EDP ENERGIAS DE PORTUGAL SA
Form 20-F/A
July 17, 2006
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As filed with the Securities and Exchange Commission on July 17, 2006

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 20-F/A

Amendment No. 1

¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2005

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

¨ **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 Date of event requiring this shell company report _____**

Commission File Number: 1-14648

EDP Energias de Portugal, S.A.

(Exact name of registrant as specified in its charter)

EDP Energies of Portugal
(Translation of registrant s name into English)

Portuguese Republic
(Jurisdiction of incorporation or organization)

Praça Marquês de Pombal, 12

1250-162 Lisbon, Portugal

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Ordinary Shares, with nominal value 1 per share*	New York Stock Exchange
American Depositary Shares (as evidenced by American Depositary Receipts), each representing 10 Ordinary Shares	New York Stock Exchange

* Not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the last full fiscal year covered by this Annual Report:

As of December 31, 2005, there were outstanding: 3,656,537,715 Ordinary Shares, with nominal value of 1 per share

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17 ¨ Item 18 x

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

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Defined terms

In this annual report, unless the context otherwise requires, the terms EDP, S.A., EDP, we, us and our refer to EDP Energias de Portugal, S. (formerly known as EDP Electricidade de Portugal, S.A.) and, as applicable, its consolidated subsidiaries. Unless we specify otherwise or the context otherwise requires, references to U.S.$, $ and U.S. dollars are to United States dollars, references to , euro or EUR are to the eur single European currency established pursuant to the European Economic and Monetary Union, references to escudo(s) or PTE are to Portuguese escudos and references to real or reais are to Brazilian reais. We have explained a number of terms related to the electricity industry in the Glossary of Terms included in this annual report.

Forward-looking statements

This annual report and the documents incorporated by reference in this annual report contain forward-looking statements. We may from time to time make forward-looking statements in our reports to the U.S. Securities and Exchange Commission, or SEC, on Form 6-K, in our annual reports to shareholders, in offering circulars and prospectuses, in press releases and other written materials and in oral statements made by our officers, directors or employees to analysts, institutional investors, representatives of the media and others.

These forward-looking statements, including, among others, those relating to our future business prospects, revenues and income, wherever they may occur in this annual report, the documents incorporated by reference in this annual report and the exhibits to this annual report, are necessarily estimates reflecting the best judgment of our senior management and involve a number of risks and uncertainties that could cause actual results to differ materially from those suggested by the forward-looking statements. As a consequence, you should consider these forward-looking statements in light of various important factors, including those set forth in this annual report. Important factors that could cause actual results to differ materially from estimates or projections contained in the forward-looking statements include, without limitation:

- the effect of, and changes in, regulation and government policy in countries in which we operate, including, in particular, European Union, or EU, directives, Portuguese, Spanish and Brazilian legislation, regulation and government policy, government and municipal concessions in Portugal and environmental regulations;
- the effect of, and changes in, macroeconomic, social and political conditions in countries in which we operate;
- the effects of competition, including competition that may arise in connection with the development of an Iberian electricity market;
- our ability to reduce costs;
- hydrological conditions and the variability of fuel costs;
- anticipated trends in our business, including trends in demand for electricity;
- our success in developing our telecommunications business;
- our success in new businesses, such as gas;
- future capital expenditures and investments;

the timely development and acceptance of our new services;

the effect of technological changes in electricity and telecommunications; and

our success at managing the risks of the foregoing.

Forward-looking statements speak only as of the date they are made. We do not undertake to update such statements in light of new information or future developments.

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Presentation of financial information

We have prepared the financial information contained in this annual report in accordance with International Financial Reporting Standards, or IFRS, as adopted by the European Commission for use in the European Union in articles 11 and 12 of Decree law no. 35/2005, of February 17, 2005, and article 4 of Regulation (EC) no. 1606/2002 of the European Parliament and Council, of July 19, 2002. IFRS differs in significant respects from generally accepted accounting principles in the United States, or U.S. GAAP. We describe these differences in Item 5. Operating and Financial Review and Prospects IFRS Compared with U.S. GAAP and in note 48 to our consolidated financial statements. Unless we specify otherwise, references in this annual report to our consolidated financial statements are to the audited consolidated financial statements, including the related notes, included in this annual report.

The SEC has adopted an accommodation permitting eligible foreign issuers for their first year of reporting under IFRS to file two years rather than three years of statements of income, changes in shareholders equity and cash flows prepared in accordance with IFRS. We are required to prepare our financial statements for the year ended December 31, 2005 for the first time in IFRS, and this annual report on Form 20-F has been prepared in reliance on the SEC accommodation.

Beginning in 2002 (for fiscal year 2001 and thereafter), we published our consolidated financial statements in euros. Unless we specify otherwise, we have translated amounts stated in U.S. dollars from euros at an assumed rate solely for convenience. By including these currency translations in this annual report, we are not representing that the euro amounts actually represent the U.S. dollar amounts shown or could be converted into U.S. dollars at the rate indicated. Unless we specify otherwise, we have translated the U.S. dollar amounts from euros at the Noon Buying Rate in The City of New York for cable transfers in foreign currencies as announced by the Federal Reserve Bank of New York for customs purposes (the Noon Buying Rate) on July 11, 2006 of U.S.$1.2754 per 1.00. That rate may differ from the actual rates used in the preparation of our consolidated financial statements included in Item 18, and U.S. dollar amounts used in this annual report may differ from the actual U.S. dollar amounts that were translated into euros in the preparation of our consolidated financial statements. For information regarding recent rates of exchange between euros and U.S. dollars, see Item 3. Key Information Exchange Rates.

PART I

Item 1. Identity of Directors, Senior Management and Advisers

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information

SELECTED FINANCIAL DATA

You should read the following in conjunction with Item 5. Operating and Financial Review and Prospects and our consolidated financial statements and other financial data, including the related notes, found elsewhere in this annual report.

The summary financial data below has been extracted from our consolidated financial statements for each of the years ended December 31, 2004 and 2005 and as of December 31, 2004 and 2005 and the related notes, which appear elsewhere in this annual report. The consolidated financial statements have been prepared in accordance with IFRS, which differs in significant respects from U.S. GAAP. We describe these differences in Item 5. Operating and Financial Review and Prospects IFRS Compared with U.S. GAAP and in note 48 to our consolidated financial statements.

Under the SEC accommodation for eligible foreign private issuers reporting in IFRS for the first time, such issuers must also present selected consolidated financial data for five years on a basis reconciled to U.S. GAAP. We have provided, in the information below, amounts in accordance with U.S. GAAP net income, net income per share, net income per ADS, net fixed assets, total assets, total liabilities and shareholders equity as of and for the years ended December 31, 2001, 2002, 2003, 2004 and 2005.

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In 2004, we selected a new firm of independent public accountants to audit our consolidated financial statements based on a solicitation of bids to a number of firms, including our previous firm of independent public accountants. Our fiscal year 2004 and 2005 consolidated financial statements were audited by KPMG. Fiscal years from 2000 through 2003 were audited by PricewaterhouseCoopers.

	Year ended December 31,		
	2004	2005	2005
	Euro	Euro[1]	U.S. $[1]
	(in millions, except per ordinary share and per ADS data)		
Statement of income:			
Amounts in accordance with IFRS			
Electricity sales	6,539	8,584	10,949
Other sales[2]	249	664	847
Services[3]	522	428	546
Total revenues	7,311	9,677	12,342
Cost of consumed electricity	(3,336)	(4,222)	(5,385)
Changes in inventories and cost of raw materials and consumables used	(608)	(1,591)	(2,029)
Supplies and services	(661)	(817)	(1,042)
Personnel costs	(528)	(546)	(696)
Employee benefits expense	(440)	(200)	(255)
Other income/expenses, net	(608)	(247)	(316)
Gross operating results	1,131	2,053	2,619
Provisions	(64)	(12)	(16)
Depreciation and amortization expense	(835)	(997)	(1,271)
Amortization of deferred income on partially funded properties received under concessions	86	98	124
Operating results	317	1,142	1,456
Gains from the sale of financial assets	10	441	562
Financial income	392	528	673
Financial expenses	(660)	(927)	(1,183)
Share of profit of associates	4	35	45
Profit before tax	62	1,219	1,554
Income tax expense	(16)	(152)	(194)
Profit after tax but before gain on discontinued operation	46	1,066	1,360
Gain on sale of discontinued operation, net of tax	0	46	58
Net income	46	1,112	1,418
Attributable to:			
Minority interests	3	41	52
Equity holders of EDP	43	1,071	1,366
Operating results from continuing operations	335	1,154	1,472
Net income from operations per ordinary share[4]	0.10	0.31	0.40
Net income from operations per ADS[4]	1.04	3.14	4.00
Basic and diluted net income per ordinary share[4]	0.01	0.29	0.38
Basic and diluted net income per ADS[4]	0.14	2.94	3.75
Dividends per ordinary share[5][6][7]	0.09	0.10	0.13

Dividends per ADS[5][6]	0.92	1.00	1.28

(1) *For 2005, euros are translated into U.S. dollars at the rate of exchange of U.S.$1.2754 = 1.00, which was the U.S. Federal Reserve Bank of New York Noon Buying Rate on July 11, 2006.*

(2) *Consists of sales of natural gas, steam, ash, information technology products, telecommunications equipment and sundry materials.*

(3) *Consists of electricity-related services, services to information technology systems, telecommunications, engineering, laboratory services, training, medical assistance, consulting, multi-utility services and other services.*

(4) *Basic net income per share is based on the weighted average number of ordinary shares outstanding during the year. Diluted net income per share is computed on the basis of the weighted average number of ordinary shares outstanding during the year plus the effect of ordinary shares issuable upon the exercise of employee stock options using the treasury stock method. Basic and diluted net income per American Depository Share, or ADS, is based upon basic and diluted net income per ordinary share multiplied by 10 as each ADS is equivalent to 10 ordinary shares on a post-split basis.*

(5) *Based on 3,656,537,715 ordinary shares issued and outstanding in 2004 and 2005.*

(6) *Dividends per ordinary share in U.S.$, translated at the prevailing rate of exchange on the date of payment between the U.S. dollar and the euro, amount to U.S.$ 0.12 in both 2004 and 2005.*

(7) *Stated figure is rounded, as actual dividend paid in relation to 2004 net income was 0.09243.*

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	Year ended December 31,					
	2001	2002	2003	2004	2005	2005
	Euro	Euro	Euro	Euro	Euro[1]	U.S. $[1]
	(in millions, except per ordinary share and per ADS data)					
Statement of income:						
Amounts in accordance with U.S. GAAP						
Revenues	5,133	5,512	5,747	6,822	9,056	11,550
Income from continuing operations	521	264	451	239	1,101	1.404
Income from continuing operations per share	0.17	0.09	0.15	0.08	0.30	0.38
Net income	521	264	451	239	1,109	1,414
Basic and diluted net income per ordinary share[2]	0.17	0.09	0.15	0.08	0.30	0.39
Basic and diluted net income per ADS[2]	1.74	0.89	1.51	0.78	3.05	3.89

(1) *For 2005, euros are translated into U.S. dollars at the rate of exchange of U.S.$1. 2754 = 1.00, which was the U.S. Federal Reserve Bank of New York Noon Buying Rate on July 11, 2006.*

(2) *Basic net income per share is based on the weighted average number of ordinary shares outstanding during the year. Diluted net income per share is computed on the basis of the weighted average number of ordinary shares outstanding during the year plus the effect of ordinary shares issuable upon the exercise of employee stock options using the treasury stock method. Basic and diluted net income per ADS are based upon basic and diluted net income per ordinary share multiplied by 10 as each ADS is equivalent to 10 ordinary shares on a post-split basis.*

	As of and for the Year ended December 31,		2005
	2004	2005	
	Euro	Euro[1]	U.S. $[1]
	(in millions, except per ordinary share and per ADS data)		
Cash flow data:			
Amounts in accordance with IFRS			
Net cash from operating activities	1,643	1,653	2,108
Net cash used in investing activities	(2,311)	(2,039)	(2,601)
Net cash used in (from) financing activities	636	707	902

(1) *For 2005, euros are translated into U.S. dollars at the rate of exchange of U.S.$1. 2754 = 1.00, which was the U.S. Federal Reserve Bank of New York Noon Buying Rate on July 11, 2006.*

	Year ended December 31,		
	2004	2005	2005
	Euro	Euro[1]	U.S. $[1]
	(in millions, except per ordinary share and per ADS data)		
Balance sheet data:			
Amounts in accordance with IFRS			
Cash and cash equivalents	231	585	747
Other current assets	2,562	3,740	4,770
Total current assets	2,793	4,326	5,517
Fixed assets, net[2]	12,557	13,891	17,717
Other assets	5,551	5,816	7,417
Total assets	20,901	24,033	30,652
Short-term debt and current portion of long-term debt	1,961	1,984	2,530
Other current liabilities	3,849	4,548	5,800

Total current liabilities	5,810	6,531	8,330
Long-term debt, less current portion	7,181	8,601	10,969

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	Year ended December 31,		
	2004	2005	2005
	Euro	Euro[1]	U.S. $[1]
	(in millions, except per ordinary share and per ADS data)		
Hydro account	364	170	217
Other long-term liabilities	2,764	2,620	3,341
Total liabilities (including Hydro account)	16,119	17,922	22,857
Minority interest	744	1,288	1,642
Total Equity attributable to equity holders of EDP	4,038	4,823	6,152

(1) *For 2005, euros are translated into U.S. dollars at the rate of exchange of U.S.$1. 2754 = 1.00, which was the U.S. Federal Reserve Bank of New York Noon Buying Rate on July 11, 2006.*

(2) *Substantially all of these assets are subject to reversion to the Portuguese Republic or the municipalities. See Item 4. Information on the Company Portugal Electricity regulation Portuguese electricity legislation and regulation Reversionary assets.*

	Year ended December 31,					
	2001	2002	2003	2004	2005	2005
	Euro	Euro	Euro	Euro	Euro[1]	U.S. $[1]
	(in millions, except per ordinary share and per ADS data)					
Balance Sheet Data:						
Amounts in accordance with U.S. GAAP						
Fixed assets, net[2]	5,929	6,602	7,172	9,722	11,648	14,856
Total assets	15,455	16,922	17,730	23,525	25,800	32,905
Total current liabilities	3,052	2,551	3,270	6,920	6,408	8,173
Total long-term liabilities	7,706	10,403	10,873	11,230	12,471	15,906
Total liabilities	10,758	12,954	14,143	18,150	18,880	24,079
Shareholders equity	4,456	3,865	3,440	4,583	5,558	7,088

(1) *For 2005, euros are translated into U.S. dollars at the rate of exchange of U.S.$1. 2754 = 1.00, which was the U.S. Federal Reserve Bank of New York Noon Buying Rate on July 11, 2006.*

(2) *Substantially all of these assets are subject to reversion to the Portuguese Republic or the municipalities. See Item 4. Information on the Company Portugal Electricity Regulation Portuguese electricity legislation and regulation Reversionary assets.*

EXCHANGE RATES

Our consolidated financial statements are published in euros. A portion of our revenues and expenses and certain liabilities are nonetheless denominated in non-euro currencies outside the euro zone, and fluctuations in the exchange rates of those currencies in relation to the euro will therefore affect our results of operations. To learn more about the effect of exchange rates on our results of operations, you should read Item 5. Operating and Financial Review and Prospects. Exchange rate fluctuations will also affect the U.S. dollar price of the ADSs and the U.S. dollar equivalent of the euro price of our ordinary shares, the principal market of which is the Euronext Lisbon Stock Exchange. In addition, any cash dividends are paid by us in euro, and, as a result, exchange rate fluctuations will affect the U.S. dollar amounts received by holders of ADSs on conversion of those dividends by the depositary.

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The following table shows, for the periods and dates indicated, information concerning the exchange rate between the U.S. dollar and the euro. These rates are provided solely for your convenience. We do not represent that the euro could have converted into U.S. dollars at these rates or at any other rate.

The column of averages in the table below shows the average of the relevant exchange rate, calculated as the average of the exchange rate on the last business day of each month during the relevant period. The high and low columns show the highest and lowest exchange rates, respectively, on any business day during the relevant period.

U.S. dollar per euro[1]

Year Ended December 31,	End of Period	Average
2001	0.89	0.89
2002	1.05	0.95
2003	1.26	1.13
2004	1.35	1.24
2005	1.18	1.24

U.S. dollar per euro[1]	High	Low
2006		
January	1.23	1.20
February	1.21	1.19
March	1.22	1.19
April	1.26	1.21
May	1.29	1.26
June	1.29	1.25

(1) *Euro amounts are based on the U.S. Federal Reserve Bank of New York Noon Buying Rate.*

Our ordinary shares are quoted in euro on the Euronext Lisbon Stock Exchange. Our ADSs are quoted in U.S. dollars and traded on the New York Stock Exchange. On July 11, 2006, the exchange rate between the euro and the U.S. dollar was U.S.$1.2754 = 1.00.

CAPITALIZATION AND INDEBTEDNESS

Not applicable.

REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

RISK FACTORS

In addition to the other information included and incorporated by reference in this annual report, you should carefully consider the following factors. There may be additional risks that we do not currently know of or that we currently deem immaterial based on information currently available to us. Our business, financial condition or results of operations could be materially adversely affected by any of these risks, resulting in a decline in the trading price of our ordinary shares or ADSs.

RISKS RELATED TO OUR CORE ELECTRICITY BUSINESS

The competition we face in the generation and supply of electricity is increasing, which may affect our electricity sales and operating margins.

The increase in competition from the Portuguese and Spanish implementation of EU directives intended to create a competitive electricity market may materially and adversely affect our business, results of operations and financial condition.

In Portugal, while we currently face limited competition from independent power producers in generation, we expect that this competition will increase as the industry further liberalizes. Portuguese law requires that contracts for the construction of future power plants in Portugal be awarded through competitive tender processes, in which we expect to participate. In a competitive tender process, we may lose opportunities to generate electricity in the Portuguese system. For further information on the structure of the Portuguese electricity market, see Item 4. Information on the Company Portugal Electricity System Overview.

In addition, the Portuguese government has implemented selected measures to encourage the development of various forms of electricity production, including auto production (entities generating electricity for their own use that may sell surplus electricity to the national transmission grid), cogeneration, small hydroelectric production (under 10 MVA installed capacity) and production using renewable sources. As an incentive from the Portuguese government, the electricity generated by these producers has been granted priority of sale in the PES. In 2005, the installed capacity of these producers was 2,389 MW, which represents 18.6% of the total installed capacity in Portugal. Through our subsidiaries, we participate in this generation area with an installed capacity of 337 MW.

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The Portuguese regulatory structure now allows for competition in the supply of electricity, which could adversely affect our sales of electricity. In particular, in the future more electricity will be sold in the competitive markets, where prices may be lower than existing tariffs. Although law provided for full liberalization in the supply of electricity in August 2004, these rules are not expected to be implemented until September 2006. Therefore the effects of this increased competition have not yet been fully determined.

Despite the complete liberalization of the Spanish generation and wholesale market since January 1, 2003, the majority of consumers have not changed their electricity supplier. Until now, this liberalization has mainly produced effects among medium- and high-voltage consumers. Although fixed rate tariffs are expected to predominate, at least in the short- and medium-term, among Spanish electricity consumers, especially low voltage consumers, there could be a more pronounced move to contractually-agreed prices in the future, and these prices could be lower than regulated tariffs.

In the context of liberalization of the electricity market within the European Union, since the end of 2001 the Portuguese and Spanish governments have entered into several agreements for the creation of an Iberian electricity market, *Mercado Ibérico da Energia Eléctrica*, or MIBEL, the main principles of which are free competition, transparency, objectivity and efficiency. The stated intent of MIBEL is to guarantee Portuguese and Spanish consumers access to electricity distribution and to create interconnections with third countries on equal conditions applicable to Portugal and Spain. In addition, it is intended that the production of electricity by producers in Portugal and Spain be subject to similar regulation, thereby allowing producers in one country to execute bilateral agreements for electricity distribution to consumers in the other country and facilitating the creation of an Iberian common electricity pool.

The scope of increased competition and any adverse effects on our operating results and market share resulting from the full liberalization of the European electricity markets, and in particular the Portuguese and Spanish electricity markets, combined with the opening of MIBEL, will depend on a variety of factors that cannot be assessed with precision and that are beyond our control. Accordingly, we cannot anticipate the risks and advantages that may arise from this market liberalization. When further implemented, the organizational model and resulting competition may materially and adversely affect our business, results of operations and financial condition.

Our core electricity operating results are affected by laws and regulations, including regulations regarding the prices we may charge for electricity.

Through its laws and regulations, the Portuguese government has created the current legal and regulatory framework governing the Portuguese electricity sector in which we operate. We cannot predict if regulatory changes will be made in the future or, if any such regulatory changes were made, the effects these changes would have on our business, financial condition and results of operations.

As an electricity public service, we operate in a highly regulated environment. An independent regulator appointed by the Portuguese government, the *Entidade Reguladora dos Serviços Energéticos,* or ERSE, regulates the electricity industry through, among other things, a tariff code that defines the prices we may charge for electricity services in the Public Electricity Sector, referred to as the PES or Binding Sector, and the prices for third-party access tariffs. In attempting to achieve an appropriate balance between, on the one hand, the interests of electricity customers in affordable electricity and, on the other hand, our need and the needs of other participants in the electricity sector to generate adequate profit, ERSE may take actions that adversely impact our profitability.

In real terms, adjusted for inflation, very high, high and medium voltage tariffs, generally applied to industrial customers, have declined by an average of 1.5% per year over the period 1999 to 2006. The tariffs for low voltage customers have also declined in real terms by an average of approximately 2.3% per year over the same period. For 2006, in nominal terms, tariffs for all voltage levels increased, on average, by 5.1% from the 2005 levels.

The component of the final tariff collected by EDP Distribuição Energia, S.A., or EDPD, our distribution company in Portugal, is calculated on the basis of a unitary tariff by voltage levels defined by ERSE, subject to a yearly adjustment on the basis of the Portuguese consumer price index, or CPI, less an efficiency coefficient. During the 2002-2004 regulatory period, the efficiency coefficient increased from 5% (applicable during the 1999-2001 regulatory period) to approximately 7%. There was no efficiency coefficient for the 2005 regulatory period as it was a one-year period without additional years within the period for the purposes of comparison. For 2006-2008, the efficiency coefficient is 4%. The tariffs to be set for the 2006-2008 regulatory period or any new regulations to be promulgated in respect of these periods may adversely affect our business, results of operations and financial condition.

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Due to uncertainty as to the timing of our receipt of compensation relating to the early termination of the PPAs, which is conditioned on the start of operations of MIBEL, we may not receive such compensation in the amount currently contemplated.

Following the Resolution of the Council of Ministers no. 63/2003, of April 28, 2003, relating to the promotion of liberalization of the electricity and gas markets in furtherance of the organizational structure of MIBEL, the Portuguese government enacted Decree law no. 185/2003, of August 20, 2003, which contemplates the early termination of existing power purchase agreements, or PPAs. Pursuant to Decree law no. 52/2004, of October 29, 2004, which was enacted by the Portuguese parliament, the terms and conditions of such termination have been set out in Decree law no. 240/2004, of December 27, 2004, which provides for the creation of compensation measures designed to ensure electricity generating companies an economic benefit equivalent to that of the PPAs. However, the early termination of the PPAs, and the resulting implementation of related compensation mechanisms, is subject to the existence of various requirements and the satisfaction of various conditions precedent, the chief among these being the commencement of MIBEL operations. Although the MIBEL forward sale market managed by OMIP Operador do Mercado Ibérico de Energia Pólo Português, S.A., or OMIP, began operations on July 3, 2006, it is still unclear whether the adequate conditions have been met to allow for the commencement of MIBEL operations. Until the requirements and conditions for the early termination of the PPAs are met, our generation facilities in the PES will continue to be operated under the existing PPAs.

The estimated amount of compensation relating to the early termination of the PPAs contemplates, among other things, the commencement of MIBEL operations by June 30, 2005, which did not occur. Currently, we do not know the timing for commencement of MIBEL. To the extent that the timing of our receipt of compensation for the early termination of the PPAs is delayed, the amount of such compensation could be different from that which is currently contemplated. As a result, perceptions of our value in the market that are based on the currently contemplated compensation amount could change.

In addition, the compensation mechanisms relating to the early termination of PPAs were devised in the context of the existing legal and regulatory framework for the Portuguese electricity market, changes to which could result in changes to the assumptions or other factors underlying the existing compensation mechanisms and eventually adversely affect the compensation we receive.

If our concessions from the Portuguese government and municipalities were terminated, we could lose control over our fixed assets.

Most of our revenues currently come from the generation and distribution of electricity. We conduct these activities pursuant to concessions and licenses granted by the Portuguese government and various municipalities. These concessions and licenses are granted for fixed periods ranging in most cases from 20 to 75 years, but are subject to early termination under specified circumstances. The expiration or termination of concessions or licenses would have an adverse effect on our operating revenues. Upon expiration of licenses or termination of concessions, the fixed assets associated with licenses or concessions will, in general, revert to the Portuguese government or a municipality, as appropriate. Although specified compensatory amounts would be paid to us with respect to these assets in these circumstances, the loss of these assets may adversely affect our operations.

Our operational cash flow is affected by variable hydrological conditions.

Hydroelectric plants operating in the PES in Portugal account for approximately 47% of the installed capacity in the PES. These plants are dependent on the amount and location of rainfall and river flows from Spain, all of which vary widely from year to year. In years of favorable hydrological conditions, there is an increase in hydroelectric generation, while in years of unfavorable hydrological conditions, there is a decrease in hydroelectric generation and a greater dependence on thermal generation. Thermal generation, which is fired by coal, fuel oil, natural gas or a combination of fuels, is more expensive in terms of variable costs than hydroelectric generation.

To account for the variability of hydrological conditions and their impact on generation costs in the PES, we use the hydrological correction account, or hydro account, which was established in accordance with Portuguese law. Because the tariffs in Portugal are computed based on the assumption of conditions in an average hydrological year, the purpose of this account is to correct the short-term effect of hydro variability on PES generation costs.

The hydro account is reinforced through cash payments by REN Rede Eléctrica Nacional, S.A., or REN (the system operator of the PES), in years of favorable hydrological conditions, while in years of unfavorable hydrological conditions we draw from the hydro account and make cash payments to REN, in order to compensate for the increased generation costs in the PES. Both the cash reinforcements and draws are based on the economic reference costs calculated on the basis of an average

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hydrological year and observed fuel prices. The increased PES generation costs in a dry year could have an adverse impact on our operational cash flow but not on our results of operations, due to the effects of the hydro account. For further information on the hydrological correction account, see Item 5. Operating and Financial Review and Prospects Critical Accounting Policies Hydrological correction account.

A significant amount of the energy we produce in certain markets is subject to market forces that may affect the price and amount of energy we sell.

We are exposed to market price risk for the purchase of fuel (including fuel-oil, coal and natural gas) used to generate electricity and the sale of a portion of the electricity that we generate. A portion of this risk is currently managed by the PPAs and we actively manage the market price risk relating to our fuel requirements. There can be no assurance that such management will eliminate all market price risk relating to our fuel requirements.

The combined-cycle gas fired power station, or CCGT, at Ribatejo, or the Ribatejo CCGT, does not operate under a PPA and its supply of natural gas is subject to market price risk for the purchase of fuel. If the Ribatejo CCGT plant does not receive an adequate supply of natural gas or if the price of natural gas is too high, it may not generate electricity or electricity generation may be limited.

Our electricity business is subject to numerous environmental regulations that could affect our results of operations and financial condition.

Our electricity business is subject to extensive environmental regulations. These include regulations under Portuguese and Spanish law, laws adopted to implement EU regulations and directives and international agreements on the environment. In Brazil, although we only operate hydroelectric plants and Brazil does not belong to Annex I of the Kyoto Protocol, we are nonetheless subject to strict environmental regulations relating to operators of generation facilities. Environmental regulations affecting our business primarily relate to air emissions, water pollution, waste disposal and electromagnetic fields. The principal waste products of fossil-fueled electricity generation are sulfur dioxide, or SO_2, nitrogen oxides, or NO_X, carbon dioxide, or CO_2, and particulate matters such as dust and ash. A primary focus of environmental regulation applicable to our business is to reduce these emissions.

We incur significant costs to comply with environmental regulations requiring us to implement preventive or remediation measures. For example, we made approximately 90.5 million of capital expenditures in 2005 to comply with applicable environmental laws and regulations to minimize the atmospheric emissions impact of our operations on the environment. Environmental regulatory measures may take such forms as emission limits, taxes or required remediation measures, and may influence our policies in ways that affect our business decisions and strategy, such as by discouraging our use of certain fuels.

Under the EU Directive relating to the emission of pollutants from Large Combustion Plants, Portuguese environmental authorities created a new National Emissions Reduction Plan, or PNRE, to reduce SO_2 and NO_x emissions. The new PNRE, which replaces the 1996-2003 PNRE, was prepared and discussed with the competent authorities during 2004 and 2005, and formally approved in June 2006. The investments we made by to minimize emissions impact took into account these targets now imposed. Additionally, with regard to CO_2 emissions, the Emission Trading Scheme, or ETS, began in the EU in 2005, and emission allowances were distributed to our operators in Portugal and Spain. We were allocated allowances for Portugal and Spain totaling 68.7 $MtCO_2$, for the period spanning 2005 to 2007. The total amount of allowances received by the electricity sectors accounts for nearly 43% and 40% of the total CO_2 accounted for in Portugal and Spain, respectively. In the binding generation system in Portugal, the costs of our thermal installed capacity are covered by the PPAs, taking into account allowances of CO_2, which means that about 50% of the risk of insufficient CO_2 emissions allowances is protected. For the other 50%, relating to the thermal generation in Spain and the Ribatejo CCGT plant, we are dependent on our CO_2 risk management practices. There can be no assurance that we will manage our CO_2 emissions within the applicable allowances.

We also have an interest in a nuclear power plant through HidroCantábrico Hidroeléctrica del Cantábrico, S.A., or HidroCantábrico, which holds a 15.5% interest in the Trillo nuclear power plant in Spain. Spanish law and regulations limit, consistent with international treaties ratified by Spain, the liability of nuclear plant operators for nuclear accidents. Current Spanish law provides that the operator of each nuclear facility is liable for up to 150.3 million as a result of claims relating to a single nuclear accident. We would be liable for our proportional share of this 150.3 million per accident amount. Trillo currently has insurance to cover potential liabilities related to third parties arising from a nuclear accident in Trillo up to 150.3 million. The 150.3 million per accident limit on liability could be increased pursuant to changes in Spanish law. In the proportion of HidroCantábrico s stake in Trillo, we could be subject to the risks arising from the operation of nuclear

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facilities and the storage and handling of low-level radioactive materials. These risks include accidents, the breakdown or failure of equipment or processes or human performance, including safety controls, and other events that could result in injury or damage to property or the environment. Liabilities we may incur in connection with these risks could result in negative publicity and reputation damage.

RISKS RELATED TO OUR OTHER BUSINESSES

Our involvement in international activities subjects us to particular risks that could affect our profitability.

Our investments in Brazil and in other countries present a different or greater risk profile than that of our electricity business in Portugal and Spain. Risks associated with our investments outside of Portugal and Spain include but are not limited to:

- economic volatility;
- exchange rate fluctuations and exchange controls;
- strong inflationary pressures;
- government involvement in the domestic economy;
- political uncertainty; and
- unanticipated changes in regulatory or legal regimes.

We cannot assure you that we will successfully manage our operations in Brazil and other international operations.

Exchange rate instability and, in particular, fluctuations in the value of the Brazilian real against the value of the U.S. dollar (appreciation of 22%, 9% and 13% during 2003, 2004 and 2005, respectively) may result in uncertainty in the Brazilian economy, which may affect the results of our Brazilian operations. In addition, we are exposed to translation risk when the accounts of our Brazilian businesses, denominated in Brazilian reais, are translated into our consolidated accounts, denominated in euro. We cannot predict movements in Brazil s currency, and, since long-term Brazilian currency hedges are not available, a major devaluation of the Brazilian real might adversely affect our business, results of operations and financial condition.

Regulatory, hydrological and infrastructure conditions in Brazil may adversely affect our Brazilian operations.

We hold interests in Brazilian distribution companies and have invested in Brazilian generation projects. In the past, our distribution activities and generation projects in Brazil have been adversely affected by regulatory, hydrological and infrastructure conditions in Brazil. These conditions could have a similar adverse effect on our Brazilian generation and distribution operations in the future.

Delays by the Brazilian energy regulatory authorities in developing a regulatory structure that encourages new generation have led to, and might also in the future contribute to, shortages of electricity to meet demand in some regions of Brazil. As a result, the supply of electricity available for our distribution companies in Brazil has been limited and may be again in the future. In addition, the geographic location of generation plants, combined with transportation constraints, has limited, and might also in the future limit, our ability to transmit electricity generated in abundant rainfall areas to distribution companies operating in areas experiencing drought conditions. Sales by these distribution businesses have been and might in the future be affected by these conditions that limit the supply of electricity available for distribution.

The Brazilian electricity rationing program that started in June 2001 and ended in February 2002 had an adverse effect on electricity consumption and on consumption habits in affected areas. During this rationing program, electricity consumption in our concession area decreased and did not return to pre-rationing levels until 2004. Consequently, in 2002 and 2003, our Brazilian operations could only dispose of

surplus electricity at depressed prices. Although total electricity distributed by our subsidiaries in the Brazilian market increased in 2004, reflecting a stronger economic environment in that region and an increase in the number of customers, material reductions in electricity consumption or generation, due to below-average rainfall or otherwise, may adversely affect our future financial results. In 2005, according to data from the Empresa de Pesquisa Energética, or EPE, energy consumption in Brazil grew 4.6% from 2004 and exceeded pre-2001 rationing levels for almost every month of the year, reflecting a recovery in demand.

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In 2004, Law No. 10,848, named the Law of the New Electricity Industry Model (*Lei do Novo Modelo do Setor Elétrico*), or New Electricity Law, for the Brazilian electric utility sector was enacted. As the regulations for the New Electricity Law have not yet been fully implemented, there is a risk that the new regulations may not be favorable for us. In addition, the New Electricity Law contemplates significant control by the Brazilian government, creating uncertainty regarding competition and further investments in the private sector.

Tariffs of distribution companies in Brazil currently consist of two components: non-manageable costs and manageable costs. The main purpose of this split is the maintenance of an adjusted tariff for inflation and the sharing of efficiency gains with consumers. The aim of distribution tariffs is to pass non-manageable costs through and to index manageable costs to inflation. Although it is expected that the New Electricity Law will maintain the pass-through of non-manageable costs, there might be delays in readjustment of the tariffs in the event of large macro-economic fluctuations (e.g., inflation and exchange rates). We cannot assure you that regulations implementing the New Electricity Law will fully mitigate the risk of delayed tariff adjustments.

We face new risks and uncertainties related to our activities in the gas sector.

We also are developing an Iberian gas business as complimentary to and strategically aligned with our electricity business, as described in more detail in Item 4. Strategy Iberian Energy Developing an Iberian gas business. We may face difficulties integrating this business with our current activities, and the development of the business will expose us to new risks, including governmental and environmental industry regulation and economic risks relating to fluctuation in the price of energy, currencies in which gas prices are quoted and time-lags in prices between the times of purchase and sale. We cannot assure you that we will successfully manage the development of our gas business, and a failure to do so could have an adverse effect on our business, results of operations and financial condition.

The supply chain of gas to Iberia by foreign countries involves gas production and treatment, transportation through international pipelines and in vessels, and processing in liquefaction terminals. This supply chain is subject to political and technical risk. Although these political and technical risks are often dealt with through force majeure clauses in supply, transit and shipping contracts that may, to a certain extent, shift risk to the end-user market, thereby mitigating contractual risk, contractual provisions do not mitigate margin risk associated with loss of profits. Additionally, once liberalization occurs in Portugal, access rules and available capacity in the infrastructures will be defined. Any capacity access or operational restrictions imposed by the system operator may impair normal supply and sales activities with resulting contractual risk leading to loss of profits.

The gas market is becoming more complex and more interrelated with the dynamics of other markets, including the market for electricity and CO_2, leading to volatility in international spot markets, with greater alternation between periods of high prices and low prices. Both high and low prices cause margin risk for market participants whose supply chain does not rely on long-term, stable contracts. Although the contractual structure of EDP s supplies in Portugal is designed to mitigate these fluctuations, we cannot assure you that our contractual structure will fully mitigate the risk arising from market volatility.

The demand for natural gas by electricity generators may be significantly affected not only by gas prices but also by a number of other factors including hydrological conditions, prices in electricity pool markets, prices of competing fuels and the availability of plants that are not gas fired. Commercial gas sales and gas distribution are affected by tariff levels, the economies conditions of the countries in which we sell and distribute gas, environmental and climate conditions and competition.

The European Commission and national regulators and authorities can unilaterally change, sometimes in a significant way, the regulation and rules applicable to the local gas industry. These changes may affect the return on investment of gas infrastructure owners, the conditions for access to infrastructure by participants, the level of storage or stranded costs supported by participants and, consequently, the potential economics of all market participants.

We face various risks in our telecommunications business, including increasing competition from various types of service providers.

The telecommunications sector is highly competitive within Portugal and across the EU, and we expect competition to remain vigorous and even increase in the future.

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In the fixed line telephone area in Portugal, we compete for market share primarily with Portugal Telecom, or PT, which historically held a monopoly on fixed line services in Portugal and continues to hold a dominant position in this market. We also face competition from other fixed line operators in Portugal.

Our fixed line telephone business also faces strong indirect competition from cellular telephone service providers, particularly those in the voice segment. Mobile subscriptions have already overtaken the number of fixed line connections in Portugal, and we expect this growth to continue.

We also face significant competition from numerous existing operators in the Internet and data services areas, both of which we have targeted, and we expect that new competitors will emerge as these markets continue to evolve.

We face managerial, commercial, technological and regulatory risks, as well as other risks, related to our telecommunications activity. Our ability to develop and successfully achieve profitability in this area may be affected if we are not able to manage these risks and this business efficiently in a competitive market. In 2005, our telecommunications activity generated a loss before taxes of 87.7 million.

OTHER RISKS

The value of our ordinary shares and ADSs may be adversely affected by future sales of substantial amounts of ordinary shares by the Portuguese government or the perception that such sales could occur.

The Portuguese government may sell all or a portion of its shareholding in us at any time. Sales of substantial amounts of our ordinary shares by the Portuguese government, or the perception that such sales could occur, could adversely affect the market prices of our ordinary shares and ADSs and could adversely affect our ability to raise capital through subsequent offerings of equity.

Restrictions on the exercise of voting rights, as well as special rights granted to the Portuguese government, may impede an unauthorized change in control and may limit our shareholders ability to influence company policy.

Under our articles of association, no shareholder, except the Portuguese Republic and equivalent entities, may exercise voting rights that represent more than 5% of our voting share capital. In addition, specific notification requirements are triggered under our articles of association when shareholders, other than the Portuguese Republic and equivalent entities, purchase 5% of our shares and under the Portuguese Securities Code when purchases or sales of our shares cause shareholders to own or cease to own specified percentages of our voting rights.

Pursuant to article 10 of Decree law no. 218-A/2004, of October 25, 2004, known as the Reprivatization Decree Law, special rights granted to the Portuguese government by Decree law no. 141/2000, of July 15, 2000, are to be maintained for so long as the Portuguese government or an equivalent entity is an EDP shareholder. These rights provide that, without the favorable vote of the government or an equivalent entity, no resolution can be adopted at our general meeting of shareholders relating to:

- amendments to our by-laws, including share capital increases, mergers, spin-offs or winding-up;
- authorization for us to enter into group/partnership or subordination agreements; or
- waivers of, or limitations on, our shareholders rights of first refusal to subscribe to share capital increases.

The Portuguese government or an equivalent entity may also appoint one member of our board of directors whenever it votes against the list of directors presented for election at our general meeting of shareholders.

Item 4. Information on the Company

HISTORY AND BUSINESS OVERVIEW

We were incorporated in 1976 under the name EDP Electricidade de Portugal, E.P., as a result of the nationalization and merger of the principal Portuguese companies in the electricity sector in mainland Portugal. In 1991, we changed our name to EDP Electricidade de Portugal, S.A. and,

in October 2004, we changed our name to EDP Energias de Portugal, S.A.

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We are the largest generator and distributor of electricity in Portugal. In addition, we own 30% of REN, the sole transmitter of electricity in Portugal, and we have significant electricity operations in Spain and Brazil. Our principal executive offices are located at Praça Marquês de Pombal, 12, 1250-162 Lisbon, Portugal. Our telephone number at this location is +351-21-001-2500. Our agent for service of process in the United States is CT Corporation System at 111 Eighth Avenue, New York, New York 10011.

Our official website address is http://www.edp.pt. The information on our website is not incorporated by reference in this annual report.

Through a privatization process that began in 1997, the Portuguese government has reduced its interest in us. The sixth phase of privatization was completed in December 2005 with the issuance of convertible bonds by Parpública corresponding to 4.376% of our share capital. As of May 31, 2006, we were approximately 20.49% owned indirectly by the Portuguese Republic and an additional 4.95% of our shares were held by Caixa Geral de Depósitos, S.A., or CGD, a state-owned bank. Other significant shareholders include Iberdrola, S.A. (9.5%), Caja de Ahorros de Asturias, or CajAstur (5.53%), BCP - Banco Comercial Português, S.A., or BCP (2.91%), the BCP Group s Pension Fund (2.23%), UBS AG (2.41%), Banco Espírito Santo, S.A., or BES (2.17%) and Baltic SGPS, S.A., or Baltic (2.00%).

The following chart shows our current structure and a list of the primary companies and investments within the EDP Group. For a more detailed listing and description, see Subsidiaries, Affiliates and Associated Companies and note 17 to our consolidated financial statements.

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Our 2005 operating revenues amounted to 9,677 million (U.S.$12,342 million), approximately 89% of which represented electricity sales, yielding operating income of 1,142 million (U.S.$1,456 million). As of December 31, 2005, our total assets were 24,033 million (U.S.$30,652 million), and shareholders equity was 4,823 million (U.S.$6,109 million).

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The following table shows our consolidated revenues by activity and geography:

	Year ended December 31,	
	2004	2005
	(millions of EUR)	
Electricity		
Portugal	5,521	6,301
Spain	416	1,697
Brazil	1,148	1,607
Gas		
Portugal	0	49
Spain	198	671
Telecommunications	156	150
Adjustments[(1)]	(129)	(798)
Total	7,311	9,677

(1) *Adjustments to include revenues from services and to exclude intercompany transactions.*

ENERGY

Iberian electricity

Historically, electricity has been our core business. We are the largest producer and distributor of electricity in Portugal. We underwent a restructuring in 1994, at which time we formed subsidiaries to operate in the areas of electricity generation, transmission and distribution. The Portuguese government purchased a 70% interest in the transmission company REN from us in 2000. We currently conduct most of our electrical generation business in Portugal through EDP Gestão da Produção de Energia, S.A., referred to in this annual report as EDP Produção, or EDPP. Our electricity distribution business in Portugal is conducted through Distribuição Energia, S.A., or EDPD.

The creation of an Iberian electricity market is the driving force behind our decision to expand our operations to Spain. In 2001, we identified HidroCantábrico as an independent utility company that could facilitate our entry into the Spanish energy market. HidroCantábrico operates electricity generation plants and distributes and supplies electricity and gas, mainly in the Asturias and Basque regions in Spain. We are now the third largest utility operator in the Iberian market following our acquisition of an additional 56.2% stake in HidroCantábrico in 2004, increasing our stake to 95.7%. In connection with our 2004 acquisition of HidroCantábrico, we entered into a shareholders agreement with CajAstur and Caser, which together retained an aggregate stake in HidroCantábrico of 3.1%. The shareholders agreement gives CajAstur and Caser certain veto rights, especially in relation to certain regional concerns, which will preserve HidroCantábrico s links with the region of Asturias. In addition, CajAstur has a long-term put option entitling it to sell its interest in HidroCantábrico to us at a price indexed to the value of our ordinary shares.

In 2005, we accounted for approximately 82% of the installed generation capacity in the PES and 99% of the distribution in the PES. REN, in which we hold a 30% equity interest, accounted for 100% of the transmission in the PES. HidroCantábrico, Spain s fourth largest utility operator, accounted for 5% of Spanish mainland installed generation capacity in the conventional regime, which includes generation in the competitive market or through bilateral contracts, and 6% of the Spanish liberalized electricity supply market.

In Portugal, we generate power for consumption in both the PES and the Independent Electricity System, or IES. In 2005, our generation facilities in Portugal had a total installed capacity of 8,921.2 MW. In the transmission function, REN operates the national grid for transmission of electricity throughout mainland Portugal on an exclusive basis pursuant to Portuguese law. REN also manages the system dispatch and the interconnections with Spain. EDPD, our distribution company, carries out Portugal s local electricity distribution almost exclusively. EDPD provided approximately 5.9 million customers with 43,784 GWh of electricity in 2005. In Spain, HidroCantábrico had a total installed capacity in the conventional regime in 2005 of 2,596 MW, distributed a total of 9,247 GWh through its own network to approximately 584,922 regulated customers and invoiced 13,611 GWh of electricity supply to regulated and liberalized customers.

Our generation activities in Portugal and Spain include renewable energy facilities that are primary held by Nuevas Energias de Occidente, SL, or Neo Energia, a company formed in 2005 to participate in the renewable energy business. In December 2005, Neo Energia acquired the Spanish operations of Nuon International Renewables Projects, B.V., a Dutch company involved in renewables, for 485.4 million. The acquired

business, Grupo Nuon España, S.L.U., or Nuon España, participates in the Spanish renewable energy sector through Desarollos Eolicos, S.A., or DESA, and has a portfolio of wind farm projects with a total capacity of 1,407 MW, of which 221 MW were already fully operational at the end of 2005 and

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1,186 MW were in different stages of development. The wind farms are located in Galicia, Aragon, Andalusia and Canary Islands and comprise assets with an average number of wind hours of 2,650 hours/year, above the average for the sector in Spain, which stands at 2,350 hours per year.

We expect regional electricity markets to consolidate in Europe as an initial step toward an integrated and liberalized electricity market within the European Union. For geographical and regulatory reasons, the regional electricity market of the Iberian Peninsula is our natural market and will be integrated with the opening of MIBEL. In anticipation of MIBEL, we elected the Iberian Peninsula electricity market as the core market for our main electricity business and expanded our energy operations in Spain with an increase of our stake in HidroCantábrico to 95.7% in 2004. Our main activities in the electricity sector are already conducted in the Iberian Peninsula market in an integrated manner. We expect this acquisition to result in the full integration of HidroCantábrico s operations with ours, which should allow us to enhance management flexibility, realize further synergies from the combination of our operations and improve business performance, thereby reinforcing our position as a leading Iberian energy company in advance of the opening of MIBEL.

Iberian gas

We also have investments in gas utilities, which we regard as complementary to our core electricity business.

In Portugal, we have direct and indirect shareholdings equal to 72.0% of Portgás Sociedade de Produção e Distribuição de Gás, S.A., or Portgás, the natural gas distribution company for the northern region of Portugal and direct and indirect shareholdings equal to 19.8% of Setgás Sociedade de Produção e Distribuição de Gás, S.A., or Setgás, the natural gas distribution company for the Setúbal region. For more information on our participation in the Portuguese gas sector, see Gas Portugal.

Our interests in the gas sector in Spain are held through HidroCantábrico, which is the controlling shareholder with a 56.18% stake in Naturgás Energia, or Naturgás, the leading gas company in the Basque region of Spain. For more information on our participation in the Spanish gas sector, see Gas Spain.

Brazilian electricity

Our investments in Brazil are held through Energias do Brasil and consist of distribution, generation and related activities in the electricity sector. Energias do Brasil is engaged in distribution through the following subsidiaries: EBE Empresa Bandeirante de Energia, S.A., or Bandeirante, Escelsa Espirito Santo Centrais Eléctricas S.A., or Escelsa, and Enersul Empresa Energética do Mato Grosso do Sul S.A., or Enersul. In generation, Energias do Brasil participates in Investco S.A., or Investco, the owner of the Lajeado plant, through EDP Lajeado S.A., or EDP Lajeado, and Enerpeixe S.A., or Enerpeixe. Energias do Brasil s related trading business is concentrated in Enertrade S.A., or Enertrade. For more information, see Brazil Overview.

TELECOMMUNICATIONS

In 2000, taking into consideration our existing resources and expertise, we decided to pursue telecommunications activities. Currently, ONI Operadora Nacional de Interactivos, S.G.P.S., S.A., or ONI, our 56.6%-owned subsidiary and the holding company for our telecommunications businesses, has the overall responsibility for strategic and financial matters relating to our telecommunications business segments. Pursuant to a recent reorganization, ONI s businesses are currently focused on wireline Portugal, discussed in further detail in Telecommunications below. In June 2006, we announced that a process for the sale of our stake in ONI might be initiated.

INTERNATIONAL INVESTMENTS

Apart from Spain and Brazil, we have made a number of international investments in the electricity and water sectors in Cape Verde, Guatemala, and Macau. Other than Neo Energia s acquisition of three wind farms in France in 2005, discussed in further detail in Renewable Energy below, we have not initiated any other new significant international investment projects since 2003.

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GROUP CAPITAL EXPENDITURES AND INVESTMENTS

The following table sets forth our capital expenditures and investments for the years 2003 through 2005, divided into operating investment and financial investment. Operating investment generally refers to the development and acquisition of fixed assets, and financial investment generally refers to the acquisition of equity interests in companies.

	Year ended December 31,		
	2003	2004	2005
	(thousands of EUR)		
OPERATING INVESTMENT:			
Energy:			
Portugal:			
Generation:			
Thermal/Hydro	213,851	178,735	182,926
Renewable: wind	38,533	53,667	46,030
Renewable: biomass	922	155	0
Cogeneration	33	161	249
Other	0	0	3,699
Engineering and Operations and Maintenance	7,809	14,181	125
Total Generation	261,147	246,899	233,029
Distribution:[(1)]			
Investment, net of subsidies	275,030	311,513	335,926
Subsidies in kind (assets)	61,039	70,405	71,158
Subsidies in cash	59,714	76,592	79,330
Total Distribution	395,783	458,510	486,415
Supply[(2)]	6,218	6,524	5,663
Total technical costs	663,148	711,933	725,107
Financial costs capitalized	24,005	24,785	15,233
Total Portugal	687,152	736,718	740,339
Spain:			
HidroCantábrico[(3)]	70,528	115,071	347,294
Total Spain	70,528	115,071	347,294
Total Energy Portugal and Spain	757,680	851,789	1,087,633
Brazil:			
Generation[(4)]	58,676	195,545	255,400
Distribution:			
Bandeirante	39,392	33,173	42,729
Escelsa	18,639	30,055	50,817
Enersul	16,184	25,932	69,857
EDP Brasil	415	222	552
Total Brazil	133,307	284,926	419,355
Telecommunications[(5)] and Information Technology:			
Telecommunications	28,564	33,498	34,070
Information Technology	58,784	20,424	0
Total Telecommunications and Information Technology	87,348	53,922	34,070

Other:			
Other Operating Investment[6]	24,939	31,317	36,583
TOTAL OPERATING INVESTMENT	1,003,274	1,221,954	1,577,642

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	Year ended December 31, 2003	2004	2005
	(thousands of EUR)		
FINANCIAL INVESTMENT:			
Energy:			
Portugal:			
Acquisition of additional 20% shareholding in Turbogás	0	0	52,010
Acquisition of shareholding in Portgás and Setgás	0	124,120	0
Other	0	0	6,747
Spain:			
Acquisition of 66.2% of Naturcorp (now Naturgás) by HidroCantábrico[7]	100,235	0	0
Acquisition of 56.2% of HidroCantábrico by EDP	0	1,200,763	0
Acquisition of DESA by Neo Energia	0	0	485,355
Acquisition of Ider, S.L. by Sinae Inversiones Eólicas, S.A.	0	0	14,907
Other	0	0	9,149
Brazil:			
Other	0	0	0
Total Energy	100,235	1,324,883	568,168
Other:			
Subscription to BCP rights issue and capital increase	40,599	0	0
Other financial investments	40,926	25,240	0
Total Other	81,525	25,240	0
TOTAL FINANCIAL INVESTMENT	181,760	1,350,123	568,168
TOTAL CAPITAL EXPENDITURES AND INVESTMENTS	1,185,034	2,572,077	2,145,810

(1) *Distribution includes capital expenditures of EDPD.*

(2) *Supply comprises the capital expenditures of EDP Energia, our company operating in the liberalized market.*

(3) *Investments represent 40% of HidroCantábrico s operational investments in 2003 and 2004, and 100% in 2005.*

(4) *Investments in 2004 and 2005 include investments Peixe Angical.*

(5) *Investments for telecommunications include primarily infrastructure.*

(6) *Other Operating Investment includes investments by the EDP Group in installations and equipment at the holding company level, investments by our real estate companies and investments by our support services companies.*

(7) *Investments represent 40% of HidroCantábrico s financial investment in the acquisition of Naturcorp. Naturcorp has since reorganized its gas holdings, as a result of which HidroCantábrico s ownership of Naturcorp decreased to 56.2%.*

Total capital expenditures and investments of 2,145.8 million in 2005 represented a 16.6% decrease from total capital expenditures and investments of 2,572.1 million in 2004. This decrease in 2005 was primarily due to the acquisition of an additional 56.2% shareholding in HidroCantábrico in 2004. In 2005, our main investments included the acquisition in Spain of Nuon España by Neo Energia, and the construction of the Peixe Angical hydroelectric power station in Brazil, which is expected to start operations during the second half of 2006. Capital expenditures by EDPD in 2005 were focused on the distribution network in order to continue improving the quality of service.

Capital expenditures and investments increased from 1,185 million in 2003 to 2,572.1 million in 2004 due to the acquisition of HidroCantábrico in 2004, a higher level of investments in generation in Portugal, following the near conclusion of Venda Nova II, which was renamed Frades in 2005, the completion of construction of the first two units of the Ribatejo CCGT plant and the additional 72 MW of Enernova s wind farm capacity and investments made at the 124 MW Albacete wind farm through HidroCantábrico.

The capital expenditures set forth above have not been adjusted to reflect the fact that certain expenditures represent transfers between businesses within the EDP Group of assets that had previously been accounted for by the transferors as their own capital expenditures. The capital expenditures above have also not been adjusted for divestments of certain financial investments. Adjusting for these transactions would result in the following:

	Year ended December 31,		
	2003	2004	2005
	(thousands of EUR)		
Total Capital Expenditures and Investments:	1,185,034	2,572,077	2,145,810
Internal Transfers:			
IT Systems (from EDINFOR to EDPD)	(11,974)	0	0
Divestments:			
60% of Edinfor Sistemas Informáticos, S.A.	0	0	(69,771)
Comunitel	0	0	(117,305)
14.27% of Galp Energia	0	0	(144,100)
2.01% of BCP Banco Comercial Português, S.A.	0	0	(153,154)
3.0% of Red Eléctrica de España, S.A.	0	0	(75,879)
48.9% of Hidraulica de Santillana, S.A	0	0	(21,338)
3% of Iberdrola, S.A.	(400,102)	0	0
Oni way	0	(61,449)	0
Retecal	0	(23,004)	0
Stake in Fafen and Enersul turbine	0	(37,936)	0
Other divestments	0	0	(14,519)
Total Internal Transfers and Divestments	(412,076)	(122,389)	(596,066)
Adjusted Total Capital Expenditures and Investments	772,958	2,449,688	1,549,743

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In recent years, a significant part of our capital expenditures on electricity projects in mainland Portugal has been in distribution. Since EDPD is required by law to connect all customers who wish to be supplied by the PES, a large part of capital expenditures is spent in connecting new customers, improving network efficiency and developing the network (installing new cables and lines) to accommodate the growth in consumption. In addition, we are required to meet government standards for meter control, which requires us to make further investments in new meters. Our investment in distribution in Portugal in 2005 totaled 486.4 million compared with 458.5 million in 2004 and 395.8 million in 2003, and mainly consisted of recurring capital expenditures necessary for the operation, improvement and expansion of our distribution network in Portugal, including expansion to accommodate growth in consumption and maintenance. Between 2001 and 2005, EDPD s capital expenditures increased due to higher investments in the distribution network pursuant to our public commitment to improve the quality of service by reducing the equivalent interruption time in the distribution of electricity. In 2003, EDPD capital expenditures also included 12.0 million related to the internal transfer of an information technology system from Edinfor to EDPD.

Under current regulations in Portugal, EDPD receives contributions directly from customers for a portion of its capital expenditures for new connections to the transmission and distribution networks. The total amount of contributions from customers in 2005 was approximately 150.5 million compared with approximately 147.0 million in 2004.

During 2005, we invested 233 million in generation in Portugal, compared with 246.9 million in 2004 and 261.1 million in 2003. Capital expenditures in 2005, 2004 and 2003 were primarily a result of expenses incurred due to the construction of the three 392 MW units of the Ribatejo CCGT plant, the two 95.8 MW units of the Frades hydroelectric plant and 160 MW of wind farms.

In Portugal, we expect to focus future distribution capital expenditures on connecting new clients and improving the quality of the electricity service through a more efficient network. We expect to concentrate future generation capital expenditures on the development of new hydroelectric projects and on the construction of new CCGT power plants. Future capital expenditures in generation may also include special projects such as co-generation and wind power generation opportunities.

In Spain, capital expenditures incurred in generation, electricity distribution, special regime generation and gas amounted to 347.32 million in 2005. HidroCantábrico s operating investments in 2005 increased compared to 2004 due to the completion of the Las Lomillas (50 MW 50% owned by Neo Energia) and La Sotonera (19 MW 65% owned by Neo Energia) wind farms. The Boquerón (22 MW 75% owned by Neo Energia), Belchite (50 MW wholly owned by Neo Energia), and Brujula (73 MW wholly owned by Neo Energia) wind farms started operations in the first half of 2006. In 2005, HidroCantábrico started the construction of the second 400 MW unit of the Castejón CCGT plant, which is forecasted to start operations by the end of 2007. When compared to 2003, investments in special regime generation were greater in 2004 due to the completion of the Albacete wind farm (124 MW), which began operations in November 2004. In 2003, apart from the capital expenditure of 250.6 million (our proportional share of this expenditure being 100.2 million) for the acquisition of HidroCantábrico s 62% stake in Naturgás, additional capital expenditures of 176.3 million were incurred (our proportional share of these expenditures being 70.5 million).

We currently expect to fund any future capital expenditures and investments in Brazil with cash flow generated by local operations and by reais-denominated debt.

As part of our capital expenditures in generation we made capital expenditures related to environmental matters of approximately 90.5 million in 2005, approximately 18 million in 2004 and approximately 10 million in 2003. We expect these capital expenditures to amount to approximately 405 million in period 2005-2008, of which 59 million will be related to new investments in emissions reduction equipment in the Sines, Aboño and Soto power plants, in order to adapt the facilities to the new environmental regulations relating to SO_2 and NO_x emissions.

We believe that cash generated from operations and existing credit facilities is sufficient to meet present working capital needs. We currently expect that our planned capital expenditures and investments will be financed from internally generated funds, existing credit facilities and customer contributions, which may be complemented with medium- or long-term debt financing and equity financing as additional capital expenditure and financial investment requirements develop. To learn more about our sources of funds and how the availability of those sources could be affected, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources.

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STRATEGY

Our principal strategic objective is the creation of shareholder value through the achievement of sustained real earnings growth, and our primary strategic focus is on consolidating and expanding our position in energy activities in the Iberian Peninsula. Accordingly, we have redefined our concept of our domestic market to include the Iberian Peninsula and are positioning ourselves for the Iberian electricity market that will develop in the future, particularly following the implementation of MIBEL. In this context, we acquired joint operating control of HidroCantábrico in 2001, the fourth largest electricity operator in Spain, which, in turn, acquired Naturcorp, the second largest gas operator in Spain, in 2003, and in December 2004 acquired full control of HidroCantábrico by increasing our stake to 95.7%. See History and Business Overview Energy Iberian electricity.

While expanding into the Spanish gas and electricity sectors, we are also strengthening our core electricity business and our gas business in Portugal. During recent years, we have been making considerable efforts to optimize and restructure our Portuguese generation and distribution activities in preparation for the full liberalization of electricity supply in Portugal and the expected integration of the Portuguese and Spanish electricity markets. In connection with these efforts, we are taking steps to improve the quality of service through cost-conscious investment in technical and commercial infrastructure, particularly in the areas of electricity distribution and sales, and further restructure our human resources, primarily in our distribution business. In this regard, we have had and continue to have programs in place that are aimed at reducing our headcount, and we intend to expand our sales and customer service capabilities. We are also increasing our electricity generation capacity through modernization of existing facilities and selective development of new facilities, in each case mindful of environmental requirements and concerns.

Outside of our Iberian energy activities, we have also sought to focus on our core business through divestiture of non-strategic investments, as demonstrated by our sale in 2005 of a 60% stake in our information technology company Edinfor and by our sale in 2005 of a 99.93% stake in our Spanish telecommunications company Comunitel. We continue to selectively pursue other business activities that are complementary to our energy activities in Iberia. These other business activities include selectively pursuing international opportunities in electricity, specifically generation in Brazil and renewables in other European markets.

IBERIAN ENERGY

Our primary strategic focus is the Iberian energy market, where we are consolidating our position as a leading energy company. We are the leading electricity company in Portugal. We also are developing our activities in the Portuguese natural gas distribution sector, mainly through Portgás and Setgás, in which we hold a direct and indirect stake of 72.0% and 19.8%, respectively. In Spain, we currently own 95.7% of HidroCantábrico, which holds a 56.18% stake in Naturcorp.

In the Iberian energy market our strategic objectives are:

- preserving the value of our business in the Portuguese energy sector in light of the liberalization of the Portuguese electricity market and the creation of an integrated Iberian market;
- growing our electricity Iberian platform through further integration with HidroCantábrico, the development of new conventional generation facilities and a significant expansion of our renewable capacity both in Portugal and Spain; and
- developing an Iberian gas business by leveraging our existing assets.

Preserving the value of our business in the Portuguese energy sector

In the Portuguese energy sector, we face increasing competition arising from the liberalization of the electricity market in Portugal, in the Iberian Peninsula and throughout the European Union. On August 18, 2004, the electricity market in Portugal was fully liberalized and all customers, including all low-voltage customers, became free to choose their electricity supplier. Competition in electricity supply will also increase once MIBEL is fully operational. Additionally, we face increasing pressure on the operating margins of our electricity distribution business in Portugal due to regulation of electricity tariffs in the PES.

In response to these challenges, we plan to:

continue efforts to enhance earnings and maintain our leading market share of generation and distribution in the liberalized and growing Portuguese electricity market, while also capitalizing on growth opportunities created by the increasing liberalization within the EU, particularly in the Iberian electricity market; and

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continue our program to increase the efficiency of our operations in the Portuguese energy sector, reduce related costs with the goal of achieving international best practice standards and minimize the impact of tariff reductions in the current regulatory period on operating margins of our electricity distribution business.

In pursuing these objectives, we intend to:

pursue effective marketing to both new and existing customers, particularly those that benefit, or will benefit, from competitive alternatives in the Non-Binding Sector (where we are present through our subsidiary EDP Comercial, S.A., or EDP Comercial);

continue to provide high quality and cost-effective services to the Binding Sector and the Non-Binding Sector;

continue to centralize and improve the efficiency of our administrative activities, such as accounting and procurement, with the aim of achieving cost savings in supplies of goods and services and personnel reduction, to which end we created EDP Valor, a company that integrates some of our service companies by consolidating resources and centralizing purchasing activities;

identify opportunities to achieve future reductions in overhead expenses; and

continue to monitor the level of recurring and non-recurring capital expenditures in our Portuguese electricity business.

Growing our Iberian electricity platform

In light of the intended integration of the Spanish and Portuguese electricity sectors, we have expanded the definition of our domestic market to embrace the entire Iberian Peninsula. We are the first Iberian company to have significant generation and distribution assets, as well as a meaningful customer base, in both Portugal and Spain two EU countries with among the highest electricity consumption growth rates in the European Union.

To grow our Iberian electricity platform, we intend to:

through HidroCantábrico, enhance management flexibility and further synergies between its operations and our existing ones, namely through the operation of a single energy trading unit for Iberia and the centralization of procurement in respect of our investment in wind and CCGT generation;

position ourselves to benefit from the creation of an Iberian electricity market and pursue growth opportunities in Spain by leveraging our investment in HidroCantábrico;

grow our customer base by capitalizing on the fully liberalized electricity market in Spain;

take advantage of a combined electricity and gas service offering in Spain through the activities of both HidroCantábrico and Naturcorp and in Portugal through the activities of EDP and Portgás in connection with the expected liberalization of the Portuguese gas sector; and

increase generation capacity through the construction of new CCGT power plants, developing renewable energy generation projects, primarily through the construction or acquisition of new wind farms, and increasing capacity in existing hydroelectric plants to cope

with strong consumption growth.

Developing an Iberian gas business

We view the gas business as being highly complementary to the electricity business and of great strategic attractiveness. Both Portugal and Spain have gas and electricity consumption growth rates above the EU average and each country requires new capacity to be gradually added. CCGT plants, fired by gas, are considered to be an advantageous option to meet the Iberian electricity system expansion requirements because of their lower investment costs per MW, greater efficiency, lower operating and maintenance costs and lower emission levels compared to other thermal generation plants. Since new gas-fired generation capacity is expected to be added to the Iberian electricity system, power generators, which are already among the largest gas consumers in the Iberian Peninsula, are and will continue to be the facilitators of the development and sustainability of the gas business in the Iberian Peninsula, although their competitive position will increasingly depend on gas prices and the

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flexibility of gas contracts. The natural gas market is characterized by the existence of long-term contracts. For electricity generators, long-term contracts in the natural gas market are usually indexed to the price of oil, are of a take-or-pay nature and restrict the final destination of contracted gas. Since gas represents a substantial portion of gas-fired power plants total costs, access to flexible and competitive gas contracts is necessary to increase the efficiency of CCGT power plants.

There are two main reasons for us to develop an integrated Iberian gas business:

- to increase the competitiveness and efficiency of our gas-fired power plants. By being involved in both gas distribution and electricity generation we expect to be able to mitigate the risk presented by variable gas prices while increasing the flexibility of gas sourcing and placing; and

- to capture synergies from distributing both gas and electricity to final consumers, leveraging our existing electricity client base and the sharing of infrastructure and system costs.

Our current interest in the gas sector in Portugal consists of our 72.0% holding in Portgás and 19.8% holding in Setgás. Portgás distributes gas to more than 150,000 customers in the industrial northern region of Portugal. Our current interest in the gas sector in Spain is through HidroCantábrico s 56.2% controlling stake in Naturcorp, which has more than 600,000 customers and approximately 10% of Spain s regulated revenues for gas distribution, or 6% of gas distributed in Spain in terms of GWh.

INTERNATIONAL ACTIVITIES

Although our core business has historically been electricity in Portugal, it has evolved to include the Iberian energy market. However, international opportunities have arisen in the electricity and related businesses through which we believe we can achieve attractive returns. In international investments, we have looked particularly toward Brazil, where we believe we can play an active role in managing the electricity operations in which we are involved and where potential returns may be attractive. In July 2005, we finalized the initial public offering of Energias do Brasil following a reassessment of our Brazil strategy and rationalizing our Brazilian operations by making them more self-sustaining and independently managed. During the process, which resulted in a decrease of our stake in Energias do Brasil from 100% to 62.4%, we focused on the following initiatives:

- corporate restructuring: integration of all activities in Brazil under our subsidiary, Energias do Brasil, which will consolidate not only financial results but also planning and strategic control;

- capital restructuring: assessment of the capital structure of Energias do Brasil and its subsidiaries;

- corporate governance: harmonization and alignment of the corporate governance structures and procedures of Energias do Brasil s subsidiaries, with a view toward improving the efficiency and transparency of governance and the decision-making process;

- strategic positioning: introduction of the necessary adjustments to our existing investments with the aim of obtaining greater added value for shareholders and the establishment of strategic platforms for the development of future businesses; and

- generation of synergies: ensuring that Energias do Brasil is worth more than the sum of its parts, thus providing adequate remuneration of capital employed, through initiatives such as the re-launch of an efficiency program and analysis of the feasibility of shared services.

We regularly review our international investments and may change their focus over time consistent with our strategic objectives. In this regard, we continuously monitor our investment portfolio in order to capitalize on our ability to efficiently manage electricity operations through significant influence or control. For a more detailed discussion of our international activities, see Brazil and Other Investments and International

Activities below.

TELECOMMUNICATIONS

Our telecommunications activities are conducted through ONI, our telecommunications subsidiary comprised of various business units. ONI is a fixed line telecommunications operator primarily focused on corporate clients and provides voice and data services in Portugal and Spain. In line with our strategic objective of increasingly focusing our activities in our electricity business, we sold our stake in Comunitel, the Spanish arm of ONI, to Tele2 in July 2005 and we announced that a process for the sale of our stake in ONI might be initiated in June 2006.

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For a more detailed discussion of our telecommunications activities, see Telecommunications below.

INFORMATION TECHNOLOGY

In April 2005, we completed the sale of a 60% stake in the share capital of Edinfor to LogicaCMG. This transaction involved the renegotiation of our existing contracts with Edinfor in order to ensure that we have access to the best international practices in the field of information technology at competitive prices and to ensure that our core information technology systems continue to be run by Edinfor, while benefiting from the worldwide positioning of LogicaCMG. As a result of this partnership with LogicaCMG, we expect to be better able to focus on our core business, while maintaining the availability and security of key systems and enhancing Edinfor s growth potential.

DEVELOPMENT OF COMPLEMENTARY BUSINESS ACTIVITIES

Consistent with our strategy, we are selectively evaluating opportunities that are complementary to our core businesses and that may enable us to achieve cost savings along the chain of activities from us to the consumer and that management expects can generate additional shareholder value. For more information on our complementary business activities see Subsidiaries, Affiliates and Associated Companies below.

THE IBERIAN ENERGY MARKET

In 2005, total generation in the Iberian electricity market amounted to approximately 282.9 TWh, excluding special regime generation, of which EDP and HidroCantábrico were responsible for approximately 39.4 TWh.

Although there is not yet an integrated electricity market in operation in the Iberian Peninsula, governments from Portugal and Spain share the common vision of creating a single, integrated and competitive electricity market for Portugal and Spain, manifested by MIBEL, within the wider context of an envisaged European single electricity market, as provided for in Directives 96/92/EC and 2003/54/EC.

After several delays in the process, the international agreement entered into by the Portuguese and Spanish governments at the Iberian Summit at Santiago de Compostela on October 1, 2004 called for the beginning of operations of MIBEL on June 30, 2005. While commencement of MIBEL has not occurred yet, both governments have undertaken to create an Iberian electricity market based on the principles of free and fair competition, transparency, objectivity and efficiency.

Under the international agreement, MIBEL will operate with a spot market, which includes daily and intra-daily markets and will initially be managed by the current market operator of the Spanish market, OMEL, and a forward market, which will initially be managed by a market operator located in Portugal, OMIP. In addition, electricity transactions may also be negotiated by means of bilateral contracts with a term not less than one year. The international agreement also clarifies that the existence of two market operators, OMEL and OMIP, is temporary and that the two operators will eventually be merged into a single market operator. Pursuant to the international agreement, within one year from the implementation of MIBEL, each market operator is expected to limit the amount of its share capital held by any single shareholder to 5% and the shareholding of any system operator to a maximum of 3%. Within two years from the implementation of MIBEL, it is expected that both market operators will merge and create a single market operator designated as the Iberian Market Operator.

The development of interconnections between Spain and Portugal has been a priority in the implementation of MIBEL. Two such interconnections were put into operation in 2004, the Alqueva-Balboa 400kV line and a second 400 kV circuit in Alto-Cartelle-Lindoso. Additionally, the Douro Internacional-Aldeadavila interconnection is scheduled for completion in 2006, and will involve either the construction of a new 400kV interconnection or an increase of the existing interconnection capacity.

Within the context of MIBEL, the Portuguese government has mandated the early termination of the existing PPAs by means of adequate compensation mechanisms and changing REN s single buyer status, as set forth in Decree law no. 240/2004. This Decree law sets out adequate compensation for the investments and commitments provided for in each PPA that are not achievable through the expected market revenues once the PPAs are terminated. It is also expected that both Portugal and Spain will take all necessary measures to open the market to all consumers and harmonize tariff structures through clear and transparent rules, particularly in Spain.

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PORTUGAL

ELECTRICITY SYSTEM OVERVIEW

The Portuguese electricity system

In the context of the liberalization of the Portuguese electricity sector, the creation of MIBEL and the termination of the PPAs, we expect the structure of the National Electricity System to be significantly altered with the implementation of Decree law no. 29/2006, of February 15, 2006, which Decree law implemented the provisions of Directive 2003/54/CE concerning common rules for the European internal electricity market. Although the basic principles of the new structure for the National Electricity System were defined by Decree Law no. 29/2006, the implementing legislation is still pending. Nevertheless, during 2005 the organization of the National Electricity System still remained unchanged due to the lack of regulations implementing Decree law no. 29/2006 and remained structured in accordance with previous legislation.

Although there have been no changes in the organizational structure of the sector in legislative terms, the legislative amendments introduced by Decree laws no. 184/2003 and no. 185/2003, of August 20, 2003, as transitory measures until the publication of the future basic law, have already brought new issues to the National Electricity System, by introducing new activities that became necessary with the deepening of the electricity market.

Since 1997, Portugal has had an electricity market structured pursuant to the legislation that introduced the National Electricity System. The chart below illustrates the structure of the National Electricity System.

Note: Operations that are 100%-owned by us are highlighted in bold.

(1) *CPPE was merged into EDP Produção in 2005. We own 11.11% of Tejo Energia and 40% of Turbogás.*

(2) *Began operations in early 1998.*

(3) *Including suppliers and external agents foreseen in Decree law no. 185/2003, of August 20, 2003 (EDP Comercial, Enel Viesgo, Iberdrola, Sodesa and Union Fenosa), which may buy electricity in organized markets or through bilateral contracts. The organized market presently includes the Spanish spot market, the Spanish Pool managed by OMEL and the MIBEL Derivatives Market, the Portuguese Pool managed by OMIP.*

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(4) *At the end of December 2005, approximately 5.9 million potential Qualifying Consumers, or Eligible Consumers, existed, of which 9,001 had become Qualifying Consumers during 2005, 4,838 were already in the Non-Binding Sector, and 613 left the Non-Binding Sector. Decree law no. 192/2004, of August 17, 2004, provided for the full liberalization of the electricity market through the decrease of the eligibility threshold in mainland Portugal to include all low-voltage customers. In early 2005, ERSE published the necessary codes that reflect the ability of normal low-voltage consumers to change suppliers. However, the full implementation of this new legal framework requires the enactment of further legislation and regulations that have not yet been published.*

The National Electricity System consists of the PES and the IES. The PES is responsible for ensuring the security of electricity supply within Portugal and is obligated to supply electricity to any consumer who requests it. Within the IES are the Non-Binding Sector and other independent producers (including auto producers). We and other generators can supply electricity to the Non-Binding Sector. The Non-Binding Sector is a market-based system that permits Qualifying Consumers to choose their electricity supplier. Over the past several years, the minimum consumption level required to be a Qualifying Consumer has progressively declined, and Decree law no. 192/2004, of August 17, 2004, provided for the full liberalization of the electricity market by decreasing the eligibility threshold in mainland Portugal to include all low-voltage customers. For more information on the liberalization of electricity sales see Distribution and Regulated Supply Competition below.

The Public Electricity System or Binding Sector

The PES includes the binding generation of our generation company, EDPP; the transmission company, REN, in which we have a 30% stake; and our distribution company, EDPD. The PES also includes two independent power producers; Tejo Energia s plant at Pego, in which we have a 11.11% stake, and the Turbogás plant at Tapada do Outeiro, in which we have a 40% stake, after acquiring an additional 20% stake in 2005. All plants in the PES entered into PPAs with REN through which they commit to provide electricity exclusively to the PES through REN, acting as the single buyer in the PES and operator of the national transmission grid. For more information on REN s activities, see Transmission below.

Power plants in the PES are each subject to binding licenses issued by the Direcção Geral de Geologia e Energia, or DGGE, which has succeeded the Direcção Geral de Energia, or DGE. These binding licenses are valid for a fixed term, ranging from a minimum of 15 years to a maximum of 75 years, but which would be revoked upon termination of the related PPAs with REN. These licenses, together with PPAs, require each power plant in the PES to generate electricity exclusively for the PES.

While REN s responsibilities relate primarily to the transmission of electricity and system dispatch, it is also responsible for working with DGGE to identify potential sites for the installation of new power plants and for the management of wholesale purchases of electricity and sales to distribution companies.

The Independent Electricity System

The IES consists of two parts the Non-Binding Sector and the other independent producers, including renewable source producers, which include small hydroelectric producers (under 10 MW installed capacity), and cogenerators.

The Non-Binding Sector

At present, the only producers in the Non-Binding Sector are EDPP s CCGT plant in Ribatejo and our three wholly-owned embedded hydroelectric generators, which are small hydroelectric plants with more than 10 MW installed capacity that deliver all of the energy they produce directly to the distribution system. Although producers in the Non-Binding Sector are required to obtain licenses, they have no obligation to supply electricity to the PES and are free to contract directly with Qualifying Consumers. On August 17, 2004, the electricity market in Portugal was fully liberalized through the decrease of the eligibility threshold in mainland Portugal to include all low-voltage customers. Therefore, in 2005, customers eligible to become Qualifying Customers, or Eligible Consumers, in Portugal represented 100% of total volume demand in mainland Portugal. During 2005, 9,001 Eligible Consumers exercised their right to become Qualifying Consumers, of which 613 returned to the Binding Sector or abandoned the market. Of the remaining 8,388 Qualifying Consumers, 5,596 entered into contracts with EDP Comercial and 2,792 entered into contracts with producers in the Spanish market. As of December 31, 2005, there were approximately 5.9 million Eligible Consumers and 13,226 of these opted to become Qualifying Consumers. Of the 13,226 existing Qualifying Consumers at the end of 2005, 9,212 were customers of EDP Comercial, representing approximately 15.6% of the electricity sold in Portugal in 2005 by us and 14% of our revenues in the electricity distribution and supply activity in Portugal in 2005. Two of the three tariff components relating to distribution are payable to EDPD by Eligible Consumers electing to become Qualifying Consumers. In addition, EDP Comercial has the opportunity to gain Qualifying Consumers as its customers, in which case the third distribution tariff component would be payable to EDP Comercial.

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Producers in the Non-Binding Sector, specifically generators and suppliers of special low-, medium-, high- and very high-voltage electricity, are able to use the national transmission grid and distribution system on an open-access basis to connect to Qualifying Consumers. Qualifying Customers pay regulated transmission and distribution charges to REN for transmission and EDPD or other companies for distribution, respectively. Our hydroelectric plants in the IES deliver all of the electricity they produce directly to the distribution system without going through the national transmission grid. These plants pay regulated transmission charges to REN. Contractual relationships between producers and consumers in the Non-Binding Sector are freely negotiable between the parties.

Other independent producers

The Portuguese government has implemented selected measures to encourage the development of various forms of electricity production, including auto producers (entities that generate electricity for their own use and may sell surplus electricity to REN), cogenerators, small hydroelectric producers and other producers using renewable sources. REN is currently required by law to purchase the excess electricity produced by these independent producers at a regulated price based on avoidable costs, defined as the costs REN avoids by receiving power from these producers rather than dispatching plants in the Binding Sector and/or investing in new plants to increase installed capacity, plus an environmental premium, referred to as the green tariff. For more information on our electricity sales, see Distribution and Regulated Supply below.

Size and composition of Portugal s electricity market

During the period from 2001 through 2005, the total electricity distributed by EDPD (in both the Binding and Non-Binding Sectors) experienced an average growth rate of 5.0% per annum. In 2002, there was a reduction in the annual growth rate to 2.4% due to a slowdown in the economy. In 2003 and 2004, the annual growth rate increased to 3.7% and 7.3%, respectively. In 2005, the annual growth rate decreased to 6.0%.

The primary factors that we believe have an impact on demand are the rate of gross domestic product growth, electricity connections to new households and changes in electricity consumption per capita. After the period from 1999-2001, during which consumption in the PES experienced an average growth rate of 2.1% above growth in Portugal s gross domestic product, or Portugal s GDP, there was a reduction to 0.7% above the growth rate in Portugal s GDP in the year 2002 due to a slowdown in the economy. In 2005, Portugal s GDP grew by 0.3%, compared with growth of 1.0% in 2004 and a decline of 1.0% in 2003. We estimate that overall consumption in the National Electricity System will increase at an average of 3.6% per year in 2006, 2007 and 2008. Low-voltage consumption is expected to increase each year by an average of 2.8%, very high-voltage by an average of 3.8%, and high-voltage and medium-voltage by an average of 26.1%.

Peak demand as a percentage of the total installed capacity, which is the sum of the total installed capacity of PES and the total installed capacity of the Non-Binding Sector, or NBES, has remained stable since 2001, except in 2003 when demand increased slightly due to an extremely cold winter and installed capacity in the PES decreased following the decommissioning of the Alto Mira power plant (132 MW). In 2005, EDP s available capacity as a percentage of the total installed capacity was 76.6%, compared with 77.8% in 2004 and 74.7% in 2003. The ratio of peak demand to EDP s average available capacity indicates that EDP alone did not have sufficient available capacity to cover the total peak demand from 2001 through 2005. We are addressing this situation by adding new generation capacity. The first two units of the Ribatejo CCGT plant began operation in 2004 and the third unit began operation in 2005, five months before the expected date. Also, new CCGT and hydroelectric capacity is planned for future years.

The following table sets forth the ratios of peak demand to installed capacity, EDP s available capacity to the installed capacity of the PES and the Non-Binding Sector and peak demand to EDP s available capacity for the periods indicated. Peak demand includes demand satisfied by generation from Other Independent Producers.

	Year ended December 31,				
	2001	2002	2003	2004	2005
	(in MW, except percentages)				
Installed capacity of the PES[1]	8,758	8,758	8,626	8,626	8,738
Installed capacity of the NBES[2]	255	255	647	1,268	1,660
Total installed capacity (PES plus NBES)	9,013	9,013	9,273	9,893	10,398
Peak demand (PES plus NBES)	7,466	7,394	8,046	8,261	8,528
Peak demand as a percentage of the total installed capacity (PES plus NBES)	82.8%	82.0%	86.8%	83.5%	82.0%

EDP:					
EDP s average available capacity (PES)	6,801	6,841	6,695	6,761	6,822
EDP s average available capacity (NBES)	247	226	228	936	1,147
EDP s available capacity as a percentage of the total installed capacity (PES plus NBES)	78.2%	78.4%	74.7%	77.8%	76.6%
Peak demand as a percentage of EDP s average available capacity (PES plus NBES)	105.9%	104.6%	116.2%	107.3%	107.0%

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(1) *The Public Electric System in 2005 includes Frades power station (192 MW) and the effect of the decommissioning of the thermal power station of Tapada do Outeiro (46.9 MW) and the termination of the PPA of the two oldest units of Tunes (32 MW). These units were kept in operation under a system services agreement with REN.*

(2) *Non-Binding Sector, which consists of generation in the IES other than the other independent producers. All of the Non-Binding Sector hydroelectric plants with an installed capacity less than or equal to 10 MW became special regime producers in October 2002. Special regime generation generally consists of small or renewable energy facilities, from which the electricity system must acquire all electricity offered, at tariffs fixed according to the type of generation. Installed capacity of the NBES in 2005 includes the third operational unit (392 MW) of the Ribatejo CCGT.*

The Portuguese overall growth rate in demand for electricity is slightly higher than the rate reflected in the figures above due to the growth of auto production of electricity in certain industries. Auto producers supply their surplus electricity to REN, which displaces electricity generation in the PES.

The term installed capacity as used in this annual report refers to the maximum capacity of a given generation facility under actual operating conditions. Maximum capacity of a hydroelectric facility is based on the gross electricity emission to the transmission network by the units of such facility, whereas maximum capacity of a thermal facility is based on the net electricity emission (net of own consumption) to the transmission network.

Transmission

The transmission system in mainland Portugal is owned and operated by REN, which is obligated by law to supply electricity within the National Electricity System. Electricity transmission in Portugal is the bulk transfer of electricity, at voltages between 150 kV and 400 kV, from generation or acquisition sites across a transmission system to areas of use via networks that are linked to each other to form an interconnected national transmission grid. The Portuguese government purchased a 70% interest in REN from us in late 2000. We currently hold a 30% interest in REN. For more information on this purchase, you should read Item 5. Operating and Financial Review and Prospects Overview.

REN operates the national transmission grid on an exclusive basis pursuant to Portuguese law under a concession provided for by Decree law no. 182/95, of July 27, 1995. The concession is valid for 50 years from September 2000, when the concession agreement was signed.

The Portuguese transmission system operates at a frequency of 50 Hz, which is consistent with the majority of the European transmission systems. At year-end 2005, there were 47 substations operating on the national transmission grid, not including power plants. All of these substations are now fully automated and operated by remote control.

Of REN s transmission lines as of December 31, 2005, approximately 2,282 km were 150 kV lines, 2,875 km were 220 kV lines and 1,500 km were 400 kV lines. At the end of 2005, REN had seven interconnection lines with Spain, three of which were 220 kV lines and three of which were 400 kV lines. Within the context of MIBEL, we understand that REN plans to establish an additional interconnection with Spain, Douro Internacional-Aldeadavila, consisting of a 220 kV line and 400 kV line scheduled for completion in 2008 and 2009, respectively.

In addition to the construction and operation of the national transmission grid, REN is also system operator of the National Electricity System and market operator of the PES. This involves scheduling generation to match, as closely as possible, the demand on the national transmission grid. As part of managing the national transmission grid, REN is also responsible for scheduling imports and exports with Spain. It buys and sells electricity in the Spanish organized electricity market at market prices. Apart from the power plants in the PES, REN is also obligated to buy energy from auto producers, cogenerators, small hydroelectric producers and other renewable source energy plants operating under Portuguese law within the Independent Electricity System.

The following table sets forth REN s net imports made in the conduct of its operations in each of the last five years in GWh and as a percentage of total demand.

Year	Net imports (GWh)	Percentage of total demand
2001	239	0.6%
2002	1,899	4.7%
2003	2,794	6.5%
2004	6,480	14.2%
2005	6,820	14.2%

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ELECTRICITY REGULATION

EU legislation

Directive 2003/54/EC of the European Parliament and the Council, concerning common rules for the internal market in electricity and repealing Directive 96/92/CE, established the rules relating to the organization and functioning of the electricity sector, access to the market, the criteria and procedures applicable to calls for tenders and the granting of authorizations and the operation of the system. Member States were to implement this Directive by July 1, 2004.

On May 23, 2006, the European Commission adopted a decision exempting for an undefined period of time several provisions of Directive 2003/54/EC in relation to the Madeira Archipelago. According to the decision, Portugal faced serious problems in the functioning of its small isolated networks with respect to renovation, improvement and development of the existing capacity, thus the European Commission granted the exemption. Nevertheless, Portuguese authorities will monitor the evolution of the electricity sector in the Madeira Archipelago and convey to the European Commission any substantial change that may require a review of the granted exemption.

Directive 2003/87/EC established a scheme for greenhouse gas emission allowance trading within the EC. Member states were required to implement this Directive by December 31, 2003. The Emission Trading Scheme, or ETS, is the first international trading system for CO_2 emissions. The ETS covers combustion plants, oil refineries, coke ovens, iron and steel plants, and factories making cement, glass, lime, brick, ceramics, pulp and paper. The primary task in preparing for the implementation of the ETS was the establishment of Natural Allocation Plans, or NAPs, by Member States. Each Member State was required to prepare and publish a NAP by March 31, 2004 (May 1, 2004 for the 10 new Member States). NAPs determine the total quantity of CO_2 emissions that Member States will grant to their companies for the first trading period, 2005 to 2007. These CO_2 emissions allowances can then be sold or bought by the companies themselves.

Beginning January 1, 2005, companies were required to monitor their emissions and produce annual reports on emissions that are verified by a third party. At the same time, companies must ensure that they possess a sufficient number of allowances to surrender each year in order to avoid being subject to financial sanctions. The first surrender date was April 1, 2006.

Member States must issue allowances by the end of February each year in accordance with the final allocation decisions, operate the national registry, collect verified emissions data and ensure that a sufficient number of allowance are surrendered by each company. Each Member state must also submit a regular annual report to the European Commission.

On December 7, 2005, the European Commission issued a Communication in support of electricity from renewable energy sources. This Communication served as the report that the European Commission is required to make under Article 4 of Directive 2001/77/EC, presenting an inventory of, and the experience gained from, the application and coexistence of the different mechanisms used in Member States for supporting electricity from renewable energy sources. The Communication also served as the report that the European Commission is required to make under Article 8 concerning administrative barriers, grid issues and the implementation of the guarantee of origin on renewable electricity. The Communication serves as a plan for coordination of the existing systems based on cooperation between countries and optimization of the national schemes, which will likely lead to a convergence of the systems.

Increasing the proportion of renewables generation in sources of EU electricity production has well-recognized benefits, thus Directive 2001/77/EC1 established as a target that renewable energy sources should provide 21% of the electricity by the year 2010. This directive also set differentiated targets for each Member State and further mandated that Member States provide better grid access for renewable energy generators, streamline and facilitate authorization procedures and establish a system of guarantees of origin.

Competition

All companies developing their activity within the EU, including EDP, are subject to the competition legislation adopted by the European Commission and the European Parliament. Under EU competition law, the European Directorate-General for Trade and Competition can evaluate price policies, internal procedures and merger and acquisition operations. These Community rules have also been adopted as national legislation by the Portuguese government.

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Portuguese electricity legislation and regulation

The basis and principles of the organization of the electricity sector in Portugal were set out in 1995 legislation that was partially revised in 1997 in accordance with the general principles of EU Directive 96/92/CE. Following the 1997 revisions, ERSE was appointed as the independent regulator in February 1997. On March 25, 2002, by Decree law no. 69/2002, ERSE s authority with respect to the electric sector was extended to the autonomous regions of Madeira and Azores. On April 12, 2002, ERSE became the regulatory entity of energy services, and its authority was extended to the domain of natural gas regulation. The following description refers to the legal and regulatory environment applicable to our activities in Portugal during year 2005. However, a reform of the legal and regulatory framework is currently underway. For more information on this reform, see New national energy policy and Recent developments in the liberalization of the Portuguese electricity system below.

The responsibilities for regulation of the electricity sector in Portugal are now generally split between Direcção Geral de Geologia e Energia, or DGGE, ERSE and the Competition Authority.

Direcção Geral de Geologia e Energia

DGGE has the primary responsibility for planning and developing the PES, including approving the issuance, modification and revocation of generation and distribution licenses and preparing expansion plans for the PES every two years, in conjunction with REN, for the approval of the Portuguese Ministry of Economy. DGGE is also responsible for regulations applicable to the transmission grid and the distribution network and service quality.

Entidade Reguladora dos Serviços Energéticos

ERSE has clearly defined regulatory duties, powers and objectives established by law, including the responsibility to approve the main regulations that are published in the form of the following:

- the tariff code and the values for the tariffs and prices to be implemented;
- the commercial relations code governing relations between entities in the Portuguese electricity system;
- the dispatch code; and
- the access to the national grids and to the interconnections code.

In January 2005, ERSE revised the codes as a result of the expansion of the eligibility threshold to all consumers pursuant to Decree law no. 192/2004, of August 17, 2004.

Following the publication of the Decree law no. 240/2004, of December 27, 2004, which established the conditions for the phase-out of the PPAs, and the probability of an early starting of operation of a wholesale market, it was necessary for ERSE to revise the Tariff Code, the Commercial Relation Code and the Access to the National Grids and to the Interconnections Code. Accordingly, in August 2005, ERSE undertook a complete overhaul of the regulations governing the electricity sector. It was first submitted to public consultation, and brought existing regulations into line with the Portuguese and European legal framework.

For more information on these codes, see ERSE and DGGE Codes and for more information on tariffs, see Distribution and Regulated Supply Portugal Tariffs.

ERSE and DGGE Codes

The first Tariff Code was enacted in December 1998, establishing a periodic definition of regulatory parameters for allowed revenues and a methodology for setting tariffs. Between 1999 (the first year ERSE published tariffs) and 2001, prices were set annually according to a series of formulas based primarily upon what is deemed to be an appropriate return on assets in transmission, a return fixed by price cap in distribution

and supply activities. Since 2002, prices are based on a return on assets and agreed costs in commercialization, or the activity of supply, measurement and billing of energy sales to final clients. From the beginning of ERSE regulation, REN has been acting as the single buyer of electricity for Portugal, although EDPD may buy electricity directly from producers. ERSE revised the Tariff Code in August 2005 to conform to Decree law no. 240/2004, which established the conditions for the phase-out of the PPAs. As soon as MIBEL enters into operation, REN will lose its status as the single buyer, and all suppliers (including EDPP) will be responsible for the wholesale purchases. The promotion of electricity efficiency through tariffs was revised with the goal of achieving better results, in order to contribute to the Portuguese commitments at the EC level. Also, the promotion of environmental and quality of service issues was changed to make it more efficient.

The Commercial Relations Code, enacted in December 1998, was revised on September 1, 2001 and is intended to govern the commercial relations between entities within the Binding Sector as well as the commercial relations between the Binding Sector and the Non-Binding Sector. This code also governs the access to the Non-Binding Sector by Qualifying Consumers and the rules applicable to the purchase and sale of electricity within a system established for the Non-Binding

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Sector. ERSE has also enacted the rules of access to this system and the rights and obligations of the system s participants, including Qualifying Consumers who have elected to participate in the Non-Binding Sector, their agents and REN as the manager of the system. The Commercial Relations Code was recently amended in April 2004, in light of the regulatory regime set out in Decree law no. 36/2004, of February 26, 2004, and again in January 2005, in light of the regime set out in Decree law no. 192/2004 of August 17, 2004. This Code was further revised in August 2005, to introduce the necessary adaptations towards a fully market-oriented system, both at the wholesale level and at the retail level. The revised Code defines the entities acting in a commercial level, the respective functions, load profiling, client s switching procedures, and the purchase of electricity by the regulated supplier (at the spot and futures markets and through bilateral arrangements). It has also established that the frequency of invoicing to low voltage customers up to 41.4kVA supplied by the regulated supplier is every two months.

The Dispatch Code, enacted in December 1998, revised on September 1, 2001 and amended in December 2001, establishes the rules of dispatch that are applicable to REN based on principles of equality of treatment and opportunity and safeguarding the public interest in the Binding Sector.

The Access to the Grid and Interconnections Code, enacted in December 1998 and revised on September 1, 2001, is based on the same general principle as the Dispatch Code. Access to the grid is subject to the execution of an agreement in accordance with a model provided by ERSE. This Code was further amended pursuant to the approval of the Decree law no. 36/2004, of February 26, 2004 and again pursuant to the approval of Decree law no. 192/2004 of August 17, 2004. This Code was also revised in August 2005 to define the agents that have the right to the access to the grids and interconnections and to define the rules of network planning. Terms for network use were specified that provide for simplified procedures.

On January 1, 2001, DGGE issued a quality of service code. Under this code, DGGE seeks to enhance the quality of service with a system of penalties assessed against electricity companies based on their performance. DGGE has defined benchmarks against which a company s performance can be measured if requested by the company s customers. Fines are imposed against electricity companies in the event of power failures or any disturbances in power supply that, in each case, cause an operator s performance to fall below DGGE s benchmarks. These benchmarks were effective as of July 1, 2001.

In February 2003, DGGE approved and published a new quality of service code that clarifies and tightens quality standards imposed on electricity companies as well as the compensation amounts to be paid to costumers. In November 2003, DGGE also approved and published the complementary rules to the Quality of Service Code, by Dispatch no. 23705/2003.

In March 2006, DGGE published a new Quality of Service Code, by Dispatch no. 5255/2006 promoting the full opening of the market by revoking the previous platform and foreseeing a platform that establishes the relations among the different market participants.

The Competition Authority

The Portuguese Competition Authority is an independent and financially autonomous institution whose mission is to ensure compliance in Portugal with national and European Community competition laws, specifically with respect to mergers, state aid and restrictive practices. It has regulatory powers on competition over all sectors of the economy, including the regulated sectors, such as electricity, in coordination with the relevant sector regulators.

Reversionary assets

Our assets held under concession agreements with the Portuguese government or municipalities or licenses issued by the government for generation and distribution of electricity are treated either as being within the public domain of the Portuguese Republic or municipalities (for assets used in low voltage distribution) or dedicated to public service. We use assets that are part of the public domain and own and use assets that are dedicated to public service subject to limitations on their disposal.

Assets within the public domain that by their nature are replaceable may be replaced by another asset performing the same function, subject to prior authorization in certain cases. Any asset that has been replaced will thereafter be treated as a private asset. Other assets held by us, including land and buildings not held under concessions or license, are our private property.

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Under Portuguese law, assets under public domain cannot be sold, pledged or otherwise encumbered and are not available for enforcement of judgments. The same regime applies to assets dedicated to public service, subject to specified exceptions.

The reversion of different assets is subject to different termination and payment terms:

Licenses for generation. Assets held by EDPP for generation revert to REN, as concessionaire for the national transmission grid, at the termination of the relevant PPA, subject to payment of the residual value of assets, in accordance with the relevant PPA, provided that the assets are considered by REN to be necessary for generation in the PES according to the expansion plan for the PES in place at the time. If not considered necessary by REN, EDPP is entitled to purchase those assets for use in the Non-Binding Sector.

Licenses for distribution. Our assets held under a binding license for distribution of high voltage and medium voltage revert to REN, as concessionaire for the national transmission grid, when the license terminates. If the termination occurs by revocation or resolution of the license, payments are due as established in the binding agreements entered into between the parties. If the license terminates for any other reason, the payment due will be the average of the net book value of the assets and value of lost profits.

Concessions with municipalities. Assets held by EDPD in low voltage revert to municipalities at the end of the term of concession, subject to payment of the net value of assets as determined by a commission of three members, one appointed by each party and a third appointed by the Portuguese government. Both the expiration and early termination of these concessions can only take place if the municipalities meet specified conditions regarding the viability of the proposed distribution arrangements and the transfer of assets and workers.

Environmental matters

In 1994, our board of directors adopted an Environmental Policy Declaration, which sets forth our principles for environmental policy and activities. Our policy is aimed at minimizing or, where possible, eliminating negative environmental impacts. We believe we are in material compliance with all existing EU, Portuguese, Spanish and Brazilian government environmental regulations, and expect that we will materially comply with proposed changes in EU and other applicable regulations.

In March 2004, our board of directors approved the Principles for Sustained Development for the EDP Group, a set of eight principles relating to the economic, environmental and social aspects of our operations.

We have been implementing an Environmental Management System, or EMS, for our electricity activities, as a fundamental aspect of our environmental policy. Pursuant to the EMS, 33% and 13% of our installed capacity in Portugal and Spain, respectively, have been certified under ISO 14001. In July 2006, this figure will increase to 46% in Portugal, with the certification of *Central Termoeléctrica do Ribatejo*, the new CCGT plant at Ribatejo.

Our main environmental focus is reducing the emission of atmospheric pollutants, namely SO_2, NO_X emissions and particles. Pursuant to environmental laws and regulations, we have been using fuel with progressively lower sulfur levels and have introduced NO_X primary reduction measures in the Sines thermal power station. In order to comply with new emission levels established by EU legislation, in 2003 we initiated the installation of the necessary emissions abatement equipment (fuel gas desulphurization and additional NO_X primary reduction measures) at Sines and are introducing similar equipment to control SO_2 and NO_X emissions at our thermal plants in Spain. The Barreiro, Carregado and Setúbal power plants in Portugal are expected to be exempt from compliance with new emission limit requirements.

CO_2 emissions have been considered in our risk model. Monitoring mechanisms were studied and adapted to the requirements of the Emissions Trading Directive. Our fuel purchases include, since January 2005, the cost of CO_2 allowances, and the risk model for our electricity trading was altered to accommodate the risk inherent in price fluctuations of CO_2 allowances. In 2005, we invested 44 million in carbon funds. These investments give CO_2 emission credits that we can use in Portugal and Spain.

In 2005, emission trading allowances were allocated to our facilities in Spain and Portugal. We were allocated a total of 68.7 $MtCO_2$, for the period spanning 2005 to 2007.

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	Emissions allowances allocated to the EDP Group		
	2005	2006	2007
		(tCO2e)[1]	
Portugal			
Carregado	1,088,575	1,088,575	1,088,575
Setúbal	2,505,210	2,505,210	2,505,210
Sines	7,837,380	7,837,380	7,837,380
Barreiro	253,048	253,048	253,048
Tunes	5,000	5,000	5,000
Ribatejo	2,019,570	2,019,570	2,019,570
Mortágua	1,510	1,510	1,510
Soporgen	239,942	239,942	239,942
Energin	199,250	199,250	199,250
Spain			
Aboño	5,542,000	4,976,000	4,338,000
Soto de Ribera	3,404,000	3,057,000	2,666,000
Castejón	898,000	692,000	709,000
Total	23,993,485	22,874,485	21,862,485

(1) *Tons of Carbon Dioxide Equivalent.*

We incur significant expenses in repair and prevention measures to fulfill the demands of environmental regulations. We made capital expenditures related to environmental matters in 2005, 2004 and 2003 of approximately 90.5 million, 18 million and 10 million, respectively. Our aggregate estimate of capital expenditures to control emissions of SO_2 and NO_X in the period 2005 to 2008 is 405 million, of which approximately half we expect to incur at our thermoelectric plants in Spain.

Portuguese special regime for renewable electricity generation

In Portugal, the generation of electricity using renewable energy sources is governed by Decree law no. 189/88, of May 18, 1988 and its amendments. Renewable electricity generation is also impacted by Decree law no. 29/2006, of February 15, 2006, which governs the organization and functioning of the national electric system, as well as the activities, related to generation, transportation, distribution and commercialization of electricity.

The statutory and regulatory regime applicable to renewable electricity generation differs from the regime applicable to generation of electricity by other non-renewable sources only in licenses and tariffs.

Licenses

Decree law no. 189/88 sets forth a specific licensing regime applicable to power plants using renewable energy sources and integrated in the Non-Binding Sector. This regime is also complemented by Decree law no. 312/2001, of December 10, 2001, which revoked the provisions of Decree law no. 189/88 relating to the information, management, attribution and elapse of the grid reception points.

The licensing process begins with a request to DGGE to assess the capacity of the grid to receive electricity generated in a determined grid point. Should that capacity exist, a grid reception point is attributed to the requesting party. The requesting party must then obtain an establishment license from DGGE prior to the beginning of the construction of the power plant and, once the power plant construction is completed, an exploration license must also be obtained.

In parallel with the DGGE licensing process, there is a licensing process with the local authorities where the power plant is to be located is also be conducted. In particular, the requesting party must obtain a construction license and a utilization license for the power plant.

In some instances, an environmental impact evaluation is conducted and the Environmental Impact Authority must issue a favorable environmental impact declaration as a condition precedent for the issuance of the establishment license. Also, in instances were the power plant is to be located within the National Ecologic Reserve territory, a special Ministerial Order recognizing the public interest of the project will be required.

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Tariffs

Decree law no. 189/88 sets forth a specific formula for the tariffs to be paid to generators for the electricity generated by power plants using renewable energy. The most recent formula amendment was made by Decree law no. 33-A/2005, of February 16, 2005. The cost, with the remuneration to the generators, is allocated in accordance with Decree law no. 90/2006, of May 24, 2006.

Additionally, Decree law no. 312/2001, of December 10, 2001, establishes the obligation of certain entities, such as REN, to receive the electricity generated by power plants using renewable energy sources.

New national energy policy

On October 24, 2005, the Portuguese Council of Ministers passed a resolution establishing a new national strategy for the energy market. This Resolution no. 169/2005 replaced the previous national energy strategy announced by the Council of Ministers through Resolution no. 63/2003, of April 28, 2003. The new national strategy for energy promotes a revision of the legal and regulatory framework, establishes the extension of the scope of the activity of the companies in the sector, ensures a competitive environment where there may be more than one relevant integrated operator in the electricity and gas sectors, grants independence to regulated participants in the natural gas sector and implements its association with the companies operating the electricity transmission grid.

Recent developments in the liberalization of the Portuguese electricity system

With the progression of the liberalization process and taking into account the creation of MIBEL, as established in the agreements between Portugal and Spain, legislation has been enacted since 2003 to bring the structure of the National Electricity System and its operations into line with a competitive market regime. Pursuant to the national energy policy defined in Resolution of the Portuguese Council of Ministers no. 169/2005 of October 24, the legal framework has been significantly reviewed by the new basis law enacted by Decree law no. 29/2006 which sets out the basic principles for the new organization model of the National Electricity System. However, the full implementation of this new legal framework requires the enactment of further legislation and regulations that have not yet been published in order to develop the regime of the several electricity business activities, including the licensing and concession procedures.

Key principles for the new organization model of the sector

The activities of the electricity sector must be developed in accordance with the principles of rationality and efficiency in the use of resources throughout the full chain of value (i.e. from generation to consumption of electricity), as well as of competition and environmental sustainability, with the purpose of contributing for the increase of competition and efficiency in the National Electricity System, without prejudice to public service obligations.

Unlike the previous regime, the basis law establishes an integrated national electricity system in which generation, supply and management of the organized markets activities are competitive and just require compliance with a licensing or authorization process for the beginning of operations. The transmission and distribution activities continue to be provided through the award of a public service concession.

Electricity generation

Electricity generation under the new basis law is now divided in two classes: ordinary regime generation and the special regime generation. The ordinary regime generation comprises the generation of electricity, which is not subject to a special legal regime that benefits from incentives to the use of endogenous and renewable sources of generation or to the combined generation of heat, and electricity. The special regime generation refers to the generation of electricity in those special circumstances. The logic of centralized planning of the generation plants is abandoned; the initiative lies with the interested parties. Within a liberalized framework, the Portuguese State only intervenes supplementary to the private initiative, covering market failures and guaranteeing the electricity supply, through public tenders.

Electricity transmission

Electricity transmission activity is carried out through the national transmission grid for which REN has the exclusive concession. The current transmission concession contract will have to be adapted to the new basis law, while keeping REN as the concessionaire. In light of the continuity and security of supply and the need for an integrated and efficient operation of the system, the national transmission grid operation includes the technical global management of the system, ensuring the coordination of the distribution and transmission infrastructures.

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An electricity business performing transmission of electricity must have separate ownership and legal separation from businesses performing distribution and supply activities. The minimum criteria for ensuring this separation are set forth in the new basis law. For example, no person or entity may directly or indirectly hold more than 10% share capital of each of the concessionaires of the electricity transmission grid or 5% share capital of each of the entities that develop activities in the electricity sector, either in Portugal or abroad. The limitations are not applicable to entities controlled by the State or the concessionaire of the transmission grid.

Electricity distribution

Electricity distribution under the new basis law is operated through the national distribution grid, corresponding to the medium and high voltage network, and through the low voltage distribution grids. The national distribution grid is carried out as an exclusive concession, as a result of which the current license held by EDPD will be converted into a concession agreement, although the new basis law provides that the balance of the exploitation must be safeguarded. The low voltage distribution grids continue to be operated under concessions from the municipalities. This activity is legally separated from the transmission activity and from other activities unrelated to the distribution activity. For operators of distribution grids supplying less than 100,000 clients this legal separation does not apply, in accordance to the Directive 2003/54/CE.

Electricity supply

The electricity supply activity under the new basis law is open to competition, subject only to a license regime. Suppliers can openly buy and sell electricity. For this purpose, they have the right to access to the transmission and distribution grids through the payment of access charges set by ERSE. Under market conditions, consumers are free to choose their supplier, without any additional payment for the switching of suppliers. A new entity, whose activity will be regulated by ERSE, will be created to oversee the logistical operations of customer switching.

Under the basis law, universal service obligations are foreseen and involve the guarantee of quality and continuous supply, protection with respect to prices and access charges, and access to information in simple and understandable terms. The new basis law also created the last resort supplier, as foreseen in the Directive 2003/54/CE, subject to regulation by ERSE. This new role will be undertaken by EDPD as operator of the medium and high voltage distribution grid, which must create an independent entity for this purpose, and by the local low voltage distribution concessionaires. This new entity will be created as a temporary measure until the liberalized market is fully efficient and until the expiration of the respective concession contracts.

Regulation

Under the new basis law, ERSE retains responsibility for regulation of the electricity sector, regulating transmission and distribution, providing the last resort supply and logistical operations relating to switching and suppliers. ERSE also has the responsibility to present a report on the market functioning, to the government, and later to the Portuguese Parliament in order to be addressed to the European Commission.

DGGE will be required under the new basis law to monitor the security of supply with the assistance of the national transmission grid concessionaire. DGGE also has the responsibility to present a report on its monitoring activities to the government, the Portuguese Parliament and to the European Commission.

GAS SYSTEM OVERVIEW

The Portuguese natural gas system was developed beginning in 1993. It consists of a high-pressure gas transmission pipeline system connected to the Spanish grid at Badajoz and Tuy, a liquefied natural gas, or LNG, terminal at Sines, an underground storage unit at Carriço and several delivery points consisting of power plants, local distribution companies and large industrial clients. A gas reduction and metering station that is part of the high-pressure transmission grid serves each of these delivery points.

In 2005, natural gas consumption in Portugal was 4.04 billion cubic meters, or bcm. This volume consisted of consumption by power generation (1.97 bcm), consumption by large industrial clients (1.42 bcm) and regional distribution to households, the services sector and small industries (0.64 bcm). It is expected that the Portuguese market may grow to a level of between seven and eight bcm by 2012, mainly due to the development of gas-fired electricity generation capacity.

All high-pressure natural gas activities in Portugal are currently engaged in exclusively by Transgás, under a concession agreement granted by the Portuguese government. These activities include the importation of natural gas, the development and operation of the high pressure transmission grid, the development and operation of underground storage units, the development

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and operation of the LNG terminal and sales to large customers (power plants, distribution companies and large industrial clients with consumption above two million cubic meters per year). Transgás maintains its supply under long-term contracts with Sonatrach, an Algerian company, and with NLNG, a Nigerian company. Transgás is indirectly owned by Galp Energia, SGPS, S.A., or GALP, which is currently owned by the Portuguese government (17.711%); Parpública (12.293%); REN (18.3%); ENI Portugal Investment, S.p.A. (33.34%); Amorim Energia, B.V. (13.312%); Iberdrola, (4%); CGD, (1%); and Setgás (0.044%).

At the end of 2005, there were six regional distribution networks in Portugal, corresponding to six regional distribution companies:

Portgás, based in Porto, covering the northern region;

Lusitâniagás, based in Aveiro, covering the littoral center region;

Lisboagás, based in Lisbon, covering the greater Lisbon region;

Setgás, based in Almada, covering the Setúbal district;

Tagusgás, based in Santarém, covering the inland region around the Tagus river course; and

Beiragás, based in Viseu, covering the center inland region.

Each regional distribution company operates under an exclusive regional distribution concession agreement granted by the Portuguese government. The activities of each company consist of acquiring natural gas from Transgás, developing and operating the gas distribution grid and selling gas to customers within its region (except for clients with consumption above two million cubic meters per year).

Each regional distribution network connects at a number of points with the high-pressure transmission network through a gas reduction and metering station. Each regional grid is composed of medium pressure steel trunklines operating at pressures up to 16 barg (the primary grid) and polyethylene capillary grids operating at pressures up to four barg (the secondary grid). At the end of 2005, the six regional distribution networks accounted for a combined total of 10,367 km of grid lines. In 2005, the six regional distribution companies combined sold approximately 0.65 bcm of gas to 874 thousand customers.

GAS REGULATION

EU legislation

Gas Directive 2003/55/EC

The European Parliament and Council of Ministers adopted the Gas Directive 2003/55/EC, of June 26, 2003, or the Gas Directive, which contains common rules for the natural gas market. The Gas Directive became effective in August 2003, and Member States were requested to implement it by July 1, 2004. The Gas Directive requires legal unbundling of network activities from supply, establishes a regulator with well-defined functions in all Member States, requires that network tariffs be published, reinforces public service obligations and introduces measures to increase the security of supply.

However, emergent markets benefit from exceptions to several obligations established in the Gas Directive, including matters relating to the unbundling of transmission and distribution systems operators, third party access to both systems of transmission and distribution and provisions related to market opening and reciprocity. These exceptions automatically expire at the time that the Member State no longer qualifies as an emergent market. The Portuguese natural gas market will be considered an emergent market until 2007.

Safeguard security of natural gas supply Directive 2004/67/EC

On September 11, 2002, the Commission proposed a new package of measures to improve the security of oil and gas supply, a major concern during the gradual integration of national markets. Consequently, on April 26, 2004, the Council adopted Directive 2004/67/EC, that established measures to safeguard an adequate level for the security of gas supply. This directive establishes a common framework within which Member States must define general, transparent and non-discriminatory security of supply policies compatible with the requirements of a competitive internal gas market, clarifies the

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general roles and responsibilities of the different market players and implements specific non-discriminatory procedures to safeguard security of gas supply. Member States were required to bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by May 19, 2006.

The main provisions established by the safeguard security of natural gas supply Directive are as follows:

- Member States must define a general policy on the security of gas supplies, including a clear definition of the roles and responsibilities of the various market players in contributing to the security of supply. This policy must be non-discriminatory and transparent.

- Member States must prepare reports at regular intervals describing the mechanisms put in place for emergencies and the levels of gas stocks in order to be considered by the Commission in its periodic reports on the overall assessment of the consequences of Directive 2003/55/EC and the overall efficiency and security of the internal gas market. Based on the Member States regular reports, the Commission will monitor the existence of adequate liquidity of gas supplies, the level of interconnection of Member States national gas systems and the foreseeable gas supply situation as a function of demand, supply autonomy and available supply sources at the Community level with regard to specific geographic areas in the Community.

- Member States must take the necessary measures to ensure that the supply to vital consumers, or those who are not in a position to replace gas with another fuel, is adequately guaranteed at least in the event of the single most important source of gas supply being disrupted or in the event of extremely low temperatures. The measures to be adopted should include ensuring that gas stocks make at least a minimum contribution to achieving the security of supply standards. Also, the level of stocks should take account of the geological conditions of the territory and the economic and technical feasibility in each Member State.

- Member States must prepare national emergency measures that ensure, where appropriate, that market players are given sufficient opportunity to provide an initial response to the emergency situation. These measures must be submitted in advance to the Commission and updated as appropriate.

- In the event of a serious interruption in gas supply, the Commission, assisted by a committee made up of representatives of the Member States, will draw up recommendations urging Member States to assist the countries most affected. If necessary, the Commission will adopt decisions requiring Member States to take the appropriate measures.

Regulation on the conditions for access to the natural gas transmission networks.

The European Parliament and Council of Ministers adopted Regulation (EC) No 1775/2005, of September 28, 2005, on the conditions for access to the natural gas transmission networks. The basis for this regulation was a second set of common rules entitled the Second Guidelines for Good Practice that was adopted at the meeting of the European Gas Regulatory Forum on September 24-25, 2003. This Regulation will apply beginning July 1, 2006, and its purpose is to set non-discriminatory rules for access conditions to natural gas transmission systems, taking into account the specificities of national and regional markets with a view to ensuring the proper functioning of the internal gas market.

This purpose will be fulfilled through the setting of harmonized principles for tariffs or the methodologies underlying their calculation and for access to the network, the establishment of third party access services, the setting of harmonized principles for capacity allocation and congestion management, the determination of transparency requirements, balancing rules and imbalance charges and the facilitation of capacity trading.

Portuguese gas regulation

The Council of Ministers adopted Decree law 30/2006, of February 15, 2006, that partially transposes Directive 2003/55/EC and establishes the general framework for the organization and functioning of the Natural Gas National System in Portugal, as well as the general framework for import, storage, transmission, distribution and commercialization of natural gas and the organization of the natural gas market. Regulations governing these activities, including the procedures for concessions and licenses, have not yet been approved. The main provisions of the Decree law are set forth below.

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General rules for the organization of the sector

Natural gas businesses must operate in accordance with the principles of the Gas Directive, with a view toward achieving a competitive, secure and environmentally sustainable market in natural gas.

Organization, definition and functioning of the activities

Natural gas business have been awarded exclusive concessions or licenses to develop facilities for reception, import storage and regasification of LNG and facilities for underground storage and transmission, which constitute overall management of the system. These companies will fulfill public service obligations, which are clearly defined, transparent, non-discriminatory and verifiable, guarantee equality of access for EU gas companies to national consumers and comply with the measures adopted for the protection of final customers.

Unbundling

A gas business performing transmission of natural gas must have separate ownership and legal separation from businesses performing distribution and supply activities. Similarly, gas businesses performing underground storage or LNG activities must have legal separation from businesses performing any of the other natural gas activities. The minimum criteria for ensuring this separation are set forth by the Decree law. For example, no person or entity may directly or indirectly hold more than 10% of the share capital of each of the concessionaires of the transmission network or 5% of the share capital of each of the entities that develop activities in the natural gas sector. The limitations are not applicable to entities controlled by the Portuguese state or the concessionaire of the transmission network. The limitations are also not applicable to the underground storage and the LNG terminal facilities that will be the object of future concessions.

Third party access to the system

Third party access to the transmission and distribution systems and to LNG facilities must be ensured by the concessionaires of the Transmission, Underground Storage and Liquefied Natural Gas Network based on published tariffs applicable to all eligible customers, including supply companies, and applied objectively and without discrimination between system users. This is without prejudice to both parties entering into long-term supply contracts, as long as these contracts comply with competition law provisions.

Liberalization of the markets

According to Article 23 of Directive 2003/55/EC, Member States must ensure that the eligible customers include all non-household customers beginning July 1, 2004, and all customers beginning July 1, 2007. Contracts for supply with an eligible customer in the system of another Member State must not be prohibited if the customer is eligible in both systems involved. Nevertheless, because Portugal is an emergent market, Article 64 of the Decree law provides that eligibility should be implemented gradually. In Portugal, beginning in 2007, the definition of eligible customers will result in an opening of the market equal to at least 33% of the total annual gas consumption of the national gas market; two years thereafter, all non-household customers must be eligible customers, and three years thereafter, all customers must be eligible.

Even though Portugal benefits from a temporary exemption from the obligations provided for in the Directive, Decree law 30/2006 already anticipates several obligations imposed by the Directive, such as the unbundling of the transmission and distribution system.

Decree law 30/2006 ERSE requires ERSE to present a report to the Ministry of Economy and Innovation, on a date to be fixed by further regulation, on the functioning of the natural gas market and the degree of effective competition, with an indication of the measures either already adopted or still to be adopted to strengthen the efficiency of the market. ERSE must publish this report and send it to the Parliament and to the European Commission.

Directive 2004/67/EC, of April 24, 2004, on the safeguard security of natural gas supply has not yet been implemented by Portugal as a separate statute. Decree law 30/2006 only establishes some principles concerning the security of natural gas supply of the Natural Gas National System. Ensuring this security is the responsibility of the Portuguese Government, while monitoring the security of supply is the responsibility of DGGE, with the cooperation of the concessionaire of the Natural Gas Transmission System. DGGE will issue a proposal of periodic report on the security of supply to be presented to the Minister of Economy and Innovation and subsequently to be sent to the Parliament and to the European Commission.

Under Article 16 of Regulation (EC) No 1775/2005, while the Portuguese natural gas market is considered an emergent market, the Regulation is not applicable to the Portuguese natural gas network. Portugal may apply to the Commission for a temporary exemption from the application of this Regulation, for a period of up to two years from the date at which the exemption expires.

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SPAIN

ELECTRICITY SYSTEM OVERVIEW

The two major characteristics of the Spanish electricity sector are the existence of the wholesale Spanish generation market, or Spanish pool, and the fact that any consumer is free to choose its supplier since January 1, 2003. Competition was first introduced in the Spanish electricity market on January 1, 1998 by Law 54/1997, which provided a regulatory framework that reorganized the functioning of the market.

Generation facilities in Spain operate either in the ordinary regime or the special regime. Special regime generators, which comprise cogeneration and renewable energy facilities of up to 50 MW, may sell their net electricity output to the system either (i) at tariffs fixed by decree, (ii) at tariffs linked to pool prices plus a premium, that vary depending on the type of generation and are generally higher than regulated tariffs (transitory regime), or (iii) in the Spanish pool (or by bilateral contracts), together with certain premiums and incentives. Ordinary regime generators provide electricity to the Spanish pool and by bilateral contract to consumers and liberalized suppliers at market prices.

Companies with the capability to sell and buy electricity may participate in the Spanish pool. Electricity generators sell electricity in the pool, and the regulated electricity distributors, suppliers in the liberalized, or unregulated, market and consumers that are permitted to participate in the pool buy electricity in this pool. Foreign companies or consumers that have foreign agent status may also sell and buy in the Spanish pool. The market operator and agency responsible for the market s economic management and bidding process is OMEL.

In addition to selling electricity to regulated consumers (customers that are subject to a regulated final tariff), transmission companies and regulated distributors must provide network access to all suppliers and qualified consumers that have chosen to be supplied in the liberalized market. However, qualified consumers must pay an access tariff to the distribution companies if such access is provided. At the end of each year, the Spanish government sets both the final and access tariffs for the incoming year. By Royal Decree no. 2392/2004, the Spanish government established the electricity tariffs for 2005.

Liberalized suppliers are free to negotiate the electricity price with qualified consumers. These entities main direct activity costs are the wholesale market price and the regulated access tariffs to be paid to the distribution companies. Electricity generators and liberalized suppliers or consumers may also engage in bilateral contracts without participating in the wholesale market.

In 2005, annual demand was 246,873 GWh, a 4.8% increase from 2004 and the installed capacity was 73,690 MW, a 7.7% increase from 2004. This installed capacity increase was due to the commissioning of eight new combined cycle power plants and additional wind farm development in 2005.

ELECTRICITY REGULATION

The enactment of Law no. 54/1997, of November 27, 1997, has gradually changed the Spanish electricity sector from a state-controlled system to a free-market system with elements of free competition and liberalization. With this change, the Spanish government intends to guarantee the electricity supply at the highest quality and at the lowest possible price. The current regulatory framework provides for:

- the unbundling of activities so that no operator can simultaneously carry out regulated activities (transmission, distribution, technical management of the system and economic management of the wholesale market) and liberalized activities (generation, trading and international/intra-community exchanges);
- a wholesale generation market, or electricity pool;
- freedom of entry for new operators with liberalized activities in the electricity sector;

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liberalized activities to take place in a competitive environment, although transmission, distribution, technical management of the system and economic management of wholesale market activities will continue to be regulated as their particular characteristics impose limitations on the possibility of introducing competition;

as of January 1, 2003, all consumers may select their suppliers and the method of supply, either at market prices or with a set tariff fixed by the Spanish government;

all operators and consumers have the right to access the transmission and distribution grid by paying access tariffs previously approved by the Spanish government; and

environmental protection.

Royal decree law no. 3/2006, of February 24, 2006, modifies the matching process of the selling and buying offers presented by companies that are within the same industrial group in the day-ahead and intra-day markets:

Energy acquired by electricity distribution companies will be matched to the sales of electricity in the ordinary regime by generation companies that are within the same industrial group.

The price that will be used to settle the purchases of distribution companies will be set by the Spanish government based on transparent market prices, although provisionally the price has been fixed at €42.35 per MWh.

Beginning on March 2, 2006, electricity generation companies in the ordinary regime became subject to a tariff deficit calculation. Under this calculation, there is a reduction in company s retribution in an amount equal to the market value of the emission allowances allocated to the company under the NAP. Between January 1, 2006 and March 2, 2006, there was a reduction related to the amount of eventual estimated shortfall in income from regulated activities to which such group is entitled and the to the market value of emission allowances granted in this period.

The Industry Ministry has not published yet the regulatory framework needed to fully evaluate the economic and financial consequences of this Royal decree law.

Royal decree law 7/2006, of June 23, 2006, modifies several aspects of Law 54/1997 by establishing the end of the recovery of the Cost of Transition to Competition and setting a new methodology for calculating regulated tariff, which allows government to establish tariff maximums and costs to be considered in average tariff.

Royal decree 809/2006, of June 30, 2006, fixed the tariffs beginning July 1, 2006, providing for an average increase of 1.38% on the 2006 tariff. The tariff for household customers has increased 0.8% since January 2006 and the tariff for large customers has increased 6% for large consumers since January 2006. This increase was adopted to recover 2005 tariff deficit, which will be recovered until year 2020. The access tariffs were unchanged.

Technical and economic management of the system

Prior to the enactment of Law no. 54/1997, operation of the electricity system in Spain was a public service provided by the government through Red Eléctrica de España, S.A., or REE, a state controlled entity. Under Law no. 54/1997, REE continues to serve as the system operator, but some of its dispatching functions have been taken over by the market operator, Operador del Mercado Ibérico de Energía Polo Español, S.A., or OMEL. Accordingly, OMEL is responsible for the economic management of the wholesale market and REE is responsible for the technical management of the transmission grid and the balancing mechanism that ensures that energy supply is equal to energy demand. The Spanish government no longer controls REE, although it still retains a 20% interest in the company through Sociedad Estatal de Participaciones Industriales, or SEPI. To ensure that REE and OMEL are guaranteed the highest levels of independence and transparency, the maximum stake that can legally be held in REE has been reduced to 3% (except for SEPI) or to 1% (for electricity operators or for those companies or individual who hold more than 5% on the share capital of an electricity operator). In the case of OMEL, the maximum stake that can be held on its share

capital is 5%, except that economic managers of other electricity systems may hold stakes of up to 10% in OMEL until June 30, 2006.

Supervision of the system

The National Energy Commission is the public authority in charge of supervision of the electricity, hydrocarbons and natural gas industries in Spain.

Generation

Law no. 54/1997 seeks to create a competitive electricity generation market where power generation plants are dispatched based on the results of a competitive bidding process administered by OMEL. It also provides for a transitional period until 2010 during which power generation companies that were subject to the Stable Legal Framework on December 31, 1987 will be entitled to partial compensation for the costs they incurred in connection with the transition to the competitive market regime, or stranded costs. This compensation is paid from amounts collected from consumers, as part of the tariffs, and settled by the National Energy Commission. Law 54/1997 also provides that the installation of new power generation plants be completely liberalized and not subject to government planning, subject only to the authorizations required by the applicable laws and regulations (town planning and environmental protection, for example). New electricity generators will be entitled to the same rights and payments as other generators.

On March 11, 2005, Royal Decree law no. 5/2005 was adopted to increase productivity, and provides for:

- limitation of activities of dominant players, such as a prohibition on importing electricity into the MIBEL from any outside country. Dominant players are defined as those companies that hold market shares in the Iberian generation and supply market above 10%. This limitation will be fully in force upon the publication of the dominant players list by the Spanish authorities and as from the commencement of MIBEL activities;

- implementation of measures at the wholesale level in order to comply with MIBEL requirements; and

- the cost of activities related to the second part of the nuclear fuel cycle, including the dismantling of nuclear facilities, has been excluded from the tariff and now it must be paid directly by the nuclear plants.

On August 27, 2004, Royal Decree law no. 5/2004 established a scheme for greenhouse gas emission allowance trading, implementing Directive 2003/87 of the European Commission. This Royal Decree law was replaced by Royal Decree law no. 1/2005,

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of March 9, 2005, which, with respect to energy generation, applies to any plant with a thermal capacity above 20 MW. As of January 1, 2005, an authorization for gas emissions is needed. The NAP, approved by the European Commission on December 27, 2004, sets forth the total quantity of allowances to be allocated for the 2005-2007 period. On January 21, 2005, a final allowance allocation list for electricity plants was published under Royal Decree no. 60/2005.

Transmission and distribution

Under some of the provisions of the current regulatory scheme, electricity transmission and distribution activities will continue to be regulated as their particular characteristics impose limitations on the possibility of introducing competition. However, in order to promote efficiency and quality of service, the current regulatory framework has changed the manner in which electricity businesses receive payments.

The regulations take into account the investment and operational costs related to transmission activities. Fixed payment for distribution is based on investment, on a reference network model as well as distribution areas, incentives for the quality of supply, loss reduction and commercial management costs. In the future, consideration of investments and operational and maintenance costs will also be included.

In order to promote the liberalization of the electricity sector, the government is preparing the substitution of the current regulated-unregulated market scheme by an unregulated-last resort supply scheme. Under the latter scheme, a last resort operator appointed by the government will be the only one able to supply domestic and small consumers under a last resort tariff. The rest of consumers will be supplied under market prices. These changes are expected to take place before 2011.

Supply

Supply (or retailing) in Spain was created by Law no. 54/1997. Suppliers are companies that have access to the transmission and distribution networks and whose function is to sell electricity to eligible consumers or other agents in the system. The parties concerned freely agree to the economic terms of retailing transactions, therefore, this type of supply is not subject to fixed tariffs.

Tariffs

Spanish electricity tariffs are fixed annually by the government through Royal Decree. Royal Decree no. 1432/2002, of December 2002, established a new method of calculation for the period 2003-2010. The new method of calculation allows tariffs to be fixed under more objective, transparent and predictable conditions.

Royal Decree no. 1556/2005, of December 23, 2005, fixed the tariffs for 2006 and provided for an average rise of 4.48% on the 2005 average tariff (or reference tariff, which includes all applicable tariffs and costs). The 2006 average tariff will be confirmed or updated, if necessary, on July 1, 2006.

The 2006 tariff for regulated customers increased 4.68% from 2005, and the 2006 access tariffs also increased 2.86% from 2005.

Competition

On January 1, 2003, the Spanish electricity market was fully liberalized allowing million of consumers access to the market to negotiate their consumption of electricity.

The consolidation of low voltage customers in the liberalized market continued in 2005. During 2005, an average of 1.76 million low voltage-consumers purchased electricity in the market. Among these consumers, approximately 123 thousand were small and medium enterprises, or SMEs, and the remaining were household consumers. In terms of electricity, this represents 17,170 GWh consumed by SMEs. By December 2005, the number of SMEs and household consumers operating in the market exceeded 1.95 million consumers, 8.3% of the total consumers of electricity in mainland Spain.

At high-voltage, the number of customers in the liberalized market increased 3.3%, on average. The number of high-voltage customers in market at the end of the year was 34,600. This represented consumption of 69,262 GWh, a 9.6% increase from the 63,171 GWh consumption in 2004 (calculated from average supplies billed during the period). Some large customers returned to the tariff market during the last months of 2005 because of better prices. High voltage-customers in market represent about 30% of the total consumption in Spain.

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Special regime

The special regime in Spain includes all renewable energy generation, such as solar thermoelectric, solar photovoltaic, wind, biomass, biogas, biofuel or mini-hydroelectric, as well as cogeneration facilities. All the plants or generation facilities included in the special regime must have less than 50 MW of installed capacity. Due to increasing concern over environmental matters, generation activities included in the special regime have become increasingly important. Renewable energy sources are also helping to reduce the energy dependence of Spain and increase the security of supply.

Development of renewable energy in Spain began twenty five years ago, when Law 82/1980, of December 30, 1980, started an ambitious promotion of this kind of energy. After 1980, several laws and regulations have intensively developed the renewable energy sector, primarily Royal Decree 436/2004, of March 12, 2004. This intense development has transformed Spain in one of the most advanced countries in the use of renewable energy. Moreover, as a signatory of the Kyoto Protocol, Spain is highly involved in increasing the use of renewable energy. On August 26, 2005, the Spanish Government approved the new Renewable Energy Plan, according to which 12% of the primary energy consumption and 29.4% of the gross energy generation should come from renewable energy by 2010.

Royal Decree 436/2004, of March 12, 2004, superseded the former regulations on renewable energy and established a new legal and financial framework for special regime generation activities. The main purposes of this Royal Decree are the establishment of a stable, predictable and transparent remuneration system for the special regime and the promotion of clean energy such that it will constitute approximately 30% of total electricity consumption by 2010.

The new financial framework established by Royal Decree 436/2004 allows special regime generators to choose between selling their energy at market prices (in the electricity pool, the long-term pool or through bilateral agreements, in all cases, plus certain premiums and incentives) or at set tariffs (to distributors). These incentives, premiums and tariffs are calculated as a percentage over the average tariff. The update of the mentioned premiums, incentives and tariffs takes place every 4 years from 2006. The new remuneration system only affects the new plants while the currently operating plants enjoy a transitional period to be adapted to the new remunerations system.

Environmental activities

During 2005, increased development of renewable energy and a strategic focus on CO_2 emissions were key drivers of HidroCantábrico s performance. HidroCantábrico also applied considerable efforts to minimize the environmental impact of processes required to assure energy supply. As an example of this commitment, flue gas desulphurization and NOx emission reduction systems are currently being installed in thermal units in order to reduce acidification.

Climate change

An emissions trading scheme was established in Spain during 2005, including the creation of the National Emission Allowance Registry. An account has been assigned for each industrial plant where the balance of both allocated and purchased allowances will be registered.

In 2005, the growth in energy demand together with low hydroelectric generation resulted in intensive use of thermal power plants in the Spanish electricity system. Consequently, HidroCantábrico coal and natural gas power plants operated above expectations for an average year.

The Aboño thermal unit, one of the most efficient in Spain, is a multi-fuel station that burns a mix of fuels including imported coal and blast furnace gases produced by the nearby Arcelor steelworks factory. As a result, its emissions are increased with transferred CO_2. This activity is an example of valorization of a pollutant by-product, which decreases environment impacts to a large extent through the cooperation between two companies.

Efforts against climate change by HidroCantábrico include recurrent programs to increase efficiency in generation units. Examples include projects for reducing unburned fuel, the reduction of fuel consumed in start-ups, and the upgrading of turbine blades.

HidroCantábrico is developing a position in clean development mechanisms, participating in projects and developing mechanisms to reduce emissions through a presence in the Community Development Carbon Fund to which HidroCantábrico contributed $2.5 million. This fund has signed four projects amounting to 0.8 $MtCO_2e$, has approved 13 projects amounting to 5.1 $MtCO_2e$ and is analyzing 34 other projects that will contribute an additional 18.8 $MtCO_2e$.

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Environmental impact control

One of the main aspects of the environmental management system of HidroCantábrico is the identification of all relevant environmental aspects, defined as those activities, products or services in the organization that can impact the environment. Controlling and reducing these impacts is one of the key objectives for HidroCantábrico.

HidroCantábrico is working on several projects to reduce pollutant emissions in thermal power plants in order to comply with the National Emission Reduction Plan for Large Thermal Units, which implements Royal Decree no. 430/2004, of March 12, 2004, the transposition of EU Directive 2001/80/CE related to Large Combustion Plants. Equipment is being installed in the Aboño and Soto units for removing sulfur in emission gases, based on wet technology, and low NOx burners are also being installed that will reduce the emission of such gasses by around 95% and will reduce the particles in the flue gas by 50%.

Waste management

The largest amount of waste generated by HidroCantábrico facilities is flying ash and slag from coal plants. In 2005, 73% of this waste produced was recycled for cement production, road construction and other uses, reducing final waste volume and environmental impact.

Environmental management system

HidroCantábrico has adopted the Integrated Environmental Management System that involves all organization levels. It is implemented through working groups and committees and eases the processes for further environmental certifications in operating units. Under the Integrated Environmental Management System, HidroCantábrico worked during 2005 to prepare for UNE/EN/ISO 14001 certification in all thermal units.

GAS SYSTEM OVERVIEW

The development of the natural gas infrastructure in Spain reflects its extremely low national production of natural gas and its geographical position far from European gas fields. Currently, the Spanish natural gas system consists of the following physical components:

- a high pressure network, consisting of 7,500 km, with four international connections, one with France, one with Morocco and two with Portugal, and approximately 340 gas regulation and measurement stations;
- four operating regasification plants and two under construction;
- three small gas deposits for national production;
- two underground storage units, located at Serrablo and Gaviota;
- a national dispatch center that oversees the entire high pressure system, including its terminal and underground storage units; and
- a distribution network, consisting of more than 31,000 km of gas pipelines, which connects each consumer to the high-pressure transportation network.

As national production in Spain is limited, natural gas supply relies mainly on imports, either through international gas pipelines or regasification terminals within Spain that receive LNG transport vessels. Imported gas in 2005 totaled 389.7 TWh. Algeria was the main supplier and the Persian Gulf countries, Nigeria and Egypt were other significant suppliers.

Natural gas consumers in Spain can choose from three types of supply:

Tariff supply through a distributor, which is the traditional relationship model between a customer and a gas company. The customer buys gas from the distributor, to whom it pays the regulated price or tariff.

Supply through a trader, for which a qualified customer enters into a supply contract with a trading company to pay a freely negotiated, competitive price. The trading company enters into gas purchase contracts on international markets and access contracts with the transporter and distributor.

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Direct purchase by a qualified consumer, for which the consumer buys the gas directly on the international market and enters into a contract for access to the gas transportation and distribution installations. This option is only practical for large consumers.

In 2005, natural gas consumption in Spain was 375.7 TWh. This volume consisted of consumption by industrial customers (53.8%), electric power stations (29.6%) and commercial customers (14.9%).

Competition

At the end of 2005, there were 2,081,172 consumers operating in the liberalized market, representing 34% of the total gas consumers in Spain. Taking into account that at the end of 2004 there were a total of 1,218,785 consumers in the liberalized market, the increase during 2005 has been more than 70%. In terms of energy, 83%, or 314,827 GWh, was sold in the liberalized market.

Most consumers in groups 1 and 2, industrial customers, were in the liberalized market and these liberalized customers accounted for 98% of the total consumption in groups 1 and 2. Liberalized consumers comprise 92% and 93% of groups 1 and 2, respectively.

With respect to group 3, residential and commercial customers, 37% of energy consumed was purchased in the liberalized market and 34% of customers were in the liberalized market.

GAS REGULATION

Law no. 34/1998, of October 7, 1998, began the liberalization process of the Spanish natural gas sector and has been amended several times in recent years in order to improve this liberalization process. The main features of the current regulatory framework are as follows:

the unbundling of activities so that no operator can simultaneously carry out regulated activities (regasification, strategic storage, transmission, distribution and supplying at set tariffs) and liberalized activities (trading at market prices) simultaneously;

as of January 1, 2003, all consumers, regardless of their consumption, are fully eligible to select their suppliers as well as the method of supply, either at market prices (unregulated market) or with a set tariff (regulated market); In order to promote liberalization of the gas sector, the government is preparing the substitution of the current regulated-unregulated market scheme by an unregulated-last resort supply scheme. Under the latter scheme, a last resort operator appointed by the government will be the only one able to supply domestic and small consumers under a last resort tariff. The rest of consumers will be supplied under market prices. These changes are expected to take place in 2008.

all operators and consumers have the right to access the transmission and distribution grids by paying access tariffs previously approved by the Spanish government. This right is based on principles of free access, objectivity and transparency. Access to the grid can only be denied under circumstances set forth in certain laws and regulations in cases where there is a lack of capacity or reciprocity;

all tariffs, tolls and royalties are based on costs that are transferred to consumers of natural gas. The tariff is based on levels of pressure and consumption rather than by type of use. The tolls and royalties for transport and distribution are based on the level of pressure at which the network is connected to the consumers installation and on the volume of annual consumption rather than on distance; In order to avoid asymmetries between the regulated market and the unregulated market, some tariffs for big consumers have been eliminated in 2006. It is expected that all the tariffs will be substituted in 2008 by a last resort tariff just for domestic and small consumers. The rest of consumers will be supplied under market prices.

to ensure that ENAGAS, S.A., the current technical manager of the system, as well as the owner of the majority of the high-pressure transmission grid, is guaranteed the highest level of independence, the maximum stake that can be legally held in it, directly or indirectly, by any shareholder has been reduced to 5%. Any necessary reductions must take place before December 31, 2006;

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Royal Decree no. 1434/2002, of December 27, 2002, specifically regulating transmission, distribution, trading and supply activities, as well as the process of authorizing natural gas plants and installations, regulates relations between gas companies and their customers, both in the regulated and unregulated markets; and

Royal Decree no. 1716/2004, of July 23, 2004, sets forth obligations concerning minimum security reserves and natural gas supply diversification.

Spanish law prescribes the following roles for participants in the Spanish gas system:

Producers, who carry out exploration, research and mining of hydrocarbon deposits.

Transporters, who own natural gas storage facilities, regasification plants or high-transportation pipelines with pressure above 16 barg. Transporters purchase natural gas on the international market for sale to distributors for the tariff market. They also allow third parties (transporters, traders and qualified consumers) to access their facilities upon application and payment of a toll.

Distributors, who own natural gas distribution facilities that have pressure below 16 barg and supply just one consumer. Distributors buy gas from transporters at a regulated transfer price and sell it at a regulated price to tariff customers. Like transporters, distributors must also allow third party access to their facilities.

Traders, who purchase natural gas from producers or other traders and sell it to their qualified customers or other traders under freely negotiated terms and conditions. Traders use the installations belonging to transporters and distributors to transport and supply gas to their customers in exchange for the payment of a toll.

Qualified consumers, who can choose between purchasing gas from their distributor at a regulated tariff or purchasing gas from any trader under freely negotiated terms and conditions. Since January 1, 2003, all Spanish gas consumers have been able to choose their supplier.

Tariff consumers, who have entered into a supply contract with a distribution company to which they pay the regulated tariff.

The Technical System Manager, who is responsible for the technical management of the primary and secondary natural gas transportation networks. This role, as well as coordination of agents in the system, has been assigned to ENAGAS as the leading transporter.

The National Energy Commission is the public agency assigned the task of ensuring effective competition in energy systems and the objective, transparent functioning of those systems for the benefit of all agents operating in those systems as well as consumers. To do so, it acts as an advisory body to the Spanish Government, participates in the process of developing regulations and authorizing installations and acts as an arbitration body in disputes between different agents in the energy systems.

GENERATION

PORTUGAL

As of December 31, 2005, our Portuguese electricity generation facilities consisted of hydroelectric, thermal (coal, fuel oil, natural gas and gas oil), biomass, cogeneration and wind generation facilities, and had a total installed capacity of 8,921 MW (including an additional 392 MW unit of the Ribatejo CCGT plant, which began commercial operation in October 2005, five months ahead of schedule, and the new two-unit hydroelectric power station of Frades with a total of 192 MW, which is a reinforcement of the power station of Vila Nova/Venda Nova), 7,164 MW of which was in the PES and 1,757 MW of which was in the IES. As of December 31, 2005, approximately 49.4% of our generation

capacity was represented by hydroelectric facilities, 34.4% by thermal facilities, 13.2% by CCGT facilities and 3.0% by wind-driven, biomass and cogeneration facilities. We do not own or operate any nuclear-powered facilities in Portugal.

We currently hold most of our generation assets in EDPP, which in 2005 accounted for approximately 97% of our generation in Portugal. Our other companies that own or operate generation assets in Portugal are EDP Comercial, Enernova and EDP Bioeléctrica. EDPP also holds a variety of engineering and operations and maintenance, or O&M, companies, including EDP Produção EM Engenharia e Manutenção, S.A., a company which undertakes hydroelectric and thermal engineering projects and studies, project management, engineering and consulting.

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Our installed capacity in the PES of 7,164 MW represents approximately 82.0% of the total installed capacity in the PES. From 2000 to 2002, the installed capacity of the PES remained constant. In 2003, a small decrease resulted from the decommissioning of the 132 MW Alto de Mira plant. At the end of 2004, we decommissioned the last unit at the Tapada do Outeiro plant (46.9 MW), and the PPA between EDPP and REN for the two old generating units of Tunes (32 MW) also reached maturity. However, in this case, these two units were considered useful for system services by REN. EDPP and REN entered into a contract pursuant to which EDPP maintains the plant and keeps it in operation only for the purpose of the supply of system services. Our smaller hydroelectric plants, wind generating facilities and cogeneration and biomass plants are part of the IES. In the IES, in addition to the three Ribatejo CCGT units, one of which entered into service in 2005, there was a capacity increase resulting from the entering into service of the Alqueva hydroelectric power plant in 2004 owned by EDIA-Empresa de Desenvolvimento e Infra-estruturas de Alqueva, S.A., or EDIA, a company wholly-owned by the Portuguese Republic that is developing a multi-purpose hydroelectric project for irrigation and the production of electricity.

In 2005, our net electricity generation in Portugal was approximately 24.1 TWh, excluding special regime production. According to REN, total net generation in Portugal in 2005 was approximately 48.0 TWh.

On March 16, 2005, we exercised a call option for a total consideration of 52 million for the purchase from National Power International Holdings BV, or IPBV, of a 20% shareholding and related shareholder loans in Turbogás and a 26.667% shareholding and related shareholder loans in Portugen. Following the completion of this transaction, we now hold a 40% shareholding in Turbogás and a 26.667% shareholding in Portugen. Turbogás was incorporated in 1994 with the sole purpose of developing, constructing and operating a CCGT plant at Tapada do Outeiro, in Portugal, with a total installed capacity of 990 MW. Turbogás currently sells all of its production to REN, within the PES under a long term PPA. Since 2002, Turbogás has generated 24,970 GWh, of which 6,287 GWh were generated in 2005. For more information on these transactions, see Other Investments and International Activities. In addition, we have also reached an agreement with International Power Portugal Holdings S.G.P.S., S.A., or IPR, and IPBV regarding our possible involvement in the management of Tapada do Outeiro s power output in the event that the current PPA of Tapada do Outeiro is terminated, with any such arrangement being subject to non-opposition by the relevant competition authority.

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The following maps set forth EDP s power plants in Portugal, the PES and in the IES, as of December 31, 2005.

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The following table sets forth our total installed capacity by type of facility at year-end for the years 2001 through 2005.

Type of Facility	As of December 31, 2001	2002	2003	2004	2005
	(in MW)				
Hydroelectric:					
Public System hydroelectric plants[1]	3,903	3,903	3,903	3,903	4,094
Independent System hydroelectric plants[2]	309	309	311	310	310
Total hydroelectric	4,212	4,212	4,214	4,213	4,404
Thermal[3]	3,281	3,281	3,149	3,149	3,070
Wind[4]	41	41	65	136	151
Biomass	9	9	9	9	9
Cogeneration	67	111	111	111	111
CCGT[5]	0	0	392	784	1,176
Total	7,610	7,654	7,939	8,402	8,921

(1) *In 2005, the Frades hydroelectric power station (192 MW) entered into operation as a reinforcement of the power station of Vila Nova/Venda Nova.*

(2) *In 2004, the Ermal power station began operations as a special regime producer with 9.9 MW instead of its previous 11.2 MW in the NBES.*

(3) *On June 30, 2003, the PPA of the Alto de Mira plant, and on December 31, 2005, the PPA of Tapada do Outeiro plant expired and the plants were decommissioned. The PPA of the two older generating units of Tunes also expired on December 31, 2005. Those units are kept in operation under a contract of system services with REN but we do not consider their capacity in this table.*

(4) *The new wind facilities that began operation in 2005 were Pena Suar (16 MW), Vila Nova (26 MW), Fonte da Quelha (13.5 MW) and Alto do Talefe (13.5 MW).*

(5) *The Ribatejo CCGT plant was in testing at the end of 2003. The first 392 MW unit of this plant began commercial service on February 14, 2004, the second 392 MW unit on November 2, 2004, and the third on October1, 2005.*

Hydroelectric generation is dependent upon hydrological conditions. In years of less favorable hydrological conditions, less hydroelectricity is generated, and the PES depends on increased thermal production. In addition, in years of less favorable hydrological conditions, imports of electricity may increase. For purposes of forecast models, our estimated annual hydroelectric production based on current installed capacity in an average year is approximately 11 TWh and can reach about 15 TWh in a wet year and may fall to less than 7 TWh in a dry year. Between 1995 and 2005, our hydroelectric production ranged from a low of 4.5 TWh in 2005, a very dry year, to a high of 14.9 TWh in 2003, a record wet year.

The following table summarizes our net electricity production (excluding internal losses and consumption of the plants) by type of generating facility from 2001 through 2005 and also sets forth our hydroelectric capability factor for the same period:

Type of Facility	As of December 31, 2001	2002	2003	2004	2005
	(in GWh, except hydroelectric capability factor)				
Hydroelectric:					
Public System hydroelectric plants[1]	12,607	6,764	13,964	8,718	4,280
Independent System hydroelectric plants[2]	790	573	901	539	254
Total hydroelectric	13,397	7,336	14,865	9,257	4,534
Thermal:					
Coal	8,677	9,532	9,473	9,530	9,590
Fuel oil and natural gas	5,613	7,892	3,119	2,215	4,937
Gas oil	50	13	26	5	18

Cogeneration	423	590	679	656	671
CCGT[2]	0	0	203	3,419	5,088
Total thermal	14,763	18,027	13,500	15,825	20,304
Wind	90	113	128	237	348
Biomass	18	37	38	49	51
Total	28,269	25,513	28,532	25,368	25,237
Hydroelectric capability factor[3]	1.19	0.75	1.33	0.83	0.41

(1) *Includes the following amounts of our own consumption for hydroelectric pumping: 485 GWh in 2001, 670 GWh in 2002, 485 GWh in 2003, 408 GWh in 2004 and 564 GWh in 2005.*

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(2) *The Ribatejo CCGT plant was in testing at the end of 2003. The first unit of this plant began commercial service on February 14, 2004, the second unit on November 2, 2004, and the third unit on October 1, 2005.*

(3) *The hydroelectric coefficient varies based on the hydrological conditions in a given year. A hydroelectric capability factor of one corresponds to an average year, a factor less than one corresponds to a dry year and a factor greater than one corresponds to a wet year.*

The average availability for production of EDPP s plants remained at favorable levels from 2001 to 2005. For thermal plants it remained relatively stable, decreasing slightly from 94.4% in 2004 to 93.5% in 2005. For hydroelectric plants, it increased from 94.8% in 2001 to 97.1% in 2004 and decreased slightly to 96.6% in 2005.

A forced outage is unplanned non-availability at a power plant caused by trips, critical repairs or other unexpected occurrences. Non-availability results from planned maintenance and forced outages. EDPP is reducing planned maintenance outages through more efficient maintenance techniques. EDPP s generating facilities have achieved very low rates of forced outage over the past five years. Management believes these low rates compare favorably with the European average. In the period 2001 through 2005, forced outages of EDPP s thermal plants have ranged between 2.1% (2003) and 4.1% (2005). During the same period, forced outages of EDPP s hydroelectric plants ranged between 0.3% (2005) and 1.0% (2001). In 2005, forced outages of EDPP s thermal plants were 4.1% and hydroelectric plants were 0.3%.

The average availability factor is defined as the total number of hours per year that a power plant is available for production as a percentage of the total number of hours in that year. This factor reflects the mechanical availability, not the actual availability of capacity, which may vary due to hydrological conditions. The table below indicates for each type of EDPP generating facility the average capacity utilization and average availability factor indicators, comparable with other European utilities, each calculated in accordance with our computational method, for the indicated periods:

	Average capacity utilization [1]					**Average availability factor**				
	Year ended December 31,					**Year ended December 31,**				
Type of Facility	**2001**	**2002**	**2003**	**2004**	**2005**	**2001**	**2002**	**2003**	**2004**	**2005**
Hydroelectric	36.9%	19.8%	40.8%	25.4%	12.5%	94.8%	95.9%	96.8%	97.1%	96.6%
Thermal:										
Coal	83.1%	91.3%	90.7%	91.0%	91.8%	90.5%	94.0%	94.2%	92.9%	93.8%
Fuel oil and natural gas	36.4%	51.2%	20.2%	14.3%	32.9%	96.6%	93.9%	90.9%	94.9%	92.7%
Gas oil[2]	1.7%	0.4%	1.2%	0.3%	1.0%	98.4%	99.1%	98.0%	98.8%	99.5%
Total weighted average thermal[3]	49.9%	60.7%	44.8%	42.5%	53.5%	94.6%	94.4%	92.7%	94.4%	93.5%

(1) *The average capacity utilization is defined as actual production as a percentage of theoretical maximum production.*

(2) *Increase in average capacity utilization in 2003 was due to the need to use the fuel stock of the Alto de Mira power plant in the context of its decommissioning.*

(3) *Weighted average is based on total installed capacity of the thermal system.*

During the period from 2001 through 2005, EDPP had operating and maintenance costs, excluding fuel and depreciation costs, below the limits contained in the relevant PPAs over that time period. Although management expects to continue maintaining these costs below the PPA limits in 2006, we expect most of the PPAs to terminate as a result of the provisions of Decree law no. 240/2004. On June 30, 2003, the PPA of our 132 MW Alto de Mira plant terminated on the scheduled expiration date. The three-unit Tapada do Outeiro plant was progressively decommissioned until the end of 2004, and the last unit was decommissioned on December 31, 2004. The gas oil Tunes plant, with four units, had the PPA relating to its first two (32 MW) units terminated on December 31, 2004. Since that PPA termination, the affected units at Tunes are serving the national grid, providing ancillary services pursuant to an agreement with REN.

Hydroelectric plants

As of December 31, 2005, we owned and operated 26 hydroelectric generating facilities in the Binding System, with 65 total units and an aggregate installed capacity of 4,095 MW.

In the IES, EDPP now owns and operates 224.9 MW. EDPP also operates 84.9 MW owned by EDP Comercial and 240 MW owned by EDIA (the Alqueva plant). As a result, the total maximum capacity operated by EDPP was approximately 4,645 MW as of December 31, 2005.

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Based on an independent revaluation of our assets in 1992, we estimate that the average remaining useful life of our dams is approximately 45 years. The table below sets out our hydroelectric plants, ordered by installed capacity as of December 31, 2005, the type of hydroelectric plant, the year of commencement of operation and the year in which the most recent major refurbishment, if any, was accomplished.

Hydroelectric plants	Installed capacity (MW)	River reservoir plant type	Year entered into service	Year of last major refurbishment
EDPP Plants:				
Alto Lindoso	630.0	Reservoir	1992	
Miranda	369.0	Run of river	1960/95	1970
Aguieira	336.0	Reservoir	1981	
Valeira	240.0	Run of river	1976	
Bemposta	240.0	Run of river	1964	1969
Carrapatelo	201.0	Run of river	1971	
Picote	195.0	Run of river	1958	1969
Frades	191.6	Reservoir	2005	
Pocinho	186.0	Run of river	1983	
Régua	180.0	Run of river	1973	
Castelo de Bode[1]	159.0	Reservoir	1951	2003
Vila Nova (Venda Nova/Paradela)	144.0	Reservoir	1951/56	1994
Torrão	140.0	Reservoir	1988	
Fratel	132.0	Run of river	1974	1997
Vilarinho Furnas	125.0	Reservoir	1972/87	
Crestuma-Lever	117.0	Run of river	1985	
Cabril	108.0	Reservoir	1954	1986
Alto Rabagão	68.0	Reservoir	1964	
Caniçada	62.0	Reservoir	1954	1979
Tabuaço	58.0	Reservoir	1965	
Bouçã	44.0	Reservoir	1955	1988
Salamonde	42.0	Reservoir	1953	1989
Pracana	41.0	Reservoir	1950/93	1993
Caldeirão	40.0	Reservoir	1994	
Raiva	24.0	Reservoir	1982	
Touvedo	22.0	Reservoir	1993	
Total	4,094.6			
Independent System Hydroelectric Plants:				
EDPP plants:[2] [3]	224.9	Various	Various	
EDP Comercial plants[4]	84.9	Various	Various	
Total maximum capacity	4,404.4			

(1) *We invested approximately 13 million in the modernization of the electricity generating turbines and other dam equipment at Castelo de Bode, which was completed at the end of 2003.*

(2) *As a result of recent reorganizations, EDPP integrated 28 plants owned by HDN and Hidrocenel with capacities ranging from 0.1 MW to 44.1 MW and dates of entry into service from 1906 to 2004.*

(3) *In 2004, the Ermal power station began operations as a special regime power station with 9.9 MW instead of the previous 11.2 MW.*

(4) *EDP Comercial owns four plants with capacities ranging from 0.72 MW to 80.7 MW and dates of entry into service from 1927 to 1951.*

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The following table presents the net generation of EDPP s hydroelectric power plants operating under PPAs for the last three years, as well as the end date of each PPA.

Hydroelectric plants	End of PPA	Annual net generation 2003	2004	2005
		(in GWh)		
Alto Lindoso	2024	948	532	268
Touvedo	2024	72	46	23
Alto Rabagão	2015	145	89	57
Vila Nova (Venda Nova/Paradela)	2015	720	484	188
Venda Nova 2/Frades[(1)]	2027			112
Salamonde	2015	261	199	108
Vilarinho Furnas	2022	181	162	57
Caniçada	2015	347	263	139
Miranda	2013	1,365	797	420
Picote	2013	1,121	879	493
Bemposta	2013	1,374	913	488
Pocinho	2024	681	388	167
Valeira	2024	1,049	617	271
Vilar-Tabuaço	2024	178	88	19
Régua	2024	891	576	253
Carrapatelo	2024	1,092	765	334
Crestuma-Lever	2024	513	309	139
Torrão	2024	314	208	126
Caldeirão	2024	76	17	16
Aguieira	2024	614	351	354
Raiva	2024	66	31	13
Cabril	2015	491	236	59
Bouçã	2015	230	128	30
C. Bode	2015	608	266	46
Pracana	2024	99	33	22
Fratel	2020	528	339	77
Total Hydro		13,964	8,718	4,279

(1) *This plant, a power reinforcement of Venda Nova, started industrial service in August 2005.*

Thermal plants

EDPP operates all our conventional thermal power plants in the PES, with total installed capacity, as of December 31, 2005, of 3,069.6 MW and installed capacity per generating unit ranging from 27 MW to 298 MW. The following table sets forth, as of December 31, 2005, our conventional thermal plants by installed capacity, type of fuel, net efficiency at maximum output, number of units and year entered into service.

Thermal plants	Installed capacity (MW)	Fuel	Net efficiency at maximum output	Number of units	Year entered into service
Sines	1,192.0	Coal	36.8	4	1985-89
Setúbal	946.4	Fuel oil	38.2	4	1979-83
Carregado I	473.8	Fuel oil	37.3	4	1968/1974
Carregado II[(1)]	236.4	Fuel oil / Natural gas	37.6	2	1976

Tunes[2]	165.0	Gas oil	28.3	2	1982
Barreiro	56.0	Fuel oil	34.1	2	1978
Total maximum capacity	3,069.6				

(1) *These units began burning natural gas in 1997.*

(2) *The PPA for the first two units (32 MW) terminated on December 31, 2004, and these units now have a system service agreement with REN (the company that operates the national grid).*

There has been no significant change in average net efficiency of EDPP s thermal plants over the past five years. With continued proper maintenance of the thermal facilities, EDPP expects to maintain net efficiency at least at the levels agreed in the PPAs.

The following table presents the net generation of EDPP s thermal power plants operating under PPAs for the last three years, as well as the expected end date of each PPA and the fuel costs per power station.

		Annual Net Generation			Annual Fuel Costs		
Thermal plants	**End of PPA**	**2003**	**2004**	**2005**	**2003**	**2004**	**2005**
			(GWh)			**(thousands of EUR)**	
Sines	2017	9,473	9,530	9,590	131,771	179,818	209,402
Setúbal	2012	1,834	1,683	3,556	71,333	64,405	172,617
Carregado (I and II)	2010	1,091	327	1,162	51,075	17,063	57,851
Barreiro	2009	195	200	220	16,971	15,573	22,643
Tunes (III and IV)	2007	26	10	18	2,757	877	2,196
Total		12,619	11,750	14,545	273,908	277,736	464,709

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Energy sources

Fuel

EDPP uses a number of fossil fuels in the generation of electricity. The introduction of natural gas in Portugal permitted growth in the sources of primary energy. For more information on our use of natural gas you should read Natural Gas below.

EDPP fuel consumption costs, including transportation costs, were 666.3 million in 2005 and 380.3 million in 2004. The increase in the total cost of fuel consumed from 2004 to 2005 resulted primarily from 2005 being a drier year than 2004, the higher cost of fuel in 2005 and the added consumption in 2005 of the new Ribatejo CCGT plant

The table below shows the costs of fuel consumed by EDPP from 2001 through 2005.

	As of December 31,				
Type	**2001**	**2002**	**2003**	**2004**	**2005**
	(thousands of EUR)				
Imported coal	142,810	148,773	130,531	179,062	208,570
Fuel oil[(1)]	193,867	259,816	117,716	86,336	248,188
Gas oil[(2)]	4,618	1,526	2,744	586	2,196
Natural gas	12,260	24,497	22,917	114,354	207,310
Total	353,555	434,612	273,908	380,337	666,264

(1) *Includes consumption for the production of steam at the Barreiro power plant.*

(2) *Small amounts of gas oil are consumed by the gas oil plants for the operation of these plants in synchronous compensation mode for purposes of voltage regulation and a very small amount of generation.*

The following table sets forth the amounts of fuel purchased by EDPP in each of the last five years.

	As of December 31,				
Type	**2001**	**2002**	**2003**	**2004**	**2005**
	(thousands of metric tons, except natural gas)				
Imported coal	3,108	3,587	3,593	3,562	3,559
Fuel oil[(1)]	1,237	1,941	716	422	1,339
Gas oil	26	3	10	1	7
Natural gas[(2)]	60	150	131	632	861

(1) *Includes purchases for the production of steam at the Barreiro plant.*

(2) *Measured in millions of cubic meters. The increase in 2004 is due to the entering into commercial service of two units of the Ribatejo CCGT power plant. The increase in 2005 is due to the entering into commercial service of the third unit of the of the Ribatejo CCGT power plant.*

Coal

As the Sines power plant is a base load, or continuous operation power plant, EDPP has supply contracts for more than one year for the major part of its consumption of coal. Pursuant to the PPAs for purchases of coal, an annual Target Contract Quantity is defined by REN based on the forecasts for coal consumption for a wet year. The Target Contract Quantity is the basis for long-term supply and shipping contracts, which are negotiated by EDPP, subject to REN approval. In addition, EDPP makes spot-market purchases as necessary. In 2005, EDPP purchased 98% of its coal through long-term contracts and 2% of its coal on the spot market. In 2004, EDPP purchased 63% of its coal through long-term contracts and 37% of its coal on the spot market. In 2003 and 2002, EDPP purchased 78% of its coal through long-term contracts and 22% of its coal on the spot market.

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The following table shows the evolution of EDPP s coal purchases from 2001 to 2005 by geographic markets as a percentage of total purchases for that year.

	As of December 31,				
Region	**2001**	**2002**	**2003**	**2004**	**2005**
South Africa	28.0%	28.9%	34.6%	29.5%	34.0%
United States	17.0%	3.2%	9.9%	13.1%	10.6%
Australia	13.0%	23.2%	18.6%	3.7%	0.0%
South America	27.0%	16.3%	32.9%	41.1%	39.2%
Southeast Asia	15.0%	16.9%	0.0%	4.4%	4.0%
Europe	0.0%	11.3%	4.0%	8.2%	12.2%
Total	100%	100%	100%	100%	100%

In 2005, the average cost of coal consumed was 56.7 per ton. In 2004, the average cost of coal consumed was 50.3 per ton. In 2003 and 2002, the average cost of coal consumed for imported coal was 36.7 per ton and 41.4 per ton, respectively. The increase in 2005 reflects the high prices associated with a long-term contract entered into in 2004.

Fuel oil and gas oil

Fuel oil purchases by EDPP are made in the spot market and pursuant to contracts. EDPP purchases fuel oil from refineries in Europe, primarily in northwestern Europe and also in Portugal, and is remunerated through PPAs based on, among other things, costs of fuel oil indexed to the spot market.

The average cost of fuel oil consumed in 2005 was 201.2 per ton, compared with 154.1 and 164.8 in 2004 and 2003, respectively. The value in 2004 was due to the low market prices, which did not follow the crude prices, resulting from low demand and of the favorable exchange rate (USD/Euro). The increase in 2005 was due to change in the market prices at the end of 2004, which began to reflect the high crude prices. To reduce the emissions impact of our operations on the environment, EDPP has shifted its fuel oil purchases to lower sulfur fuel oil, which has increased the cost of consumed fuel oil. In 2005, the average sulfur content of fuel oil purchased by EDPP was approximately 0.9%, compared with 0.8% in 2004. The use of lower sulfur fuel oil has increased, and will increase in the future, the average cost of fuel oil consumed.

EDPP maintains gas oil reserves as fuel for emergency gas turbine generators. Since gas oil is very expensive and economically inefficient, these reserves are used on a very limited basis. Consequently, small purchases of gas oil have been made by EDPP, as required by REN.

Natural gas

EDPP has had access to natural gas as a source of primary energy since Transgás began importing natural gas from Algeria into Portugal in 1997. EDPP converted two units of Carregado into dual-fired (fuel oil and natural gas) units in late 1997. In 2005, EDPP purchased 861 million cubic meters of natural gas for a total of 207.3 million compared to 632 million cubic meters of natural gas in 2004 for a total of 114.4 million. For more information on our activities related to natural gas you should read Gas.

Planned new plants

In order to meet increased demand for electricity in Portugal, additional capacity is planned for the National Electricity System. The following table sets out planned new power facilities in Portugal in which we are participating.

Facility	**Type of Generation**	**Developing entity**	**Planned capacity (MW)**	**Target year**	**Status**
Picote II	Hydroelectric	EDPP	236	2011	Licensing
Bemposta II	Hydroelectric	EDPP	178	2012	Licensing
Baixo Sabor	Hydroelectric	EDPP	180	2013	Licensing

Small hydro	Hydroelectric	EDPP	20	2006/2010	Planning
New CCGT plants	CCGT	EDPP	4 x 400	2009/2014	Planning
Sines	Super critical coal	EDPP	750	2013/2014	Planning
Foz Tua	Hydroelectric	EDPP	208	2014	Planning

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Capital expenditures

In 2005, we spent 237.2 million in capital expenditures in technical costs for our generation facilities, compared with 246.9 million in 2004 and 261.1 million in 2003. Our capital expenditures in the generation sector have been concentrated on the following activities: conducting preliminary studies for and building of hydroelectric plants, maintaining and upgrading existing power plants, investing in environmental projects such as the installation of emission reduction equipment and, in 2005, investing 81.4 million in the new Ribatejo CCGT (combined cycle gas turbine) power plant and 42.6 million in wind energy farms.

The following table sets forth our capital expenditures in technical costs from 2001 through 2005 on plants by type and status of generating plant.

Plant type and status	Year ended December 31, 2001	2002	2003	2004	2005
			(thousands of EUR)		
Thermal/Hydro					
Public Electricity System					
Hydroelectric plants under construction	16,877	25,690	34,359	24,127	3,558
Hydroelectric plants in operation	10,289	12,756	11,732	11,849	13,604
Thermal plants in operation	14,764	16,261	20,340	12,955	75,659
Plants under study	1,450	1,011	349	729	4,653
Total PES	43,380	55,718	66,780	49,659	97,473
Independent Electricity System					
Hydroelectric plants	4,964	4,137	3,849	1,018	2,141
Ribatejo CCGT	58,535	142,946	142,350	128,329	81,317
Wind	6,521	11,159	38,389	53,667	46,030
Cogeneration facilities	13,083	9,602	255	129	249
Biomass[(1)]	0	35,180	614	155	0
Total IES	83,103	203,024	185,456	183,298	129,736
Others[(2)]	0	0	312	2,854	2,711
Non-specific investment[(3)]	5,250	17,721	8,599	11,089	3,108
Total Generation	131,733	276,463	261,147	246,900	233,029

(1) *Investments in 2002 include 35.2 million related to an intra-group transfer of the Mortagua biomass power plant (built in 1999) to EDP Produção.*

(2) *Other investments include studies and investment relating to our trading system.*

(3) *Non-specific investment refers to investments not directly related to our plants, such as administrative buildings, transportation equipment and implementation of new information systems.*

We currently expect that our planned capital expenditures and investments will be financed from internally generated funds, existing credit facilities and customer contributions, which may be complemented with medium- or long-term debt financing and equity financing as additional capital expenditure requirements develop. To learn more about our sources of funds and how the availability of those sources could be affected, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources.

Early termination of the PPAs

The generation capacity of EDPP plants in the PES is bound to the PES under PPAs between EDPP and REN. Under the PPAs, EDPP is guaranteed a monthly fixed revenue component (capacity charge) that remunerates, at an 8.5% real rate of return on assets, the net asset value of EDPP s power plants. The revenue amount EDPP receives as a capacity charge also includes the depreciation related to these assets, and is based on the contracted availability of each power plant, regardless of the energy it produces. The PPAs also allow EDPP to pass-through to the final tariff its total fuel consumption cost through a variable revenue component (energy charge) that is invoiced monthly to REN. Pursuant to the Portuguese government s policy for the reorganization of the energy sector, the PPAs will be terminated in connection with the creation of MIBEL.

Pursuant to Law no. 52/2004, of October 29, 2004, enacted by the Portuguese parliament, Decree law no. 240/2004 establishes the conditions for the early termination of the PPAs and defines compensatory measures for the respective contracting parties through the pass-through of charges to all electric energy consumers as permanent components of the Global Use of System Tariff. The early termination of the PPAs set forth in the Decree law is subject to certain conditions, which include the ministerial approval of termination agreements between EDP and REN, (ii) the entry into force of MIBEL under conditions that allow the sale of electricity produced and (iii) the granting of non-binding generation licenses to the

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relevant producers. The first of these conditions was met on March 4, 2005 when the Ministry of Economy approved the termination agreements entered into by us and REN on January 27, 2005 for all of EDPP s power plants operating in the PES. Although the MIBEL forward sale market managed by OMIP began operations on July 3, 2006, it is still unclear whether the conditions have been met to allow the sale of the electricity produced by EDP in MIBEL.

The termination of each PPA grants to the producer a right to cash compensation as a way to guarantee economic benefits equal to the portion of the benefit that is not otherwise sufficiently guaranteed to be received as future revenue under a free market regime. The gross value of the compensation corresponds to the difference between the present value of each PPA and the present value of the forecasted market revenues, net of fuel and variable O&M costs.

For the purposes of calculating this compensation, the value of each PPA includes the depreciation and remuneration of the relevant initial net asset value and the additional investment value, the fixed and variable operation costs and the forecasted market revenues, net of fuel and variable O&M costs, which must correspond to the expected production for the relevant power plant multiplied by the reference market price, reduced by the corresponding variable operating charges. These amounts are to be updated at a rate (as of a date closer to the entry into force of MIBEL and the effective termination dates of the PPAs) equal to the yield of Portuguese public debt with a maturity date close to the average life of all PPAs of each generator, plus 25 basis points. The reference average annual price, as defined in Decree law no. 240/2004, is 36/MWh.

The termination agreements that were signed on January 27, 2005 set the estimated amount of compensation to be granted to us as a result of the early termination of all of our PPAs. These termination agreements contemplate, among other things, the commencement of MIBEL operations by June 30, 2005, which did not occur. The termination agreements contemplated a present value of the compensation as of July 1, 2005 of at 3,356 million. This compensation, designed to ensure economic benefits equivalent to those delivered by the PPAs to all parties to these contracts, was calculated based on a number of economic assumptions and parameters including the present value of the existing PPAs, the forecasted revenues of these power plants operating under market conditions and a discount rate of 3.78%. However, the actual amount of compensation granted to us as a result of the early termination of all our PPAs will be different because the commencement of MIBEL operations did not occur as anticipated.

The compensation value for the early termination of the PPAs was deemed adequate by two independent entities, the investment bank Rothschild and the consulting firm Deloitte & Touche, based upon the applicable legal framework, market valuation and a set of data and assumptions provided by, among others, EDP.

During the first ten years after termination, the initial amount of the compensation relating to each PPA termination agreement is subject to annual positive or negative adjustments, based on the real net revenue obtained in a market regime, so as to ensure appropriate economic benefits equivalent to the PPAs. At the end of the tenth year, the compensatory amount must be subject to a final adjustment to be calculated based on a new forecast of the net revenues for the remaining period. However, the amount of compensation is subject to a global maximum amount per producer and is calculated based on the values set forth in Decree law no. 240/2004, updated by a rate equal to the yield of Portuguese public debt and assuming an inflation rate of 2% a year.

The Decree law sets forth a tax neutrality regime that allows for the inclusion of the compensation amounts in the taxable income of producers only when such amounts are recovered through energy tariffs.

The Decree law also allows securitization of compensation amounts, establishing a set of rules concerning billing and collection of such compensation that assure the rights of producers and third parties to cash flows. We are considering securitizing the compensation amounts and using the proceeds for the partial redemption of our financial indebtedness, although we cannot assure you that this securitization will occur.

Competition

The existing power stations of EDPP, which accounted for 97.3% of our generating capacity in Portugal in 2005, operate in the PES and in the IES. The earnings that EDPP derives from the power stations in the PES, in accordance with the terms of the PPAs, are dependent on the availability of capacity and are substantially unaffected by levels of actual output.

The PES includes two power stations that are not owned and operated by us: the Pego power plant, which was constructed and commissioned by us and later sold to Tejo Energia, and Tapada do Outeiro, which commenced full operations in 1999 and is owned and operated by Turbogás. The admission of these power stations to the PES resulted from two international tender processes coordinated by us in accordance with Portuguese government policy in effect at that time to establish competitive practices in the electricity generation sector. In addition to these two power stations, we have constructed

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plants to operate in the Independent Electricity System, such as the Ribatejo CCGT plant. The first unit of this plant entered commercial service in early 2004. In connection with the creation of MIBEL, the PPAs will be subject to early termination and the power stations operating in the PES will operate in a competitive market. For more information, see Early termination of the PPAs above.

Because Portugal is contiguous only with Spain and there are limited connections between Spain and the rest of Europe, the Portuguese and Spanish governments entered into an agreement for the creation of MIBEL. This agreement calls for, among other things, the harmonization of tariff structures and a common pool for Portugal and Spain. Accordingly, once MIBEL is in operation, we expect to face increased competition in generation and wholesale supply from Spanish participants in the Iberian electricity market. See The Iberian Energy Market and Spain.

SPAIN

HidroCantábrico s installed capacity represents 4.3% of Spain s mainland generation capacity, or 5.1% excluding special regime facilities. In 2005, HidroCantábrico had a total installed capacity of 3,207 MW, approximately 48% of which was from coal-fired facilities, 12% from CCGT facility, 13% from hydroelectric facilities, 1% from cogeneration facilities, 2% from waste to energy facilities, 19% from renewable energy facilities other than special regime hydroelectric and 5% from nuclear facilities. HidroCantábrico holds a 15.5% interest in Central Nuclear Trillo I, A.I.E., which owns the Trillo nuclear power plant, corresponding to 165 MW of the plant s total installed capacity of 1,066 MW.

The following table sets forth HidroCantábrico s total installed capacity by type of facility at year-end 2003, 2004 and 2005.

Type of facility	As of December 31, 2003	2004	2005
		(MW) [1]	
Hydroelectric:			
Hydroelectric Ordinary regime	432	433	433
Hydroelectric Special regime	3	3	3
Total hydroelectric	435	436	436
Thermal:			
Coal	1,605	1,605	1,605
CCGT	393	393	393
Nuclear	165	165	165
Total Thermal	2,163	2,163	2,163
Cogeneration	24	41	39
Wind[2]	81	223	490
Biomass	3	7	7
Waste	33	72	72
Total	2,738	2,941	3,207

[1] *Capacity figures do not reflect the capacity of plants owned by companies that are consolidated by HidroCantábrico using the equity method of consolidation.*

[2] *Wind figures include 224 MW owned by DESA, the company bought by Neo Energia in December 2005.*

The following table sets forth HidroCantábrico s thermal plants.

Thermal plants	Installed capacity (MW)	Fuel	Year entered into service
Coal			
Aboño			
Unit I	366	Coal / Blast furnace gas / Fuel gas	1974

Unit II	556	Coal / Blast furnace gas / Fuel gas	1985
Soto de Ribera			
Unit I	68	Coal	1962
Unit II	254	Coal	1967
Unit III	361	Coal	1984
Nuclear			
Trillo[(1)]	165	Uranium	1988
CCGT			
Castejón[(2)]	393	Natural gas	2002
Total installed capacity	2,163		

(1) *Corresponding to 15.5% of Trillo s capacity.*

(2) *The Castejón CCGT unit is operated by Elerebro, of which HidroCantábrico holds a 90.4% stake and EDP holds the remaining the 9.6%.*

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The following table sets forth HidroCantábrico s hydroelectric plants in the ordinary regime.

Hydroelectric plants	Installed capacity (MW)	River reservoir plant type	Year entered into service	Year of last major refurbishment
La Malva	9.1	Reservoir	1917/24	2002
La Riera	7.8	Run of river	1946/56	2001
Miranda	73.2	Run of river	1962	2000
Proaza	50.3	Reservoir	1968	2002
Priañes	18.5	Reservoir	1952/67	2003
Salime	79.7	Reservoir	1954	2003
Tanes [(1)]	125.5	Reservoir	1978	1995
La Barca	55.7	Reservoir	1967/74	2002
La Florida	7.6	Reservoir	1952/60	1998
Laviana	1.1	Run of river	1903	2001
Caño	1.0	Run of river	1928	1996
San Isidro	3.1	Run of river	1957	2002
Total	432.7			

(1) *Tanes is a pumped-storage facility with natural inflows. Pumping capacity is 110 MW.*

The average remaining useful life of HidroCantábrico s hydroelectric generation plants is approximately 45 years.

Since hydroelectric generation is dependent on hydrological conditions, for forecasting model purposes the estimated HidroCantábrico hydroelectric production based on current installed capacity in an average year is 730 GWh, ranging from a maximum of 950 GWh in a wet year to a minimum of 530 GWh in a dry year. These figures include only the electricity production from natural hydrological inflows.

Generation activity in 2005 was characterized by high availability and efficiency of HidroCantábrico s power plants. Net production in the ordinary regime, which was 15,372 GWh in 2005, increased 6.7% from 14,408 GWh in 2004 (out of a total generation in the Spanish market in 2005 of approximately 213.4 TWh, according to REE). Hydroelectric generation represented 847 GWh in 2005, compared to 854 GWh in 2004. Coal-fired thermal generation amounted to 11,164 GWh in 2005, an increase of 7.8% from 10,356 GWh in 2004. Natural gas-fired thermal generation (combined cycle) amounted to 2,109 GWh in 2005, an increase of 7.5% from 1,961 GWh the previous year. Nuclear generation, corresponding to our 15.5% stake in the Trillo nuclear power plant was 1,252 GWh in 2005, a slight increase of 1.2% from 1,237 GWh in 2004.

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The following table summarizes HidroCantábrico s electricity generation for 2003, 2004 and 2005, excluding losses at generation plants and HidroCantábrico s own or ancillary consumption, and sets forth the hydroelectric coefficient at year-end 2003, 2004 and 2005.

Type of facility	As of December 31, 2003	2004	2005
	(in GWh, except by hydroelectric coefficient factor) [1]		
Hydroelectric:			
Hydroelectric Ordinary regime[2]	861	854	847
Hydroelectric Special regime	12	12	5
Total hydroelectric	873	866	852
Thermal:			
Coal	10,491	10,356	11,164
Natural Gas	1,546	1,961	2,109
Nuclear[3]	1,257	1,237	1,252
Cogeneration	87	129	212
Total thermal	13,381	13,683	14,737
Wind[4]	35	272	523
Biomass	12	15	20
Waste	86	198	387
Total	14,387	15,035	16,519
Hydroelectric coefficient[5]	1.07	1.08	1.01

(1) *Generation figures do not reflect the generation of plants owned by companies that are consolidated by HidroCantábrico using the equity method of consolidation.*

(2) *Includes the following amounts generated by hydroelectric pumping: 89 GWh in 2003, 76 GWh in 2004 and 122.5 GWh in 2005.*

(3) *Corresponding to 15.5% of Trillo s generation.*

(4) *Wind figures do not include DESA, the company bought by Neo Energia in December 2005.*

(5) *The hydroelectric coefficient varies based on the hydrological conditions in a given year. A hydroelectric coefficient of one corresponds to an average year, a factor less than one corresponds to a dry year and a hydroelectric coefficient greater than one corresponds to a wet year.*

The average availability for production of HidroCantábrico s power plants decreased from 95.4% in 2004 to 94.7% in 2005 for thermal plants and increased from 96.4% in 2004 to 96.6% in 2005 for hydroelectric plants. HidroCantábrico s forced outages in 2005 were 3.93% for thermal plants and 0.40% for hydroelectric plants.

The table below sets out for each type of HidroCantábrico generating facility the average capacity utilization and the average availability factor for 2003, 2004 and 2005.

	Average capacity utilization [1]			Average availability factor		
	Year ended December 31,			Year ended December 31,		
Type of Facility	**2003**	**2004**	**2005**	**2003**	**2004**	**2005**
Hydroelectric	23.1%	22.8%	22.7%	87.7%	96.4%	96.6%
Thermal:						
Coal	78.8%	77.7%	84.0%	95.7%	95.0%	94.0%
Natural gas[2]	46.6%	58.8%	62.5%	96.3%	98.4%	97.6%
Nuclear	93.0%	91.0%	92.7%	93.9%	92.2%	93.3%

Total weighted average thermal[3]	74.0%	75.2%	80.7%	95.7%	95.4%	94.7%

(1) *The average capacity utilization is defined as actual production as a percentage of theoretical maximum production.*

(2) *HidroCantábrico s natural gas fueled CCGT plant began operations in 2002.*

(3) *Weighted average is based on total installed capacity of the thermal system.*

Similar to 2004, the availability and efficiency of HidroCantábrico power plants was high, leading to a 6.7% increase in generation in 2005. The new Castejón plant had an average availability factor of 97.6%. HidroCantábrico had maintenance outages at its Soto 2 and Castejón power plants in 2005, as well as a refueling outage in the Trillo nuclear power plant. HidroCantábrico s generation facilities benefited from several environmental improvements and equipment upgrades.

Thermal generation consumed 4,102 thousand metric tons of coal in 2005, of which 81.2% was imported and 18.8% was domestic. Fuel consumption costs including transportation amounted to 323 million in 2005 and 293 million in 2004. HidroCantábrico s fuel costs increased in 2005. The increase in the price of imported coal was mainly due to strong demand in China and India, while the cost of natural gas was influenced by the increase in the price of oil and its derivatives during 2005 due to the rising costs for coal and natural gas. Oil prices have risen steadily due to the growing demand for fuel worldwide, the continuing Iraq conflict, political instability in producing countries (Venezuela, Nigeria) and restrictions on production, refinery and transmission capacity.

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In 2005, capital expenditures on generating facilities amounted to 238 million, an increase of 8.0% from 2004. These expenditures are set forth below.

Plant type and status	Year ended December 31, 2003	2004	2005
	(thousands of EUR)		
Hydroelectric plants in operation	2,107	943	1,175
Thermal plants in operation	20,151	32,170	57,254
Special regime:[1]			
Hydroelectric plants in operation	0	0	3
Wind	49,047	140,685	176,371
Waste	3,500	10,530	2,937
Biomass	350	10,905	0
Cogeneration facilities	18,720	5,880	0
Total Generation	93,875	201,113	237,740

(1) *Data corresponding to Neo Energia, a 42% owned subsidiary of HidroCantábrico as of December 31, 2005, and Genesa, an 80%-owned subsidiary of HidroCantábrico as of December 31, 2003 and 2004, represents 100% of capital expenditures.*

HidroCantábrico is planning to develop five CCGT plants as set forth in the table below.

Type of Facility	Type of generation	Developing entity	Planned capacity (MW)	Target year	Status
Soto 4 and Soto 5	CCGT	HidroCantábrico	2 x 400	2008-2009	Licensing Process
Castejón 2	CCGT	Elerebro	400	2007	Under Construction
Aboño 3	CCGT	HidroCantábrico	3 x 400	2010-2012	Licensing Process
Alange	CCGT	HidroCantábrico	2 x 400	2010	Licensing Process
Barajas de Melo	CCGT	HidroCantábrico	2 x 400	2012	Licensing Process

(1) *At the end of 2005, HidroCantábrico signed a contract with Alstom, the leading gas turbine manufacturer, for the construction of Castejón 2 and Soto 4.*

HidroCantábrico is currently analyzing other locations for new power plants.

Competition

HidroCantábrico competes with other generators in the wholesale electricity market. The wholesale market was characterized by three very different periods in 2005: January through May, June through August and September through December. In the first five months of 2005, the final prices were higher than those in 2004: 54.5 per MWh in 2005 compared to 31.39 per MWh for the same period in 2004. In the summer period, prices rose to 73.6 per MWh compared to 35.47 per MWh for the same period in 2004. In the last 4 months of 2005 prices remained high at 66.38 per MWh compared to 40.81 per MWh in the same period in 2004. Altogether, the final marginal pool price in 2005 was 62.04 per MWh, which represented a 74.0% increase compared to 35.65 per MWh in 2004. HidroCantábrico s market share in the Spanish pool was approximately 7.1% in 2005, up from 7.4% in 2004. Including special regime and energy imports, the market share was 6.8% in 2005 and 6.9% in 2004.

This overall price increase in 2005 was caused by the increase in fuel costs, especially oil and gas, reduced hydro availability resulting from a drought, a decrease in nuclear production, the growing demand for electricity and the expenses associated with the CO2 emission rights deficit that began in 2005.

Research and development

Research and development activities carried out in 2005 were aimed at the reduction of emissions, treatment of by-products, maintenance and the extension of equipment life at various plants. They were conducted in coordination with various universities and industry groups and were partially subsidized by the Spanish government and EU entities.

RENEWABLE ENERGY

HISTORY AND OVERVIEW

In 2005, we were the fourth largest renewable energy operator in Iberia, with a total installed capacity at year-end of 1,270 MW, primarily through Neo Energia, which operates most of our special regime assets in Spain, through its subsidiaries Genesa and DESA, and all our wind energy assets in Portugal, through its subsidiary Enernova. We formed Neo Energia in 2005 and began consolidating our renewable energy business into it to take advantage of business development and growth opportunities in the Iberian and international renewable energy markets and to increase business efficiency, both through improved operations and effective synergy capture. The objective was to create an effective and consistent platform designed to promote growth of a business that presents significant potential for future value creation. Two EDP Group companies, Enernova, a 100% subsidiary of EDP, S.A. and Genesa, a 80% subsidiary of HidroCantábrico, operating in Portugal and Spain, respectively, were consolidated into Neo Energia.

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Neo Energia today participates in wind, hydroelectric, biomass, waste and cogeneration in both Portugal and Spain with a total installed capacity of 1,084 MW as of December 31, 2005, of which 808 MW is fully consolidated. Additionally, we hold 65.9 MW of special regime hydroelectric power plants and 111.1 MW of cogeneration plants in Portugal. We also hold 9 MW of a biomass power plant in Portugal through a joint venture with Celulose do Caima, SGPS, S.A., a company that focuses its activity on forestry management and production, and paper pulp production and supply.

Neo Energia has also been defining a strategy to capture opportunities in the international wind energy market, and has acquired three ready-to-build wind farm projects in France. Neo Energia has also been promoting opportunities related to solar and wave energy technology. Neo Energia believes that solar power is one of the most promising and mature new technologies, and that it can provide significant expertise to the promotion and operations of a solar power business.

In 2005, Neo Energia was active in the construction and promotion of wind farms for its own portfolio as well as in the acquisition of third party companies with wind farm licenses or wind farms in construction or operation. Five major acquisitions made by Neo Energia in 2005 are:

Agreement for the acquisition of five Tecneira Tecnologias Energéticas, S.A., or Tecneira, subsidiaries that are developers of wind farms in Portugal. The operation comprises a portfolio of 120.7 MW, of which 48.3 MW corresponds to existing installed capacity and 72.4 MW accounts for projects either under construction or at an earlier stage of development. Of these, 33.1 MW are expected to start operations during 2006 and 39.3 MW to be fully operational in the beginning of 2007. We have completed the acquisition of two of the five, which have a combined installed capacity of 48.3 MW. In accordance with the purchase agreement, we will complete each of the remaining subsidiaries upon the start of operations of their wind farms, subject to the conditions set forth in the purchase agreement.

Acquisition of the Ortiga and Safra wind farms formerly owned by the companies Energía y Recursos Ambientales, S.A. and Vendaval Promociones Eólicas, S.A. This operation comprises two wind projects under development with a total capacity of 53.4 MW, which are expected to entry into service during 2006.

Acquisition of Nuon España from Nuon International Renewables Projects B.V. Nuon España participates in the renewable energy sector in the Spanish market and has a portfolio of wind farm projects with a total capacity of 1,407 MW, out of which 221 MW are fully operational and 1,186 MW are in different stages of development. The wind farms are located in Galicia, Aragon, Andalusia and the Canary Islands and comprise assets with an average number of wind hours of 2,650 hours per year, above the average for the sector in Spain, which stands at 2,350 hours per year.

Acquisition of three wind farms in Bretagne, France Le Gollot (10.4 MW), Keranfouler (9.1 MW) and Plouvien (10.4 MW) from Nuon France Holding SAS. The three wind farms, with a total capacity of 30.0 MW, are expected to work, an average number of wind hours of 2,250 hours per year. These projects will require an additional 32 million investment and are fully licensed. Construction of Le Gollot and Keranfouler began in the first quarter of 2006 and these wind farms are expected to be fully operational before the end of 2006. Plouvien is expected to be fully operational before the end of 2007.

Acquisition of Investigación Y Desarollo de Energías Renovables S.L., or Ider, whose operations consist of four wind farms currently under construction totaling 114 MW located in the Spanish region of León. These wind farms are expected to be fully operational before the end of 2007 and to have an average number of wind hours of 2,250 hours per year.

In 2005, Neo Energia, through its subsidiary Enernova, worked within a consortium composed of three additional wind promoters, Grupo GENERG, Endesa and TP Térmica Portuguesa and a industrial partner, Enercon, to prepare a binding offer for the Portuguese Tender Process for 1,000 MW of new wind capacity for 2009-2012. The auction for this new capacity was launched by DGGE on July 28, 2005 and the consortium submitted its proposal on March 1, 2006.

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The table below presents the aggregated installed capacity and capacity under construction of Neo Energia as of December 31, 2005:

Type of facility	As of December 31, 2003	2004	2005
		(MW)[1]	
Hydroelectric Special regime	3	3	3
Wind	146	359	690[2]
Biomass	3	7	7
Cogeneration	24	41	39
Waste	33	68	69
Total	209	478	808

(1) *Capacity figures do not reflect the capacity of plants owned by associated companies.*
(2) *Includes 224 MW from Desa and 48.3 MW from Tecneira, acquired at year end.*

The following map displays Neo Energia s wind farms in Iberia as of May 2006:

Neo Energia currently plans to develop 1,786 MW of wind farms in the period 2006-2008. As of May 2006, wind farms representing 83 MW are already in operation and 494 MW are currently under construction.

Wind energy production is dependent upon weather conditions. In years of less wind hours or wind speed, less wind energy is generated and the PES in Portugal depends on increased thermal production. Nevertheless, based on historical data the annual volatility of the wind ranges from 5% to 10%, and in the long term there are not significant variations. For forecasting purposes, the market practice consists of using an average number of wind hours estimate.

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Before the construction of a wind farm, an audit of the conditions of the site is performed for wind forecast purposes and to determine the equipment that most suits the location. Wind turbine suppliers estimate a useful life between 20 and 25 years for their equipment. The life of the equipment is the most important factor to determine the life of the wind farm as licenses are not consumable. Land rights usually extend from 25 to 35 years and therefore do not affect the estimated useful life of the wind farms.

In order to provide incentives for the production of renewable energy sources, renewable generators have dispatch priority over conventional generation in Portugal and Spain.

PORTUGAL

Neo Energia develops wind farms in Portugal through Enernova, which has the responsibility for the development and promotion of renewable energy in Portugal. Its first wind facility commenced operation in 1996. Enernova had a combined installed capacity of 151 MW in 2005 contributing to revenues and 212.9 MW of gross capacity, including wind farms bought from Tecneira.

The following table sets forth our wind capacity and net electricity production from wind farms in Portugal at year-end for the years 2001 through 2005.

	As of December 31,				
	2001	**2002**	**2003**	**2004**	**2005**
Installed capacity (MW)[(1)]	41	41	65	136	151
Net electricity production (GWh)[(1)(2)]	90	113	128	237	348

(1) *Does not include wind farms bought from Tecneira and the capacity of plants owned by associated companies.*

(2) *Excluding internal losses and consumption of the plants.*

The following table identifies our wind farm facilities in operation at year-end 2005 although the wind farms acquired from Tecneira are included even though they were formally transferred to Enernova in March 2006.

Facility	**Gross Capacity (MW)[(1)]**	**Type of Generation**	**Year entered into service**	**Direct and Indirect Shareholding**
Fonte da Mesa	10.20	Wind	Pre-2003	100%
Pena Suar	10.00	Wind	Pre-2003	100%
Cabeço da Rainha	10.20	Wind	Pre-2003	100%
Cadafaz	10.20	Wind	Pre-2003	100%
Serra do Barroso expansion	18.00	Wind	2003	70%
Cabeço da Rainha expansion	6.00	Wind	2003	100%
Bolores[(2)]	5.20	Wind	2003	100%
Fonte da Quelha	12.00	Wind	2004	100%
Alto do Talefe	12.00	Wind	2004	100%
Padrela/Soutelo	7.50	Wind	2004	80%
Vila Nova	20.00	Wind	2004	100%
Açor	20.00	Wind	2004	100%
Mosteiro[(2)]	9.10	Wind	2004	100%
Amaral 1[(2)]	8.00	Wind	2004	100%
Alagoa de Cima[(3)]	13.50	Wind	2005	40%
Vila Nova expansion	6.00	Wind	2005	100%
Fonte da Quelha and Alto do Talefe expansion	3.00	Wind	2005	100%
Pena Suar expansion	6.00	Wind	2005	100%
Caldas 1[(2)]	10.00	Wind	2005	100%
Fanhões 1[(2)]	12.00	Wind	2005	100%

Amaral 1 2nd phase[2]	2.00	Wind	2005	100%
Fanhões 2 1st phase[2]	2.00	Wind	2005	100%
Total	212.90			

(1) *Includes the capacity of plants owned by companies that are consolidated through the equity method of consolidation*
(2) *Acquired from Tecneira and transferred to Enernova in March 2006.*
(3) *Reflects 40% of total capacity corresponding to our 40% ownership interest.*

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New projects are in progress, some of which are under construction and others are in licensing or development. The table below shows wind farms under construction as of December 31, 2005:

Facility	Planned Capacity (MW)	Type of Generation	Target Year	Current Status
Ortiga	11.69	Wind	2006	Construction
Fanhões 2 2nd phase[1]	2.00	Wind	2006	3rd party Construction
Madrinha	10.00	Wind	2006	Construction
Safra 1st phase	26.72	Wind	2006	Construction
Pó[1]	9.10	Wind	2006	3rd party Construction
Sobral 2[1]	10.00	Wind	2006	3rd party Construction
Arruda 1[1]	6.00	Wind	2006	3rd party Construction
Serra D El Rei	21.71	Wind	2006	Construction
Abogalheria	3.34	Wind	2006	Construction
Serra de Alvoça	20.00	Wind	2006	Construction
Total	120.56			

(1) *These wind farms are being constructed by Tecneira and will be transferred to Enernova upon completion.*

Neo Energia expects an additional gross capacity in Portugal of 380 MW in the period 2006-2008.

Capital Expenditures

In 2005, our capital expenditures in technical costs on wind farms in Portugal was 46.0 million, not including wind farms acquired from Tecneira and transferred to Enernova in March 2006. In 2004, our capital expenditures in technical costs on wind farms in Portugal was 53.7 million, compared with 38.4 million in 2003, 11.2 million in 2002, and 6.5 million in 2001.

SPAIN

Special regime generation in Spain was previously developed by HidroCantábrico through Genesa I, an 80%-owned subsidiary. In February 2006, Genesa was integrated into Neo Energia, with the objective of providing a basis for stable and sustained development focusing on the promotion, operation and management of renewable energy sources in Iberia. In December 2005, Neo Energia also bought DESA, which added an additional growth platform for the Spanish business.

The following table sets forth Neo Energia s renewable installed capacity in Spain by type of facility at year-end 2003, 2004 and 2005.

Type of facility	As of December 31, 2003	2004	2005
		(MW)[1]	
Hydroelectric Special regime	3	3	3
Wind	81	223	490[2]
Biomass	3	7	7
Cogeneration	24	41	39
Waste	33	68	69
Total	144	342	608

(1) *Capacity figures do not reflect the capacity of plants owned by associated companies.*

(2) *Including 224 MW from DESA.*

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The following table summarizes Neo Energia s renewable electricity generation in Spain for 2003, 2004 and 2005.

Type of facility	As of December 31, 2003	2004	2005
	(GWh)[1][2]		
Hydroelectric Special regime	12	12	5
Wind	35	272	523[3]
Biomass	12	15	20
Cogeneration	87	129	212
Waste	86	198	364
Total	232	626	1,124

(1) *Generation figures do not reflect the generation of plants owned by associated companies.*
(2) *Excluding losses and our own or ancillary consumption*
(3) *Generation figures do not include the 2005 generation of DESA´s plants (558 GWh).*

The following table identifies the facilities in operation at December 31, 2005. The table sets forth the full capacity of plants owned by Neo Energia s companies in Spain.

Facility	Gross Capacity (MW)	Type of Generation	Year entered into service	Neo Energia Direct and Indirect Shareholding
EITO Bio	3.20	Biomass	2001	72%
Uniarte Uniener	3.58	Biomass	2004	80%
Cog La Espina	2.24	Cogeneration	1995	40%
Cogeneración y mantenimiento	7.94	Cogeneration	1995	40%
Enercem	1.99	Cogeneration	1995	16%
Proenercam	2.04	Cogeneration	1995	40%
Cogeneración del Esla	5.83	Cogeneration	2001	72%
EITO Cogeneración Energía e Industria de Toledo	10.86	Cogeneration	2001	72%
CTI Cerámica Térmica de Illescas	3.12	Cogeneration	2002	72%
Renovamed	1.54	Cogeneration	2002	60%
Mazarrón	6.21	Cogeneration	2004	72%
Nestlé Sevares	5.48	Cogeneration	2004	80%
HidroAstur	8.65	Hydroelectric	1987	20%
Fuentehermosa	0.37	Hydroelectric	1992	72%
Gormaz	0.45	Hydroelectric	1995	60%
Rumblar	2.00	Hydroelectric	1998	64%
Intever	16.32	Waste	2000	80%
Sinova	16.32	Waste	2003	67%
Lorca (Sierra Tercia)	16.32	Waste	2004	70%
Sidergas	20.40	Waste	2004	80%
P.E. Juan Grande	20.10	Wind	1996	45%
P.E. Enix	13.20	Wind	1997	4%
P.E. Sierra Madero	28.71	Wind	1998	34%
P.E. Estrecho	30.00	Wind	1998	100%
P.E. Décor	18.30	Wind	2000	95%
P.E. Altos del Voltoya I	55.44	Wind	2000	25%
P.E. Buena Vista e Llanos de Esquina	13.75	Wind	2001	100%
P.E. Monte de las Navas	48.84	Wind	2002	4%
P.E. Sierra Cortado	18.48	Wind	2003	34%
P.E. Dega	24.00	Wind	2003	97%

P.E. Arlanzón	34.00	Wind	2003	62%
P.E. Cantábrico I (Cuesta, Lagos)	46.68	Wind	2003	80%
P.E. Altos del Voltoya II	6.60	Wind	2004	25%
P.E. Cantábrico II (Acebo)	17.82	Wind	2004	80%
P.E. Santa Quiteria	36.00	Wind	2004	58%
P.E. Monseivane y La Celaya	70.20	Wind	2004	100%
P.E. Campollano	124.10	Wind	2004	60%
P.E. La Sotonera	18.90	Wind	2005	55%
P.E. Rabosera	31.35	Wind	2005	95%
P.E. Pesur	30.00	Wind	2002	17%
P.E. Las Lomillas	49.50	Wind	2005	40%
Total	870.83			

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New projects are in progress, some of which are under construction and others are in licensing or development. The table below shows wind farms under construction at the beginning of the year.

Facility	Planned Capacity (MW)	Type of Generation	Target Year	Current Status
P.E. Brújula	73.50	Wind	2006	Construction
P.E. Boquerón	21.80	Wind	2006	Construction
P.E. Belchite	49.50	Wind	2006	Construction
P.E. Hoya Gonzalo	49.50	Wind	2006	Construction
Total	194.30			

Neo Energia expects an additional gross capacity in Spain of 1,397 MW in the period 2006-2008.

Capital Expenditures

In 2005, capital expenditures on renewable energy in Spain amounted to approximately 133.2 million, as set forth below.

Plant type and status	Year ended December 31, 2003	2004	2005 [1]
	(thousands of EUR)		
Hydroelectric Special Regime	0	0	0
Wind	49,047	140,685	130,290
Waste	3,500	10,530	2,870
Cogeneration facilities	18,720	5,880	0
Biomass	350	10,905	0
Total Generation	71,617	168,000	133,160

[1] *Does not include DESA, acquired at year end.*

RENEWABLE ENERGY OUTSIDE IBERIA

The acquisition of three wind farms in France in 2005, amounting to a capital expenditure of approximately 4.4 million, represents the first step of Neo Energia s international expansion. By the end of 2010, Neo Energia expects an additional 500 MW of installed capacity to be developed in other European markets outside Iberia.

The following table presents the wind farms under construction outside of Iberia:

Facility	Planned Capacity (MW)	Country	Type of Generation	Target Year	Current Status
P.E. Le Gollot	10.4	France	Wind	2006	Construction
P.E. Keranfouler	9.1	France	Wind	2006	Construction
P.E. Plouvien	10.4	France	Wind	2006	Promotion
Total	29.9				

DISTRIBUTION AND REGULATED SUPPLY

PORTUGAL

Electricity distribution in Portugal is a regulated business and involves the transfer of electricity from the transmission system, its delivery across a distribution system to regulated consumers and Qualifying Consumers, meter reading, installation, and supply to regulated consumers. The local electricity distribution function in mainland Portugal is carried out almost exclusively by EDPD. Through fourteen network distribution areas, EDP distributed electricity to approximately 5,907,000 consumers in 2005, out of a total of approximately 5,935,000 according to the DGGE. This amounted to 43,785 GWh, of which 9,621 GWh was distributed to Qualifying Consumers. As of December 31, 2005, EDPD had 4,613 employees.

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Under Portuguese law, distribution of high-voltage electricity, greater than 45kV and less than 110kV, and medium-voltage electricity, greater than 1kV and less than or equal to 45kV, is regulated by DGGE through the issuance of a binding license with no time limitation. EDPD holds high- and medium-voltage electricity licenses, which were obtained in 2000. Distribution of low-voltage electricity is regulated through 20-year municipal concession agreements with municipal councils. EDPD pays rent to each municipality as required by law.

Under the terms of the binding licenses, EDPD is obliged to supply electricity to all customers located within its licensed area that are part of the PES. EDPD is also obliged to provide access to the distribution network to producers in the IES in return for a regulated access charge from consumers. EDPD owns, leases or has rights of way for the land on which its substations are situated. In addition, EDPD has long-term rights of way for its distribution lines. If necessary, new properties may be acquired through the exercise of eminent domain. In those cases, EDPD compensates affected private property owners.

The authorized area of EDPD covers all of mainland Portugal. As of December 31, 2005, EDPD s distribution lines spanned a total of approximately 205,327 kilometers. The only distribution lines in Portugal not owned by EDPD are those of auto producers and small cooperatives, which own their own lines. The following table sets forth the kilometers of EDPD s distribution lines, by voltage level, at December 31, 2005.

Distribution lines	Km
Overhead lines:	
High-voltage (60/130kV)	7,632
Medium-voltage (6/10/15/30kV)	55,240
Low-voltage (<1kV)	100,380
Total overhead lines	163,252
Underground cables:	
High-voltage (60/130kV)	420
Medium-voltage (6/10/15/30kV)	13,045
Low-voltage (1kV)	28,610
Total underground cables	42,075
Total	205,327

Customers and sales

EDPD distributes electricity to approximately 5.9 million customers. Approximately 69% of electricity consumption in 2005 was along the coast, with approximately 18.7% in the Lisbon metropolitan region and 13.4% in the Oporto metropolitan region. EDPD classifies its customers by voltage level of electricity consumed. The following chart shows the number of customers as of December 31, 2005, according to level of voltage contracted, and indicates whether such customers are binding customers supplied by EDPD or Qualifying Consumers to which EDPD distributes electricity on behalf of suppliers in the IES.

	Year ended December 31, 2005		
	Binding	Qualifying	
Customers by voltage level	**customers**	**consumers**	**Total**
High and very high-voltage[1]	173	18	191
Medium-voltage[2]	16,600	5,124	21,724
Special low-voltage[3]	22,036	8,084	30,120
Low-voltage[4]	5,855,330	0	5,855,330
Total	5,894,139	13,226	5,907,365

(1) *High-voltage is greater than 45 kV and less than or equal to 110 kV. Very high-voltage is greater than 110 kV.*

(2) *Medium-voltage is greater than or equal to 1 kV and less than or equal to 45 kV.*

(3) *Special low-voltage consumers have subscribed demands above 41.4 kW and voltage levels below 1 kV. Special low-voltage customers are primarily small industrial and commercial customers.*

(4) *Low-voltage is less than 1 kV.*

EDPD has experienced increased demand over the past five years in all electricity voltage levels. Considering overall demand on EDPD s distribution network, both from customers in the Binding Sector and Qualifying Consumers, consumption has grown at an average annual growth rate of 5% from December 31, 2001 to December 31, 2005. The highest average annual growth rate during this period, 10.4%, was in demand from very high- and high-voltage customers. These voltage levels experienced a 17.5% increase in demand in 2005 due to a higher demand on the distribution grid from auto producers. Under

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current regulations, auto producers may purchase electricity at a price below that at which they may sell it to the National Electricity System. As a consequence, auto producers have increased their demand on the distribution grid. Demand by medium-voltage levels increased from 11,702 GWh in 2001 to 13,580 GWh in 2005, representing average annual growth of 3.8%.

Following the gradual decrease of the eligibility threshold between 2001 and 2005, more electricity distributed through EDPD s network corresponds to consumption by medium-voltage qualifying consumers. As a result, electricity demand by medium-voltage binding consumers decreased from 11,358 GWh in 2001 to 5,091 GWh in 2005, whereas electricity demand by medium-voltage qualifying consumers increased from 344 GWh in 2001 to 8,489 GWh in 2005. Consumption by low-voltage binding customers, typically residential and services, increased from 18,823 GWh in 2001 to 21,360 GWh in 2005, representing average annual growth of 3.2%. This growth is slightly lower than that in total low voltage (4.3% per annum) as 951 GWh were consumed by large low-voltage qualifying consumers. The growth in low-voltage consumption during this period resulted from the increase in the number of low-voltage customers from approximately 5.8 million to approximately 5.9 million, as well as an increase in annual consumption per consumer.

The following table shows electricity distributed in each of the last five years by type of consumer.

	Year ended December 31,				
Electricity distributed	**2001**	**2002**	**2003**	**2004**	**2005**
			(GWh)		
Very high-voltage and high-voltage:					
Binding customers	4,259	4,271	4,795	5,562	6,413
Qualifying consumers	176	182	114	49	182
Total very high-voltage and high-voltage	4,435	4,453	4,909	5,611	6,595
Medium-voltage:					
Binding customers	11,358	11,198	8,600	6,506	5,091
Qualifying consumers	344	776	3,934	6,680	8,489
Total medium-voltage	11,702	11,974	12,534	13,187	13,580
Low-voltage:					
Binding customers	18,823	19,424	20,346	21,267	21,360
Qualifying consumers	0	0	0	33	951
Total Low-voltage	18,823	19,424	20,346	21,300	22,311
Public lighting	1,065	1,080	1,167	1,218	1,299
Total	36,025	36,931	38,955	41,315	43,785

On a revenue basis, our Portuguese electricity sales grew from 3,219 million in 2001 to 3,738 million in 2005. The most significant increase in sales has been related to low-voltage customers (typically residential and services), to whom sales increased from 2,194 million in 2001 to 2,718 million in 2005. Recent growth in revenue from electricity sales was due to expansion in consumption and average tariff increases set by ERSE of 2.3% in 2005 and 2.1% in 2004. Furthermore, revenue from electricity sales was also influenced by the tariff adjustment, as discussed below.
The following table shows EDPD s total domestic sales of electricity to binding customers by level of voltage required, as well as revenues from the use of distribution network, charged to Qualifying Consumers for the periods indicated.

	Year ended December 31,				
Electricity sales by voltage	**2001**	**2002**	**2003**	**2004**	**2005**
			(thousands of EUR)		
Very high-voltage and high-voltage	165,957	167,827	186,467	228,939	288,389
Medium-voltage	772,357	783,388	615,394	487,807	417,273
Low-voltage	2,194,035	2,335,135	2,500,380	2,664,809	2,718,469
Public lighting	83,918	86,614	95,731	101,991	92,959
Total binding customers	3,216,267	3,372,964	3,397,972	3,483,546	3,517,090

Qualifying Consumers	2,788	12,939	70,485	126,647	220,534

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Tariffs are fixed by ERSE in advance for each year and are based in part on estimated data for variables such as demand and cost. If there are differences between the estimated data and the data actually experienced during the period, adjustments will be made to the tariff in a subsequent period to account for these differences. The tariff adjustment reflects our estimate of the amount that will be applied in fixing tariffs in subsequent periods as a result of these differences.

The number of distribution customers per distribution employee is an important measure for EDPD. In the period from 2001 through 2005, the number of customers per employee increased from 771 to 1,281.

Purchases of electricity

EDPD still purchases all of its electricity in the Binding Sector from REN. ERSE established a limit on purchases of electricity by EDPD from the Non-Binding Sector at 8% for the 2002-2004 and 2005 regulatory periods. In the past, EDPD purchased less than 8% of its total energy from suppliers in the Non-Binding Sector and abroad. REN must purchase, and EDPD must purchase from REN, all electricity supplied by Other Independent Producers. The cost of purchased electricity is passed through to customers in accordance with the regulated tariff system and is not a determining factor in EDPD s results. However, in the ERSE regulatory revision of August 2005, it was established that once the PPAs are terminated early, the regulated supplier EDPD must assure the purchases of electricity to supply the respective demand, which purchase might be made in the organized spot and futures markets or through bilateral contracts.

The following table presents the electricity purchases of EDPD:

	Year ended December 31,				
Electricity Purchases	**2001**	**2002**	**2003**	**2004**	**2005**
			(GWh)		
From Binding Sector generation	35,282	34,801	32,307	30,342	29,961
From Other Independent Producers	2,552	2,817	3,694	4,482	6,314
From the Non-Binding Sector	891	1,354	2,044	2,933	902
Total	38,726	38,972	38,046	37,757	37,178

Distribution losses

EDPD experiences technical losses of electricity which are associated with the normal use of its network and, to a far lesser extent, commercial losses of electricity due primarily to gaps between estimated meter readings and actual levels of consumption, which are usually recovered in subsequent years, with the exception of losses due to stolen energy and faulty meters. The losses are within the normal range for the types of networks employed.

The following table sets forth data regarding the losses of EDPD in absolute terms and as a percentage of demand, as well as EDP s own uses of energy for the periods indicated.

	Year ended December 31,				
	2001	**2002**	**2003**	**2004**	**2005**
			(in GWh, except percentages)		
Demand on the distribution network	39,263	39,965	42,261	44,808	47,268
Own uses of energy	22	20	33	29	25
Distribution losses	3,183	3,008	3,259	3,451	3,437
Distribution losses/demand on the distribution network	8.1%	7.5%	7.7%	7.7%	7.3%

Service interruption

We did not experience, and we do not currently expect to experience, any interruptions to our generation and distribution activities that were or might be material to our consolidated financial condition. We cannot assure you, however, that we will be able to foresee any interruptions or that interruptions will not occur.

In Portugal, the equivalent interruption time, or EIT, of our medium voltage grid dropped to 184 minutes in 2005 from 215 minutes in 2004, which represented a 14% improvement, as a result of our investments in the distribution grid and in

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quality of service. In 2004, we had already achieved a 155-minute improvement compared to 2003, which represented a 42% improvement. Approximately 29 minutes of the 370 minutes measured in 2003 were related to the wildfires that took place in Portugal.

Capital expenditures

In recent years, our largest capital expenditures have been on the distribution system. EDPD is obligated by law to connect all customers who request to be linked to the PES. As a result, the largest component of capital expenditures is spent on connecting new customers, improving network efficiency and developing the network (installing new cables and new lines) to accommodate the growth in demand.

EDPD s total 2005 capital expenditures in technical costs amounted to 404.6 million, of which approximately 3% were expenditures on non-specific administrative, technical and commercial systems and corresponding technology support infrastructure, including an installment payment of approximately 3.7 million for the acquisition of an information technology system from Edinfor. EDPD s capital expenditures in technical costs in distribution totaled 388.1 million in 2004, 334.5 million in 2003, 379.0 million in 2002 and 260.4 million in 2001. These amounts also included amounts paid by customer contributions in cash, but did not include assets in kind contributed by customers. These in kind contributions amounted to 71.2 million in 2005, 70.4 million in 2004, 61.0 million in 2003, 54.1 million in 2002 and 69.5 million in 2001. New customers are required by current regulation to make a contribution, in cash or in kind, for connections based on factors such as the type of voltage, the amount of power to be supplied, and distance to the network. In 2005, total customer contributions, and certain amounts contributed for infrastructure improvements, amounted to approximately 150 million.

Conservation measures

We have been progressively implementing a voluntary policy to promote electricity conservation in an effort to decrease the variability of the load on the system and to increase efficient use of electricity. In doing so, we have increased dissemination of information on end-use efficiency in several industrial subsectors, services and residential use. We have also launched a program of granting awards to industrial customers for successfully implementing electricity efficiency projects and have established a joint venture with other energy sector companies whose main goal is to promote energy conservation.

In addition, the tariff structure has been designed to promote the rational use of electricity by basing tariffs on marginal costs, which may vary by time of day or season. Large consumers with a capability to reduce demand are offered an interruptible tariff rate, which results in a discount to the consumer and helps to reduce demand at peak times.

Competition

Until 1988, we had a monopoly in the generation, transmission and distribution of electricity in Portugal, although a very small number of municipalities distributed low-voltage electricity to consumers. Since 1988, measures have been taken to encourage limited competition in power generation in Portugal. In 1999, ERSE implemented measures to encourage competition in the supply of electricity in Portugal. For more information on these measures, you should read Electricity System Overview. In addition, as a result of political and regulatory developments, especially within the context of the creation of MIBEL, we are facing and expect increased competition from Spanish electricity companies.

In December 2005, five qualified suppliers were authorized to operate in the Portuguese Non-Binding Sector, four of which are Spanish companies: Endesa Energia, S.A., Iberdrola, S.A., Union Fenosa Comercial, and Sodesa Comercialização de Energia, S.A., and EnelViesgo, an Italian company. See The Iberian Energy Market and Spain Business System Overview.

As of May 15, 2003, all Eligible Consumers may automatically become Qualifying Consumers. In 2005, the total number of Qualifying Consumers represented approximately 21% of demand in mainland Portugal in terms of volume.

From January 1, 2002 until February 25, 2004, all electricity consumers other than low-voltage consumers were Eligible Consumers. From February 26, 2004 to August 18, 2004, the eligibility threshold was extended to include special low-voltage consumers, and with Decree law no. 192/2004, of August 17, 2004, full liberalization of the electricity market was completed with the opening of the market to the remaining low-voltage consumers.

If Eligible Consumers elect to become Qualifying Consumers, EDPD will continue to receive two of the three tariff components relating to the activities performed by EDPD.

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Tariffs

The prices we charge for electricity are subject to extensive regulation under a tariff regime that was revised in 1998, causing significant price reductions. In December 1998, ERSE implemented a new tariff regulatory code to be applied in mainland Portugal, establishing a periodic definition of regulatory parameters for allowed revenues and a methodology for setting tariffs. Since 1999 (the first year ERSE published tariffs), prices are set annually according to a series of formulas that are derived from what is deemed to be an appropriate return on assets in transmission, a return fixed by price cap in distribution and supply activities, up to 2001. From 2002 onwards, we have a return on assets and agreed costs in commercialization, i.e., the activity of supply, measurement and billing of energy sales to final clients.

Generation revenues arising from power sold by EDPP in the Binding Sector under PPAs allow these plants to achieve a return on assets of 8.5% in real terms. For more information on the PPAs, you should read Generation. The price of electricity in each PPA consists of the capacity and energy charges, which account for 95% of PPA costs, together with costs associated with imports, auto production and generation facilities. The capacity and energy charges have been, and continue to be, passed through to the final tariff paid by customers in the PES.

Transmission revenues changed from the 1999-2001 regulatory period to the 2002-2004 regulatory period. The transmission component of the tariff is calculated annually by ERSE to cover operating and maintenance expenses of the national transmission grid as well as to provide to REN a return on assets in the 2002-2004 regulatory period of 9% in nominal terms, excluding the remuneration of the land used for generation sites owned by REN. During the 1999-2001 regulatory period, an 8.5% return on assets figure was used, and for the 2005 regulatory period, REN was provided with a return on assets of 8%. The rate of return for the 2006-2008 regulatory period is 7%.

For the 2002-2004, 2005 and 2006-2008 regulatory periods, ERSE considered the distribution function to consist of three business areas, which could in the future be liberalized at different times and be subject to different tariff regulatory regimes: use of the distribution network, network commercialization services and commercialization of supply in the Binding Sector. The use of the distribution network area involves activities relating to investments in and the operation of the distribution grid. Tariffs applicable to the use of the distribution network are based on a price cap mechanism designed to reduce distribution tariffs on an annual basis by an average over the three years of the regulatory period, a percentage equal to the Portuguese Consumer Price Index, minus a percentage referred to as the efficiency coefficient. The efficiency coefficient was approximately 5% for the 1999-2001 regulatory period and approximately 7% for the 2002-2004 regulatory period. There was no efficiency coefficient for the 2005 regulatory period as it was a one-year period without additional years within the period for purposes of comparison. For the 2006-2008 regulatory period, the efficiency coefficient is approximately 4%. The network commercialization area consists of activities related to meter installation, reading and the billing of all services associated with the use of the distribution network. The commercialization of supply in the PES consists of activities directly relating to the final consumer, such as customer service, billing of final consumers in the PES and collecting payments from consumers. The tariff applicable to the network commercialization services and commercialization of supply in the PES area is based on costs accepted by ERSE plus a 9% return on assets for the 2002-2004 regulatory period and an 8.5% return on assets for the 2005 regulatory period. In light of the expected new legal framework for the Portuguese electricity system, the termination of the PPAs and the commencement of MIBEL, ERSE determined that the 2005 regulatory period should be transitory and have a one-year duration. The rate of return for the 2006-2008 regulatory period is 8%.

Tariffs are set according to estimated data for variables such as cost and demand. Each tariff formula incorporates an annual adjustment mechanism that operates with a two year time lag and is intended to adjust for differences between amounts recorded as revenue and the revenue level permitted by the tariff when applied to actual operational data. The tariff adjustment in our consolidated financial statements reflects our estimate of the amount that will be applied in fixing tariffs in subsequent periods as a result of differences between estimated and actual data. For more information on the tariff adjustment, you should read Distribution and Regulated Supply Customers and sales. Item 5. Operating and Financial Review and Prospects and notes 2(x) and 3 to our consolidated financial statements.

In the PES, distribution tariffs for customers are differentiated by voltage level, tariff option and period of electricity consumption. These tariffs, when set, are uniform throughout mainland Portugal within each level of voltage. At the beginning of the 2002-2004 regulatory period, ERSE introduced a new tariff structure, based on the concept of an additive tariff consisting of sub-tariff components using an approach that is more reflective of costs, both between the Binding and Non-Binding Sectors, and also in each sector. Beginning in 2002, ERSE applied a four-rate tariff price structure related to the time of day for medium-, high- and very high-voltage consumers. Low-voltage consumers with subscribed demands above 20.7 kVA had a three-rate time of day structure, while low-voltage consumers with subscribed demands up to 20.7 kVA were able to choose between a single-rate tariff and a day-night tariff option. The tariff regime offered two discount schemes for customers in the PES, which apply to all customers equally. Under the first scheme, medium-voltage customers with

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contracted demand above 4 MW and a yearly utilization greater than 5,000 hours or consumption above 30 GWh were entitled to a discount of 3% (in 2004). Discounts were applied to monthly invoices. This scheme ended in 2004. The second method available for obtaining discounts is through a reduction of a customer s load. A customer that is able to reduce its load by at least 4 MW can elect to have an interruptible tariff. In cases in which a distributor declares an interruptibility period and the customer complies with that period, the customer can receive an additional discount. Under the load discount scheme, an eligible customer may elect one of two interruptible tariffs, which results in average rebates of approximately 12%, depending on the interruptible load contracted. Customer tariffs for very high-voltage, high-voltage and medium-voltage from 2002 to 2005 are subject to quarterly adjustments, basically to accommodate changes in fuel prices and demand. These quarterly adjustments have been discontinued for 2006.

Producers and consumers in the Non-Binding Sector have a right to access and use the national transmission grid and our distribution network through the payment of access tariffs for the Global Use of System, the Use of the Transmission Network, the Use of the Distribution Network and Network Commercialization, terms and conditions of which were established by ERSE.

Based on certain assumptions, including an expected inflation rate in 2006 of 2.3% and an expected increase in the electricity consumption of 3.4% in 2006 (in mainland Portugal), in December 2005 ERSE published the prices of electricity and other services for 2006 and the parameters for the 2006-2008 regulatory period, according to which the tariffs for sale to final customers in mainland Portugal were increased by 5.1% in nominal terms compared to 2005. In addition, the approval of the new legal framework for the electricity system, the termination of PPAs and the expected opening of MIBEL will cause a revision of the tariffs by that time. Pursuant to law, low-voltage tariffs cannot increase each year more than the inflation rate. For the first time in 2006, the level of costs in the electricity system would lead to an increase in low-voltage tariffs of 14.7%. This has created a tariff deficit of 369 million euros to be possibly recovered in the next five years. For 2003, 2004, 2005 and 2006, in nominal terms, tariffs increased across all voltage levels by an average of 2.8%, 2.1%, 2.3% and 5.1%, respectively, from the prior year levels. For 2001, in nominal terms, tariffs for all voltage levels increased, on average, by 1.2% from the 2000 levels. For 2000, in nominal terms, tariffs for all voltage levels declined by 0.5% from the 1999 levels. In real terms, adjusted for inflation, very high-, high- and medium-voltage tariffs have decreased by an average of 1.5% over the period 1999-2006. The tariffs for low-voltage customers have declined by an average of 2.3% over the same period.

SPAIN

HidroCantábrico has a network infrastructure that covers the regions of Asturias (accounting for the vast majority of its network), Valencia, Madrid and Alicante, totaling 20,100 km (a 2.3% increase from 2004), as follows:

Distribution lines	Km
Overhead lines:	
High-voltage (50/132kV)	1,437
Medium-voltage (5/10/16/20/22/24 kV)	4,451
Low-voltage (<1kV)	11,380
Total overhead lines	17,268
Underground cables:	
High-voltage (50/132kV)	10
Medium-voltage (5/10/16/20/22/24 kV)	994
Low-voltage (1kV)	1,828
Total underground cables	2,832
Total	20,100

Electricity distributed in 2005 through HidroCantábrico s own network amounted to 9,247 GWh, a 2.7% increase from 2004. As of December 31, 2005, HidroCantábrico s distribution business had 584,922 customers, including 20,006 qualified consumers that are being supplied by non-regulated suppliers. The total number of consumers in Spain was 23,436,889, according to The Spanish National Energy Commission representing a 2.2% increase from 2004. Since January 1, 2003, every consumer in HidroCantábrico s market can elect to be supplied by non-regulated suppliers.

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In 2005, the volume of electricity distributed and the number of customers by voltage level was as follows:

	Year ended December 31, 2005		
Distribution by voltage level	GWh	% annual increase from 2004	Total customers
High and very high-voltage[1]	5,788	2%	21
Medium-voltage[2]	1,116	6%	819
Low-voltage[4]	2,343	4%	584,082
Total	9,247	3%	584,922

(1) *High-voltage is greater than 36 kV and less than or equal to 145 kV. Very high-voltage is greater than 145 kV.*
(2) *Medium-voltage is greater than or equal to 1 kV and less than or equal to 36 kV.*
(3) *Low-voltage is less than 1 kV.*

During 2005, HidroCantábrico s distribution business, HidroCantábrico Distribución Eléctrica, S.A.U., continued its expansion outside of Asturias in the autonomous communities of Madrid and Valencia, both of which are geographic areas with strong economic activity.

The main objective of the development of distribution and transport grids in Asturias is to maintain the supply quality of HidroCantábrico and to meet growing demand, especially in eastern and central Asturias.

In 2005, HidroCantábrico continued to improve technical and operational management activities. The networks and facilities were enlarged and HidroCantábrico continued the development of information technology and automation of the distribution network. HidroCantábrico maintained the quality indicator for distribution electricity activity (TIEPI, or equivalent interruption time of installed capacity) of 1.16 hours in 2005.

LIBERALIZED SUPPLY

PORTUGAL

EDP operates in the Non-Binding Sector through its wholly owned subsidiary, EDP Comercial. EDP Comercial is developing an enlarged offering of energy-related services. The development of the EDP Comercial s portfolio of energy services is designed to contribute to the improvement of the business performance and competitiveness of our clients. In 2005, EDP Comercial undertook several one-to-one customer initiatives that led to a better understanding of customer needs and increased customer loyalty.

At December 31, 2005, the total number of Eligible Consumers in Portugal represented approximately 54% of total demand, compared with approximately 53% at December 31, 2004, in volume terms. As of December 31, 2004, the market suppliers supplied 4,838 Eligible Consumers, 3,616 of which entered into contracts with EDP Comercial. By December 31, 2005, there were 52,035 Eligible Consumers, and 13,226 of these were being served by market suppliers. From these existing Qualifying Consumers, 9,212 were EDP Comercial customers as of December 31, 2005.

In 2005, the Portuguese regulatory framework was revised in the context of liberalization of the electricity market within the European Union. This includes structural changes in the Portuguese market both on the demand side with full liberalization and the supply side. Under the new regulatory framework, all recognized electricity suppliers are allowed to operate with no physical constraints.

EDP Comercial manages electrical energy sourcing through an internal contract with EDP s trading unit, which buys electricity to cover for EDP Comercial supply contracts at a settled transfer price, largely correlated to forecasted production marginal cost and wholesale market prices. Generation from EDP units and trade in the Spanish Pool ensure the supply of this energy.

EDP Comercial faces several risks from its operations in the liberalized market, such as competition, volume and regulatory risk. To pursue its strategic goals while minimizing such risks, EDP Comercial pursues an interactive and dynamic commercial strategy along with diversified contract structures that aim to hedge both supplying contracts with its customers and the contract with EDP s trading unit.

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The following table sets forth the number of clients and the total amount of energy supplied in the liberalized market and by EDP Comercial:

	As of December 31,				
	2001	2002	2003	2004	2005
Number of clients in the liberalized market	33	493	1,919	4,838	13,226
Number of clients of EDP Comercial	22	350	1,404	3,616	9,212
Market share of EDP Comercial	67%	71%	73%	75%	70%
Energy supplied in the liberalized market (GWh)	520	958	4,048	6,763	9,621
Energy supplied by EDP Comercial (GWh)	241	644	2,724	4,395	6,337
Market share of EDP Comercial	46%	67%	67%	65%	66%

SPAIN

The liberalization process in Spain began in 1998 and residential customers have had the right to choose its electricity supplier since 2003. During 2005, there was increased activity in the supply market. Over 1 million customers, most of them residential customers, chose a market supplier. As of December 31, 2005, approximately 2.6 million customers, representing 11% of the total customer base, were being supplied by market suppliers. Over 90,000 GWh was supplied to these customers, representing 36% of Spain s total energy consumption.

HidroCantábrico Energía, S.A.U., or HC Energía, a supply company wholly owned by HidroCantábrico offers simple products supported by customer relations and energy-related services. HC Energía is committed to participating in the liberalized supply market in Spain. We expect that the supply market will allow HC Energía to grow its customer base and improve customer service, in the traditional distribution zones and in new areas. Participation in the retail market is important for HC Energía as an integrated company because it contributes to the management of the volume and price risks of electricity generation.

The electricity supply activity performed by HC Energía and Naturcorp includes the supply of electricity to qualified consumers. In December 2005, the total number of clients in free market supplied by HidroCantábrico and Naturgás was 21,446. HC Energía invoiced 5,926 GWh of electricity supply in 2005, including 1,154 GWh invoiced to Naturcorp, compared to 4,616 GWh of electricity supply in 2004. Total sales were 354.5 million in 2005, compared with sales of 282.8 million in 2004. The energy sold by HidroCantábrico represents 6.6% of the total energy sold in liberalized market in Spain in 2005.

HC Energía s commercial activity in the residential segment began in 2005. For that purpose, and after intensive market research, HC Energía defined a new position statement and HidroCantábrico was rebranded HC Energía to unify the HidroCantábrico Group image. HidroCantábrico s commercial strategy in 2005 was based on gaining businesses clients and small clients, due to their greater tendency to move the free market and their expected greater profitability. The amount of energy supplied in the free market to businesses and small clients increased in 2005 by 44% and 120%, respectively.

The new offer to residential customers includes dual fuel and maintenance and repair services for home electrical and gas services. In 2005, HC Energía s customer base increased by over 200% and energy volume increased by 28%. HC Energía s market share as of December 31, 2005 was 6.3%, compared with 5.8% in 2004.

The following table sets forth the number of clients and amount of energy supplied by HC Energia and the annual growth of each.

	As of December 31,			
	2002	2003	2004	2005
Number of clients	2,265	3,376	6,094	21,446
Annual Growth		49%	81%	252%
Energy Supply (GWh)	3,955	4,526	4,616	5,926
Annual Growth		14%	2%	28%

The wholesale market daily price in 2005 increased 94% to 55.7 per MWh from 28.7 per MWh in 2004. Energy sourcing is managed by bilateral contracts with HidroCantábrico generation units and by purchases in the Spanish pool.

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GAS

PORTUGAL

We have gas-related activities in Portugal both in electricity generation and in gas distribution. In electricity generation, we own a 1,200 MW CCGT and interests in gas-fired cogeneration plants.

In December 2004, we acquired a direct stake of 46.625% in Portgás, the natural gas distribution company for the northern region of Portugal. At the same time, pursuant to the exercise by CGD of the put option that we had granted to it on November 25, 2003, we also acquired NQF Projectos de Telecommunicaçoes e Energia, S.A., that held stakes of 12.9% is Portgás and 10.1% in Setgás through a 51% stake in NQF Gás, S.A., or NFQ Gás. To implement our strategy for the Iberian gas market, on September 5, 2005 we concluded negotiations with Endesa Gas, S.A. for the acquisition of the remaining 49% shareholding in NQF Gás. NQF Gás directly holds a 25.348% shareholding in Portgás and, indirectly, a 19.8% shareholding in Setgás. With the completion of this transaction in May 2006, we are now the sole shareholder of NQF Gás, thus increasing our direct and indirect shareholdings in Portgás and Setgás to 72.0% and 19.8%, respectively. The current shareholder structure of Portgás includes EDP (72.0%) and Gas de France and Elyo, with a joint stake around 25.34%. Currently, the main shareholders of Setgás include GALP (45%), Eni (21.9%), EDP (19.8%) and Koch (13.2%).

In 2005, we sold our 14.268% stake in the share capital of GALP to Américo Amorim Group for 720.5 million.

EDP plans to grow in the Portuguese market through the development of new gas-fired power generation facilities and also taking advantage of the opportunities raised by the liberalization of the national natural gas market.

Gas distribution network

Portgás is the second largest distribution company in Portugal. Its concession area is located in the north area of Portugal, and is based in Oporto. Its network backbone, or primary grid, runs for 274 km. Its secondary grid has been developing at a compound annual growth rate above 9.5% in the last 4 years and reached 2,151 km at the end of 2005.

The following table displays the evolution of Portgás grid:

	As of December 31,				
Total network extension	**2001**	**2002**	**2003**	**2004**	**2005**
			(in km)		
Primary grid[(1)]	259	262	263	263	274
Secondary grid[(2)]	1,425	1,628	1,759	1,986	2,151
Total	1,684	1,890	2,022	2,249	2,425

(1) *Maximum admissible operating pressure up to 16 bar.*
(2) *Maximum admissible operating pressure up to 4 bar.*

Gas distribution and supply

Currently, the distribution companies in Portugal are bundled companies that both develop the network and supply end-use customers consuming below 2 million cubic meters (about 23.2 GWh) per year. Each distribution company is the exclusive supplier for the customers in its own region.

Distribution companies currently have to buy natural gas from Transgás, the high-pressure network concessionaire. Apart from that, distribution companies also receive and deliver natural gas to end-use customers consuming above 2 million cubic meters per year and connected at pressures below 16 bar, on behalf of Transgás, receiving a fee for this service.

Certain current and historical operating and commercial data for Portgás are set forth in the following tables:

Connected Customers	As of December 31, 2001	2002	2003	2004	2005
	(number of clients)				
Households	97,525	116,492	126,914	136,672	146,132
Small industry and services	1,446	1,825	2,063	2,351	2,729
Large industrial customers	221	256	281	305	335
Total	99,192	118,573	129,258	139,328	149,196

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Volume Sales	As of December 31, 2001	2002	2003	2004	2005
			(GWh)		
Households	353,813	431,306	551,102	507,620	617,173
Small industry and services	153,013	222,315	258,704	311,381	334,656
Large industrial customers	826,455	1,039,670	1,147,834	1,293,917	1,296,613
Total	1,333,281	1,693,291	1,957,640	2,112,918	2,158,442

Sales	As of December 31, 2001	2002	2003	2004	2005
			(thousands of EUR)		
Households	19,500	22,634	28,651	28,986	37,779
Small industry and services	5,567	7,443	8,682	10,134	12,778
Large industrial customers	20,126	22,063	25,117	26,244	29,792
Total	45,193	52,140	62,450	65,364	80,349

Setgás is the concessionaire of the distribution activity in the Setúbal peninsula area, its primary grid runs for 95 km. Its secondary grid has been developing at a compounded annual growth rate above 9.3% in the last 4 years, and reached 1,316 km at the end of 2005. As of December 31, 2005, Setgás had 107,854 connected clients, of whom 106,353 were households, 1,405 were small industry and services customers, and 96 were large industrial clients. For 2005, Setgás had total sales of 633 GWh for 30.3 million, of which 252 GWh for 17.6 million were sales to households, 42 GWh for 1.9 million were sales to small industry and services customers, and 361 GWh for 11.0 million were sales to large industrial clients.

SPAIN

In March 2003, HidroCantábrico won the auction privatization process that led to its acquisition of 62% of Naturcorp. Subsequently, Naturcorp reorganized its gas holdings, as a result of which HidroCantábrico s ownership of Naturcorp decreased from 62% to 56.2%. As a result of the reorganization of Naturcorp, HidroCantábrico has become the second largest gas company in the Spanish market, with more than 500,000 customers. Naturcorp was renamed Naturgás Energia in 2005, and current shareholders, apart from HidroCantábrico, include Grupo EVE Ente Vasco de Energía (30.4%), Gas Natural (9.4%) and Donostiako Udala Ayuntamento de San Sebastián (4%).

Gas distribution network

Naturgás owns 165 km of high-pressure transportation pipelines in the Basque County, 13 Km in Navarra (50% of the connection to Castejón CCGT, the other 50% owned by Iberdrola) and 121 Km in Castilla y León.

Naturgás also distr