxes	206	80
Other overheads	170	144
Provision for liabilities (note 10)	13	261
TOTAL OPERATING EXPENSES	67,751	45,392
OPERATING PROFIT	23,077	20,955
FINANCIAL EXPENSES		
Interest and similar expenses	6,571	7,309
Exchanges losses	38	1,268
TOTAL FINANCIAL EXPENSES	6,609	8,577
PROFIT ON ORDINARY ACTIVITIES	17,073	13,031
EXTRAORDINARY LOSSES AND EXPENSES		
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
TOTAL EXTRAORDINARY EXPENSES	2,103	805
NET EXTRAORDINARY INCOME	321	972
PROFIT BEFORE TAX	17,394	14,003
INCOME TAX (note 19)	(5,858)	(4,463)
PROFIT FOR THE YEAR	11,536	9,540

INCOME	1998	1997
OPERATING INCOME		
Net sales (note 20)	89,247	63,107
Self-constructed assets	1,345	2,546
Other operating income	236	694
TOTAL OPERATING INCOME	90,828	66,347
FINANCIAL INCOME		
Investment income	406	130
Other interest and similar income	139	456
Exchange gains	60	67
TOTAL FINANCIAL INCOME	605	653
NET FINANCIAL EXPENSE	6,004	7,924
EXTRAORDINARY PROFIT AND INCOME		
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
TOTAL EXTRAORDINARY INCOME	2,424	1,777

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
BALANCES AT 31 DECEMBER 1996	45,090	41,101	8,312	1,352	17,873	3,028	30,565	10,547	(2,367)	124,936
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)
BALANCES AT 31 DECEMBER 1997	45,090	41,101	9,018	1,352	980	2,922	14,272	9,540	(3,000)	107,003
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
BALANCES AT 31 DECEMBER 1998	45,090	41,101	9,018	1,352	5,153	2,816	18,339	11,536	—	116,066

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

APPLICATIONS	1998	1997		
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		
TOTAL APPLICATIONS	21,067	81,177		
INCREASE IN WORKING CAPITAL	42,060	—		
	63,127	81,777		
SOURCES				
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		
TOTAL SOURCES	63,127	61,946		
DECREASE IN WORKING CAPITAL	—	19,231		
	63,127	81,177		
CHANGES IN WORKING CAPITAL				
	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	—
	42,463	42,463	19,754	19,754

(*) 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	%
FIXED ASSETS	231,116	98	4,375	2	30	—	298	—	235,819	100
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
DEFERRED EXPENSES	801	98	15	2	—	—	1	—	817	100
CURRENT ASSETS	13,733	50	92	—	8,039	29	5,973	21	27,837	100
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
TOTAL ASSETS	245,650	92	4,482	2	8,069	3	6,272	3	264,473	100
SHAREHOLDERS' EQUITY AND LIABILITIES										
SHAREHOLDERS' EQUITY	113,490	98	6	—	716	1	1,854	1	116,066	100
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
DEFERRED INCOME	14,574	45	1,259	4	1,222	4	15,349	47	32,404	100
PROVISIONS FOR LIABILITIES	1,685	65	795	31	46	2	63	2	2,589	100
LONG-TERM CREDITORS	74,460	100	152	—	—	—	5	—	74,617	100
CURRENT LIABILITIES	27,959	72	658	2	9,463	24	717	2	38,797	100
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
INTERACTIVITY FINANCING	13,482	—	1,612	—	(3,378)	—	(11,716)	—	—	—
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES	245,650	92	4,482	2	8,069	3	6,272	3	264,473	100

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
= VALUE OF PRODUCTION	52,958	58	1,183	1	34,358	38	2,296	3	90,795	100
- 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
= VALUE ADDED BY THE COMPANY	44,762	94	307	1	1,058	2	1,604	3	47,731	100
- Other expenses	(74)	100	—	—	—	—	—	—	(74)	100
- Personnel expenses	(6,742)	77	(1,630)	18	(39)	—	(415)	5	(8,826)	100
= GROSS OPERATING PROFIT/(LOSS)	37,946	98	(1,323)	(3)	1,019	2	1,189	3	38,831	100
- 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
= NET OPERATING PROFIT/(LOSS)	22,690	98	(1,723)	(7)	1,019	4	1,045	5	23,031	100
+ Financial income	220	36	2	—	12	2	371	62	605	100
- Financial expenses	(6,346)	96	(46)	1	(209)	3	(8)	—	(6,609)	100
= PROFIT/(LOSS) ON ORDINARY ACTIVITIES	16,564	97	(1,767)	(10)	822	5	1,408	8	17,027	100
+ 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
= PROFIT/(LOSS) BEFORE TAX	15,806	91	(1,932)	(11)	1,021	6	2,499	14	17,394	100
- Income tax	(4,762)	81	—	—	(318)	6	(778)	13	(5,858)	100
= PROFIT/(LOSS) FOR THE YEAR	11,044	96	(1,932)	(17)	703	6	1,721	15	11,536	100

(*) 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

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

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.





The transmission network
of **RED ELÉCTRICA**



The transmission network of RED ELÉCTRICA (Dec 31, 1998)

LINES	CIRCUITS		VOLTAGES			
	planned	installed	400 kV	220 kV	132 kV	66 kV
In service	1	1				
Under construction and planned	2	1				
	2	2				
Underground / underwater cable						

All the lines are shown in the colour corresponding to their present operation. In the case of lines at a different voltage, this is shown in brackets, eg. (400 kV)

SUBSTATIONS	STATUS	
	In service	Under construction and planned

Photography:

Javier Azurmendi, pages 26, 30, 36, 38, 42, 44, 49, 52 y 66

José Conejo, pages 14 y 18

Óscar Masats, page 46

Fernando Prados, pages 2, 12, 17, 22, 34, 41, 54 y 61

By RED ELÉCTRICA:

Ángel Andrés Martínez, pages 4 y 20

Juan Carlos Corral Santalla, page 24

Agapito García Gonzalo, pages 29, 63 y 64

Mariano Hernández Toledo, page 11.

Raúl Santamaría Álvarez, pages 58 y 62

Pedro Somarriba Conde, pages 40 y 56

Graphic Design:

Estudio Gráfico Juan de la Mata



RED ELÉCTRICA
DE ESPAÑA

Pº del Conde de los Gaitanes, 177
28109 La Moraleja - Madrid
<http://www.ree.es>



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