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RED ELECTRICA

Annual Report 1997



Resolutions of the Board of Directors

The Board of Directors drew up the following documents which it submitted to the General Assembly of shareholders for approval:

1997 Annual accounts - 59

INDEPENDENT AUDITOR'S REPORT - 61
BALANCE SHEETS - 62
PROFIT & LOSS ACCOUNTS - 64
NOTES TO THE ANNUAL ACCOUNTS - 66

Management report - 92

Proposed distribution of profits - 96

**1997 Annual
accounts**

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 1997 and 1996, 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 Company's Board of Directors. 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 1997 and 1996 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 1997 contains such explanations as the directors consider relevant to the situation of the Company, the evolution of its business and other matters, and 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 1997. 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 audited accounting



Valeriano Pérez Lozano

11 March 1998



Assets	1997	1996
INTANGIBLE ASSETS		
Research and development expenses.....	2,801,044,768	2,592,014,766
Software	595,010,383	384,610,528
Accumulated amortisation.....	-1,636,978,378	-1,371,512,755
TANGIBLE ASSETS		
Land and buildings.....	5,814,631,753	5,541,670,502
Plant and machinery.....	335,425,047,354	315,753,104,494
Other installations, equipment and furniture.....	4,243,034,396	4,036,914,172
Assets under construction.....	21,049,768,418	30,010,243,658
Other tangible assets.....	7,125,331,197	5,479,551,752
Provisions	-2,956,799,447	-2,621,286,285
Accumulated depreciation	-126,960,840,397	-111,614,694,064
INVESTMENTS		
Long-term investment portfolio	5,658,553	5,658,553
Other loans	1,459,213,104	1,544,531,298
Long-term guarantee deposits	9,802,866	10,102,866
Long-term balances due from public entities	535,138,633	582,537,214
LONG-TERM TRADE DEBTORS	6,352,700,000	-
TOTAL FIXED ASSETS.....	253,861,763,203	250,333,446,699
DEFERRED EXPENSES	960,502,625	935,393,091
Stocks		
Raw materials and other supplies.....	1,258,246,586	1,281,804,866
Provisions for obsolescence.....	-589,513,693	-456,463,421
Debtors		
Sundry debtors	16,024,066,306	16,579,489,946
Personnel.....	283,714,371	264,306,330
Public entities	1,064,734,332	284,982,600
Short-term investments		
Interests in group companies.....	82,500,000	-
Short-term investment portfolio.....	347,500	427,500
Other loans	653,652,835	1,035,823,173
Short-term guarantee deposits.....	-	31,280
CASH AND BANKS.....	40,154,314	106,217,329
PREPAID EXPENSES	611,326,118	332,155,399
TOTAL CURRENT ASSETS.....	19,429,228,669	19,428,775,002
TOTAL ASSETS.....	274,251,494,497	270,697,614,792

BALANCE SHEETS

31 December 1997 and 1996

(Expressed in pesetas)

Shareholders' equity and liabilities	1997	1996
SHARE CAPITAL	45,090,000,000	45,090,000,000
REVALUATION RESERVE	41,100,991,320	41,100,991,320
RESERVES		
Legal reserve	9,018,000,000	8,312,157,514
Other reserves	5,254,165,885	22,252,671,077
PROFIT FOR THE YEAR	9,539,777,762	10,547,361,645
INTERIM DIVIDEND	-3,000,000,000	-2,367,225,000
TOTAL SHAREHOLDER'S EQUITY	107,002,934,967	124,935,956,556
Capital grants	6,683,503,211	6,644,997,836
Other deferred income	25,101,749,004	2,772,408,377
TOTAL DEFERRED INCOME	31,785,252,215	9,417,406,213
Provisions for pensions and other liabilities	93,303,912	84,528,445
Other provisions	659,983,301	487,411,067
PROVISIONS	753,287,213	571,939,512
BONDS	18,517,500,000	24,432,500,000
LOANS	36,675,919,386	37,780,158,848
OTHER CREDITORS	7,067,639,704	20,341,754,320
TOTAL LONG-TERM LIABILITIES	62,261,059,090	82,554,413,168
BONDS		
Non-convertible bonds	14,432,500,000	-
Interest payable	996,823,512	927,439,944
LOANS		
Loans and other debt	28,632,273,406	16,079,283,018
Interest payable	2,054,117,109	2,386,643,991
TRADE CREDITORS		
Purchases and services received	7,801,723,342	11,183,553,128
OTHER CREDITORS		
Public entities	1,877,664,832	4,433,097,849
Others	9,342,054,551	14,879,673,910
Wages and salaries	1,323,826	1,300,336
Short-term guarantee deposits	466,348,631	351,994,254
ACCRUED EXPENSES	6,844,131,803	2,974,912,913
CURRENT LIABILITIES	72,448,961,012	53,217,899,343
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES ..	<u>274,251,494,497</u>	<u>270,697,614,792</u>

	1997	1996
Expenses		
COST OF MATERIALS CONSUMED		
Purchase of electrical power	10,396,969,569	29,617,366,987
Maintenance and repair material	1,345,575,241	1,559,542,742
PERSONNEL EXPENSES		
Wages and salaries	6,220,788,611	6,002,587,760
Social benefits	2,299,953,865	2,138,090,054
DEPRECIATION AND AMORTISATION	15,719,774,468	13,676,265,338
VARIATION IN TRADE PROVISIONS	133,050,272	186,043,269
OTHER OPERATING EXPENSES		
External services	8,790,722,842	9,835,230,964
Local taxes	80,548,900	119,234,170
Other administrative expenses	143,926,626	172,423,766
Provision for liabilities	261,000,000	50,000,000
TOTAL OPERATING EXPENSES	45,392,310,394	63,356,785,050
OPERATING PROFIT	<u>20,954,709,314</u>	<u>24,651,911,526</u>
FINANCIAL AND RELATED EXPENSES		
On debt with third parties	7,309,345,673	8,933,432,258
EXCHANGE LOSSES	1,268,263,219	666,636,401
TOTAL FINANCIAL EXPENSES	8,577,608,892	9,600,068,659
PROFIT ON ORDINARY ACTIVITIES	<u>13,031,144,258</u>	<u>15,402,446,135</u>
VARIATION IN PROVISIONS FOR TANGIBLE ASSETS		
FOR TANGIBLE ASSETS	335,513,162	1,514,286,229
LOSSES ON TANGIBLE ASSETS	48,222,771	19,030,919
EXTRAORDINARY EXPENSES	3,880,869	2,064,293
PRIOR YEARS' EXPENSES	418,151,343	275,126,535
TOTAL EXTRAORDINARY EXPENSES	805,768,145	1,810,507,976
NET EXTRAORDINARY INCOME	<u>971,602,763</u>	<u>-</u>
PROFIT BEFORE TAX	<u>14,002,747,021</u>	<u>14,434,309,938</u>
INCOME TAX	4,462,969,259	3,886,948,293
NET PROFIT FOR THE YEAR	<u>9,539,777,762</u>	<u>10,547,361,645</u>

PROFIT & LOSS ACCOUNTS

31 December 1997 and 1996

(Expressed in pesetas)

	1997	1996
Income		
NET SALES		
Sales of electrical power	11,173,487,067	30,958,002,546
Sale of by-products	44,692,898	34,713,400
Income on international power exchange	1,055,188,106	571,398,122
Services rendered	50,833,675,100	52,837,379,280
SELF-CONSTRUCTED ASSETS	2,546,477,087	2,791,212,322
OTHER OPERATING INCOME		
Other administrative income	633,053,536	759,104,159
Capital grants	60,445,914	56,886,747
TOTAL OPERATING INCOME	<u>66,347,019,708</u>	<u>88,008,696,576</u>
INVESTMENT INCOME	130,248,428	21,183,728
OTHER INTEREST AND SIMILAR INCOME		
Other interest	356,846,024	228,725,859
Profit on investments	99,448,694	-
EXCHANGE GAINS	67,500,690	100,693,681
TOTAL FINANCIAL INCOME	<u>654,043,836</u>	<u>350,603,268</u>
NET FINANCIAL EXPENSE	<u>7,923,565,056</u>	<u>9,249,465,391</u>
PROFIT ON TANGIBLE ASSETS	1,482,196	573,855
CAPITAL GRANTS TAKEN TO INCOME	512,118,508	451,757,619
EXTRAORDINARY INCOME	430,389,250	114,402,984
PRIOR YEARS' INCOME	833,380,954	275,637,321
TOTAL EXTRAORDINARY INCOME	<u>1,777,370,908</u>	<u>842,371,779</u>
NET EXTRAORDINARY EXPENSE	<u>-</u>	<u>968,136,197</u>

NOTES TO THE ANNUAL ACCOUNTS 31 DECEMBER 1997 AND 1996

(1) Nature and principal activities

Red Eléctrica de España, S.A. (hereinafter «the Company») was incorporated on 29 January 1985. The Company took over part of the assets forming the high voltage grid network which was in service at 15 February 1984. Other assets in service at that date were simultaneously transferred by the shareholders to the Company and recorded as debt arising from the acquisition of fixed assets upon incorporation (see note 13).

During 1997 and 1996 the Company carried out activities related to the joint operation of the public electric power system, the transmission of power and the international exchange of power, in accordance with Law 40 date 30 December 1994 governing the Spanish electricity sector.

Towards the end of 1997 new legislation governing the electricity sector (Law 54 dated 27 November 1997) was enacted, as a result of which Law 40/1994 was repealed. This legislation represents a significant step towards the deregulation of the sector as it provides for the creation of a free market for electricity generating. Law 54/1997 also establishes two new agents 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, it has been necessary to create a new trading company, the market operator, to match orders for the purchase and sale of power between generators, distributors, electricity traders and qualifying consumers. As required by the new Law, Red Eléctrica de España, S.A. has incorporated the new company and subscribed 100% of its share capital, as explained in note 6.

The Company will carry out the functions established by the new Law for 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 Company will also perform the functions of Manager of the Transmission Network, as required by the new Law. In this capacity, the Company will be responsible for the development and extension of the high voltage grid network and for ensuring that it is maintained and improved in accordance with uniform and coherent criteria. The Manager of the Transmission Network will also be responsible for the administration of power transmissions between external systems through the Spanish grid.

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

The Company receives a consideration for the transmission of power which is based on the cost of investment, operation and maintenance of the installations, as well as other costs inherent in the activity. The remuneration of the system operation reflects the identifiable costs.

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 capacity relating to security, frequency or quality of supply. The terms of access, including applicable tariffs, conditions for connecting new installations and restrictions on access, are established by Law.

The interests in the capital of the Company owned by individual shareholders must be brought into line with the requirements of the new Law governing the electricity sector within six months and its articles of association modified to restrict the maximum permitted shareholding (see note 8).

In accordance with the new Law, the Company is authorised to carry out activities of all kinds related to the transmission of electricity, in particular planning, construction, operation and maintenance or modification of the transmission and auxiliary installations, as well as activities related to the Operation of the System and Management of the Transmission Network. The Company may also diversify activities in legally permitted areas such as those relating to telecommunications and the construction and maintenance of electrical installations. The Company will also continue to manage agreements entered into prior to the enactment of the new Electricity Sector Law for the long-term exchange of power between EU member States and other countries.

(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 1996 and 1997, and the proposed distribution of profit for 1997.

The annual accounts have been prepared on the basis of the accounting 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 the Profit and Loss account expressed in millions of Pesetas have been included as Appendices I and II, and cross-referenced to the notes. The Board of Directors considers that the 1997 annual accounts will be approved without significant changes at the Annual General Meeting. The 1996 annual accounts were approved by the shareholders at their Annual General Meeting held on 27 May 1997.

Certain reclassifications have been made to the 1996 profit and loss account for the purposes of comparison with 1997. The effects of these reclassifications are not significant to the annual accounts taken as a whole.

(3) Distribution of profits

The board of directors propose that the 1997 profit be distributed as follows:

	Million pesetas
BASIS OF DISTRIBUTION	
Profit for the year.....	9,540
TOTAL	9,540
DISTRIBUTION	
Voluntary reserve.....	4,173
Dividends:	
Interim dividend.....	3,000
Supplementary dividend....	2,367
TOTAL	9,540

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

At their Extraordinary General Meeting held on 4 June 1997 the shareholders authorised the Company to distribute an extraordinary dividend of Ptas. 22,000 million with a charge to voluntary reserves. At the same meeting the shareholders also authorised the distribution an interim dividend of Ptas. 3,000 million on account of 1997 profits, which was paid on 30 September 1997. This amount is less than the legal limit specified in article 216 section b) of the amended Spanish Companies Act.

The cash flow forecasts for the period from 30 April to 30 September 1997 showed that the Company had sufficient liquidity to distribute this dividend and, as required by article 216 section a) of the amended Companies Act, the following provisional statement of liquidity was prepared:

	Million pesetas
Funds available at 30.04.97:	
Long-term credit facilities available	27,000
Short-term credit facilities available	7,790
Cash in hand and at banks ..	67
Forecast collections:	
Trading operations	35,162
Financial operations	16,034
Forecast payments:	
Trading operations	(35,654)
Financial operations	(10,622)
Ordinary dividend for 1996.	(2,367)
Extraordinary dividend	(22,000)
Funds available at 30.09.97	<u>15,410</u>

The forecast of distributable profits at 30 April 1997 was as follows:

	Million pesetas
Profits before tax at 30-04-97	5,696
Estimated income tax charge	(1,970)
Profit after tax at 30-04-97	3,726
Maximum distributable earnings (Article 216 b) Companies Act).....	<u>3,726</u>
Proposed dividend on account of 1997 profits	<u>3,000</u>

On the basis of the cash flow projection for the twelve months commencing 4 June 1997 no restrictions were expected on the funds available for distribution. Also, the earnings generated in 1997, as reflected in these annual accounts, were sufficient to permit the distribution of this interim dividend.

The distribution of the profit for the year ended 31 December 1996, carried out in 1997, is presented in the detail of shareholders' equity disclosed in Appendix III, which forms an integral part of note 8.

(4) Accounting principles

The accompanying annual accounts have been prepared in accordance with accounting principles established in the Spanish Chart of Accounts, the most significant of which 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 (see section c) to this note), 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 the legislation, reduced by 40% in order to take into consideration the structure of the Company's financing (see note 5).

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 expected useful lives of the relevant assets, applying the following annual rates:

	Annual rate
Buildings	2%-5%
Plant and machinery:	
• In operation when acquired by the Company:	
Power lines.....	5%
Substations.....	5%
Control and communication systems (supervisory control centres).....	14.28%
• Built and put into operation by the Company:	
Power lines.....	2.5%
Substations.....	2.5%
Control and communication systems (supervisory control centres).....	7.14%
Other installations, equipment and furniture.....	4%-20%
Other tangible assets.....	25%

- Financial expenses relating to specific and general financing obtained. Interest charges on general financing are calculated by applying the average effective rate of interest to the average accumulated cost of the investment for which no specific financing has been obtained. In 1997 and 1996 the Company has capitalised Ptas. 1,497 and 1,635 million, respectively.

Costs capitalised in this respect are credited to the Profit and Loss account under 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 the legislation, reduced by 40% in order to take into consideration the structure of the Company's financing (see note 5).

Provision is made against the value of self-constructed tangible assets 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 total for a specific asset represents a significant portion of the cost of a project as a consequence of delays in bringing the asset into operation which are not attributable to the Company.

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 has 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 estimated useful life of power lines and substations built and put into operation by the Company is now 40 years (38 and 30 years, respectively, in 1996). Accordingly, during 1997 the net book value of these assets at 31 December 1996 has been depreciated on a straight line basis over the new estimated useful lives. The effect on the depreciation charge for 1997 is approximately Ptas. 2,354 million.

(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 1997 and 1996 the Company has capitalised Ptas. 831 and 868 million, respectively.

(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 the recovery of items is doubtful.

(e) Foreign exchange transactions

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

Until 31 December 1996, inclusive, net unrealised exchange losses at 31 December were expensed over the duration of the operation using the interest method. The portion relating to future years was taken to deferred expenses in the Balance Sheet.

Unrealised net exchange gains at 31 December were taken to income using the same criteria, the future portion being deferred as a liability on the balance sheet. Nevertheless, foreign exchange gains were taken to income each year only to the limit of net exchange losses expensed in that and prior years.

As a consequence of changes in the legislation governing the electricity sector (see note 1), the special accounting principals permitting the deferral of net unrealised exchange losses are no longer applicable. Accordingly, at 31 December 1997 the Company has recognised net exchange losses of Ptas. 913 million.

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 recorded represents the net difference between the hedged and hedging operations. The average interest rates on financial debt are calculated by applying the same criteria (see note 24).

(g) Bond issues

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 periods to the maturity of the debt using the interest method.

When interest rate swaps are contracted to hedge the related interest rate risk and, where applicable, redemption premiums 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 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 income tax expense in the year 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 (see note 25 a)) are recognised in proportion to the value of the assets financed 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 25 e)) and, in general, on any agreement or commitment with a duration of more than one year (see note 25 a)) are taken to income over the term of the related agreement or commitment.

(l) Pension plan

The voluntary pension plan with defined contributions adopted by the Company on 31 December 1985 was integrated into a pension fund under current legislation with effect from 2 November 1990. Equal contributions are made by the Company and the participants by way of monthly instalments equivalent to 6% of the base salary established in the fund. The Company's contributions are recorded on an accruals basis.

(5) Tangible assets

Tangible assets at 31 December 1997 and 1996 and movement during the years then ended are as follows:

	(Expressed in million pesetas)					
	December 31, 1995	Additions and adjustments	Disposals and adjustments	Transfers	1996 Revaluation	December 31, 1996 (1)
Cost						
Land and buildings.....	4,639	20	-	377	507	5,543
Plant and machinery						
- Power lines	158,563	(133)	-	4,625	27,937	190,992
- Substations.....	75,637	21	(27)	4,911	10,159	90,701
- Control and communication systems (supervisory control centres).....	29,460	29	(1)	2,554	2,017	34,059
	<u>263,660</u>	<u>(83)</u>	<u>(28)</u>	<u>12,090</u>	<u>40,113</u>	<u>315,752</u>
Other installations, equipment and furniture.....	3,585	115	-	145	192	4,037
Advances and assets under construction	29,028	12,063	(11)	(12,612)	1,542	30,010
Other tangible assets	5,747	171	(457)	-	18	5,479
	<u>306,659</u>	<u>12,286</u>	<u>(496)</u>	<u>-</u>	<u>42,372</u>	<u>360,821</u>
Accumulated depreciation						
Land and buildings.....	(348)	(89)	-	-	-	(437)
Plant and machinery						
- Power lines	(59,682)	(6,653)	-	-	-	(66,335)
- Substations.....	(25,864)	(3,678)	-	-	-	(29,542)
- Control and communication systems (supervisory control centres).....	(6,349)	(2,091)	-	-	-	(8,440)
	<u>(91,895)</u>	<u>(12,422)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(104,317)</u>
Other installations, equipment and furniture.....	(1,525)	(360)	-	-	-	(1,885)
Other tangible assets	(4,920)	(510)	454	-	-	(4,976)
	<u>(98,688)</u>	<u>(13,381)</u>	<u>454</u>	<u>-</u>	<u>-</u>	<u>(111,615)</u>
Provision for impairment						
(note 4(c))	(1,107)	(1,514)	-	-	-	(2,621)
Net value	<u>206,864</u>	<u>(2,609)</u>	<u>(42)</u>	<u>-</u>	<u>42,372</u>	<u>246,585</u>

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

Transfers to plant and machinery during 1997 comprise two power lines, bays at two substations and communication and control systems amounting to Ptas. 19,384 million (Ptas. 12,090 million in 1996 relating to five lines, bays at nine substations and communication and control systems).

(Expressed in million pesetas)

	December 31, 1996	Addition and adjustments	Disposals and adjustments	Transfers	December 31, 1997 (1)
Cost					
Land and buildings.....	5,543	(12)	-	284	5,815
Plant and machinery					
- Power lines	190,992	276	(2)	15,749	207,015
- Substations.....	90,701	191	(133)	1,273	92,032
- Control and communication systems (supervisory control centres).....	34,059	(43)	-	2,362	36,378
	<u>315,752</u>	<u>424</u>	<u>(135)</u>	<u>19,384</u>	<u>335,425</u>
Other installations, equipment and furniture.....	4,037	94	(9)	121	4,243
Advances and assets under construction	30,010	12,273	-	(21,233)	21,050
Other tangible assets	5,479	215	(13)	1,444	7,125
	<u>360,821</u>	<u>12,994</u>	<u>(157)</u>	<u>-</u>	<u>373,658</u>
Accumulated depreciation					
Land and buildings.....	(437)	(109)	-	-	(546)
Plant and machinery					
- Power lines	(66,335)	(8,923)	1	-	(75,257)
- Substations.....	(29,542)	(3,032)	89	-	(32,485)
- Control and communication systems (supervisory control centres).....	(8,440)	(2,532)	-	-	(10,972)
	<u>(104,317)</u>	<u>(14,487)</u>	<u>90</u>	<u>-</u>	<u>(118,714)</u>
Other installations, equipment and furniture.....	(1,885)	(418)	6	-	(2,297)
Other tangible assets	(4,976)	(441)	13	-	(5,404)
	<u>(111,615)</u>	<u>(15,455)</u>	<u>109</u>	<u>-</u>	<u>(126,961)</u>
Provision for impairment					
(note 4(c)).....	(2,621)	(336)	-	-	(2,957)
Net value	<u>246,585</u>	<u>(2,797)</u>	<u>(48)</u>	<u>-</u>	<u>243,740</u>

As a result of the revaluation of assets carried out as permitted by Royal Decree 7 of 7 June 1996 and Royal Decree 2697 of 20 December 1996, the depreciation charge for 1997 amounts to approximately Ptas. 3,859 million. At 31 December 1997 the revaluation of tangible fixed assets, net of depreciation, amounts to Ptas. 38,513 million.

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

(6) Investments

Details at 31 December 1997 are as follows:

	Million pesetas	
	1997	1996
Long-term investments:		
- Long-term guarantee deposits...	10	10
- Long-term public entities.....	535	583
- Other investments.....	1,465	1,550
Total investments.....	2,010	2,143
Short-term investments:		
- Investments in group companies.....	300	-
- Uncalled portion of investment in group companies.....	(218)	-
- Other short-term investments	654	1,036
Total short-term investments	736	1,036

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

Other investments comprise mainly long-term loans extended by the Company to employees.

Investments in group companies reflect the share capital of Compañía Operadora del Mercado Español de Electricidad, S.A. subscribed by the Company for Ptas. 300 million. At 31 December 1997 the unpaid portion amounts to Ptas. 218 million.

Compañía Operadora del Mercado Español de Electricidad, S.A. was incorporated by the Company pursuant to Law 54 dated 27 November 1997 governing the Spanish electricity sector, which required that it create a new company 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 this entity. In accordance with the Ninth Transitory Provision of Law 54/1997 the Company is required to divest itself of this investment within six months.

Other short-term investments comprise mainly interest earned during the year on operations involving financial derivatives. Interest accrues on these operations in line with the hedged operations (see note 24). In 1996 short-term investments also included deposits made by the Company.

(7) Debtors

Details of debtors at December 31 are as follows:

	Million pesetas	
	1997	1996
Long-term trade debtors	6,353	-
Total (long-term)	6,353	-
	Million pesetas	
	1997	1996
Sundry debtors:		
Domestic electricity companies	4,333	14,803
Foreign electricity companies.....	4,523	108
Other debtors.....	7,168	1,669
	16,024	16,580
Personnel	284	264
Tax authorities:		
VAT receivable.....	821	-
Transitory VAT receivable	-	76
Withholdings.....	4	-
Deferred tax assets (note 19).....	240	209
	1,065	285
Debtors (short-term)	17,373	17,129

Long-term trade debtors at 31 December 1997 mainly represent long-term receivables relating to an agreement to cede surplus capacity in the Company's fibre optic network (see note 25 e)).

At 31 December 1997 the net balance receivable from domestic electricity companies includes Ptas. 8,954 million (Ptas. 4,247 million at 31 December 1996) representing the part due to Red Eléctrica de España, S.A. of electricity charges invoiced or pending billing to end users of electricity by those companies, which collect such amounts on the Company's behalf. The estimated

amount pending billing to the final consumer at 31 December 1997 is Ptas. 3,634 million (Ptas. 3,734 million at 31 December 1996). This balance also includes uninvoiced income recognised on the power supply contract between Electricité de France (EDF) and the Company in respect of the month of December 1997, which amounts to Ptas. 1,084 million (Ptas. 2,575 million in 1996). The total balance receivable from domestic electricity companies is presented net of amounts due to electricity sub-systems for a total of Ptas. 8,974 million 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 made on 8 January 1997 (see notes 20 and 25a)).

The balance of foreign electricity companies at 31 December 1997 represents mainly invoices issued to l'Office Nationale de l'Electricité (ONE) of Morocco in respect of guaranteed power supplies for a portion of 1998, in accordance with the Agreement for the supply of electrical power (see notes 18 and 25c)).

At 31 December 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 25 e)).

At 31 December 1996 transitory VAT receivable relates to a refund claimed in 1987 in relation with the transitory regulations governing VAT on investments in certain assets. This claim was initially rejected by the tax authorities and the company lodged an appeal through the courts, which issued a final ruling in favour of the Company. The amount of the refund, plus interest, was received on 3 April 1997. Accordingly, the provision made in this regard has been released during the year.

(8) Shareholders' equity

Details of movement in shareholders' equity during 1997 and 1996 are shown in Appendix III, which forms an integral part of this note.

(a) Share capital

At 31 December 1997 and 1996 share capital comprises 45,090,000 shares of Ptas. 1,000 each, subscribed and fully paid. All shares have the same rights. The transfer of shares is subject to certain statutory restrictions.

At 31 December 1997 and 1996 the share capital is held as follows:

Shareholders	1997		1996	
	Million pesetas	Percentage ownership	Million pesetas	Percentage ownership
Sociedad Estatal de Participaciones Industriales.....	22,549	50.01	451	1.00
Iberdrola, S,A,	12,308	27.30	12,308	27.30
Unión Eléctrica Fenosa, S,A,	2,892	6.41	2,892	6.41
Empresa Nacional de Electricidad, S,A,	2,255	5.00	20,291	45.00
Empresa Nacional Hidroeléctrica del Ribagorzana, 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,	636	1.41	735	1.63
Eléctricas Reunidas de Zaragoza, S,A,	198	0.44	198	0.44
Hidroeléctrica del Cantábrico, S,A,	186	0.41	186	0.41
Fuerzas Eléctricas de Cataluña, S,A,	—	—	3,963	8.79
Total share capital	45,090	100.00	45,090	100.00

In accordance with Law 54 dated 27 November 1997 governing the electricity sector, within six months the Company must bring the ownership of its share capital line with the requirement that the total direct and indirect interest owned by any single shareholder should not exceed 10%. Also, the sum of the total interests held directly and indirectly by companies operating in the electricity sector may not exceed 40%. These shares may not be syndicated. These 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%.

In the context of this reorganisation process, on 21 October 1997 Sociedad Estatal de Participaciones Industriales acquired a total of 22,098,580 shares, representing 49.01% of the share capital of the Company, from the Endesa Group. Of these shares, 18,036,000 were acquired from Empresa Nacional de Electricidad, S.A., 3,963,382 from Fuerzas Eléctricas de Cataluña, S.A. and 99,198 from Electra de Viesgo, S.A. At 31 December 1997 the Endesa Group holds a 15.87% interest in the Company.

(b) Revaluation reserve

As required by 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 and may not be disposed of until it has been inspected and agreed by the tax authorities or the inspection period, which ends on 31 December 1999, 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 since the 31st of december of 1996.

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 1997 the legal reserve is equal to 20% of the share capital of the Company.

(d) Investment reserve

This reserve has been established in accordance with the Spanish Electricity 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 Electricity Council.

(e) Reserve for accelerated depreciation

As permitted by Royal Decree-Law 2/1985, prior to 1990 the Company provided accelerated depreciation 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 1997 amounts to Ptas. 2,922 million (Ptas. 3,028 million in 1996). 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. Deferred tax liabilities arising as a result of accelerated depreciation are estimated, using the standard tax rate of 35%, at approximately Ptas. 1,023 million at 31 December 1997 (Ptas. 1,060 million in 1996).

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 (see note 19).

(f) Own shares

The Company carries out no operations involving own shares.

(9) Deferred income

Details at December 31 are as follows:

	Million pesetas	
	1997	1996
Capital grants	6,683	6,645
Other deferred income	25,102	2,772
	<u>31,785</u>	<u>9,417</u>

At 31 December 1997 other deferred income includes amounts arising from the agreement to cede the use of surplus capacity from the Company's fibre optic network (see note 25 e)). It also includes the portion of the compensation received from EDF assigned to the Company in respect of the Agreement made on 8 January 1997 in relation to the adaptation of the electricity supply contracts (see note 25 a)). Other amounts recorded under this caption relate to unrealised gains on operations in September 1997 involving financial derivatives contracted to hedge bond issues and on the contribution of non-returnable tangible assets.

(10) Provisions for liabilities

Details are as follows:

	Million pesetas	
	1997	1996
Provision for pensions and other commitments	93	85
Provision for other liabilities	660	487
	<u>753</u>	<u>572</u>

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

(11) Issue of long-term debentures and other negotiable securities

At 31 December 1997 and 1996 this balance represents bonds issued at rates varying between 3.65% and 12.15% per annum which mature in periods of between 2 and 7 years.

During 1997 unhedged and hedged debts have accrued average annual interest at rates of 9.40% and 9.39%, respectively (9.96% for hedged debts in 1996).

(12) Long term loans

Details of long-term loans are as follows:

	Million pesetas	
	1997	1996
Debt ceded by electricity companies to banks relating to assets acquired on incorporation	13,084	14,970
Less, transfer to other long-term creditors	(2,556)	-
Less, current portion (note 15)	(1,711)	(1,886)
	<u>8,817</u>	<u>13,084</u>
Other long-term loans...	30,013	25,989
Less, current portion (note 15)	(2,154)	(1,293)
	<u>36,676</u>	<u>37,780</u>

At 31 December 1997 debt related to assets acquired on incorporation has decreased compared to the prior year mainly because one of the electricity companies has recovered its portion of the debt, which amounts to Ptas. 2,556 million (see note 13).

Other long-term loans bear interest at fixed annual rates of between 5.35% 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 December 31 are as follows:

Moneda	Million pesetas	
	1997	1996
ECU.....	6,126	5,955
Swiss Franc	2,015	1,874
German Mark	1,217	1,212
U,S, Dollar	1,498	1,498
Dutch Guilder.....	1,000	1,000
	11,856	11,539

During 1997 unhedged and hedged Peseta loans have accrued average annual interest at rates of 8.67% and 8.27%, respectively (9.99% for hedged loans in 1996). Average interest on unhedged and hedged foreign currency loans has been 8.42% and 9.12%, respectively (8.76% for hedged loans in 1996).

Long-term maturities of the loans are as follows:

	Million pesetas	
	1997	1996
Two years	4,966	4,231
Three years.....	4,593	4,375
Four years	4,996	4,911
Five years.....	5,430	5,383
Thereafter	16,691	18,880
	36,676	37,780

In September 1997 the Company renegotiated a syndicated credit facility with a limit of Ptas. 20,000 million. No amounts have been drawn down against the facility at 31 December 1997.

(13) Other long term creditors

A detail of other long-term creditors at 31 December 1997 and 1996 is as follows:

	Million pesetas	
	1997	1996
Debt with electricity companies relating to assets acquired on incorporation	13,938	16,155
Other debt related to the acquisition of fixed assets	-	1,740
	13,938	17,895
Transfer from long-term bank loans.....	2,556	-
Less, repayments in advance.....	(16,307)	-
Less, current portion (note 17).....	(30)	(3,957)
	157	13,938
Deferred tax liability (note 19)	6,906	6,399
Long-term deposits	5	5
	7,068	20,342

On 30 December 1997 the Company repaid the debt with electricity companies related to assets acquired on incorporation in advance for Ptas. 16,307 million. This amount includes a balance of Ptas. 2,556 million in respect of debt recovered by an electricity company (see note 12). Until that date the debt bore variable interest based on the average interest rate at three months for deposit and swap operations involving treasury bills.

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

	Million pesetas	
	1997	1996
Two years.....	290	2,601
Three years	286	2,816
Four years.....	285	3,016
Five years	342	3,255
Thereafter	5,865	8,654
	7,068	20,342

(14) Issue of short-term debentures and other negotiable securities

At 31 December 1997 this balance comprises Ptas. 997 million (Ptas. 927 million in 1996) related to accrued interest payable on the bonds issued by the Company (see note 11) and bonds amounting to Ptas. 14,432 million which fall due in 1998.

(15) Short term loans

Details of short-term loans are as follows:

	Million pesetas	
	1997	1996
Debt ceded to banks relating to assets acquired on incorporation (note 12).....	1,711	1,886
Loans (note 12).....	2,154	1,293
Promissory notes and credit facilities.....	24,767	12,900
	<u>28,632</u>	<u>16,079</u>
Accrued interest payable.....	2,054	2,387
	<u>30,686</u>	<u>18,466</u>

In 1997 promissory notes bear interest at annual rates of between 4.59% and 8.88% (between 5.99% and 10.60% in 1996).

In both 1997 and 1996 credit facilities bear interest at MIBOR or LIBOR rates plus a differential of between 0.10% and 0.20%.

At 31 December 1997 there were no promissory notes or draw downs in foreign currency (at 31 December 1996 short-term credit facilities in Swiss francs amounted to Ptas. 390 million).

During 1997 unhedged and hedged promissory notes and short-term Peseta loans have accrued average annual interest at rates of 5.79% and 5.93%, respectively (8.59% on hedged operations in 1996). Foreign currency loans bear average interest of 1.93% (3.73% in 1996).

Promissory notes are those 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 1997 and 1996 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 1997 the Company has unused credit facilities of Ptas. 8,282 million (Ptas. 8,360 million at 31 December 1996).

(16) Trade creditors

Details at December 31 are as follows:

	Million pesetas	
	1997	1996
Electricity and power purchases.....	785	5,434
Services rendered.....	7,017	5,750
	<u>7,802</u>	<u>11,184</u>

The decrease in the balance related to electricity and power purchases is mainly related to the agreement with Electricité de France (EDF) to supply electricity and power (see note 25 a)).

(17) Other creditors

At 31 December 1997 and 1996 other creditors are as follows:

	Million pesetas	
	1997	1996
Tax and social security authorities.....	1,878	4,433
Short-term guarantee deposits received.....	466	352
Other debts.....	9,344	14,881
	<u>11,688</u>	<u>19,666</u>

Balances due to the tax and social security authorities comprise the following:

	Million pesetas	
	1997	1996
Taxes payable:		
Withholding taxes ...	213	195
Income tax.....	1,272	2,025
One-off tax charge on revaluation.....	-	1,271
VAT.....	-	619
Other taxes.....	3	3
Social security	143	140
Deferred income tax liability (note 19).....	247	180
	<u>1,878</u>	<u>4,433</u>

Other debts are as follows:

	Million pesetas	
	1997	1996
Debts with electricity companies relating to assets acquired on incorporation	30	2,217
Other debts relating to the acquisition of fixed assets.....	-	1,740
Transferred from long term (note 13).....	30	3,957
Accrued interest payable.....	7	439
	37	4,396
Creditors, purchases and maintenance of assets and other items	6,732	9,119
National electricity companies international power exchange.....	2,575	1,366
	<u>9,344</u>	<u>14,881</u>

(18) Prepaid expenses and accruals

At 31 December 1997 prepaid expenses comprise Ptas. 611 million (Ptas. 332 million in 1996) mainly in respect of financial expenses generated 1997 which will be recognised over the ensuing years.

Accruals mainly reflect income of Ptas. 4,357 million received in advance in respect of billings for guaranteed power supplies relating to a part of 1998 in accordance with the power supply agreement between ONE and the Company (see note 25 c)). Accruals also include income of Ptas. 2,296 million (Ptas. 2,636 million in 1996) received in advance on the power supply agreement between EDF and the Company (see note 25 a)).

(19) Taxation

In 1997 the Company has filed a consolidated income tax return as a part of the consolidated tax group n° 9/1986, which 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. 1,272 million to Sociedad Estatal de Participaciones Industriales in respect of income tax for 1997. This amount represents the expected income tax charge for the year of Ptas. 4,153 million, less deductions of Ptas. 2,881 million for withholdings at source of interest income and payments on account which the Company settled directly with the tax authorities prior to joining the consolidated tax group.

As a consequence of the treatment permitted by fiscal legislation for certain transactions, the accounting profit differs from taxable income. A reconciliation of accounting profit for the year with the taxable income that the Company expects to declare after approval of the 1997 annual accounts, together with that for 1996, is as follows:

	Million pesetas			Million pesetas	
	1997	1996		1997	1996
Profit before income tax.....	14,003	14,434	Accounting income at 35%.....	4.952	5.059
Permanent differences	146	21	Less, tax credits.....	(199)	(1.260)
Taxable accounting income.....	14,149	14,455	Expense for the year	4.753	3.799
Timing differences:			Prior years' adjustment	(290)	88
Generated during the year	(565)	(604)	Income tax charge	<u>4.463</u>	<u>3.887</u>
Reversal of prior years	(1,147)	(1,381)			
Taxable income.....	<u>12,437</u>	<u>12,470</u>			

Details of the 1997 and 1996 income tax charge are as follows:

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 1997 and 1996 and the related accumulated deferred tax assets and liabilities are as follows:

	1997		1996	
	Timing difference	Tax effect	Timing difference	Tax effect
Deferred tax assets				
- Long-term (note 6)				
Deferred income	1,020	357	983	344
Other	509	178	681	239
	<u>1,529</u>	<u>535</u>	<u>1,664</u>	<u>583</u>
- Short-term (note 7)				
Transitory VAT	-	-	76	26
Other	686	240	520	182
	<u>686</u>	<u>240</u>	<u>596</u>	<u>208</u>
	<u>2,215</u>	<u>775</u>	<u>2,260</u>	<u>791</u>
Deferred tax liabilities:				
- Long-term (note 13)				
1985 accelerated depreciation (Royal Decree 2/1985)	1,974	691	2,040	714
1975 accelerated depreciation (Royal Decree 175/1975) ..	7,768	2,719	8,083	2,829
1988 accelerated depreciation (Royal Decree 12/1988)....	2,515	880	2,597	909
1993 accelerated depreciation (Royal Decree 3/1993).....	6,117	2,141	4,640	1,624
1992 accelerated depreciation (Royal Decree 31/1992)....	580	203	437	153
Accelerated amortisation of capitalised	777	272	486	170
	<u>19,731</u>	<u>6,906</u>	<u>18,283</u>	<u>6,399</u>
- Short-term (note 17)				
1985 accelerated depreciation (Royal Decree 2/1985)	76	27	-	-
1975 accelerated depreciation (Royal Decree 175/1975) ..	251	88	271	95
1988 accelerated depreciation (Royal Decree 12/1988)....	101	35	121	43
Accelerated amortisation of capitalised	278	97	120	42
	<u>706</u>	<u>247</u>	<u>512</u>	<u>180</u>
	<u>20,437</u>	<u>7,153</u>	<u>18,795</u>	<u>6,579</u>

At 31 December 1997 the Company has open to inspection by the tax authorities all applicable taxes since 1994, inclusive, except for VAT which is open to inspection since December 1992. The directors do not expect that significant additional liabilities would arise in the event of inspection.

(20) Net sales

Details are as follows:

	Million pesetas	
	1997	1996
Income from services rendered	49,624	52,246
Sales of electricity	11,173	30,958
Income from international power exchanges	1,055	571
Other income from services rendered	1,210	591
Sales of by-products ..	45	35
	<u>63,107</u>	<u>84,401</u>

Income from services rendered is a percentage of the amounts invoiced to end users by the electricity generating companies for power supplied. The percentage is fixed each year by the Ministry of Industry and Energy.

Sales of electricity represent income recognised in respect of sales of energy under the power supply contract between EDF and the Company. The decrease at 31 December 1997 is due to re-negotiation of the agreement, which has resulted in less power and lower prices, as well as a decline in imports and the effect on invoicing of the application of the compensation established in the revised agreement (see note 25a)).(This decrease in sales of electricity is also reflected in the cost of purchases of electricity recorded under materials consumed)

Of the profits obtained from international electricity exchange operations, 70% is assigned to the domestic electricity companies and the remaining 30% to the Company. These amounts are recorded under income from international power exchanges.

(21) Personnel expenses

Details are as follows:

	Million pesetas	
	1997	1996
Wages and salaries	6,221	6,003
Social Security	1,557	1,455
Pension fund and other similar commitments	122	113
Other social costs	621	570
	<u>8,521</u>	<u>8,141</u>

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

	1997	1996
Managers	22	21
Honours graduates	317	317
Graduates	327	325
Assistants	277	279
Administrative staff	159	159
	<u>1,102</u>	<u>1,101</u>

(22) Prior years income and expenses

Details are as follows:

	Million pesetas			
	Income		Expenses	
	1997	1996	1997	1996
Adjustments to the EDF contracts.....	681	238	381	175
Other items	152	38	37	100
	833	276	418	275

Adjustments to the EDF contracts mainly reflect amounts arising as a result of annual modifications to the conditions established relate to prior years.

(23) Remuneration of and balances with members of the Board of Directors

In 1997, the members of the Board of Directors, including those who are employees of the Company, have received Ptas. 55 million (Ptas. 45 million in 1996) in respect of salaries, allowances and other remuneration.

At 31 December 1997 no loans or advances have been granted to members of the Board of Directors (loans and advances amounted to Ptas. 16 million in 1996).

(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 4f).

The bonds issued in September 1997 have been hedged through a swap operation. Income arising on the part of this operation related to the coverage of the redemption premium and issue expenses are deferred over the period to maturity of the bond.

At 31 December 1997 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	14,000	Up to 6 years
Long-term Peseta loans	Interest rate	Swap and collar	6,000	6 months-5 year
Long-term foreign currency loans:				2-4 years
• ECU	• Interest rate	• Collar	3,182	
• German Mark	• Interest rate	• Swap	254	
• US Dollar	• Interest and exchange rates	• Swap	1,498	
• Dutch Guilder	• Interest and exchange rates	• Swap and collar	1,000	
Short-term Peseta loans	Interest rate	Collar	1,000	1-9 months

(25) Commitments

At 31 December 1997 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 and will be 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 has 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 have been reduced. Both parties undertake to extend the Pyrenees electricity connection by constructing a new electricity line.

In accordance with the agreement, in 1997 the Company received compensation from EDF amounting to French Francs 400 million for the decrease in power and the electricity not supplied, as well as the opportunity cost relating to other connections and costs incurred in the modification of existing Spanish connections. On 29 December 1997 the Spanish Ministry of Industry and Energy ruled that the Company should pay the domestic electricity companies an amount of Ptas. 7,736 million, which represents the portion of the aforementioned compensation not attributable to the Company.

During 1997 EDF has also paid the Company an amount of French Francs 140 million in respect of compensation for expenses incurred in the construction of the Spanish part of the electricity connection.

- 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 per year during the winter months, in accordance with the modifications agreed on 8 January 1997.
- c) An agreement for the supply of energy, which requires that the Company supply the Office Nationale de l'Electricité de Maroc (ONE) with energy of 300 MW. In accordance with the agreement, power will be supplied between January 1996 and December 1998. Although the Spain-Morocco electricity connection has been completed in 1997, supply has not commenced as both parties are analysing how to adapt the original agreement to the current situation.
- d) A supply agreement with Forces Electricas d'Andorra (FEDA), whereby EDF and the Company, jointly, will supply a maximum equivalent to a transmission capacity of 100 MVA until 31 December 1999.
- e) An agreement dated 4 June 1997 between the Company and Netco Redes, S.A. to cede the use and maintenance of the surplus capacity from the Company's fibre optic network for a period of 30 years. During 1997 the rights ceded under this agreement have been transferred to Retevisión, S.A.

(26) Statements of source and application of funds

The statements of source and application of funds for 1997 and 1996 are set out in Appendix IV, which forms an integral part of this note.

Appendixes

Assets	1997	1996
FIXED ASSETS		
Intangible assets	1,759	1,605
Tangible assets (note 5).....	243,740	246,585
Investments (note 6)		
Guarantee deposits	10	10
Public entities (note 19)	535	583
Other investments	1,465	1,550
	2,010	2,143
Long-term trade debtors (note 7).....	6,353	-
TOTAL FIXED ASSETS.....	253,862	250,333
DEFERRED EXPENSES	960	935
CURRENT ASSETS		
Stocks.....	669	826
Debtors (note 7)	17,373	17,129
Short-term investments (note 6).....	736	1,036
Cash and banks.....	40	106
Prepaid expenses (note 18).....	611	332
TOTAL CURRENT ASSETS.....	19,429	19,429
 TOTAL ASSETS.....	274,251	270,697

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

BALANCE SHEETS

31 December 1997 and 1996

APPENDIX I

(Expressed in million pesetas)

Shareholders' equity and liabilities	1997	1996
SHAREHOLDERS' EQUITY (note 8)		
Share capital	45,090	45,090
Revaluation reserve	41,101	41,101
Reserves	14,272	30,565
Profit for the year	9,540	10,547
Interim dividend (note 3)	(3,000)	(2,367)
TOTAL SHAREHOLDERS' EQUITY	107,003	124,936
DEFERRED INCOME (note 9)		
Capital grants	6,683	6,645
Other deferred income	25,102	2,772
TOTAL DEFERRED INCOME	31,785	9,417
PROVISIONS FOR LIABILITIES (note 10)	753	572
LONG-TERM CREDITORS		
Bonds (note 11)	18,517	24,432
Loans (note 12)	36,676	37,780
Other creditors (note 13)	7,068	20,342
TOTAL LONG-TERM CREDITORS	62,261	82,554
CURRENT LIABILITIES		
Bonds (note 14)	15,429	927
Loans (note 15)	30,686	18,466
Trade creditors (note 16)	7,802	11,184
Other creditors (note 17)	11,688	19,666
Accruals (note 18)	6,844	2,975
TOTAL CURRENT LIABILITIES	72,449	53,218
TOTAL SHAREHOLDER'S EQUITY AND LIABILITIES	274,251	270,697

Expenses	1997	1996
OPERATING EXPENSES		
Materials consumed	11,742	31,177
Personnel expenses (note 21).....	8,521	8,141
Depreciation and amortisation.....	15,720	13,676
Variation in trade provisions.....	133	186
OTHER OPERATING EXPENSES		
External services	8,791	9,835
Local taxes	80	119
Other overheads.....	144	172
Provision for liabilities (note 10).....	261	50
TOTAL OPERATING EXPENSES	45,392	63,356
OPERATING PROFIT	20,955	24,652
FINANCIAL EXPENSES		
Interest and similar expenses	7,309	8,933
Exchanges losses	1,268	667
TOTAL FINANCIAL EXPENSES	8,577	9,600
PROFIT ON ORDINARY ACTIVITIES	13,031	15,402
EXTRAORDINARY LOSSES AND EXPENSES		
Variation in provision for tangible assets (note 5)	336	1,514
Losses on tangible assets.....	48	19
Extraordinary expenses	3	2
Prior years' expenses (note 22).....	418	275
TOTAL EXTRAORDINARY EXPENSES	805	1,810
EXTRAORDINARY PROFIT	972	-
PROFIT BEFORE TAX	14,003	14,434
INCOME TAX (note 19).....	(4,463)	(3,887)
PROFIT FOR THE YEAR	9,540	10,547

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

PROFIT AND LOSS ACCOUNTS

31 December 1997 and 1996

APPENDIX II

(Expressed in million pesetas)

Income	1997	1996
OPERATING INCOME		
Net sales (note 20).....	63,107	84,401
Self-constructed assets.....	2,546	2,791
Other operating income.....	694	816
TOTAL OPERATING INCOME.....	66,347	88,008
FINANCIAL INCOME		
Investment income.....	130	21
Other interest and similar income.....	456	228
Exchange gains.....	67	101
TOTAL FINANCIAL INCOME.....	653	350
NET FINANCIAL EXPENSE.....	7,924	9,250
EXTRAORDINARY PROFIT AND INCOME		
Profit on tangible assets.....	2	-
Capital grants taken to income.....	512	452
Extraordinary income.....	430	114
Prior years' income (note 22).....	833	276
TOTAL EXTRAORDINARY INCOME.....	1,777	842
NET EXTRAORDINARY LOSSES.....	-	968

MOVEMENT IN SHAREHOLDERS' EQUITY

31 December 1997 and 1996

APPENDIX III

(Expressed in million pesetas)

	Share capital	Revaluation reserve	Legal reserve	Investment reserve	Voluntary reserve	Accelerated depreciation	Total reserves	Profit for the year	Interim dividend	Total
Balances at 31 December 1995.....	45,090	-	7,349	1,352	13,935	3,142	25,778	9,636	(2,255)	78,249
Distribution of 1995 profits:										
Legal reserve	-	-	963	-	-	-	963	(963)	-	-
Dividends	-	-	-	-	-	-	-	(4,735)	2,255	(2,480)
Voluntary reserves ...	-	-	-	-	3,938	-	3,938	(3,938)	-	-
Reversal of accelerated depreciation reserve	-	-	-	-	-	(114)	(114)	-	-	(114)
1996 profit.....	-	-	-	-	-	-	-	10,547	-	10,547
Interim dividend	-	-	-	-	-	-	-	-	(2,367)	(2,367)
Revaluation of fixed assets (Royal Decree 7/1996).....		41,101	-	-	-	-	-	-	-	41,101
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 profits:										
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)
1997 profit.....	-	-	-	-	-	-	-	9,540	-	9,540
Interim dividend (note 3)	-	-	-	-	-	-	-	-	(3,000)	(3,000)
Extraordinary dividend 30/06/97 (note 3)...	-	-	-	-	(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

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

STATEMENTS OF SOURCE AND APPLICATION OF FUNDS

31 December 1997 and 1996

APPENDIX IV

(Expressed in million pesetas)

APPLICATIONS	1997	1996		
ACQUISITION OF FIXED ASSETS				
Intangible assets.....	429	401		
Tangible assets	12,994	12,286		
Investments.....	317	744		
	13,740	13,431		
DIVIDENDS.....	2,367	2,480		
INTERIM DIVIDEND.....	3,000	2,367		
EXTRAORDINARY DIVIDEND.....	22,000	-		
CANCELLATION OR TRANSFER TO SHORT TERM OF LONG-TERM DEBT.....	34,635	11,751		
PROVISION FOR LIABILITIES.....	50	76		
REVALUATION TAX CHARGE.....	-	1,271		
TOTAL APPLICATIONS	75,792	31,376		
SOURCES				
FUNDS GENERATED ON OPERATIONS				
Profit for the year.....	9,540	10,547		
Reversal of provision for liabilities.....	(106)	(221)		
Depreciation and amortisation.....	15,720	13,676		
Reversal of accelerated depreciation reserve.....	(106)	(114)		
Provision for pensions and similar commitments.....	9	8		
Loss on disposal of fixed assets.....	56	19		
Provision for liabilities.....	328	138		
Exchange losses.....	1,251	528		
Deferred expenses recognised during the year.....	58	-		
Capital grants and other deferred income recognised during the year.....	(1,163)	(479)		
Provisions for impairment.....	336	1,514		
	25,923	25,616		
DEFERRED INCOME (*).....	22,563	1,665		
LONG-TERM DEBTORS (*).....	(5,385)	-		
LONG-TERM LIABILITIES (*).....	13,057	1,796		
DEFERRED EXPENSES (*).....	(50)	-		
DISPOSAL OF FIXED ASSETS				
Tangible assets.....	3	42		
Investments.....	450	343		
	453	385		
TOTAL SOURCES	56,561	29,462		
DECREASE IN WORKING CAPITAL.....	19,231	1,914		
	75,792	31,376		
CHANGES				
IN WORKING CAPITAL				
	1997		1996	
	Increases	Decreases	Increases	Decreases
Stocks.....	-	157	-	198
Debtors.....	244	-	5,713	-
Current liabilities.....	-	19,231	-	8,184
Short-term investments.....	-	300	685	-
Cash and banks.....	-	66	77	-
Prepaid expenses.....	279	-	-	7
	523	19,754	6,475	8,389
Changes in working capital.....	19,231	-	1,914	-
	19,754	19,754	8,389	8,389

(*) These amounts are shown net of the redemption premium relating to the issue of bonds in 1997, which was hedged through a swap operation (see note 24). This Appendix forms an integral part of note 26 to the 1997 annual accounts.

During 1997 Red Eléctrica has maintained balanced growth in key areas and has surpassed its business objectives, both with regard to profits on ordinary activities and self-financing of investments.

Profit before tax for 1997 amounted to Ptas. 14,003 million, which is similar to the 1996 figure of Ptas. 14,434 million. Nevertheless, in 1997 income earned through electricity tariffs declined by Ptas. 2,500 million compared to the prior year and, as a result of the revaluation of tangible assets by Ptas. 42,372 million at 31 December 1996, the depreciation charge for the year increased. The impact of both these matters on profit and loss has been cushioned by improvements in the management of revenues and expenses.

Profit after tax was Ptas. 9,540 million, which will permit the Company to pay an appropriate dividend and continue to apply funds to reserves in line with prior years.

At their extraordinary general meeting held in June 1997 the shareholders authorised the Company to distribute an extraordinary dividend of Ptas. 22,000 million with a charge to distributable reserves, and approved the distribution of dividends of Ptas. 3,000 million on account of profit for 1997.

In 1997 the ordinary income of Red Eléctrica amounted to Ptas. 67,000 million, which is Ptas. 21,358 million less than in the prior year. This is mainly due to the reduction in income derived from the import by Red Eléctrica of electricity and power from Electricité de France (EDF), which has decreased as a result of the modifications agreed in January 1997 to the original contract. Expenses incurred in the import of power and energy related to the aforementioned agreement have also fallen, which has resulted in a fall in the cost of electricity tariffs.

As mentioned above, income earned on energy transmission and administration of the public electric power system declined by approximately Ptas. 2,500 million, 5% less than in 1996. Total revenues in this respect amounted to Ptas. 49,624 million in 1997.

Total expenses before tax amounted to Ptas. 54,774 million compared to Ptas. 74,766 million in 1996, as a consequence of lower costs related to the import agreement with EDF. If costs related to this agreement are excluded, total expenses before tax fell by 1.7%, from Ptas. 45,149 million in 1996 to Ptas. 44,378 million in 1997.

Management report

Cash-flow before income tax amounted to Ptas. 30,240 million, 2.6% up on the prior year. This represents 44% of the total income of Red Eléctrica or 52.5% excluding income generated as a result of agreements for the import and export of energy. As a consequence, the Company has been able to finance all of its investment activities, which amounted to Ptas. 13,423 million in 1997, and achieve a net ratio of self-financing of investments of 153%.

The funds generated, together with those derived from the agreement to cede the surplus capacity of the Red Eléctrica's fibre optic telecommunication network have made it possible to finance a significant portion of the extraordinary dividend distributed to the shareholders in June with a charge to voluntary reserves and limit the need for additional borrowings to Ptas. 1,290 million.

The new installations incorporated into the transmission network during 1997 are as follows:

- In western Andalusia, the 400 kV Pinar del Rey-Estrecho line (34.2 km) and the Estrecho-Fardioua cable, making the Spain-Morocco interconnection across the Straits of Gibraltar. Red Eléctrica owns 15.2 km of the cable for this new interconnection, of which 2.1 km is underground and 13.1 km underwater.
- Reconfiguration of the Loeches substation in central Spain through the installation of two new 400 kV bays and a 600 MVA auto-transformer.
- Renovation and improvement work in Aragón and Catalonia on the Spanish lines of the interconnection with France (Biescas-Pragneres and Vic-Baixas). In 1998 this work, together with work on the French side, will permit a capacity increase of 500 MW in the interconnection between the Spanish and French electrical systems.

Construction work has continued on the new installations to complete the 400 kV transmission circuit in Andalusia (Pinar del Rey-Tajo de la Encantada line) and to improve the power supply on the East Coast (Litoral-Rocamora line) and in the Cantabria region (Soto-Penagos-Güeñes-Itxaso axis).

During 1997 the Company's telecommunications network has grown by 680 km of fibre optic cable and 6 new links. Accordingly, the network currently consists of a total of 8,200 km of fibre optic cable and 130 links. The Company's telecommunications control centre has also commenced operations during the year.

The capacity of the telecommunications network of Red Eléctrica has also made it possible to serve third parties during the year. In June 1997 Red Eléctrica entered into an irrevocable agreement with the telecommunications consortium Netco Redes, S.A. which is formed by Endesa, Union-Fenosa and STET to cede the use and maintenance of the surplus capacity of the Company's fibre optic network for a period of thirty years. This surplus capacity is currently being used by Retevisión, S.A. to provide telecommunications services. The agreement reserves significant transmission capacity for the sole use of Red Eléctrica and requires that the fibre optic network give priority to electricity sector activities.

The most significant matters in relation to the operation of the electricity systems have been the growth in demand, the increase in energy acquired from self-producers and the high level of natural hydraulic contributions from hydroelectric power stations, whose reservoirs reached record high water levels. The demand for electricity in mainland Spain reached 162,198 GWh (provisional data), which represents an increase of 3.8% over 1996.

This percentage rises to 5.3% if the effect of the weather conditions and the number of working days is taken into consideration.

Key aspects relating to the structure of production were the increase in the contribution of coal-fired power stations, which at 39.5% was 4% up on 1996, and the decrease in the contribution of hydroelectric and nuclear power stations. In 1997 hydroelectric power accounted for 21.0% of the total, 4% less than in the prior year and nuclear power stations contributed 35.1%, a 3% decline compared to 1996. Energy generated by gas has increased significantly from 0.4% to 4.2% of the total in 1997. The average variable cost of generating was Ptas. 2.58/kWh, which at constant fuel prices represents an increase of Ptas. 0.33/kWh over the prior year.

International electricity exchanges resulted in net exports of 3,085 GWh, comprising imports of 1,409 GWh and exports of 4,494 GWh. In 1997 electricity supplies continued under the long-term contract between EDF and Red Eléctrica. The Company has continued the habitual exports to France and Portugal, as well as those to various companies in Belgium and Switzerland as a result of surplus hydroelectric power. During 1997 Red Eléctrica has also commenced exports to Morocco.

In May 1997 the new Red Eléctrica control centre was opened in the presence of the Minister of Industry and Energy. This control centre for the management of the electrical system in real time has been developed using the most advanced IT and telecommunications technologies available. The control system installed and those which have entered service in the regional control centres incorporate specific technologies developed by Red Eléctrica, including, inter alia, expert systems to assist in operations and simulators to train operators.

In 1997 Red Eléctrica's environmental activities have focused on the completion of environmental impact studies for six lines and three substations, while the assessment of a further twelve lines and four substations has advanced considerably.

The Company has continued with its programme of activities regarding the protection of plant cover, bird-life and the landscape, as well as the prevention and correction of the impact produced by the installations and activities of Red Eléctrica. The Company has also persevered with research into the effect of electromagnetic fields, as well as promoting and disseminating environmental issues to the general public. To this end, Red Eléctrica has organised a course in conjunction with the University of Valladolid on the subject of recent research into the links between electromagnetic fields, health and the environment, with the participation of both Spanish and international experts. In 1997 the Company commenced publication of the «Bulletin of new developments regarding electrical and magnetic fields» on a twice-monthly basis.

Red Eléctrica's Environmental Management System has been implemented during the year and the Company expects to obtain the AENOR quality certificate in 1998.

The Company has already obtained AENOR certificates in recognition of the quality of the maintenance of power lines and high tension substations, which comply with ISO-9001 and ISO-9002 standards, respectively. The first internal audit of the system to ensure quality in the operation of the electricity system was performed at the end of the year as part of the process of obtaining the AENOR certificate in accordance with ISO-9002.

During 1997 Red Eléctrica has completed several long-term research and development projects, the total direct and indirect cost of which is approximately Ptas. 900 million. Key projects completed include the basic design and specification of flexible power control systems (FACTS) for application to the Spanish electrical system, the development of prototype optoelectronic measurement transformers, as well as an automated system incorporated into high tension lines to detect fires, which will provide notable environmental benefits.

The average number of employees in 1997 has been 1,102, which is similar to the figures for the last two years, which indicates that Red Eléctrica has attained a stable workforce.

The new Law governing the electricity sector was approved in November 1997, which represents a considerable step towards deregulating the electricity sector as it provides for a free market for electricity generating. This legislation also requires the creation of a new trading company to act as Market Operator, which will be responsible for the economic management of the system and will match orders for the purchase and sale of electricity between generators, distributors, electricity traders and qualified consumers.

The new Law ratifies Red Eléctrica as an electricity transmission company which is responsible for the technical management of the electricity system, in accordance with the functions assigned to it as System Operator, and management of the transmission network. The Law requires that the ownership of the Company be restructured during the first half of 1998 to ensure that individual shareholders own no more than 10% of the share capital and that the sum of direct or indirect shareholdings of parties operating in the sector be limited to 40% of the share capital. Prior to approval of the Law, Sociedad Estatal de Participaciones Industriales (SEPI) acquired part of the share capital owned by the Endesa group. Accordingly, SEPI currently owns a 50.01% interest in Red Eléctrica.

In accordance with the ninth transitional provision of this law, Compañía Operadora del Mercado Español de Electricidad, S.A. (Market Operator) was incorporated in December 1997 with a share capital of Ptas. 300 million, fully subscribed by Red Eléctrica. This investment will subsequently be divested in accordance with the requirements of the Law in relation to maximum shareholdings within the period established to that effect.

The incorporation of Compañía Operadora del Mercado Español de Electricidad, S.A. was preceded by a period of intense activity for Red Eléctrica with the collaboration

of the electricity companies, the Spanish Electricity Council and the Ministry of Industry and Energy, as well as specialist companies. In the final quarter of 1997 Red Eléctrica provided the new company with the necessary information systems and procedures to guarantee its operations and the transparency of transactions carried out in the electricity production market. The Market Operator has been responsible for the economic management of the system since 1 January 1998.

Red Eléctrica, as System Operator in charge of the technical management of the electricity system, has developed the required procedures and information systems to ensure that market criteria are applied to the operation of the system, as well as the security and continuity of the electricity supply. This refers particularly to the implementation of regulations and systems for the management of the technical restrictions inherent in the transmission network and system and the management of the complementary services sector, which will both be subject to market criteria, as well as systems for IT, communication and co-ordination with the Market Operator and entities participating in the market.

Accordingly, Red Eléctrica has played a significant part in preparing the necessary operational tools to establish the Spanish electricity market. This deregulation process commenced in December 1996 when the electricity Protocol was signed and has proceeded apace with the enactment of the relevant legislation, which will be further developed over the coming months.

1997 has been an eventful year, from both an economic and institutional point of view. Red Eléctrica's objectives for 1998 are to respond efficiently and competitively to the new challenges raised by the new Electricity Act, and to maintain the profitability and efficiency achieved in prior years. In 1998 the Company expects to make investments of approximately Ptas. 10,000 million, which will be entirely self-financed, and to maintain the workforce in line with figures for 1997.

1997

(Pesetas)

BASIS FOR DISTRIBUTION

Profit for the year 9.539.777.762

TOTAL 9.539.777.762

DISTRIBUTION

Legal reserve —

Voluntary reserve 4.172.552.762

Dividends:

Interim dividend 3.000.000.000

Supplementary dividend 2.367.225.000

TOTAL 9.539.777.762

**Proposed
distribution
of profits**

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

HEREBY CERTIFIES:

That the annual accounts, management 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 10th, 1998. A copy of the annual accounts and the management report, signed by all the administrators 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 the required legal effects, this certificate is hereby issued in Madrid on April 30th, 1998.

