EDP ENERGIAS DE PORTUGAL SA
Form 20-F
September 30, 2005
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As filed with the Securities and Exchange Commission on September 30, 2005

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 20-F

x ANNUAL REPORT PURSUANT TO SECTION 13 OF THE

SECURITIES EXCHANGE ACT OF 1934,

for the fiscal year ended December 31, 2004

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:

At December 31, 2004, there were outstanding:

3,656,537,715 Ordinary Shares, with nominal value of 1 per share

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 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 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, Portuguese, Spanish and Brazilian 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

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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.

Presentation of financial information

Unless we specify otherwise, we have prepared the financial information contained in this annual report in accordance with generally accepted accounting principles in Portugal, or Portuguese GAAP, which 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 Portuguese GAAP Compared with U.S. GAAP and in note 42.i 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.

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 September 26, 2005 of U.S.$1.2036 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.

In addition, for convenience only and except where we specify otherwise, we have translated certain reais figures into euro at the fixed rate of exchange between the real and euro of 2.7235 reais = 1.00. The rate of exchange between reais and euros represents the euro equivalent of the U.S. dollar/real fixed rate of exchange, calculated by translating reais into U.S. dollars using the Noon Buying Rate on September 26, 2005 of 2.2628 reais = U.S.$1.00 and then translating U.S. dollars into euros using the rate of exchange between U.S. dollars and euros of U.S.$1.2036 = 1.00, which was the applicable Noon Buying Rate on September 26, 2005. By including convenience currency translations in this annual report, we are not representing that the reais amounts actually represent the euro amounts shown or could be converted into euros at the rates indicated.

Prior to January 1, 2001, our reporting currency was Portuguese escudos. For convenience and to facilitate a comparison, all escudo-denominated financial data for periods prior to January 1, 2001 included in this annual report have been restated from escudos to euros at the fixed rate of exchange as of January 1, 1999 of PTE 200.482 = 1.00. Where escudo-denominated amounts for periods prior to January 1, 2001 have been rounded, the restated euro amounts have been calculated by converting the rounded escudo-denominated amounts into euros. The comparative balances for prior years now reported in euros depict the same trends as would have been presented had we continued to report such amounts in Portuguese escudos.

Pursuant to 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 17, 2002, commencing January 2005, our consolidated financial statements are prepared and reported in accordance with the International Accounting Standards approved pursuant to the foregoing July 17, 2002 EC regulation.

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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

S ELECTED 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 five years ended December 31, 2004 and as of December 31, 2000, 2001, 2002, 2003 and 2004 and the related notes, which appear elsewhere in this annual report. The consolidated financial statements have been prepared in accordance with Portuguese GAAP, which differ in certain significant respects from U.S. GAAP. See Item 5. Operating and Financial Review and Prospects Portuguese GAAP compared with U.S. GAAP and note 42.i to our consolidated financial statements for a discussion of the principal differences between Portuguese GAAP and U.S. GAAP with respect to our consolidated financial statements.

Management has identified errors in the previous application of U.S. GAAP to certain Portuguese GAAP financial information. Accordingly, the reconciliation to U.S. GAAP for each of the two years ended December 31, 2003 and as of December 31, 2002 and 2003 has been restated to reflect the following:

i) ***Minority Interests.*** Under both Portuguese GAAP and U.S. GAAP, in prior years, the losses attributable to minority interests that exceeded the equity capital attributable to minority interests in subsidiaries had been recorded as negative minority interests in the balance sheet. In the income statement, the referred losses attributable to minority interest were charged to the minority interest in the proportion of their shareholding. Under Portuguese GAAP, and beginning January 1, 2004, we adopted a new accounting policy, by which the negative minority interest in the balance sheet resulting from the accumulated losses attributable to minority interests which exceed the equity capital attributable to minority interests in subsidiaries are debited against equity when there is no binding obligation of the minority interests to cover such losses. In the income statement, under Portuguese GAAP, losses continue to be attributed to minority interest in the proportion of their shareholding. Under U.S. GAAP, as there is no binding obligation of the minority interest to cover such losses, such losses which exceed the equity attributable to the minority interest are charged to the majority interest, therefore the net income of the prior years has been restated to allocate the losses attributable to minority interests in 2002 and 2003 to the majority interest (EDP). If future earnings do materialize, the majority interest will be credited to the extent

of such losses previously absorbed.

ii) ***Concession Subsidies.*** Under Portuguese GAAP, the amount classified as deferred income related to assets under concession in Brazil is not amortized. However, the assets under concession are amortized on a straight-line basis over the concession period. Under U.S. GAAP, the amortization of the accrued income should be recorded using the same period as the assets amortization. As this amount was not amortized in prior years under U.S. GAAP, we made a restatement to correct this issue in the income statement and in shareholders equity of each reported period.

iii) ***Guarantees.*** Under U.S. GAAP, a guarantor is required to recognize, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing the guarantees. In 2003, we made a provision with a charge against equity, even though it is unlikely that any disbursement related to those guarantees will have to be made. An adjustment is made under U.S. GAAP as a restatement at December 31, 2003 to reverse the provision that was made in the prior year.

iv) ***Other Comprehensive Income.*** In relation to other comprehensive income, in prior years, a reconciliation between the opening and closing balance of other comprehensive income was not presented in the notes to our consolidated financial statements in accordance with SFAS 130, which requires that the total of other comprehensive income be disclosed separately from retained earnings. We have included the information required for the total of other comprehensive income for each of the reported periods and have restated the balances to comply with the requirements of SFAS 130. While this restatement had an impact on the total value of other comprehensive income, it had no impact on the total value of shareholders equity.

For more information on our restatement of certain U.S. GAAP financial information for each of the two years ended December 31, 2003 and as of December 31, 2002 and 2003, please see note 42.ii to our consolidated financial statements. In addition, all financial information under U.S. GAAP in this annual report presented for years prior to 2004 has also been restated.

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 consolidated financial statements were audited by KPMG. Fiscal years from 2000 through 2003 were audited by PricewaterhouseCoopers.

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	Year ended December 31,					
	2000 Euro	2001 Euro	2002 Euro	2003 Euro	2004 Euro[1]	2004 U.S.$[1]
	(in millions, except per ordinary share and per ADS data)					
Statement of income:						
Amounts in accordance with Portuguese GAAP						
Electricity sales	3,676	5,201	5,876	6,296	6,450	7,764
Other sales[2]	61	98	112	160	249	300
Services[3]	110	351	398	521	522	629
Total revenues	3,846	5,650	6,387	6,978	7,222	8,692
Raw materials and consumables	1,731	3,080	3,687	3,921	4,017	4,835
Personnel costs	439	592	625	647	643	773
Depreciation and amortization	614	665	740	846	796	957
Supplies and services	369	651	675	633	650	782
Own work capitalized[4]	(229)	(233)	(242)	(236)	(259)	(311)
Concession and power-generation rental costs[5]	133	149	158	176	190	229
Hydrological correction[6]	(35)	0	0	0	0	0
Other operating expenses, net	102	73	95	86	127	153
Total operating costs and expenses	3,122	4,977	5,738	6,072	6,163	7,418
Operating income	724	674	649	906	1,058	1,274
Net interest expense[7]	175	205	223	359	335	404
Other non-operating income (expenses), net	289	126	(139)	(14)	(165)	(198)
Income before income taxes	838	594	287	532	558	672
Provision for income taxes (net of deferred taxes)	(313)	(203)	(172)	(196)	(160)	(192)
Minority interest	23	60	220	44	41	50
Net income	549	451	335	381	440	530
Net income from operations per ordinary share[8]	0.24	0.23	0.22	0.30	0.35	0.42
Net income from operations per ADS[8]	2.42	2.26	2.18	3.04	3.48	4.19
Basic and diluted net income per ordinary share[8]	0.18	0.15	0.11	0.13	0.14	0.17
Basic and diluted net income per ADS[8]	1.83	1.51	1.12	1.28	1.45	1.74
Dividends per ordinary share[9][10] [11]	0.14	0.11	0.09	0.09	0.09	0.11
Dividends per ADS[9][10]	1.40	1.13	0.90	0.90	0.92	1.11
Amounts in accordance with U.S. GAAP[13][14]						
Net income	407	521	264	451	239	287
Basic and diluted net income per ordinary share[8]	0.14	0.17	0.09	0.15	0.08	0.09
Basic and diluted net income per ADS[8]	1.36	1.74	0.89	1.51	0.78	0.94
Cash flow data:						
Amounts in accordance with Portuguese GAAP						
Net cash from operating activities	1,122	1,221	898	1,774	1,643	1,978
Net cash used in investing activities	914	1,243	1,141	529	2,272	2,734
Net cash used in (from) financing activities	482	96	415	(1,144)	644	775

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	Year ended December 31,					
	2000 Euro	2001 Euro	2002 Euro	2003 Euro	2004 Euro[1]	2004 U.S.$[1]
	(in millions, except per ordinary share and per ADS data)					
Balance sheet data (at period end):						
Amounts in accordance with Portuguese GAAP						
Cash and cash equivalents	58	34	214	287	278	335
Other current assets	1,162	1,496	1,863	1,959	2,504	3,013
Total current assets	1,220	1,530	2,077	2,246	2,782	3,348
Fixed assets, net[12]	9,540	9,844	11,204	11,652	13,559	16,320
Other assets	4,128	4,860	4,844	4,753	6,248	7,521
Total assets	14,887	16,233	18,125	18,651	22,589	27,189
Short-term debt and current portion of long-term debt	1,807	1,744	1,887	1,579	1,858	2,236
Other current liabilities	890	1,286	1,631	1,711	2,392	2,879
Total current liabilities	2,697	3,030	3,518	3,290	4,250	5,115
Long-term debt, less current portion	3,205	4,055	6,107	5,914	6,741	8,113
Hydro account	366	388	324	388	364	438
Other long-term liabilities	2,377	2,423	2,616	3,525	4,032	4,853
Total liabilities (including Hydro account)	8,645	9,896	12,566	13,116	15,387	18,519
Minority interest	37	241	65	236	801	964
Shareholders equity	6,205	6,097	5,494	5,298	6,402	7,705
Amounts in accordance with U.S. GAAP[13][14]						
Fixed assets, net[12]	5,316	5,929	6,602	7,172	9,722	11,701
Total assets	14,010	15,455	16,922	17,730	23,525	28,315
Total current liabilities	2,714	3,052	2,551	3,270	6,920	8,328
Total long-term liabilities	6,763	7,706	10,403	10,873	11,230	13,517
Total liabilities	9,477	10,758	12,954	14,143	18,150	21,845
Shareholders equity	4,496	4,456	3,865	3,440	4,583	5,516

(1) *For 2000, escudos are translated into euro at the fixed rate of exchange established at the commencement of the third stage of European Monetary Union on January 1, 1999 by the European Council of Ministers between the euro and escudo of PTE 200.482 = 1.00. For 2004, euros are translated into U.S. dollars at the rate of exchange of U.S.$1.2036 = 1.00, which was the U.S. Federal Reserve Bank of New York noon buying rate on September 26, 2005.*

(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) *Our consolidated income statements present expenses in accordance with their nature rather than their function. Therefore, costs incurred by us for self-constructed assets are capitalized as part of fixed assets and included as a reduction of total expenses under Own work capitalized when the related costs have been included in the relevant expense items.*

(5) *Substantially all of these amounts relate to rent expenses paid to municipalities for the right to distribute electricity in the relevant municipal areas.*

(6) *Until the year 2000 and as required by government regulation, we recorded charges and credits to operating income, against the hydro account in the balance sheet, depending on hydrological conditions in a given year, to correct the effect on our earnings and customer prices that result from changes in hydrological conditions and observed fuel prices. The difference between the economic costs of generating electricity in the Public Electricity System, or PES, and the economic reference costs based on an average hydrological year*

were included in this item through 2000. Since 2001 and following the sale of REN in 2000, we ceased recording such charges and credits on our income statement and began recording charges and credits to Cash and cash equivalents, against the Hydro account, on our balance sheet. The imputed interest on the accumulated balance of the hydro account is included in Net interest expense. Net gains and losses arising from the hydro account are being charged to Other non-operating income (expenses). In this respect, we booked income items of 47.5 million and 19.4 million in 2001 and 2003, respectively. We did not record such an item in 2002 and 2004.

(7) *Includes interest and related expenses and interest and related income. See Item 5. Operating and Financial Review and Prospects 2004 compared with 2003 Interest and related income/(expenses), net.*

(8) *Basic earnings per share are based on the weighted average number of ordinary shares outstanding during the year. Diluted earnings per share are 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. During 1999, we established two employee stock option plans. Basic and diluted earnings per ADS are based upon basic and diluted earnings per ordinary share multiplied by 10 as each ADS is equivalent to 10 ordinary shares on a post-split basis.*

(9) *Based on 3,000,000,000 ordinary shares issued and outstanding in 2000, 2001, 2002 and 2003 and 3,656,537,715 ordinary shares issued and outstanding in 2004.*

(10) *Dividends per ordinary share in U.S.$, translated at the prevailing rate of exchange at the date of payment between the U.S. dollar and the escudo amount to U.S.$ 0.12 in 2000. Dividends per ordinary share in U.S.$, translated at the prevailing rate of exchange at the date of payment between the U.S. dollar and the euro amount to U.S.$ 0.10 in 2001, U.S.$ 0.11 in 2002, U.S.$ 0.11 in 2003 and U.S.$ 0.12 in 2004. The dividend per ordinary share in 2000 is translated at the fixed rate of exchange between the euro and the escudo.*

(11) *Stated figure is rounded as actual dividend paid in 2004 was 0.09243.*

(12) *Substantially all of these assets are subject to reversion to the Republic or the municipalities. See Item 4. Information on the Company Portugal Regulation Reversionary assets.*

(13) *U.S. GAAP amounts for 2000 and 2001 are not comparable to 2002, 2003 and 2004 due to the implementation of SFAS 142.*

(14) *The U.S. GAAP amounts for 2002 and 2003 were restated resulting from adjustments that were identified in 2004 relating to prior years (see note 42.ii of the consolidated financial statements).*

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EXCHANGE RATES

Effective January 1, 1999, Portugal and 11 other member countries of the European Union, or EU, adopted the euro as their common currency. The euro was traded on currency exchanges and was available for non-cash transactions during the transition period between January 1, 1999 and December 31, 2001. During this transition period, the national currencies remained legal tender in the participating countries as denominations of the euro, and public and private parties paid for goods and services using either the euro or the participating countries existing currencies. On January 1, 2002, the euro entered into cash circulation. Between January 1, 2002 and February 28, 2002 both the euro and the escudo were in circulation in Portugal. From March 1, 2002, the euro became the sole circulating currency in Portugal. As of January 1, 2002, we ceased to use the escudo.

The vast majority of our revenues, assets, expenses and liabilities have historically been denominated in escudos, and we prepared and published our consolidated financial statements in escudos through the 2000 fiscal year. Beginning in 2002 (for fiscal year 2001 and thereafter), our consolidated financial statements have been 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.

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 escudo could have been, or that the euro could be, converted into U.S. dollars at these rates or at any other rate.

The column of averages in the table below shows the averages of the relevant exchange rates 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
2000	0.94	0.92
2001	0.89	0.89
2002	1.05	0.95
2003	1.26	1.13
2004	1.35	1.24

U.S. dollar per euro[(1)]

Period	High	Low
2005		
March	1.29	1.35
April	1.28	1.31
May	1.23	1.29

June	1.20	1.23
July	1.19	1.22
August	1.21	1.24

(1) *Euro amounts are based on the U.S. Federal Reserve Bank of New York noon buying rate.*

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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 September 26, 2005, the exchange rate between the euro and the U.S. dollar was U.S.$1.2036 = 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 in the Public Electricity System, herein referred to as the PES or the Binding Sector, 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 Binding Sector in Portugal. For further information on the Binding Sector and 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 2004, the installed capacity of these producers was 1,862 MW, which represents 15.9% of the total installed capacity in Portugal. Through our subsidiaries, we participate in this generation area with an installed capacity of 322 MW.

The Portuguese regulatory structure now allows for competition in the supply of electricity, which could adversely affect our sales of electricity. In particular, as more electricity consumers elect to participate in the market-based Non-Binding Sector in Portugal, more electricity will be sold in the competitive markets, where prices may be lower than existing tariffs. The minimum annual consumption thresholds set by regulation have declined over time (from 20 GWh in 2000 to zero in 2004), resulting in an increase in the number of Qualifying Consumers. The effects of this increased competition have not yet been fully determined, as full liberalization in the supply of electricity only entered into effect on August 18, 2004.

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

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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, referred to as MIBEL, the main principles of which are free competition, transparency, objectiveness 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 understand that the Portuguese government is currently considering regulatory changes that would affect this framework. We cannot predict whether any such regulatory changes will be made, nor, if any such regulatory changes are 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,* referred to as ERSE, or the regulator, regulates the electricity industry through, among other things, a tariff code that defines the prices we may charge for electricity services in the Binding Sector. 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, the regulator 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 3.9% per year over the period 1998 to 2005. The tariffs for low voltage customers have also declined in real terms by an average of approximately 2.7% per year over the same period. For 2005, in nominal terms, tariffs for all voltage levels increased, on average, by 2.3% from the 2004 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 factor. During the previous regulatory period (2002-2004), the efficiency factor increased from 5% (applicable during the 1999-2001 regulatory period) to approximately 7%. In light of the expected beginning of operations of MIBEL, a new regulatory

period has been established with a duration of only one year (2005). Tariffs for this new regulatory period continue to be set according to a price cap mechanism, but there is no efficiency factor as this one-year period does not have additional years for purposes of comparison. Although the nominal final tariff charged to consumers increased, on average, across all voltage levels in 2005, the component of the final tariff collected by EDPD decreased from 2004 to 2005, and had already decreased from 2003 to 2004, which adversely affected our profitability. The tariffs set for periods after 2005 or any new regulations 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 same amount as is 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 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, or Decree law no. 240/2004, which provides for the creation of compensation measures designed to ensure electricity generating companies an economic benefit equivalent to that of the PPAs, and the EU Commission announced on September 22, 2004 that the stranded cost compensation mechanism notified by the Portuguese government is not contrary to the state aid rules of the European Union. 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. Until the requirements and conditions for the early termination of the PPAs exist, our generation facilities in the PES will continue to be operated under the existing PPAs.

The estimated amount of the compensation relating to the early termination of the PPAs contemplate, among other things, the commencement of MIBEL operations by June 30, 2005, which did not occur. Currently, the timing for commencement of MIBEL is uncertain. 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, 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. However, considering the current liberalization environment and market integration process, as well as the rules, parameters and procedures set out in Decree law no. 240/2004, which have been approved by the European Commission, the compensation mechanisms and the respective terms provided in such decree law should and are expected to be applied in case of early termination of our PPAs.

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 45% 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.

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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 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.

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. 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 expect to make approximately 70 million of capital expenditures in 2005 to comply with applicable environmental laws and regulations to minimize the 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 (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 in the first half of 2004 and should be formally approved by the end of 2005. Additionally, with regard to CO_2 emissions, the Emission Trading Scheme (ETS) is almost set to begin in Portugal. Since January 2005, Portugal has prepared itself by setting the allowances for each sector within the National Allocation Plan (NAP). The last step in the process to start emission trading in Portugal is the distribution of allowances to each plant within each sector. It is expected that the government will soon announce this distribution. The total amount of allowances received by the sectors within the NAP accounts for nearly 43% of the total CO_2 accounted for in Portugal. The distribution of these allowances to each sector showed that nearly 21.5 million tons of CO_2 per year (56% of the total amount of allowances distributed) will be distributed to the electricity sector for the 2005-2007 period. In this context, we expect to start emission trading as soon as the government defines the allowances for each power plant, which is expected to occur in 2005. In Spain, the NAP on greenhouse gas trading published in 2004 states the quantity of allowances for each plant for the 2005-2007 period. This allocation was approved by the European Commission in December 2004, and, in January 2005, a final list of allowance allocations for electricity plants was published, which allocated approximately 86.4 million tons of CO_2 per year for the 2005-2007 period to power plants (40% of the total amount of allowances distributed in Spain). Although we expect to be in timely compliance with these new requirements, such requirements could necessitate additional licenses or the acquisition of emission rights and result in higher electricity costs.

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

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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 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 reputational 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 (depreciation of 34% during 2002 and appreciation of 22% and 9% during 2003 and 2004, 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

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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 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.

If Investco is unable to successfully renogotiate the terms of the redemption of its class R preferred shares, Energias do Brasil may be adversely affected or may lose its investment in Investco.

Investco, a Brazilian company of which we, through our subsidiary EDP Energias do Brasil (formerly known as EDP Brasil), or Energias do Brasil, own 27.65% of the voting capital and 16.33% of the total capital and that owns the Lajeado hydroelectric plant, is currently renegotiating with Eletrobrás Centrais Eléctricas Brasileiras S.A., or Eletrobrás, the terms and conditions of the redemption of its class R shares held by Eletrobrás, as a result of Investco s inability to redeem these shares due the lack of capital reserves required by the Brazilian corporation law. If, as a result of Investco s investment agreement, the shareholders of Investco are required to make capital contributions to Investco to redeem the class R preferred shares, we believe Energias do Brasil will be liable for a portion of the total obligation equivalent to its proportional ownership of Investco s voting shares. However, according to the terms of the investment agreement, we cannot assure you that Energias do Brasil will not be liable for capital contributions in excess of this amount, in which case our financial condition and results of operations may be adversely affected.

If Investco and Eletrobrás do not agree on a new timetable for the redemption of the class R preferred shares or to an alternative solution for this matter and Investco s shareholders do not make the required capital contributions for the redemption or repurchase of the shares, the Brazilian Development Bank, or BNDES, and other financial institutions that are creditors of Investco may accelerate the debts under their relevant contracts and foreclose the corresponding guarantees (including certain guarantees provided by us), including the pledge of the shares Energias do Brasil holds in Investco and EDP Lajeado S.A., or EDP Lajeado. In addition, Investco did not make available to Energias do Brasil certain approvals required by certain financing agreements for the issuance of convertible and non-convertible debentures by Investco. If Investco does not have such approvals or does not obtain them on a timely fashion, and its creditors accelerate Investco s debt, such acceleration could implicate guarantees provided by us.

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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.

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 Spain and across the EU, and we expect competition to remain vigorous and even increase in the future.

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 2004, our telecommunications activity generated a loss before taxes of 150.8 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 holder of ordinary shares, 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 purchase 5% of our ordinary shares and under the Portuguese Securities Code when purchases or sales of our ordinary 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

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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 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.

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. Following the rights offering in November 2004, which also resulted in the fifth phase of the privatization process that started in 1997, as of June 30, 2005 we were approximately 15.59% owned indirectly by the Portuguese Republic and an additional 9.80% of our shares are held by Caixa Geral de Depósitos, S.A., a state-owned bank. Other significant shareholders include Iberdrola, S.A. (5.70%), 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 (3.08%) and, indirectly, Brisa - Autoestradas de Portugal S.A., or Brisa (2.00%).

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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, please see Subsidiaries, Affiliates and Associated Companies and note 9 to our consolidated financial statements.

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Our 2004 operating revenues amounted to 7,221.7 million (U.S.$8,692.0 million), approximately 89% of which represented electricity sales, yielding operating income of 1,058.4 million (U.S.$1,273.9 million). As of December 31, 2004, our total assets were 22,589.3 million (U.S.$27,188.5 million), and shareholders equity was 6,401.7 million (U.S.$7,705.1 million).

The following table shows our revenues by activity and geography:

	Year ended December 31,		
	2002	2003	2004
	(millions of EUR)		
Energy[1]			
Portugal	5,001	5,038	5,413
Spain	324	675	747
Brazil	669	1,008	1,154
Telecommunications			
Portugal	187	161	156
Spain	134	170	169
Information Technology	224	186	175
Adjustments[2]	(151)	(261)	(592)
Total	6,387	6,978	7,222

(1) *Consists of electricity in Portugal and Brazil and electricity and gas in Spain.*

(2) *Revenue figures for each year have been adjusted to include revenues from services and to exclude intercompany transactions.*

Energy

Iberian electricity

Historically, electricity has been our core business. We underwent a restructuring in 1994, at which time we formed subsidiaries to operate in the areas of electricity generation, transmission and distribution. Following the government s purchase from us of a 70% interest in REN in 2000, our two principal electricity subsidiaries were our electrical generation company, CPPE Companhia Portuguesa de Produção de Electricidade, S.A., or CPPE, and our distribution company, EDPD, which was formed in early 2000 by the merger of our four wholly-owned distribution companies. These two wholly-owned subsidiaries, together with REN, carried out electricity generation, transmission and distribution activities in Portugal. On March 29, 2001, we announced the creation of EDP Gestão da Produção de Energia, S.A., or EDP Produção, a subsidiary that began operations in July 2001 and now holds most of our Portuguese energy production-related units as part of measures we are implementing to enhance our organizational efficiency.

We are the largest producer and distributor of electricity in Portugal and 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% of Hidrocantábrico. Hidrocantábrico operates electricity generation plants and distributes and supplies electricity and gas, mainly in the Asturias and Basque regions in Spain.

In 2004, 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 4.3% of Spanish mainland installed generation capacity, or 5.1% excluding special regime facilities (which are generally cogeneration and renewable energy facilities), and 5.8% 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 2004, our generation facilities in Portugal had a total installed capacity of 8,401.5 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.

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EDPD provided approximately 5.8 million customers with 41,315 GWh of electricity in 2004. In Spain, Hidrocantábrico had a total installed capacity in 2004 of 2,941 MW, distributed to regulated customers a total of 9,002 GWh through its own network to approximately 575,000 customers and invoiced 13,618 GWh of electricity supply to regulated and liberalized customers.

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 consubstanciated with the opening of MIBEL. In anticipation of MIBEL, we have acquired full control of Hidrocantábrico and have elected the Iberian peninsula electricity market as our core market for our main electricity business. Our main activities in the electricity sector are already conducted in the Iberian peninsula market in an integrated manner. Further to this strategic focus, in 2004, we expanded our energy operations in Spain with an increase of our stake in Hidrocantábrico to 95.7%. We expect this acquisition to result in the full integration of Hidrocantábrico s operations within 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, notably in gas utilities, which we regard as complementary to our core electricity business.

Since July 2000, we have held a 14.27% ownership interest in GALP Energia SGPS, S.A. or GALP, a holding company with interests in GDP Gás de Portugal, SGPS, S.A., or GDP, and Transgás Sociedade Portuguesa de Gás Natural, S.A., or Transgás, companies that transport and supply natural gas throughout Portugal, and Petróleos de Portugal Petrogal, S.A., a company involved in oil refining and distribution and the production of petroleum products.

In December 2004, we acquired a direct stake of 46.625% in Portgás Sociedade de Produção e Distribuição de Gás, S.A., or Portgás, the natural gas distribution company for the northern region of Portugal, pursuant to the exercise of a call option agreement executed on November 14, 2003 with GALP, GDP and GDP Distribuição, SGPS, S.A. At the same time we also acquired additional indirect stakes of 12.9% in Portgás and 10.1% in Setgás Sociedade de Produção e Distribuição de Gás, S.A., or Setgás, the natural gas distribution company for the Setúbal region, pursuant to the exercise by Caixa Geral de Depósitos, S.A. or CGD, of the put option that we had granted to it on November 25, 2003. In the context of the implementation of our strategy for the Iberian gas market, on September 5, 2005 we concluded negotiations with Endesa Gas, S.A. for the acquisition of a 49% shareholding in NQF Gás, S.A., or NQF Gás. NQF Gás directly holds a 25.348% shareholding in Portgás and, indirectly, a 19.8% shareholding in Setgás. Upon completion of this transaction, we will be the sole shareholder of NQF Gás, thus increasing our direct and indirect shareholdings in Portgás and Setgás to 72.0% and of 19.8%, respectively. For more information on our participation in the Portuguese gas sector, please see Portugal Gas.

Our interests in the gas sector in Spain are held through Hidrocantábrico, which is the controlling shareholder in Naturcorp Multiservicios, S.A.U. (56.18% ownership stake), or Naturcorp, the leading gas company in the Basque region of Spain. For more information on our participation in the Spanish gas sector, please see Spain Gas.

Brazilian electricity

Our investments in Brazil consist of distribution, generation and related activities in the electricity sector. The following of our Brazilian subsidiaries are engaged in distribution: 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, we participate in the following companies: Investco (Lajeado plant), through EDP Lajeado S.A. and Enerpeixe S.A., or Enerpeixe. Our related businesses comprise our trading businesses, which are concentrated in Enertrade S.A., or Enertrade. For more information, see Brazil Overview.

In 2005, we reorganized our corporate holdings in order to comply with new government regulations that impose the unbundling of our generation and distribution activities in Brazil. We have started optimizing the corporate structure of our Brazilian holdings through the roll-up of minority shareholdings in Escelsa, Enersul and Bandeirante into Energias do Brasil. This process was completed with an initial public offering of shares in Energias do Brasil in July 2005. For more information, see Brazil Corporate Reorganization.

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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%-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.

Information technology

We participate in the information technology business through Edinfor Sistemas Informáticos, S.A., or Edinfor, which owns 100% of ACE Holding SGPS, S.A. or ACE. ACE owns 100% of CASE Concepção e Arquitectura de Soluções Informáticas Estructuradas, S.A., or CASE. CASE provides consulting and information systems services to us and to third parties. Following our sale of 60% of Edinfor to LogicaCMG Corporate Holdings Limited, or LogicaCMG, we own 40% of Edinfor. For more information on Edinfor, please see Subsidiaries, Affiliates and Associated Companies.

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. In 2003, 2004 and 2005 to date, we have not initiated any new international investment projects. In accordance with our strategy of shareholder value creation, we have divested in non-strategic holdings in Chile in December 2001 and Morocco in March 2002.

Group capital expenditures and investments

The following table sets forth our capital expenditures and investments for the years 2002 through 2004, 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		
	2002	2003	2004
	(thousands of EUR)		
OPERATING INVESTMENT:			
Energy:			
Portugal:			
Generation:			
Thermal/Hydro	204,979	213,851	178,735
Renewable: wind	11,397	38,533	53,667
Renewable: biomass[(1)]	35,205	922	155

Cogeneration	9,618	33	161
Engineering and Operations and Maintenance	15,264	7,809	14,181
Total Generation	276,463	261,147	246,899
Distribution:[2]			
Investment, net of subsidies	241,551	263,056	311,513
IT Systems (transfer from Edinfor to EDPD)	80,547	11,974	0
Subsidies in kind (assets)	54,095	61,039	70,405
Subsidies in cash	56,853	59,714	76,592
Total Distribution	433,046	395,783	458,510
Supply[3]	8,337	6,218	6,524
Total technical costs	717,846	663,148	711,933
Financial costs capitalized	15,361	24,005	24,785
Total Portugal	733,208	687,152	736,718
Spain:			
Hidrocantábrico[4]	84,775	70,528	115,071

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	Year ended December 31		
	2002	2003	2004
	(thousands of EUR)		
Total Spain	84,775	70,528	115,071
Total Energy Portugal and Spain	817,983	757,680	851,789
Brazil:			
Generation	55,600	58,676	195,545
Distribution:			
Bandeirante	25,413	39,392	33,173
Escelsa	16,208	18,639	30,055
Enersul	25,152	16,184	25,932
Energias do Brasil	261	415	222
Total Brazil	122,634	133,307	284,926
Telecommunications[5] and Information Technology:			
Telecommunications	311,962	28,564	33,498
Information Technology	41,833	58,784	20,424
Total Telecommunications and Information Technology	353,795	87,348	53,922
Other:			
Other Operating Investment[6]	45,362	24,939	31,317
TOTAL OPERATING INVESTMENT	1,339,773	1,003,274	1,221,954
FINANCIAL INVESTMENT:			
Energy:			
Portugal:			
Acquisition of additional 10% shareholding in Turbogás	20,986	0	0
Acquisition of Portgás/Setgás	0	0	124,120
Spain:			
Acquisition of Naturcorp by Hidrocantábrico[7]	0	100,235	0
Acquisition of Hidrocantábrico by EDP[8]	520,591	0	1,200,763
Total Energy	541,577	100,235	1,324,882
Other:			
Subscription to BCP rights issue and capital increase	30,636	40,599	0
Acquisition of Escelsa notes[9]	379,964	0	0
Other financial investments	15,718	40,926	25,240
Total Other	426,318	81,525	25,240
TOTAL FINANCIAL INVESTMENT	967,896	181,760	1,350,123
TOTAL CAPITAL EXPENDITURES AND INVESTMENTS	**2,307,669**	**1,185,034**	**2,572,077**

(1) *Renewable biomass investment in 2002 includes 35.2 million relating to an internal transfer of the Mortágua biomass power plant, from EDP, S.A. to EDP Produção Bioeléctrica. As such, this did not affect our cash flow in 2002.*

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

(3) *Supply comprises the capital expenditures of EDP Commercial (formerly known as EDP Energia), our company operating in the liberalized market.*

(4) *Investment represents 40% of Hidrocantábrico s operational investments.*

(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) *Investment represents 40% of Hidrocantábrico s financial investments in the acquisition of Naturcorp.*

(8) *Total investment in the acquisition of 95.7% of Hidrocantábrico (which we previously proportionally consolidated at the 40% level) amounts to 1,983.7 million, of which 262.4 million was invested in 2001, 520.6 million was invested in 2002 and 1,200.8 was invested in 2004.*

(9) *In 2002, we acquired certain notes issued by Escelsa. For more information on this transaction, please see Item 11. Quantitative and Qualitative Disclosures About Market Risk.*

Total capital expenditures and investments of 2,572.1 million in 2004 represented a 117% increase from total capital expenditures and investments of 1,185.0 million in 2003. This increase was primarily due to the acquisition of an additional 56.2% shareholding in Hidrocantábrico in 2004 and higher operating investments in Brazil in connection with the construction of the Peixe Angical hydro power station. The increase in total capital expenditures and investments from 2003 to 2004 was also due to a higher level of investments in generation in Portugal, following the near conclusion of Venda Nova II, 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. Investment at EDPD was focused on the distribution network in order to continue improving the quality of service. Capital expenditures in Brazil more than doubled following the investment made at the Peixe Angical hydro power station, which we expect will start operations during 2006. We had lower expenditures in

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telecommunications in 2004 following a decrease in ONI s investment needs following the completion of most of the major investments required for the expansion of the network. The decrease in total capital expenditures and investments from 2002 to 2003 was also due to a lower level of operational investments in 2003. In Portugal, we made lower operating investments in our distribution business in 2003, reflecting the internal transfer from Edinfor to EDPD of a commercial and administrative information technology system in 2002, and overall investments in generation were lower as a result of the internal transfer in 2002, from EDP to EDP Produção Bioeléctrica, of the investment made in 1999 related to the Mortágua biomass power plant, which does not represent a cash outflow, but was included in our 2002 capital expenditures and investments. We had lower expenditures in telecommunications in 2003 as a result of the divestment of our UMTS business. In addition, in 2002 we also acquired part of Escelsa s notes issued in U.S. dollars for the total amount of 380 million. Having reduced the exchange rate risk relating to U.S. dollar debt of our Brazilian subsidiaries, we did not enter into any further debt acquisition programs in 2003.

We expect total operational investments in 2005 to be approximately 1,400 million, concentrated mainly in generation and distribution.

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,		
	2002	2003	2004
	(thousands of EUR)		
Total Capital Expenditures and Investments:	2,307,669	1,185,034	2,572,077
Internal Transfers:			
IT Systems (from Edinfor to EDPD)	(80,547)	(11,974)	
Mortágua Biomass Power Plant (from EDP, S.A. to EDP Produção Bioeléctrica)	(35,180)		
Divestments:			
Redal	(26,905)		
Optep (Optimus)	(315,000)		
Iberdrola, S.A.		(400,102)	
Oni Way			(61,449)
Retecal			(23,004)
Stake in Fafen and Enersul turbine			(37,936)
Total Internal Transfers and Divestments	(457,632)	(412,076)	(122,389)
Adjusted Total Capital Expenditures and Investments	1,850,037	772,958	2,449,688

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 2004 totaled 458.5 million compared with 395.8 million in 2003 and 433.0 million in 2002, 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 2000 and 2004, 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 2002, the increase in EDPD capital expenditures also reflects the internal transfer from Edinfor to EDPD of 80.5 million worth of assets that relate to non-recurring investments made in a commercial and administrative

information technology system based on the SAP platform. In 2003, EDPD capital expenditures also included 12.0 million related to the transfer of this information technology system.

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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 2004 was approximately 147.0 million compared with approximately 121 million in 2003.

During 2004, we invested 246.9 million in generation in Portugal, compared with 261.1 million in 2003 and 276.5 million in 2002. Capital expenditures in 2004, 2003 and 2002 were primarily a result of expenses incurred due to the construction of the first two 392 MW units of the Ribatejo CCGT plant, the two 94 MW units of the Venda Nova hydroelectric plant and the 72 MW of wind farms. We expect a higher level of operational investment in generation in Portugal in 2005 due to the investment plan of Enernova, our wind farm development and operation unit in Portugal.

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 in the construction of the Ribatejo CCGT power plant. Future capital expenditures in generation may also include special projects such as co-generation and wind power generation opportunities. While the actual amount of our future investments will depend on factors that cannot be currently foreseen, we expect to incur capital expenditures of approximately 850 million annually through 2007 in the aggregate in our core electricity generation and distribution businesses in Portugal during this period.

In Spain, capital expenditures incurred in 2004 in generation, electricity distribution, special regime generation and gas amounted to 287.7 million (our proportional share of this expenditure being 115.1 million). Hidrocantábrico s operating investments in 2004 increased compared to 2003 due to greater investments in special regime generation and the consolidation of the Basque gas company, Naturcorp, beginning in August 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 Naturcorp, additional capital expenditures of 176.3 million were incurred (our proportional share of these expenditures being 70.5 million). Hidrocantábrico s 2003 operating investments decreased compared to 2002, due to lower investments in generation and electricity distribution activities. Investments in generation decreased due to the completion of the Castejón CCGT plant in September 2002. As for electricity distribution activity, fewer investments were made in expansion outside Asturias (northern region of Spain). Investment in special regime generation increased in 2003 with the construction of Cantábrico (65 MW), Arlanzón (34 MW) and Albacete (124 MW) wind farms.

In line with our strategic objectives of building our fixed line telecommunications and our international activities, we also may incur additional capital expenditures in connection with these activities and other strategic investments as well as non-recurring capital expenditures such as for information technology. With respect to investments in Brazil, we currently expect to fund any future capital expenditures with cash flow generated by local operations and or by reais-denominated debt.

We made capital expenditures related to environmental matters in 2004 of approximately 18 million, in 2003 of approximately 10 million and in 2002 of approximately 15 million. We expect these capital expenditures to amount to approximately 70 million in 2005, of which 59 million will be related to new investments in emissions abatement 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.

Over the next three years, we expect to incur capital expenditures of approximately 4,900 million, more than 85% of which will be dedicated to the expansion of electricity generation facilities in Portugal and Spain, including renewable energy facilities, and the improvement of the quality of our electricity distribution network in Portugal.

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

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and how the availability of those sources could be affected, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources.

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 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 2004 of a 60% stake in our information technology company Edinfor, and to selectively pursue other business activities that are complementary to our energy activities. These other business activities include selectively pursuing international opportunities in electricity, and developing our telecommunications business in Portugal and Spain.

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, in which we hold a direct and indirect stake of 59.55%, and through our minority interests of 14.27% in GALP and 10.11% in Setgás. Upon the completion of our acquisition of NQF Gás, we will increase our direct and indirect shareholdings in Portgás and Setgás to 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 Hidrocantábrico; 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

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in electricity supply will also increase as the newly created Iberian electricity market comes into operation. 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 increasing liberalization within the EU, particularly in the Iberian electricity market; and

- 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;

- further centralize our corporate structure, as we have done with the merger of our four distribution companies into EDPD and the centralization of most of our generation companies in EDP Produção;

- 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 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 on our investment in Hidrocantábrico;

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

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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 one or more new CCGT power plants, the development of renewable energy generation projects, primarily through the construction or acquisition of new wind farms, and the increase of capacity in existing plants to cope with strong consumption growth.

Developing an Iberian gas business

We view the gas business as being highly complementary to electricity and of great strategic attractiveness. Both Portugal and Spain have gas and electricity consumption growth rates above the EU average. Each country requires new capacity to be gradually added and 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 required 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 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 on our existing electricity client base and on the sharing of infrastructure and system costs.

After a decision of the European Commission in December 2004 which prevented our planned acquisition of joint control of GDP Gás de Portugal, SGPS, S.A., or GDP, which operates in the Portuguese gas sector and owns assets for the transport and distribution of gas, we are currently appealing to the Court of First Instance of the European Court of Justice from the European Commission s decision. Our ability to determine a detailed strategy for the gas sector in Portugal is limited pending a final decision on the GDP acquisition and the liberalization of the Portuguese gas sector, along with the necessary legal and industry framework.

Our current interest in the gas sector in Portugal consists of our 59.55% holding in Portgás, and our minority interests of 14.27% in GALP and 10.11% in Setgás. Upon the completion of our acquisition of NQF Gás, we will increase our direct and indirect shareholdings in Portgás and Setgás to 72.0% and 19.8%, respectively. Our current interest in the gas sector in Spain is through Hidrocantábrico s 56.8% controlling stake in Naturcorp, which has more than 500,000 customers and approximately 10% of Spain s regulated revenues for gas distribution, or 8% 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 arise in the electricity business 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. During the first half of 2003, we reassessed our Brazil strategy and are undertaking the following initiatives with the goal of rationalizing our

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Brazilian operations by making them more self-sustaining and independently managed:

- 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 at 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, you should read 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.

We plan to build on our existing operations in order to achieve a competitive role in the corporate fixed line telecommunications sector in Portugal and Spain, which we regard as attractive markets of suitable size and high growth potential.

Although our plans and strategy continue to evolve and adapt to trends in the telecommunications sector, we currently anticipate emphasizing the following business areas:

- fixed line operations, using ONI s fixed line voice and data operations as a platform; and
- Internet access services, building on ONI s Internet service provider activities.

We also have allied and expect to ally ourselves with other partners who may bring resources and synergies to facilitate our efforts to develop a presence in each of these business areas. For a more detailed discussion of our telecommunications activities, please 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.

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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 you should read Subsidiaries, Affiliates and Associated Companies below.

THE IBERIAN ELECTRICITY MARKET

In 2004, total generation in the Iberian electricity market amounted to approximately 227.7 TWh in the ordinary regime (i.e., excluding special regime), of which EDP and Hidrocantábrico were responsible for approximately 38.2 TWh.

Although there is not yet an integrated electricity market in operation in the Iberian Peninsula, governments from Portugal and Spain share the common view 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 this 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 will be limited 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 (*Operador do Mercado Ibérico*).

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

Within the context of MIBEL, the Portuguese government has determined 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, which 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 should take all necessary measures to open the market to all

consumers and harmonize both tariff structures through clear and transparent rules, particularly in Spain.

The Spanish government is currently conducting a public hearing to assess eventual measures that should be implemented in the Spanish market with a view to creating MIBEL.

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PORTUGAL

ELECTRICITY SYSTEM OVERVIEW

Portuguese Electricity System

Since 1997, Portugal has had an electricity market structured pursuant to the legislation enacted by the government 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) *We own 10% of Tejo Energia and 40% of Turbogás.*

(2) *Began operations in early 1998.*

(3) *In 2004, the Ribatejo CCGT power plant began operations.*

(4) *At the end of December 2004, approximately 50,500 potential Qualifying Consumers, or Eligible Consumers, existed, of which 2,919 had become Qualifying Consumers during 2004 and 1,919 were already in the Non-Binding Sector. Prior to February 2004, all consumers except low-voltage consumers were Eligible Consumers. Decree law no. 36/2004, of February 26, 2004, provided for the decrease of the eligibility threshold in mainland Portugal to include special low-voltage consumers, which are those with subscribed demands above 41.4 KW and voltage levels below 1kV. Decree law no. 192/2004, of August 17, 2004, subsequently 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, the regulator published the necessary codes that reflect the ability of normal low voltage consumers to change suppliers.*

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The National Electricity System consists of the PES, also sometimes referred to in this annual report as the Binding Sector, 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 through the decrease of the eligibility threshold in mainland Portugal to include all low-voltage customers. For more information on the liberalization of electricity sales you should read Distribution Competition below.

In the context of the liberalization of the Portuguese electricity sector, the creation of MIBEL and the termination of PPAs, we expect the structure of the National Electricity System to be significantly altered in the near future. For further information on the termination of the PPAs, see Item 3. Risk Factors Risks Related to Our Core Electricity Business 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 same amount as is currently contemplated.

The Public Electricity System or Binding Sector

The PES includes the binding generation in our generation company, CPPE, 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 10% stake, and the Turbogás plant at Tapada do Outeiro, in which we have a 40% stake (after having acquired an additional 20% stake in early 2005). All plants in the PES enter 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, you should read 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, that 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 our three wholly-owned embedded hydroelectric generators, which are small hydroelectric plants with more than 10MW installed capacity that deliver all of the energy they produce directly to the distribution system, and CPPE s CCGT plant in Ribatejo. Although producers in the Non-Binding Sector are required to obtain licenses, they have no obligation to supply electricity to the PES. These entities are free to contract directly with Qualifying Consumers. In 2004, the total number of Eligible Consumers in Portugal represented approximately 54% of total demand in mainland Portugal in volume terms. During 2004, 2,919 Eligible Consumers exercised their right to become Qualifying Consumers, of which 2,212 entered into contracts with EDP Comercial and 707 entered into contracts with producers in the Spanish market. As of December 31, 2004, approximately 50,500 Eligible Consumers existed and 4,838 of these had opted to become Qualifying

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Consumers. Of the 4,838 existing Qualifying Consumers at the end of 2004, 3,616 are customers of EDP Comercial, representing approximately 11% of the electricity sold in Portugal in 2004 by us and 9% of our revenues in the electricity distribution and supply activity in Portugal in 2004. 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. We expect a limited impact on our revenues due to this final step in the progressive elimination of the eligibility threshold. Two of the three tariff components relating to distribution, representing approximately 91% of tariff revenue in 2004, 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.

Producers in the Non-Binding Sector are able to use the national transmission grid and distribution system on an open-access basis to connect to Qualifying Consumers, which 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, you should read Distribution below.

Size and composition of Portugal s electricity market

During the period from 2000 through 2004, the total electricity supplied by EDPD (in both the Binding and Non-Binding Sectors) experienced an average growth rate of 5.1% 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, the annual growth rate increased to 3.7%. In 2004, the annual growth rate increased to 7.3%.

The primary factors that management believes 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 2004, Portugal s GDP grew by 1.0% after a decline of 1.0% in 2003. Management estimates that overall consumption in the National Electricity System will increase at an average of 4% per year in 2005, 2006 and 2007. Residential consumption is assumed to increase each year over the same period by an average of 3.4%, services by an average of 4.7%, and industrial by an average of 2.5%.

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 System, or NBES, has remained fairly stable in recent years, except in 2003 when it increased slightly due to an extremely cold winter and a decrease in installed capacity in the PES following the decommissioning of the Alto Mira power plant (132 MW). Our available capacity as a percentage of the total installed capacity has returned to a value of approximately 78% after a slightly lower value 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 2004. EDP is trying to address this situation by adding new generation capacity. The first two units of the Ribatejo CCGT plant began operation in 2004 and the third unit is expected to begin operation in 2006. Also, new CCGT and hydroelectric capacity is planned for future years.

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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 System and peak demand to EDP s available capacity for the periods indicated. Peak demand includes demand satisfied by generation from Other Independent Producers.

	As of December 31,				
	2000	2001	2002	2003	2004
	(in MW, except percentages)				
Installed capacity of the PES	8,758	8,758	8,758	8,626	8,626
Installed capacity of the NBES[1]	255	255	255	647	1,268
Total installed capacity (PES plus NBES)	9,013	9,013	9,013	9,273	9,893
Peak demand (PES plus NBES)	6,890	7,466	7,394	8,046	8,261
Peak demand as a percentage of the total installed capacity (PES plus NBES)	76.4%	82.8%	82.0%	86.8%	83.5%
EDP:					
EDP s average available capacity (PES)	6,765	6,801	6,841	6,695	6,761
EDP s average available capacity (NBES)	215	247	226	228	936
EDP s available capacity as a percentage of the total installed capacity (PES plus NBES)	77.4%	78.2%	78.4%	74.7%	77.8%
Peak demand as a percentage of EDP s average available capacity (PES plus NBES)	98.7%	105.9%	104.6%	116.2%	107.3%

(1) *Non-Binding System, which consists of generation in the IES other than the other independent producers. All of the NBES 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 2004 includes the first two operational units (2x392 MW) of the Ribatejo CCGT and the two units of the Alqueva hydroelectric power plant (2x120 MW). Installed capacity in the NBES also reflects a decrease of 11 MW related to the Ermal plant, which became a special regime power station.*

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 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 in line with the majority of the European transmission systems. At year-end 2004, 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.

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Of REN s transmission lines at December 31, 2004, approximately 2,198 km were 150 kV lines, 2,838 km were 220 kV lines and 1,454 km were 400 kV lines. At the end of 2004, REN had seven interconnection lines with Spain, one of which is a 150 kV line, three of which are 220 kV lines and three of which are 400 kV lines. We understand that, within the context of creation of MIBEL, REN plans to establish an additional interconnection with Spain: Douro Internacional-Aldeadavila, a 220 kV line or 400 kV line scheduled for completion in 2006.

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 includes 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
2000	931	2.5
2001	239	0.6
2002	1,899	4.7
2003	2,794	6.5
2004	6,480	14.2

GENERATION

As of December 31, 2004, our Portuguese electricity generation facilities consist of hydroelectric, thermal (coal, fuel oil, natural gas and gas oil), biomass, cogeneration and wind generation facilities, and had a total installed capacity of 8,402 MW (including two 392 MW units of the new Ribatejo CCGT plant, one of which began commercial operations in early 2004 and the other of which began commercial operations in November 2004), 7,052 MW of which was in the PES and 1,350 MW of which was in the IES. As of December 31, 2004, approximately 50% of our generation capacity was represented by hydroelectric facilities, 31% by fuel oil/natural gas facilities, 14% by coal-fired facilities, 2% by gas oil facilities and 3% by wind-driven, biomass and cogeneration facilities. We do not own or operate any nuclear-powered facilities in Portugal.

Our installed capacity in the PES of 7,052 MW represents approximately 82% 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 CPPE 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. CPPE and REN entered into a contract pursuant to which CPPE maintains the plant and keeps it in operation. Our smaller hydroelectric plants, wind generating facilities and cogeneration and biomass plants are part of the IES. In the IES, in addition to the two Ribatejo CCGT units that entered into service in 2004, there was an increase in IES capacity resulting from the entering into service of the Alqueva hydroelectric power plant in 2004 owned by EDIA-Empresa de Desenvolvimento e Infra-estraturas 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 2004, our net electricity generation in Portugal was approximately 24.3 TWh, excluding special regime production. According to REN, total net generation in Portugal in 2004 was approximately 35.0 TWh.

Since its creation in 1994, CPPE has operated all of our conventional thermal plants and approximately 92.6% of our hydroelectric plants. During the second half of 2003, we began reorganizing our generation business in preparation for the commencement of MIBEL. In 2004, we consolidated a number of generation companies formerly held by EDP Produção, which operate in the IES, into CPPE as part of the reorganization of our generation business. The companies merged into CPPE were: HDN,

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S.A., Hidrocenel, S.A., TER S.A., EDP Cogeração, S.A., Hidrinor, S.A. and Hidroem, S.A. As a result of this reorganization, in 2004 CPPE accounted for approximately 97% of our generation in Portugal. Our other companies that own or operate generation assets are EDP Comercial, Enernova and EDP Bioeléctrica.

EDP Comercial was created to supply electricity to Qualifying Consumers and to conduct energy trading activities. The energy trading activities were subsequently transferred to EDP Produção.

Enernova (wind energy) and EDP Bioeléctrica (biomass plants) are now held directly by EDP outside of EDP Produção. Since 1996, Enernova has increased its installed generation capacity from 10 MW to 136 MW in 2004. New projects are in progress, some of which are under construction and others are in licensing or development, which are expected to add installed capacity of 872 MW by 2007, and 1,432 MW by 2010.

EDP Produção 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.

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 carrying out the development, construction and operation of a combined-cycle gas fired power station (CCGT) at Tapada do Outeiro, in Portugal, with a total installed capacity of 990 MW. Turbogás currently sells the whole of its production to REN, within the PES under a long term PPA. In 2002, 2003 and 2004, Turbogás generated 7,126 GWh, 5,404 GWh and 6,153 GWh, respectively. For more information on these transactions, please 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.

The following maps set forth the CPPE power plants in the PES and our power plants in the IES, in each case as of December 31, 2004.

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The following table sets forth our total installed capacity by type of facility at year-end for the years 2000 through 2004.

	As of December 31,				
Type of facility	**2000**	**2001**	**2002**	**2003**	**2004**
Hydroelectric:					
CPPE plants	3,903	3,903	3,903	3,903	3,903
Independent System hydroelectric plants[1]	309	309	309	311	310
Total hydroelectric	4,212	4,212	4,212	4,214	4,213
Thermal[2]	3,281	3,281	3,281	3,149	3,149
Wind	30	41	41	65	136
Biomass	9	9	9	9	9
Cogeneration	67	67	111	111	111
CCGT[3]	0	0	0	392	784
Total	7,599	7,610	7,654	7,939	8,402

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

(2) *On June 30, 2003, the PPA of the Alto de Mira plant expired and the plant was decommissioned.*

(3) *This plant was in testing at the end of 2003. The first 392 MW unit of this plant began commercial service on February 14, 2004 and the second 392 MW unit on November 2, 2004.*

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 10.6 TWh and can reach about 15 TWh in a wet year and may fall to less than 7 TWh in a dry year. Between 1994 and 2004, our actual hydroelectric production ranged from a low of 6.9 TWh in 1999, 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 2000 through 2004, and also sets forth our hydroelectric capability factor for the same period:

	Year ended December 31,				
Type of facility	**2000**	**2001**	**2002**	**2003**	**2004**
	(in GWh, except hydroelectric capability factor)				
Hydroelectric:					
CPPE plants[1]	10,229	12,607	6,764	13,964	8,718
Independent System hydroelectric plants	624	790	573	901	539

Total hydroelectric	10,853	13,397	7,336	14,865	9,257
Thermal:					
Coal	9,091	8,677	9,532	9,473	9,530
Fuel oil and natural gas	4,631	5,583	7,848	3,120	2,210
Gas oil	38	50	13	26	5
Coal and fuel oil[2]	11	30	44	(1)	5
Cogeneration	134	423	590	679	656
CCGT[3]				203	3,419
Total thermal	13,905	14,763	18,027	13,500	15,825
Wind	70	90	113	128	237
Biomass	5	18	37	38	49
Total	24,833	28,269	25,513	28,532	25,368
Hydroelectric capability factor[4]	1.08	1.19	0.75	1.33	0.83

(1) *Includes the following amounts of our own consumption for hydroelectric pumping, 558 GWh in 2000, 485 GWh in 2001, 670 GWh in 2002, 485 GWh in 2003 and 408 GWh in 2004.*

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(2) *Since the beginning of 1998, our existing plant at Tapada do Outeiro uses only fuel oil. Production in 2003 was less than the plant s own consumption.*

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

(4) *The hydroelectric coefficient varies based on the hydrological conditions in a given year. A hydroelectric capability factor of one corresponds to an average year, while 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 CPPE s plants remained at favorable levels from 2000 (93.2%) through 2004 (94.4%) for thermal plants, and increased from 95.0% to 97.1% for hydroelectric plants during the same period. Forced outage is unplanned availability at a power plant caused by trips, critical repairs or other unexpected occurrences. Non-availability results from planned maintenance and forced outages. CPPE is reducing planned maintenance outages through more efficient maintenance techniques. CPPE 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 2000 through 2004, forced outages of CPPE s thermal plants has ranged between 2.11% and 2.91%. During the same period, forced outages of CPPE s hydroelectric plants ranged between 0.44% and 1.00%. In 2004, forced outages of CPPE s thermal plants was 2.19% and hydroelectric plants was 0.48%.

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 CPPE 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	**2000**	**2001**	**2002**	**2003**	**2004**	**2000**	**2001**	**2002**	**2003**	**2004**
Hydroelectric	29.8%	36.9%	19.8%	40.8%	25.5%	95.0%	94.8%	95.9%	96.8%	97.1%
Thermal:										
Coal	86.8%	83.1%	91.3%	90.7%	91.3%	89.2%	90.5%	94.0%	94.2%	92.9%
Fuel oil and natural gas	30.8%	37.2%	52.3%	20.8%	14.7%	94.6%	96.6%	93.7%	90.8%	95.1%
Coal and fuel oil(2)	2.8%	7.2%	10.8%	0.0%	0.0%	99.6%	98.9%	98.2%	94.9%	88.0%
Gas oil(3)	1.3%	1.7%	0.4%	1.2%	0.3%	99.4%	98.4%	99.1%	98.0%	98.8%
Total weighted average thermal(4)	47.8%	49.9%	60.7%	44.8%	42.6%	93.2%	94.6%	94.4%	92.7%	94.4%

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

(2) *None, primarily due to minimal generation at our Tapada do Outeiro plant as a result of a wet year in 2003 and the fact that this is a peak load power plant.*

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

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

During the period from 2000 through 2004, CPPE 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 to maintain these costs below the PPA limits in 2005, we expect most of the PPAs to terminate during 2005 or 2006 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. 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, 2004, we owned and operated 25 hydroelectric generating facilities in the Binding System, with 63 total units and an aggregate installed capacity of 3,903 MW.

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In the IES, CPPE now owns and operates 224.9 MW formerly owned by HDN and Hidrocenel. CPPE 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 CPPE was approximately 4,453 MW as of December 31, 2004.

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, installed capacity as of December 31, 2004, 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
CPPE 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
Pocinho	186.0	Run of river	1983	
Picote	195.0	Run of river	1958	1969
Carrapatelo	201.0	Run of river	1971	
Régua	180.0	Run of river	1973	
Torrão	140.0	Reservoir	1988	
Castelo de Bode[1]	159.0	Reservoir	1951	2003
Vilarinho Furnas	125.0	Reservoir	1972/87	
Vila Nova (Venda Nova/Paradela)	144.0	Reservoir	1951/56	1994
Fratel	132.0	Run of river	1974	1997
Crestuma-Lever	117.0	Run of river	1985	
Cabril	108.0	Reservoir	1954	1986
Alto Rabagão	68.0	Reservoir	1964	
Tabuaço	58.0	Reservoir	1965	
Caniçada	62.0	Reservoir	1954	1979
Bouçã	44.0	Reservoir	1955	1988
Salamonde	42.0	Reservoir	1953	1989
Pracana	41.0	Reservoir	1950/93	1993
Caldeirão	40.0	Reservoir	1994	
Touvedo	22.0	Reservoir	1993	
Raiva	24.0	Reservoir	1982	
Total	3,903.0			
Independent System Hydroelectric Plants:				
CPPE plants:[2]				
Hidrocenel	107.6	Various	Various	
HDN[3]	117.3	Various	Various	
EDP Comercial[4]	84.9	Various	Various	
Total	309.8			
Total maximum capacity	4,212.8			

(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 a recent reorganization, CPPE integrated 28 plants owned by HDN and Hidrocenel plants 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, for the last three years, of CPPE s hydroelectric power plants operating under PPAs, as well as the end date of each PPA.

		Annual Net Generation		
	End of PPA	**2002**	**2003**	**2004**
			(GWh)	
Hydro				
Alto Lindoso	2024	599	948	532
Touvedo	2024	48	72	46
Alto Rabagão	2015	54	145	89
Vila Nova (Venda Nova/Paradela)	2015	353	720	484
Venda Nova 2/Frades[(1)]	2027			
Salamonde	2015	153	261	199
Vilarinho Furnas	2022	160	181	162
Caniçada	2015	238	347	263
Miranda	2013	478	1,365	797
Picote	2013	513	1,121	879
Bemposta	2013	535	1,374	913
Pocinho	2024	262	681	388
Valeira	2024	444	1,049	617
Vilar-Tabuaço	2024	48	178	88
Régua	2024	428	891	576
Carrapatelo	2024	558	1,092	765
Crestuma-Lever	2024	258	513	309
Torrão	2024	272	314	208
Caldeirão	2024	49	76	17
Aguieira	2024	538	614	351
Raiva	2024	41	66	31
Cabril	2015	185	491	236
Bouçã	2015	97	230	128
C. Bode	2015	216	608	266
Pracana	2024	49	99	33
Fratel	2020	188	528	339
Total Hydro		6,764	13,964	8,718

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

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Thermal plants

CPPE operates all our conventional thermal power plants in the PES, with total installed capacity, as of December 31, 2004, of 3,149 MW and installed capacity per generating unit ranging from 16 MW to 298 MW. The following table sets forth, as of December 31, 2004, 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	Years 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]	197.0	Gas oil	28.4	4	1973/1982
Tapada do Outeiro (EDP facility)[3]	46.9	Coal / fuel oil	29.4	1	1959/ 1967
Barreiro	56.0	Fuel oil	34.2	2	1978
Total maximum capacity	3,148.5				

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

(2) *The PPA for the first two units terminated on December 31, 2004 and these units now serve the national grid to synchronize the transmission network.*

(3) *This three-unit plant was progressively decommissioned until the end of 2004; the first unit on December 31, 1997, the second unit on December 31, 1999 and the third unit on December 31, 2004.*

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

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

		Annual Net Generation			Annual Fuel Costs		
	End of PPA	2002	2003	2004	2002	2003	2004
			(GWh)			(thousands of EUR)	
Sines	2017	9,532	9,473	9,530	149,741	131,771	179,818
Setúbal	2012	5,191	1,834	1,683	173,290	71,333	64,405
Carregado (I and II)	2010	2,408	1,091	327	92,121	51,075	17,063

Barreiro	2009	249	195	200	16,003	16,971	15,573
Tunes (III and IV)	2007	57	26	10	3,457	2,757	877
Total		17,437	12,619	11,750	434,612	273,908	277,736

Other energy sources

Renewables

In addition to our hydroelectric and thermal plants, we promote the use of renewable energy sources with other types of facilities. Enernova, our subsidiary specializing in this area, concentrated its initial investments in wind farms (due to greater technological advances made to date). Our first wind facility commenced operation in 1996. We now have ten wind facilities with a combined installed capacity of 136 MW. In 2002, we created a new subsidiary for the biomass assets, EDP Produção Bioeléctrica, which operates the Mortágua biomass (forestry waste) power plant. This plant started operations in 1999 and has an installed capacity of 9 MW.

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Fuel

CPPE 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. For the purposes of this section, the Ribatejo plant, which began testing in 2003 and operation in 2004, is considered as if it was owned by CPPE during such periods.

CPPE fuel consumption costs, including transportation, were 380.3 million in 2004 and 273.9 million in 2003 (for ease of comparison, the 2003 figure has been adjusted to reflect CPPE as reorganized in 2004). The increase in the total cost of fuel consumed from 2003 to 2004 resulted primarily from a dry year in 2004 compared to a wet year in 2003, the higher cost of fuel in 2004 and the added consumption in 2004 of the new Ribatejo CCGT plant.

The table below shows a breakdown of costs of fuel consumed by CPPE from 2000 through 2004.

	Year ended December 31,				
Type	**2000**	**2001**	**2002**	**2003**	**2004**
	(thousands of EUR)				
Imported coal	128,902	142,810	148,773	130,531	179,062
Fuel oil[1]	146,721	193,867	259,816	117,716	86,336
Gas oil[2]	1,895	4,618	1,526	2,744	586
Natural gas	25,364	12,260	24,497	22,917	114,354
Total	302,882	353,555	434,612	273,908	380,337

(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 CPPE in each of the last five years.

	Year ended December 31,				
Type	**2000**	**2001**	**2002**	**2003**	**2004**
	(thousands of metric tons, except natural gas)				
Imported coal	3,564	3,108	3,587	3,593	3,562
Fuel oil[1]	1,052	1,237	1,941	716	422
Gas oil	0	26	3	10	1
Natural gas[2]	142	60	150	131	632

(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.*

Coal

As the Sines power plant is a base load, or continuous operation power plant, CPPE 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, or TCQ, is defined by REN based on the forecasts for coal consumption for a wet year. The TCQ is the basis for long-term supply and shipping contracts, which are negotiated by CPPE, subject to REN approval. In addition, CPPE makes spot-market purchases as necessary. In 2004, CPPE purchased 63% of its coal through long-term contracts and 37% of its coal on the spot market. In 2003 and 2002 CPPE 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 CPPE s coal purchases from 2000 to 2004 by geographic markets as a percentage of total purchases for that year.

	Year ended December 31,				
Region	**2000**	**2001**	**2002**	**2003**	**2004**
South Africa	38.0%	28.0%	28.9%	34.6%	29.5%
United States	10.0%	17.0%	3.2%	9.9%	13.1%
Australia	0.0%	13.0%	23.2%	18.6%	3.7%
South America	48.0%	27.0%	16.3%	32.9%	41.1%
Southeast Asia	4.0%	15.0%	16.9%	0.0%	4.4%
Europe	0.0%	0.0%	11.3%	4.0%	8.2%
Total	100%	100%	100%	100%	100%

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 2004 reflects increased demand in the Chinese market and related capacity constraints on shipping from Asia.

Fuel oil and gas oil

Fuel oil purchases by CPPE are made in the spot market and pursuant to contracts. CPPE 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 2004 was 204.6 per ton, compared with 164.8 and 143.3 in 2003 and 2002, respectively. The increase in 2004 was due to increases in market prices as a result of the conflict in Iraq and production control by OPEC members. To meet its objectives to improve air quality, CPPE has shifted its fuel oil purchases to lower sulfur fuel oil, which has increased the cost of consumed fuel oil. In 2004, the average sulfur content of fuel oil purchased by CPPE was approximately 0.8%, compared with 0.9% in 2003. In October 2002, CPPE initiated the use of fuel with a 1% sulfur content. The use of lower sulfur fuel oil has increased, and will increase in the future, the average cost of fuel oil consumed.

CPPE 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 CPPE, as required by REN.

Natural gas

Since the introduction in 1997 of the import of natural gas from Algeria into Portugal by Transgás, CPPE has had access to natural gas as a source of primary energy. CPPE converted two units of Carregado into dual-fired (fuel oil and natural gas) in late 1997. In 2004, CPPE

purchased 632 million cubic meters of natural gas for a total of 114.4 million compared to 175 million cubic meters of natural gas in 2003 for a total of 22.9 million. However, the costs in 2003 reflect only 131 million cubic meters as the remaining 44 million cubic meters were considered as investment expenses of the Ribatejo CCGT plant while this plant was undergoing testing. For more information on our activities related to natural gas you should read Other Investments and International Activities.

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.

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Facility	Type of generation	Developing entity	Planned capacity (MW)	Target year	Status
Alqueva[1]	Hydroelectric	EDIA/CPPE	240	2005	Under Construction
Pedrogão	Hydroelectric	EDIA/CPPE	10	2006	Under Construction
Venda Nova II	Hydroelectric	CPPE	192	2005	Under Construction
Baixo Sabor	Hydroelectric	CPPE	180	2012	Licensing
Picote II	Hydroelectric	CPPE	236	2012	Licensing
Bemposta II	Hydroelectric	CPPE	178	2014	Planning
Foz Tua	Hydroelectric	CPPE	208	2015	Planning
Ribatejo CCGT[2]	CCGT	CPPE	3x392	2004/2006	Under Construction
New CCGT plants	CCGT	CPPE	2x400	2008/2011	Planning
Small hydro	Hydroelectric	CPPE	20	2006/2010	Planning

(1) *EDIA is developing a multi-purpose hydroelectric scheme for irrigation and the production of electricity with the Alqueva and Pedrogão plant. CPPE will operate the Alqueva hydroelectric power plant. Alqueva s pumping capacity is expected to be in service by the end of 2005.*

(2) *This power station operates in the Non-Binding Sector and has three units. The first two units began operation in 2004 and the third unit is expected to begin commercial service in March 2006.*

Capital expenditures

In 2004, we spent 247.0 million in capital expenditures in technical costs for our generation facilities, compared with 261.1 million in 2003 and 276.5 million in 2002. 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 2004, investing 128.3 million in the new Ribatejo CCGT (combined cycle gas turbine) power plant and 53.7 million in wind energy farms. At this stage, management expects that the Ribatejo CCGT plant will cost approximately 600 million, including all three units.

The following table sets forth our capital expenditures in technical costs from 2000 through 2004 on plants by type and status of generating plant.

Plant type and status	Year ended December 31, 2000	2001	2002	2003	2004
	(thousands of EUR)				
Thermal/Hydro					
Public Electricity System					
Hydroelectric plants under construction	14,235	16,877	25,690	34,359	24,127
Hydroelectric plants in operation	9,038	10,289	12,756	11,732	11,849
Thermal plants in operation	17,623	14,764	16,261	20,340	12,955
Plants under study	190	1,450	1,011	349	729
Total PES	41,086	43,380	55,718	66,780	49,659

Independent Electricity System					
Hydroelectric plants	7,913	4,964	4,137	3,849	1,018
Ribatejo CCGT	3,571	58,535	142,946	142,350	128,329
Wind	11,128	6,521	11,159	38,389	53,667
Cogeneration facilities	25,439	13,083	9,602	255	129
Biomass[1]	0	0	35,180	614	155
Total IES	48,051	83,103	203,024	185,456	183,298
Others[2]	0	0	0	312	2,854
Non-specific investment[3]	4,969	5,250	17,721	8,599	11,089
Total Generation	94,106	131,733	276,463	261,147	246,900

(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.*

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(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 CPPE plants in the PES is bound to the PES under PPAs between CPPE and REN. Under the PPAs, CPPE 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 CPPE s power plants. The revenue amount CPPE 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 CPPE 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 the future 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 (UGS Tariff). The early termination of the PPAs set forth in the Decree law is subject to certain conditions, which include (i) 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 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 CPPE s power plants operating in the PES.

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 global amount of the compensation to be granted to us as a result of the early termination of all of our PPAs, at present value, 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%.

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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 shall 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 the Decree law noted above, updated by a rate equal to the above mentioned 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 CPPE, which in 2004 formed 97% of our generating capacity, operate in the PES and in the IES. The earnings that CPPE 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 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 Electricity Market and Spain.

DISTRIBUTION

Electricity distribution in Portugal is a regulated business and involves the transfer of electricity from the transmission system and its delivery across a distribution system to regulated consumers and Qualifying Consumers, meter reading and 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, as well as seven commercial areas directed at serving customers supplied in the PES, EDP distributed electricity to approximately 5.8 million consumers in 2004 (out of a total of approximately 5.9 million according to DGGE), amounting to 41,315 GWh, of which 6,763 GWh was distributed to Qualifying Consumers. At December 31, 2004, EDPD employed 5,530 personnel.

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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 it 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. For more information on licenses and concessions held by us, you should read note 1 to our consolidated financial statements.

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. At December 31, 2004, EDPD s distribution lines spanned a total of approximately 201,090 kilometers. The only distribution lines in Portugal not owned by EDPD are those of the 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, 2004.

Distribution lines	Km
Overhead lines:	
High-voltage (60/130kV)	7,428
Medium-voltage (6/10/15/30kV)	53,905
Low-voltage (<1kV)	99,447
Total overhead lines	160,780
Underground cables:	
High-voltage (60/130kV)	383
Medium-voltage (6/10/15/30kV)	12,356
Low-voltage (1kV)	27,571
Total underground cables	40,310
Total	201,090

Customers and sales

EDPD distributes electricity to approximately 5.8 million customers. Approximately 70% of electricity consumption in 2004 was along the coast, with approximately 15% in the Oporto metropolitan region and 20% in the Lisbon metropolitan region. EDPD classifies its customers by voltage level of electricity consumed. The following chart shows the number of customers as of December 31, 2004, 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 2004
Customers by voltage level	**Total**

	Binding customers	Qualifying consumers	
High and very high-voltage[1]	174	3	177
Medium-voltage[2]	18,184	3,135	21,319
Special low-voltage[3]	27,306	1,700	29,006
Low-voltage[4]	5,772,840	0	5,772,840
Total	5,818,504	4,838	5,823,342

(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 41.4KW 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.*

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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 4.8% from December 31, 2000 to December 31, 2004. The highest average annual growth rate during this period (7.6%) was in demand from very high- and high-voltage customers. These voltage levels experienced a 14.3% increase in demand in 2004 due to a large increase in the industrial activity of one of our largest customers, as well as a higher demand on the distribution grid from auto producers. Under 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 11,225 GWh in 2000 to 13,187 GWh in 2004, representing average annual growth of 4.1%.

Following the gradual decrease of the eligibility threshold between 2000 and 2004, 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 11,092 GWh in 2000 to 6,506 GWh in 2004, whereas electricity demand by medium-voltage qualifying consumers, increased from 133 GWh in 2000 to 6,680 GWh in 2004. Consumption by low-voltage binding customers, typically residential and services, increased from 17,884 GWh in 2000 to 21,267 GWh in 2004, representing average annual growth of 4.4%. This growth is slightly lower than that in total low voltage (4.5% per annum) as 33 GWh were consumed by large low-voltage qualifying consumers. The growth in low-voltage consumption during this period resulted primarily from the increase in the number of low-voltage customers from approximately 5.4 million to approximately 5.8 million, as well as an increase in annual consumption per consumer.

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

	Year ended December 31,				
	2000	2001	2002	2003	2004
			(GWh)		
Electricity distributed					
Very high-voltage and high-voltage:					
Binding customers	4,104	4,259	4,271	4,795	5,562
Qualifying consumers	83	176	182	114	49
Total very high-voltage and high-voltage	4,187	4,435	4,453	4,909	5,611
Medium-voltage:					
Binding customers	11,092	11,358	11,198	8,600	6,506
Qualifying consumers	133	344	776	3,934	6,680
Total medium-voltage	11,225	11,702	11,974	12,534	13,187
Low-voltage					
Binding customers	17,884	18,823	19,424	20,346	21,267
Qualifying consumers	0	0	0	0	33
Total Low-voltage	17,884	18,823	19,424	20,346	21,300
Public lighting	1,010	1,065	1,080	1,167	1,218
Total	34,306	36,025	36,931	38,955	41,315

On a revenue basis, our Portuguese electricity sales grew from 3,011 million in 2000 to 3,518 million in 2004. The most significant increase in sales has been to low-voltage customers (typically residential and services), to whom sales increased from 2,080 million in 2000 to 2,665 million in 2004. Recent growth in revenue from electricity sales was due to expansion in consumption and average tariff increases set by the regulator of

2.1% in 2004 and 2.8% in 2003. 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.

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	Year ended December 31,				
	2000	2001	2002	2003	2004
	(thousands of EUR)				
Electricity sales					
Very high-voltage and high-voltage	156,049	165,957	167,827	186,467	228,939
Medium-voltage	749,100	772,357	783,388	615,394	487,807
Low-voltage	2,080,475	2,194,035	2,335,135	2,500,380	2,664,809
Public lighting	80,279	83,918	86,614	95,731	101,991
Tariff adjustment	(55,995)	42,218	70,482	77,919	(92,118)
Total binding customers	3,009,908	3,258,485	3,443,446	3,475,891	3,391,427
Qualifying Consumers	1,152	2,788	12,939	70,485	126,647
Total	3,011,060	3,261,273	3,456,385	3,546,376	3,518,074

Tariffs are fixed by the regulator 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, shown in the table above as the tariff adjustment, 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. Tariff adjustments, which represent adjustments related to EDPD s distribution and supply activities, include compensation from previous years which is factored into the tariffs. For more information on the tariff adjustments you should read Item 5. Operating and Financial Review and Prospects.

The number of distribution customers per distribution employee is an important measure for EDPD. In the period from 2000 through 2004, the number of customers per employee has increased from 658 to 1,053.

Purchases of electricity

EDPD purchases all of its electricity in the Binding Sector from REN. The regulator has 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.

	Year ended December 31,				
	2000	2001	2002	2003	2004
	(GWh)				
Electricity Purchases					
From Binding Sector generation	33,915	35,282	34,801	32,307	30,342
From Other Independent Producers	2,469	2,552	2,817	3,694	4,482
From the Non-Binding Sector	622	891	1,354	2,044	2,933

Total	37,007	38,726	38,972	38,046	37,757

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 and we expect the amount of annual losses to remain constant as a result of capital expenditures in our distribution network, although we expect an increase in consumption.

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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,				
	2000	2001	2002	2003	2004
	(in GWh, except percentages)				
Demand on the distribution network	37,230	39,263	39,965	42,261	44,808
Own uses of energy	21	22	20	33	29
Distribution losses	2,875	3,183	3,008	3,259	3,451
Distribution losses/demand on the distribution network	7.7%	8.1%	7.5%	7.7%	7.7%

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 any interruptions will not occur.

In Portugal, the equivalent interruption time, or EIT, of our medium voltage grid dropped to 215 minutes in 2004 from 370 minutes in 2003, which represented a 42% improvement, as a result of our investments in the distribution grid and in quality of service. In 2003, we had already achieved a 50-minute improvement in comparison with 2002, which represented a 12% improvement. Approximately 29 minutes of the 370 minutes related to the wildfires that took place in Portugal during the summer of 2003, which affected a significant number of distribution lines and resulted in frequent cuts in electricity supply.

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 2004 capital expenditures in technical costs amounted to 388.1 million, of which approximately 6% were expenditures on non-specific administrative, technical and commercial systems and corresponding technology support infrastructure, including an installment payment of approximately 7.2 million for the acquisition of an information technology system from Edinfor. EDPD s capital expenditures in technical costs in distribution totaled 334.7 million in 2003, 379.0 million in 2002, 260.4 million in 2001 and 234.0 million in 2000. 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 70.4 million in 2004, 61.0 million in 2003, 54.1 million in 2002, 69.5 million in 2001 and 52.8 million in 2000. 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 2004, total customer contributions, and certain amounts contributed for infrastructure improvements, amounted to approximately 147 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, 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 alleviate demand at peak times.

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Competition

Until 1988, we had a monopoly for 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, the regulator 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 2004, five qualified suppliers were authorized to operate in the Portuguese Non-Binding System, 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 Electricity Market and Spain History and Overview.

EDPD, and previously, our distribution companies, have historically held an effective monopoly over distribution. However, increases in the levels of industrial auto production have reduced the amount of electricity sold to these entities from the PES. In addition, in early 1999, the regulator implemented legislation liberalizing the electricity supply business.

As of May 15, 2003, all Eligible Consumers automatically may become Qualifying Consumers. In 2004, the total number of Qualifying Consumers represented approximately 15% of demand in mainland Portugal in volume terms.

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.

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, the regulator implemented a new tariff regulatory code to be applied in mainland Portugal, establishing a periodic definition of regulatory parameters for tariffs and a methodology for setting tariffs. Since 1999 (the first year the regulator published tariffs), prices are set annually according to a series of formulae that are derived based primarily upon what is deemed to be an appropriate return on assets in transmission, a return fixed by price cap in distribution, and 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 CPPE 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, autoproduction 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 were changed from the 1999-2001 regulatory period to the 2002-2004 regulatory period. The transmission component of the tariff is calculated annually by the regulator 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,

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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 is provided with a return on assets of 8%.

For the 2002-2004 and 2005 regulatory periods, the regulator considered the distribution function to consist of three business areas, which could in the future be liberalized at different times and 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 is no efficiency coefficient for the 2005 regulatory period as it is a one-year period without additional years within the period for purposes of comparison. 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 the regulator 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 framework law for the Portuguese electricity system, the termination of the PPAs and the commencement of MIBEL, the regulator determined that the 2005 regulatory period should be transitory and have a one-year duration.

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 Customers and sales. Item 5. Operating and Financial Review and Prospects and note 42(p) 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, the regulator 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, the regulator 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, or a day-night tariff option. The current tariff regime offers two discount schemes for customers in the PES, which apply to all customers equally. Under the first scheme, medium voltage customers with contracted demand above 4 MW and a yearly utilization greater than 5,000 hours or consumption above 30 GWh are entitled to a discount of 3% (in 2004). Discounts are applied to monthly invoices. This scheme was over by the end of 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 13.5%, depending on the interruptible load contracted. Customer tariffs for very high-voltage, high-voltage and medium-voltage are subject to quarterly adjustments, basically to accommodate changes in fuel prices and demand.

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 the regulator.

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Based on certain assumptions, including an expected inflation rate in 2005 of 2.3% and an expected increase in the electricity consumption of 3.4% in 2005 (in mainland Portugal), in December 2004 the regulator published the parameters and prices of electricity and other services for 2005, according to which the tariffs for sale to final customers in mainland Portugal were increased by 2.3% in nominal terms compared to 2004. In addition, the approval of the new framework law for the electricity system, the termination of PPAs and the expected opening of MIBEL will cause a revision of the tariffs by that time. For 2002, 2003 and 2004, in nominal terms, tariffs increased across all voltage levels by an average of 2.2%, 2.8% and 2.1%, 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 declined by an average of 3.9% over the period 1999-2005. The tariffs for low voltage customers have also declined by an average of 2.7% over the same period.

GAS

EU Directives 98/30/EC and 2003/55/EC defined a legal framework for gradually establishing the internal market in natural gas in the EU. Specific provisions are contained in both Directives for emergent markets, defined as markets where the first commercial supply contract for natural gas was made not more than 10 years earlier. Due to the emergent nature of the Portuguese natural gas sector, Portugal benefits from a derogation from the obligation to liberalize the gas sector. The derogation for Portugal expires in April 2007, at which time customers representing at least 33% of the total annual gas consumption of the national gas market must be eligible to be supplied under competitive conditions. Two years thereafter, supply to all non-domestic customers must be declared eligible and three years after all the market should be liberalized.

The liberalization of the gas market in Portugal will allow us to contract gas for our CCGT plants and to be active in the retail gas market. With respect to the Portgás concession area, after households and small industrial customers become liberalized, other companies will compete with Portgás in its concession area. It is possible that the Portgás distribution network will be used by third parties to sell gas to final customers. However, the regulatory framework to be implemented is not yet defined.

In accordance with the existing legal framework, the Portuguese gas sector is currently a legal monopoly, characterized by a concessions regime in which all activities import, transport, storage, wholesale supply, distribution and retail are considered public services and are carried almost exclusively by GDP, which is wholly owned by GALP. Portgás is the only exception, as it is the only participant Portuguese natural gas section that is not controlled by GDP.

We established a presence in the natural gas markets in Spain and Portugal in accordance with our strategic objectives. In Portugal, we are present in the natural gas market through ownership interests of 59.55% in Portgás and 10.11% in Setgás. We acquired our interests in Portgás and Setgás as a result of the exercise, in 2004, of two options granted in two agreements signed in November 2003. Pursuant to the agreement among us, GALP, GDP and GDP Distribuição, we acquired a shareholding equivalent to 46.625% of the share capital and respective shareholder loans of Portgás for 86.4 million. Pursuant to an agreement between EDP and CGD, we acquired for 66.9 million the total share capital of NQF PTE S.A., which indirectly holds 12.9% and 10.1% of the share capital of Portgás and Setgás, respectively. Under shareholders agreements between NQF, Endesa Gás and Gaz de France/Elyo, we have joint control of Portgás, together with the entities noted above.

In the context of the implementation of our strategy for the Iberian gas market, on September 5, 2005 we concluded negotiations with Endesa Gas, S.A. for the acquisition of a 49% shareholding in NQF Gás for a reference global consideration of €56.5 million. NQF Gás directly holds a 25.348% shareholding in Portgás and, indirectly, a 19.8% shareholding in Setgás.

Upon completion of this transaction, we will be the sole shareholder of NQF Gás, thus increasing our direct and indirect shareholdings in Portgás and Setgás to 72.0% and of 19.8%, respectively.

We also have an interest in GALP corresponding to 14.27% of GALP s share capital.

Portgás and Setgás are two of six local distribution companies in Portugal. Portgás covers 29 municipalities in the northern coast area of Portugal. Setgás covers 10 municipalities on the right southern bank of the Tagus River.

As of December 31, 2004, Portgás and Setgás had approximately 139,300 customers and 98,900 customers, respectively, constituting estimated market shares of 17% and 12%, respectively. Total revenues in 2004 for Portgás and Setgás were 68.0 million and 27.7 million, respectively.

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The table below sets forth additional information regarding Portgás and Setgás as of December 31, 2004:

	Network size (km)	Natural gas equivalent of gas distributed[1][2] (millions of cubic meters)
Portgás	2,249	181
Setgás	1,219	54

(1) *Includes propane gas.*

(2) *Estimated market share of natural gas equivalents is 28% and 9% for Portgás and Setgás, respectively.*

REGULATION

EU legislation

Electricity

On December 19, 1996, a major breakthrough in the creation of an internal market in energy in the EU was reached with the adoption by the European Parliament and the EU Council of Ministers of Directive 96/92/EC concerning common rules for the internal market in electricity, or the Access Directive.

The Access Directive endeavors to promote a competitive open electricity market reconciling the following challenges: (1) increasing efficiency in production, transmission and distribution; (2) reinforcing security of supply; (3) increasing competitiveness of the European economy. The Access Directive was reviewed beginning in March 2001. As a result, Directive 2003/54/EC was adopted and went into effect in August 2003. Member States must implement this Directive by July 1, 2004. The expected scope and impact of this new Directive is discussed below.

Furthermore, Directive 2003/87/EC establishes 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 (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. One of the core tasks in the run-up to the implementation of the ETS is the elaboration of 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 for the first trading period 2005 to 2007 the total quantity of CO_2 emissions that Member States will grant to their companies, which can then be sold or bought by the companies themselves.

Starting January 1, 2005, companies must monitor their emissions and produce at the end of each year a report on annual emissions that will be verified by a third party. At the same time, they must ensure that they are in possession of a sufficient number of allowances to surrender year by

year (the first surrender date is the end of April 2006) in order to avoid being subject to financial sanctions.

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 produce a regular annual report to the European Commission.

Public service obligations and customer protection

Member States must ensure that electricity companies are operated in accordance with the principles of Directive 2003/54/EC with a view toward achieving a competitive, secure and environmentally sustainable market in electricity and must not discriminate between these companies with respect to rights or obligations. Member States may require distribution companies to connect customers to their grid under the Directive. Member States must ensure that eligible customers are effectively able to switch to new suppliers.

Planning of new generation capacity

With regard to construction of new generating capacity, Member States must adopt a tender procedure that must be conducted in accordance with objective, transparent and non-discriminatory criteria. Member States must provide precise criteria for the tender and these criteria must be made public. In the event of a refusal of authorization to construct new generation facilities, the applicants must be duly informed of the reasons for such refusal, and appeal procedures must be made available.

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Tendering for new generation capacity

Member States must ensure the possibility of providing for new capacity or energy efficiency/demand-side management measures through a tendering procedure or an equivalent procedure based on certain objectives, including transparency, non-discriminatory terms and published criteria. However, these procedures may only be launched if, on the basis of the authorization procedure, the generating capacity being built or the energy efficiency/demand-side management measures being taken are not sufficient to ensure the objectives referred to above.

Tender specifications must be made available to any interested undertaking established in the territory of a Member States, and must contain a detailed description of the contract specifications and the procedure to be followed by all tenderers, including an exhaustive list of criteria governing the selection of tenderers and incentives.

Member States must designate an independent authority responsible for the organization, monitoring and control of the tendering procedure.

Transmission system operation

Member States must ensure the long-term ability of the system to meet reasonable demands for the transmission of electricity in order to ensure the security of supply. The transmission system operator will be, in that context, responsible for ensuring a secure, reliable and efficient electricity system and ensuring the availability of all necessary ancillary services insofar as this availability is independent from any other transmission system with which its system is interconnected. The transmission system operator must also provide to any other system operator with which its system is interconnected, sufficient information to secure efficient cooperation and non-discrimination between users or classes of system users.

Where the transmission system operator is part of a vertically-integrated undertaking, it must be independent, at least in terms of its legal form, organization and decision-making, from other activities not relating to transmission, but these rules do not require the separation of ownership of assets of the transmission system from the vertically-integrated undertaking. In order to ensure the independence of the transmission system operator, specific criteria must be followed, including that the entities responsible for the management of the transmission system operator may not be part of the corporate structure of the integrated electricity undertaking responsible, directly or indirectly, for the day-to-day operation of the generation, distribution and supply of electricity.

Distribution system operation

Member States must designate or require companies that own or are responsible for distribution systems to designate, for a period of time to be determined by the Member State, one or more distribution system operators. The distribution system operator must maintain a secure, reliable and efficient electricity distribution system in its area, respecting the environment and without discrimination between system users or classes of users in favor of its related companies.

Where the distribution system operator is part of a vertically-integrated undertaking, it must be independent, at least in terms of its legal form, organization and decision making, from other activities not relating to distribution, without having to separate the ownership of assets of the distribution system operator from the vertically-integrated undertaking. In order to ensure the independence of the distribution system operator, specific criteria must be followed, including that the ones responsible for the management of the distribution system operator may not be part of the corporate structure of the integrated electricity undertaking responsible, directly or indirectly, for the day-to-day operation of the generation, transmission or supply of electricity. These requirements, however, may not be applied to integrated electricity undertakings serving less than 100,000 connected customers, or serving small, isolated systems.

The above considerations do not prevent the existence of a combined transmission and distribution system operator, which is independent in its legal form, organization and decision making from other activities not related to transmission or distribution system

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operation. These rules do not require separation of ownership of assets of the combined system from the vertically-integrated undertaking.

Unbundling and transparency of accounts

Member States or designated authorities, including regulatory authorities, must have access to the accounts of electricity undertakings. Electricity companies whatever their system of ownership or legal form, must draw up, submit to audit and publish their annual accounts in accordance with the rules of national law concerning the annual accounts of limited liability companies.

Electricity companies must keep separate accounts for their transmission and distribution activities, as they would be required to do if the activities in question were carried out by separate companies, in order to avoid discrimination, cross subsidization and distortion of competition. Until July 1, 2007, they must keep separate accounts for supply activities for eligible customers and supply activities for non-eligible customers.

Organization of access to the system

Third party access to transmission and distribution must be ensured by Member States, based on published tariffs and applicable to all eligible customers and applied objectively and without discrimination between system users. The operator of a transmission or distribution system may refuse access only if it lacks the necessary capacity, but must provide duly substantiated reasons for such refusal.

Member States must ensure that the eligible customers are: (a) from July 1, 2004, all non-household customers; and (b) from July 1, 2007, all customers. In order to avoid imbalance in the opening of electricity markets, contracts for the supply of electricity with an eligible customer in the system of another Member State may not be prohibited if the customer is considered eligible in both systems involved.

Member States must designate one or more competent bodies as regulatory authorities. Those bodies must be completely independent from the interests of the electricity industry and are responsible for ensuring non-discriminatory, effective competition and the efficient functioning of the market and have the authority to require transmission and distribution system operators, if necessary, to modify terms, conditions, tariffs, rules, mechanisms and methodologies. They may act as dispute settlement authorities and, therefore, must be competent to judge and to decide on a complaint that any third party may present relating to the transmission or distribution system operator.

Member States are to create appropriate and efficient mechanisms for regulation, control and transparency so as to avoid any abuse of a dominant position. In the event of a sudden crisis in the energy market, a Member State may temporarily take the necessary safeguard measures, taking into consideration that such measures must cause the least possible disturbance in the functioning of the internal market.

Derogation of relevant provisions concerning transmission, distribution, unbundling and transparency of accounts and organization of access to the system may apply if Member States demonstrate that there are substantial problems with regard to the operation of their small isolated systems.

Member States were requested to bring into force all necessary provisions to comply with the Directive 2003/54/EC by July 1, 2004. Member States may, however, postpone until July 1, 2007, the implementation of unbundling of distribution system operators (Article 15 (1)), without prejudice to all legal requirements to produce such implementation.

Gas

The European Parliament and Council of Ministers adopted the new 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 entered into force 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 are published, reinforces public

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service obligations and introduces measures to increase the security of supply.

The main provisions established by the Gas Directive are as follows:

General rules for the organization of the sector: Member States must ensure, on the basis of their institutional organization and with due regard to the principle of subsidiarity, that natural gas undertakings are operated in accordance with the principles of the Gas Directive with a view toward achieving a competitive, secure and environmentally sustainable market in natural gas and must not discriminate between these undertakings with respect to either rights or obligations. Member States may require that undertakings, in the general economic interest, carry out public service obligations that are clearly defined, transparent, non-discriminatory, verifiable and guarantee equality of access for EU gas companies to national consumers and must take appropriate measures to protect final customers. Member States must ensure that eligible customers are effectively able to switch to new suppliers. Nevertheless, long-term contracts will continue to be an important part of the gas supply of Member States and should be maintained as an option for gas supply undertakings as long as they do not undermine the objectives set by the Gas Directive and are compatible with the EU Treaty, including competition rules.

Transmission, storage, LNG, distribution and supply: In the case of a gas undertaking performing transmission, distribution, storage or liquified natural gas (LNG) activities that are separate, in legal form, from those undertakings performing production and/or supply activities, the designated operators may be the same undertaking owning the infrastructure. In order to ensure efficient and non-discriminatory network access, transmission and distribution systems should be operated through legally separate entities where vertically-integrated undertakings exist.

Organization of access to the system: Third party access to the transmission and distribution system, and LNG facilities must be ensured based on published tariffs, applicable to all eligible customers, including supply undertakings, and applied objectively and without discrimination between system users.

For the organization of access to storage facilities and linepack, Member States may choose either or both of the following access procedures (i) negotiated access (with the relevant storage system operator or natural gas undertakings) in which the parties are obliged to negotiate in good faith and must publish their main commercial conditions for the use of storage, linepack and other ancillary services; or (ii) in the case of regulated access, Member States must give rights to access on the basis of published tariffs and/or other terms and obligations for use of those facilities. This right of access for eligible customers may be given by enabling them to enter into supply contracts with competing natural gas undertakings other than with the owner and/or operator of the system or a related undertaking.

Member States must ensure that natural gas undertakings and eligible customers are able to access upstream pipeline networks in compliance with the objectives of fair and open access, achieving a competitive market in natural gas and avoiding any abuse of a dominant position.

Eligibility: Member States must ensure that the eligible customers are: (a) from July 1, 2004, all non-household customers and (b) from July 1, 2007, all customers. 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.

Unbundling of accounts: Natural gas undertakings, whatever their system of ownership or legal form, must draw up, submit to audit and publish their annual accounts. These undertakings must, in their internal accounting, keep separate accounts for each of their transmission, distribution, LNG and storage activities as they would be required to do if the activities in question were carried out by separate undertakings, in order to avoid discrimination, cross-subsidization and distortion of competition.

Emergent markets: Member States qualifying as an emergent market, which, due to the implementation of the Gas Directive would experience substantial problems, may derogate some provisions of the Gas Directive, including matters relating to the

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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. This derogation must automatically expire at that time the Member State no longer qualifies as an emergent market.

According to Article 28 of the Gas Directive, at the time the derogation referred to in the previous paragraph expires, the definition of eligible customers must 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.

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 April 12, 2002, ERSE became the regulatory entity of energy services, and its authority was extended to the domain of natural gas regulation. 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. 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, as described below.

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 Public Electricity Sector 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.

The regulator

ERSE, or the regulator, 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 codes:

the tariff code and the values for the tariffs and prices to be implemented (please see Tariffs);

the commercial relations code governing relations between entities in the Portuguese electricity system;

the dispatch code;

the access to the national transmission grid code; and

the interconnections code.

The codes listed above are applicable to the 2002-2004 regulatory period and were adopted by the regulator in September 2001. In April 2004, the regulator revised the codes referred to above to incorporate the recent expansion, in February 2004, of the eligibility threshold to include special low voltage consumers. In January 2005, the regulator revised the codes once again as a result of the expansion of the eligibility threshold to all consumers pursuant to Decree law no. 192/2004, of August 17, 2004.

The Competition Authority

The Competition Authority applies legislation relating to competition, especially with regard to restrictive practices and concentrations.

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National energy policy

In March 2003, the Portuguese Council of Ministers passed two resolutions regarding, on the one hand, Portuguese energy policy, and, on the other hand, the Portuguese government s options for the restructuring of the Portuguese energy sector.

Resolution no. 63/2003 of the Portuguese Council of Ministers, of April 28, 2003, revoked the previous national energy strategy of September 2001, announced the new Portuguese energy policy and defined general objectives and specific measures to carry out the new policy. In accordance with this resolution, the Portuguese government declared its intention to:

- develop and assure the safety of the national energy supply by adopting measures necessary to (i) reduce the dependency of external sources of energy primarily by country and type of source, (ii) diversify external sources of energy by country and type of source, (iii) keep mandatory reserves of combustibles, and (iv) guarantee an adequate energy generation capacity;

- develop rational energy needs in order to fulfill environmental requirements, namely by (i) setting up mechanisms to achieve the Kyoto Protocol s goals, (ii) participating in European market of emissions, and (iii) promoting the rational use of energy; and

- promote national competitiveness in the new liberalized energy market, namely through, among other measures, (i) the implementation of MIBEL, in stages, to be fully operational by 2006, (ii) the promotion of competition and the opening of the Portuguese electricity and natural gas sectors, which involves, for instance, implementing procedures to renegotiate or terminate the existing PPAs, and (iii) expansion of natural gas regulation, liberalization of combustibles prices and monitoring the functioning of the respective markets, which involves, for example, the separation of the gas high pressure transport network from other activities related with natural gas.

On May 10, 2003, Resolution no. 68/2003 of the Portuguese Council of Ministers defined the options the Portuguese government may utilize to restructure the Portuguese energy sector: (i) combine gas and electricity management and offer the two via the same company, allowing a better use of its synergies and complementarities; (ii) no unilateral imposition of energy sector model restructuring on the sector s companies and their shareholders; (iii) definition of the political, competition and regulatory framework of the energy sector; (iv) freedom of the market s functioning, requiring that from the strategic and organizational framework, rational solutions should arise for the interests of the companies, their shareholders, workers and costumers in order to assure competition of Portuguese companies and the economy within a progressively integrated European market.

In 2005, the Portuguese government announced its intention to consider revisions to the existing regulatory framework and policy, as described in this section. At this time, we cannot predict what changes, if any, the Portuguese government is considering or what effect, if any, such changes would have on our operations.

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, new legislation has been enacted during the last year to bring the structure of the National Electricity System and its operations into line with a competitive market regime, as detailed below:

Decree law no. 153/2004, of June 30, 2004: With a view to facilitating the early termination of the PPAs, establishes that the resolution of the General Meeting of EDP of August 18, 1994, accompanied by a joint declaration by EDP and REN, for the full and accurate identification of the land provided for in Decree law no. 198/2003, of September 2, 2003. It also grants the RNT concession holder, currently REN, the right to use the public water domain under a concession regime;

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Order no. 927/2004, of July 27, 2004: Authorizes OMI Clear Sociedade de Compensação de Mercados de Energia, S.A. to operate as clearing house for electricity derivatives;

Order no. 945/2004, of July 28, 2004: Authorizes the establishment of the electricity derivatives market operated by OMIP Operador do Mercado Ibérico de Energia (Pólo Português) S.A. and defines the entities that may operate as OMIP members;

Decree law no. 192/2004, of August 17, 2004: Building on Decree law no. 36/2004, of February 26, 2004, this decree law extends eligibility to standard low voltage electricity consumers and public lighting, corresponding to a potential customer base of 5,772,840 with an annual consumption of 19,329 GWh, and defines the exercise of the right to eligibility. Decree law no. 192/2004 also designates EDPD as a regulated retailer;

EC Decision 161/2004, of September 22, 2004: The European Commission decided not to raise objections to the stranded costs mechanism intended to compensate such irrecoverable losses on the part of EDP, Tejo Energía and Turbogás;

Law no. 52/2004, of October 29, 2004: Authorizes the Government to regulate on the compensatory measures applicable to the early termination of the PPAs;

Decree law no. 240/2004: Defines the terms for early termination of the PPAs and establishes the compensatory measures designated as Costs for the Maintenance of Contractual Balance (CMECs). For more information, please see Generation Early termination of the PPAs ;

Order no. 139/2005, of February 3, 2005: Establishes the relevant criteria for the issuing of a regulated retailer license and for the registration of external agents;

Decree law no. 33-A/2005, of February 16, 2005: Revises the factors for calculation of the remuneration value for the supply to the PES network of the energy produced in renewable power plants and defines procedures for the attribution of the PES available power and periods for attainment of the license for renewable power plants;

Order no. 228/2005, of February 28, 2005: Establishes and reviews adjustments of the power plants generation used for the computation of the CMECs.

Ministerial Order no. 4672/2005, of March 4, 2005: Approves the agreements for the PPAs early termination.

Taking into account the transitory nature of some of the recent legislation, the need to integrate all the main structural changes into a law that will effect a thorough reform of the organization and functioning of the electricity sector, and the need to translate into national law the Directive 2003/54/CE on the common rules for the electricity market, on March 2005, the Portuguese Government launched a public consultation on a draft basis law.

Other codes

The Commercial Relations Code was published 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 Sector. The regulator 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.

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The Dispatch Code, also published 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 published 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 the regulator. This Code was also 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.

Since 2001, the regulator has been updating these codes, on a yearly basis, to accommodate changes in the electricity sector.

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.

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.

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 assets is subject, in specified cases, to payment as described in the following paragraphs:

Licenses for generation

Assets held by CPPE 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, CPPE 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.

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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 one 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.

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, 38% and 17% of our installed capacity in Portugal (85% of our thermal installed capacity) and Spain, respectively, has been certified under ISO 14001.

Our main environmental focus concerns the reduction of the emission of atmospheric pollutants, namely SO_2, NO_x emissions and particles. Pursuant to environmental laws and regulations to which we are subject, we have been using fuel with progressively lower sulfur levels and have introduced NO_x primary reduction measures in the Sines thermoelectric power station (with the last phase of this introduction having been completed in 2004). 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 desulfurization and additional NO_x primary reduction measures) at Sines and are introducing similar equipment to control SO_2 and NO_X emissions at our thermoelectric plants in Spain. The Barreiro, Carregado and Setúbal power plants in Portugal are expected to be exempt from compliance with new emission limit requirements.

We have closely monitored national and international initiatives related to climatic changes. We have also actively contributed to discussions on the Portuguese National Program on Climate Change, which defines greenhouse gases (or GHG) emission reduction measures to be implemented in Portugal, as well as discussions on the NAP, which assigns GHG emission allowances (namely, allowances for CO_2 emissions) to installations in specific industrial sectors, including thermal power plants. Similar initiatives are being considered in Spain. We are prepared for the European CO_2 emission allowances market, which is expected to start in 2005. Monitoring mechanisms were studied and adapted to the requirements of the Emissions Trading Directive and the trading unit is now able to begin trading future CO_2 allowances. Our fuel purchases include, since January 2005, the cost of CO_2 allowances and the risk model for our trading was altered to accommodate the risk inherent in price fluctuations of CO_2 allowances.

We incur significant expenses in repair and prevention measures in order to fulfill the demands of environmental regulations. We made capital expenditures related to environmental matters in 2004, 2003 and 2002 of approximately 18 million, 10 million and 15 million, respectively. Our aggregate estimate for capital expenditure to control emissions of SO_2 and NO_X in the period 2005 to 2007 is 345 million, of which half is expected to be incurred at our thermoelectric plants in Spain.

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 the Group s operations.

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Portuguese gas regulation

Although the Portuguese government committed, through Resolution of the Council of Ministers no. 63/2003, to anticipate the liberalization of the natural gas sector by July 1, 2004, the corresponding legislation has not been enacted and, therefore, the Portuguese natural gas market can still be classified as an emergent and non-liberalized market.

The participation of companies in the operation of the gas sector is structured by public concession agreements (concessions for the importation, storage and treatment of natural gas and its transport and concessions for regional distribution of natural gas) and administrative licenses (for gas facilities, for the implantation and operation of autonomous local networks from liquefied gas autonomous units (UAG) and for the construction of terminals of natural gas for refilling of vehicles).

Portuguese companies operating in the natural gas market benefit from a public statute which awards a wide set of rights, such as the right to use the public domain, the possibility of benefiting from eminent domain and from administrative easements, the existence of a specific administrative procedure through which approval of infrastructure incorporated in the natural gas system is required, the right to apply for EU incentives, an exemption from payment of the Portuguese tax on oil products (*Imposto sobre Produtos Petrolíferos*) and a decrease in the percentage of Portuguese value added tax to be paid.

Decree law no. 14/2001, of January 27, 2001, provides for the organization and operation of the natural gas sector, transposing into national law EU Directive no. 98/30/CE, of June 22, 1998, which set out the common rules for the achievement of a competitive natural gas market within the broader goal of the creation of the Internal Market in Energy. In order to ensure the effective application of the natural gas market operation rules defined in Decree law no. 14/2001, Decree law no. 97/2002, of April 12, 2002, expanded ERSE s responsibilities to include the regulation of the gas sector. Among the attributions of ERSE with respect to the gas sector is the power to adopt regulations on the following subjects:

- Regulation of access to the networks, interconnections and storage facilities;
- Commercial relations regulation;
- Regulation of the service quality; and
- Tariff regulation.

With respect to tariff regulation, the organizational documents of ERSE grant to it the power to approve or to fix the tariffs proposed by the entities to which the regional distribution concessions are granted, or by the entities licensed to operate the autonomous local networks, for the supply of natural gas to industrial, commercial and domestic consumers. However, while the natural gas market maintains its present nature of being an emergent market, the powers regarding tariff regulations reside with the Portuguese government or DGGE.

Presently, the key aspects regarding the natural gas legal framework are governed by Decree law no. 374/89, of October 25, 1989, Decree law no. 274-A/93, of August 4, 1993, and Decree law no. 8/2000, of February 8, 2000, which relate to regulation of the importation, storage, treatment and distribution of natural gas, liquefied gas and substitution gases and the respective public licensing. The Portuguese natural gas

legal framework, which is presently characterized by a wide variety of regulations, is expected to be subject in the near future to a general revision and reorganization, pursuant to EU Directive no. 2003/55/CE, of June 26, 2003, relating to the liberalization of natural gas market. In this respect, Order no. 14/2003, of February 5, 2003 and Order no. 68/2003, of May 10, 2003 already reflect the concerns over reorganizing the natural gas sector as a part of the general reorganization of the energy sector, and, most recently, Order no. 10 317/2005, of April 20, 2005 has created two working groups for the purpose of presenting legislative proposals for the restructuring of the electricity and natural gas sectors, transposing into national law EU Directives no. 2003/54/CE and no. 2003/55/CE.

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SPAIN

HISTORY AND OVERVIEW

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.

After tender offers for Hidrocantábrico shares in 2001, a consortium formed by us, CajAstur Caja de Ahorros de Asturias, or CajAstur, a Spanish savings bank, and Caser Caja de Seguros Reunidos, Compañía de Seguros y Reaseguros, S.A., or Caser, a Spanish insurance company, owned approximately 35% of Hidrocantábrico. In addition, CajAstur and Caser each owned Hidrocantábrico shares outside of the consortium. Approximately 60% of Hidrocantábrico was owned by Energie-Baden-Württemberg AG, or EnBW, a German utility company. In December 2001 we signed an agreement with EnBW, CajAstur and Caser concerning joint control of Hidrocantábrico. At that time, Hidrocantábrico was 39.52% owned by us, 34.58% owned by EnBW and 24.7% owned by CajAstur and Caser. The remaining 1.20% was comprised of shares owned by other shareholders and shares held by Hidrocantábrico itself.

Under agreements executed on July 29, 2004, we agreed to acquire the following stakes in Hidrocantábrico: 34.6% from EnBW for 649 million in cash, 17.5% from CajAstur for 453 million in EDP ordinary shares and 4.1% from Caser for 93 million in cash. In connection with our acquisition of an additional 56.2% stake in Hidrocantábrico in December 2004, we entered into a shareholders agreement with CajAstur and Caser, which 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.

ELECTRICITY

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, or at tariffs linked to pool prices plus a premium, that vary depending on the type of generation and are generally higher than regulated tariffs, or (ii) 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, or qualified consumers, 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 beginning of each year, the Spanish government sets both the final and access tariffs. By Royal Decree no. 2392/2004, the Spanish government established the electricity tariffs for 2005.

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Liberalized suppliers are free to set a price to 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.

GENERATION

Hidrocantábrico s installed capacity represents 4.3% of Spain s mainland generation capacity, or 5.1%, excluding special regime facilities. In 2004, Hidrocantábrico had a total installed capacity of 2,941 MW, approximately 54.5% of which are coal-fired facilities, 13.4% a CCGT facility, 14.8% hydroelectric facilities, 1.4% cogeneration facilities, 2.4% waste to energy facilities and 7.9% renewable energy facilities other than special regime hydroelectric. Hidrocantábrico also 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 2002, 2003 and 2004.

	As of December 31,		
Type of facility	**2002**	**2003**	**2004**
	(MW) [1]		
Hydroelectric:			
Hydroelectric Ordinary regime	413	432	433
Hydroelectric Special regime	3	3	3
Total hydroelectric	416	435	436
Thermal:			
Coal	1,588	1,605	1,605
CCGT	393	393	393
Nuclear	165	165	165
Total Thermal	2,146	2,163	2,163
Cogeneration	23	24	41
Wind	0	81	223
Biomass	3	3	7
Waste	16	33	72
Total	2,605	2,738	2,941

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

The following table sets forth Hidrocantábrico s thermal plants.

Thermal plants	**Installed capacity**	**Fuel**	**Year entered into**

	(MW)		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	393	Natural gas	2002
Total installed capacity	2,163		

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

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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	9.14	Reservoir	1917/24	2002
La Riera	7.83	Run of river	1946/56	2001
Miranda	73.19	Run of river	1962	2000
Proaza	50.33	Reservoir	1968	2002
Priañes	18.50	Reservoir	1952/67	2003
Salime	79.74	Reservoir	1954	2003
Tanes	125.46	Reservoir	1978	1995
La Barca	55.72	Reservoir	1967/74	2002
La Florida	7.60	Reservoir	1952/60	1998
Laviana	1.10	Run of river	1903	2001
Caño	1.00	Run of river	1928	1996
San Isidro	3.12	Run of river	1957	2002
Total installed capacity	432.73			

The average remaining useful life of Hidrocantábrico s hydroelectric generation plants is approximately 46 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 2004 was characterized by high availability and efficiency of Hidrocantábrico s power plants. Net production in the ordinary regime, which was 14,408 GWh in 2004, increased 1.8% from 14,154 GWh in 2003 (out of a total generation in the Spanish market in 2004 of approximately 197.7 TWh, according to REE). Hydroelectric generation represented 854 GWh, a decrease from 861 GWh in 2003; the coal-fired thermal generation amounted to 10,356 GWh in 2004, a slight decrease of 1.3% from 10,491 GWh in 2003; natural gas-fired thermal generation (combined cycle) amounted to 1,961 GWh in 2004, an increase of 26.8% from 1,546 GWh the previous year. Nuclear generation, corresponding to our 15.5% stake in the Trillo nuclear power plant was 1,237 GWh in 2004, compared to 1,256 GWh in 2003.

The following table summarizes Hidrocantábrico s electricity generation for 2002, 2003 and 2004, excluding losses at generation plants and Hidrocantábrico s own or ancillary consumption, and sets forth the hydroelectric coefficient at year-end 2002, 2003 and 2004.

	Year ended December 31,		
Type of facility	2002	2003	2004
	(in GWh, except by		

				hydroelectric coefficient factor) [1]
Hydroelectric:				
Hydroelectric	Ordinary regime[2]	771	861	854
Hydroelectric	Special regime	6	12	12
Total hydroelectric		777	873	866
Thermal:				
Coal		10,997	10,491	10,356
Natural Gas		522	1,546	1,961

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Type of facility	Year ended December 31, 2002	2003	2004
	(in GWh, except by hydroelectric coefficient factor) [1]		
Nuclear[3]	1,212	1,257	1,237
Cogeneration	80	87	129
Total thermal	12,811	13,381	13,683
Wind	0	35	272
Biomass	9	12	15
Waste	61	86	198
Total	13,658	14,387	15,035
Hydroelectric coefficient[4]	0.96	1.07	1.08

(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: 92 GWh in 2002, 89 GWh in 2003 and 76 GWh in 2004.*

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

(4) *The hydroelectric coefficient varies based on the hydrological conditions in a given year. A hydroelectric coefficient of one corresponds to an average year, while 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 95.68% in 2003 to 95.40% in 2004 for thermal plants and increased from 87.71% in 2003 to 96.42% in 2004 for hydroelectric plants. Hidrocantábrico s forced outages in 2004 were 2.67% at thermal plants and 1.26% at hydroelectric plants.

The table below sets out for each type of Hidrocantábrico generating facility the average capacity utilization and the average availability factor for 2002, 2003 and 2004.

Type of facility	Average capacity utilization[1] Year ended December 31, 2002	2003	2004	Average availability factor Year ended December 31, 2002	2003	2004
Hydroelectric	21.66%	23.12%	22.83%	89.26%	87.71%	96.42%
Thermal:						
Coal	83.79%	78.75%	77.65%	93.94%	95.73%	94.99%
Natural gas[2]	47.31%	46.55%	58.76%	97.19%	96.26%	98.40%
Nuclear	89.57%	92.95%	91.01%	89.66%	93.85%	92.23%

Total weighted average thermal[3]	81.75%	73.98%	75.24%	94.21%	95.68%	95.40%

(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 2003, the availability and efficiency of Hidrocantábrico power plants were high, leading to a 1.8% increase in generation in 2004. The new Castejón plant had an average availability factor of 98.4%. Hidrocantábrico had maintenance outages at its Soto 3 and Castejón power plants in 2004, 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 3,749 thousand metric tons of coal in 2004, 78.3% of which was imported and 21.7% domestic. Fuel consumption costs including transportation amounted to 293 million in 2004 and 211 million in 2003. During 2004 there was an increase in Hidrocantábrico s fuel costs. The increase in the price of imported coal was mainly due to strong demand in China and India, while the cost of natural gas, although lower than in 2003, was influenced by the increase in the price of oil and its derivatives during 2004.

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In 2004, capital expenditures on generating facilities amounted to 201 million, an increase of 114% from 2003. These expenditures are set forth below.

Plant type and status	Year ended December 31, 2002	2003	2004
	(thousands of EUR)		
Hydroelectric plants in operation	1,428	2,107	943
Thermal plants in operation	65,082	20,151	32,170
Special regime:[1]			
Hydroelectric plants in operation	2	0	0
Wind	16,264	49,047	140,685
Waste	2,067	3,500	10,530
Biomass	1,120	350	10,905
Cogeneration facilities	814	18,720	5,880
Total Generation	86,777	93,875	201,113

(1) *Excludes capital expenditures of H. Santillana, a company in which we hold in minority stake. Data corresponding to Genesa I, S.L., or Genesa I, a 60%-owned subsidiary of Hidrocantábrico as of December 31, 2002, and an 80%-owned subsidiary of Hidrocantábrico as of December 31, 2003 and 2004, respectively, represents 100% of capital expenditures of SINAE and its subsidiaries. For more information on SINAE, see Special regime generation below.*

Hidrocantábrico is planning to develop three CCGT plants as set forth in the table below:

Facility	Type of generation	Developing entity	Planned capacity (MW)	Target year	Status
Soto 4 and Soto 5	CCGT	Hidrocantábrico	2 x 400	2007-08	Licensing Process
Castejón 2	CCGT	Elerebro	400	2007	Licensing Process

In addition, Hidrocantábrico is currently analyzing other locations for new power plants.

Special regime generation

Special regime generation is developed by Hidrocantábrico through Genesa I, an 80%-owned subsidiary, which mainly focuses on cogeneration and wind power. Throughout 2004, Hidrocantábrico worked on the restructuring of this business s shareholdings and industrial activities, with the objective of providing a basis for stable and sustained development focusing on the promotion, operation and management of renewable energy sources, mainly wind power. As part of this restructuring, on July 31, 2004, Hidrocantábrico merged its subsidiaries Genesa and Sinae to form a new company, Genesa I.

During 2004, we finalized the construction of the 124 MW Campollano wind farm in Albacete and the 6.6 MW expansion at the Cruz del Hierro wind farm. Currently, the following plants are under construction: La Brújula, Boquerón, Sotonera, Belchite and Las Lomillas, totaling more than 200 MW.

Hidrocantábrico is planning to develop the following wind farms:

Facility	Type of Generation	Planned Capacity (MW)	Target Year	Status
P.E. Brújula	Wind	73.5	2005	Construction
P.E. Las Lomillas	Wind	49.5	2005	Construction
P.E. La Boquerón	Wind	22	2005	Construction
P.E. La Sotonera	Wind	18.9	2005	Construction
P.E. Belchite	Wind	49.5	2005	Construction
P.E. Carondio	Wind	47.3	2006	Planning
P.E. Munera I & II	Wind	70	2006	Planning
P.E. Medinaceli	Wind	40	2007	Planning
P.E. Avila Oeste	Wind	68.0	2007	Planning
P.E. Burgos Este	Wind	111	2007	Planning
P.E. San Roque	Wind	24.7	2006	Planning
P.E. La Dehesica	Wind	28.5	2006	Planning
P.E. Madero	Wind	33	2006	Planning
P.E. Curiscao Pumar	Wind	89.3	2006	Planning
P.E. Belmonte	Wind	34	2007	Planning

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Competition

Hidrocantábrico competes with other generators in the wholesale electricity market. The wholesale market was characterized by three very different periods in 2004: January through May, June through August and September through December. In the first five months of the year, the final prices were similar to those in 2003: 31.39 per MWh from 31.20 per MWh in 2003. In the summer period, June to August, prices were reduced: 35.47 per MWh in 2004 from 45.90 per MWh in 2003. In the last 4 months of the year prices increased: 40.97 per MWh in 2004 from 37.68 per MWh in 2003. Altogether, the final marginal pool price in 2004 was 35.65 per MWh, which represented a reduction of 3.3% compared to 37.26 per MWh in 2003. Hidrocantábrico s market share in the Spanish pool was approximately 7.4% in 2004, up 7.6% from 2003.

This price environment was determined by a lower hydro availability in the first months 2004, and an excess of offered electricity in the first months of the start up of CCGT plants and the significant increase of wind power in the system, which caused the reduction of prices, especially during the summer months. During the last part of 2004 prices rose, due to the reduction of the hydroelectric contribution.

DISTRIBUTION AND SUPPLY

Electricity Distribution and Supply

Hidrocantábrico has a network infrastructure that covers the regions of Asturias (accounting for the vast majority of its network), Valencia, Madrid and Alicante, totaling 19,572 km as follows:

Distribution lines	Km
Overhead lines:	
High-voltage (50/132kV)	1,366
Medium-voltage (5/10/16/20/22/24 kV)	4,496
Low-voltage (<1kV)	11,259
Total overhead lines	17,121
Underground cables:	
High-voltage (50/132kV)	12
Medium-voltage (5/10/16/20/22/24 kV)	875
Low-voltage (1kV)	1,564
Total underground cables	2,451
Total	19,572

Electricity distributed in 2004 through Hidrocantábrico s own network amounted to 9,002 GWh, a 4.0% increase from 2003 levels. As of December 31, 2004, Hidrocantábrico s distribution business had 574,560 customers out of a total number of consumers of 22,832,749, according to the *Comisión Nacional de Energia*, representing a 2.4% increase from 2003 and including 6,723 qualified consumers that are being supplied by non-regulated suppliers. Since January 1, 2003, every consumer in Hidrocantábrico s market can elect to be supplied by non-regulated suppliers. In 2004, there were a total of 28.7 million consumers in the Iberian electricity market according to the Portuguese DGGE and the

Spanish *Comisión Nacional de Energia*.

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In 2004, the volume of electricity distributed and the number of customers by voltage level was as follows:

Distribution by level of voltage	GWh	% annual increase (decrease) from 2003	Total customers
High and very high-voltage[1]	5,691	3.1%	20
Medium-voltage[2]	1,057	6.7%	757
Low-voltage[3]	2,254	4.9%	573,783
Total	9,002	4%	574,560

(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 2004, 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.

In 2004, 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. The quality indicator for distribution electricity activity (TIEPI, or equivalent interruption time of installed capacity) was 1.13 hours in 2004, which we believe is better than the average of the Spanish electricity sector.

The electricity supply activity performed by Hidrocantábrico Energía, S.A.U., and Naturcorp includes the supply of electricity to qualified consumers. Hidrocantábrico Energía and Naturcorp invoiced 4,616 GWh of electricity supply in 2004, with sales of 259.1 million in 2004, compared to 4,526 GWh of electricity supply with sales of 260.8 million in 2003. This figure represents 5.80% of the liberalized market. More than 75% was supplied outside of Hidrocantábrico s traditional market.

In 2004, Hidrocantábrico Energía successfully participated in the annual auction of the RENFE electricity contract, the Spanish railroad and the biggest electricity consumer currently in the market. Hidrocantábrico Energía won 13% of the 2004 supply contracts.

Environmental activities

In 2004, the Castejón CCGT plant obtained the UNE/EN/ISO 14001 (the 2004 compliant environmental management certification). It is the first plant in Spain to obtain this certification.

Also in 2004, Spain s NAP on greenhouse gas trading was published for the period 2005-2007. The emission rights assigned to Hidrocantábrico will enable it to operate normally.

In 2004, Hidrocantábrico published its first Environmental Annual Report, following an audit by an independent company.

Competition

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

The highlight of 2004 was the consolidation of low voltage customers in the liberalized market. During 2004, an average of 547,000 consumers purchased energy in the market. Among these 547,000 consumers, approximately 67,300 were small and medium enterprises (SMEs) and the rest corresponded to household consumers. In terms of energy, this represents a consumption of 8,613 GWh. By December 2004, the number of SMEs operating in the market exceeded 97,000 consumers and household consumers totaled over 1,000,000. Nevertheless, these 1.1 million total customers operating in the market at the end of 2004 comprised only 4.8% of the total consumers of electricity in mainland Spain.

At high voltage, a small increase of 2.3% occurred with the customers in the market (on average). This represented a consumption of 63,171 GWh, slightly lower than the consumption in 2003 that was 68,439 GWh (average supplies billed during the period), due to the fact that some large customers returned to the tariff market because of better prices.

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GAS

Overview

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.

Gas distribution

Gas invoiced in 2004 to the regulated market amounted to 7,227 GWh, representing a 65.4% increase from 4,370 GWh in 2003, due to the contribution of Naturcorp. Additionally, the volume of gas distributed in the liberalized market (in which we provide third-party access to our network) reached 14,832 GWh. The total number of gas consumers that are connected to Hidrocantábrico s distribution network increased from 542,794 in 2003 to 577,802 in 2004, representing approximately 10.3% of the 5,632,136 total number of consumers in Spain, according to the *Comisión Nacional de Energia*. Hidrocantábrico s gas distribution activities revenues of 299.9 million in 2004 compared with 157.0 million in 2003, the increase primarily reflecting the acquisition of Naturcorp. In 2004, Hidrocantábrico had 9.0% of the gas consumers in Iberia (according to GALP Energia there were approximately 0.8 million consumers in Portugal in 2004 and according to the *Comisión Nacional de Energia* there were approximately 5.6 million consumers in Spain in 2004).

Gas supply

In 2004, Hidrocantábrico Energía continued its natural gas supply service that began in 2002. Since August 1, 2003, Naturcorp has been included in reported results of gas supply. Taking Naturcorp into account, Hidrocantábrico has entered into 1,500 contracts and invoiced 10,989 GWh.

Competition

At the end of 2004, the number of consumers operating in the liberalized market were 1,218,785, representing 21.6% of the total gas consumers in Spain (approximately one out of five consumers). Taking into account that at the end of 2003 there were a total of 171,580 consumers in the liberalized market, the increase during 2004 has been more than 1,000,000. This figure constitutes a sevenfold increase in the number of clients in the liberalized market. In terms of energy, 80.2% was sold in the liberalized market (259,960 GWh).

By group of customers, most of the consumers in groups 1 and 2, industrial customers, were in the liberalized market, with a share of consumption in such groups in terms of energy of 99% and 98%, respectively. In terms of the number of consumers, the percentages are 98.8% and 92%, respectively.

For group 3, residential and commercial consumers, 22.4% of consumption in terms of energy was purchased in the liberalized market. In terms of the number of consumers, the percentage in the liberalized market was 21.6%.

OTHER ACTIVITIES

Telecommunications

Hidrocantábrico is in the process of divesting in non-strategic businesses, as reflected by the sale of its shareholding in Retecal. On October 20, 2004, Hidrocantábrico sold its total shareholding of 34.96% in Retecal to Group Corporativo Ono. The cash proceeds from this sale amounted to 57.5 million, while the book value of the shareholding was 32.8 million.

Hidrocantábrico continues to own 45.95% of Sociedad Promotora de las telecomunicaciones en Asturias, S.A.

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Research and development

Research and development activities carried out in 2004 were aimed at the reduction of emissions, treatment of by-products, maintenance and the extension of equipment life at various plants and were conducted in coordination with various universities and industry groups and were partially subsidized by the Spanish government and European Union entities.

REGULATION

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 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) at the same time;
- a wholesale generation market, or electricity pool;
- freedom of entry for new operators with liberalized activities in the electricity sector;
- liberalized activities to take place in a competitive environment, while transmission, distribution, technical management of the system and economic management of wholesale market activities will continue to be regulated as these activities particular characteristics impose severe 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.

During 2004, the Industry Ministry announced the elaboration of a White Paper in order to study whether possible changes in the Electricity System to improve its operation and performance are feasible at this time.

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. Currently, 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, Compañía Operadora del Mercado Español de Electricidad, 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 28.5% 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) and in the case of OMEL to 5%, except that economic managers of other electricity systems may hold stakes of up to 10% in OMEL until June 30, 2006.

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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. Moreover, the same law 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. The main consequences of this law measures are the following:

- limitation of activities of dominant players , such as a prohibition on importing electricity into the MIBEL from any 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 as from 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. One of these measures is the suspension until 2006 of the 2004 Technologic Stranded Costs payment; and

- the nuclear combustible financing system has been amended. The cost of the activity related to the second part of the nuclear fuel cycle (radioactive waste management) has been excluded from the tariff and now it must be paid directly by the nuclear plants.

Due to increasing concern over environmental matters, generation activities included in the special regime (those based on non-consumable, renewable energies as well as specific cogeneration plants) have become increasingly important in recent times. Royal Decree no. 436/2004, of March 12, 2004, establishes a new legal and financial framework for generation activities. The aim of this Royal Decree is to promote clean energy such that it will constitute approximately 30% of total electricity consumption by 2010. The new financial framework 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).

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. On March 9, 2005, this Royal Decree law was replaced by Law no. 1/2005, 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 states the total quantity of allowances intended to be allocated for the 2005-2007 period. This allocation was approved by the European

Commission on December 27, 2004. 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. The current regulatory framework has changed, however, the manner in which electricity businesses receive payments, in order to promote efficiency and quality of service.

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.

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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. Economic terms of retailing transactions are freely agreed to by the parties concerned. 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. Annual increases to tariffs cannot exceed 2% and electricity companies carrying out regulated activities can recover the losses known as rate deficits, caused by the reduction of tariffs during the period 2000-2002.

Royal Decree no. 2392/2004, of December 2004, fixed the tariffs for 2005 and provided for an average rise of 1.71% on the 2003 average tariff (or reference tariff, which includes all applicable tariffs and costs).

The tariff for regulated customers increased 1.71% from 2004 and access tariffs also increased 1.71% from 2004. Both the supply and access tariffs for residential consumers increased 1.74% from 2004, and tariffs for other consumers increased 1.61% from 2004.

These tariff increases are due to the inclusion of the following elements of the tariffs for 2005:

- payments in respect of regulated activities such as transport, distribution and trading carried out by certain companies, mainly in the Canary and Balearic Islands;
- fixed compensation for the costs incurred by specific companies owning electricity generation facilities in connection with the transition to the competitive market regime (stranded costs);
- the annual compensation for recovering the rate deficit of regulated activities as well as the review of the compensation to the electricity systems inside and outside the Iberian Peninsula during 2001 and 2002;
- the outcome of the updates for predictions and deviations in the estimates adopted for calculating the 2003 tariff; and
- REE s costs relating to the management of the system outside the Iberian Peninsula.

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 may 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 or with a set tariff;

- 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;

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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;

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;

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.

BRAZIL

OVERVIEW

Brazil s electricity industry is organized into one large interconnected electricity system, which is known as the Sistema Interligado Nacional, or the Brazilian SIN, comprised of electricity companies in the southern, southeast, central-western, northeast and parts of the northern regions of Brazil, and several other small, isolated systems. Generation, transmission, distribution and supply activities are legally separated in Brazil.

In 2004, Brazil had a total installed generation capacity of 88,629 MW, of which approximately 78.0% was hydroelectric and 19.8% was thermal, according to the Brazilian National Electric Agency (Brazil s electricity regulator), or ANEEL. In addition, in order to satisfy its electricity requirements, Brazil imported 8.3% (8,170 MW) of its required electricity in 2004. In 2003, the Ministry of Mines and Energy (*Ministério de Minas e Energia*), or MME, approved a ten-year expansion plan under which Brazil s total installed electricity generation capacity is projected to increase to 117,473 MW by 2012, of which 90,022 MW (76.6%) will be hydroelectric, 17,072 MW (14.5%) will be thermoelectric, 8,201 MW (7.0%) will be from small power plants and 2,178 MW (1.9%) will be imported through the interconnected system.

Eletrobrás, a company controlled by the Brazilian government, owns approximately 42% of the installed generating capacity within Brazil. Eletrobrás has regional subsidiaries responsible for generation and transmission of electricity: Centrais Elétricas do Norte de Brasil S.A. Eletronorte and Companhia Hidroelétrica do São Francisco CHESF in the north and northeast of Brazil, Furnas Centrais Elétricas S.A. in the southeast and central-west of Brazil and Centrais Elétricas do Sul do Brasil S.A. Eletrosul in the south of Brazil. In addition, Eletrobrás controls Eletrobrás Termonuclear S.A. Eletronuclear. In addition, some Brazilian states control entities involved in the generation, transmission and distribution of electricity. They include, among others, Companhia Energética de São Paulo CESP, Companhia Paranaense de Energia COPEL and Companhia Energética de Minas Gerais CEMIG. Currently, private companies own approximately 39% and 69% of the generation and distribution markets in Brazil, respectively, in terms of total capacity.

In 2004, total electricity consumption in Brazil reached 320,772 GWh, exceeding 2003 figures by 4.5% and representing growth similar to that of Brazil s GDP for the same period, which was 4.9%. Growth in electricity consumption is expected to remain consistent with Brazil s overall economic performance in the coming years.

Through Energias do Brasil, our Brazilian holding company, and our other Brazilian subsidiaries, we engage in the distribution, generation and trading of electricity in the Brazilian market. Our Brazilian electricity distribution companies have approximately 2.9 million customers, located in 171 municipalities with a total population of 9.6 million inhabitatants. Our Brazilian generation assets provided our Brazilian operations with an installed capacity of 529.6 MW at December 31, 2004. Our Brazilian subsidiaries engaged

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in distribution include Bandeirante, one of the principal electricity distribution concessionaires in the state of São Paulo; Escelsa, the principal electricity distribution concessionaire in the state of Espirito Santo; and Enersul, the principal electricity distribution concessionaire in the state of Mato Grosso do Sul. In the generation segment, we participate in the Lajeado hydroelectric plant, through EDP Lajeado, located on the Tocantins River, with a total installed capacity of 902.5 MW, and in the Peixe Angical hydroelectric plant, which is expected to commence operations in 2006 and to have a total installed capacity of 452 MW. We also control a number of hydroelectric and thermoelectric plants that have a combined installed capacity of 280.1 MW. We expect to expand our generation capacity through planned plant construction and generation projects and through participation in public auctions for new hydroelectric power plants. Our electricity trading operations are carried out by Enertrade, which sold a total of 4,849 GWh in 2004, making it one of the largest electricity trading companies in Brazil.

In 2005, we concluded the process of corporate reorganization of our Brazilian operations. For more information on this, see Corporate Reorganization. For the structure of our holdings in Brazil, see History and Business Overview.

In recent years, the electricity sector in Brazil has been adversely affected by internal and external economic circumstances. The Brazilian economy was affected by the worldwide economic slowdown, and in 2002, uncertainty surrounding the October presidential elections. As a result, the value of the real sharply depreciated and Brazilian inflation and interest rates increased. These conditions led to a scarcity of financing sources, which adversely affected the industrial sectors of the Brazilian economy, including the electricity sector.

In addition to these adverse economic circumstances, in recent years, electric utility companies in Brazil have had to contend with low wholesale prices in the wholesale electricity market, or the MAE, and uncertainties regarding the electricity sector s regulations and framework due to the implementation of new programs by the administration and the lack of an existing stable and consistent legal framework. Also, the Brazilian government s implementation of an electricity plan from 2001 to 2002 had an adverse effect on consumption habits in affected areas, which continues to affect demand for electricity from our distribution businesses in Brazil. In 2003, the main events affecting the Brazilian electric utility industry were the macroeconomic turnaround in the country, good hydrological conditions that resulted in an oversupply of electricity, a substantial increase in the installed capacity, mainly due to investments started in the previous periods, and moderate consumption growth.

In 2004, the main events affecting the Brazilian electric utility industry were:

- Economic growth became more visible due to the effects of a less restrictive monetary policy that began to produce results. Brazil s GDP grew 4.9% in 2004 and the real appreciated by 8.8% in relation to the U.S. dollar between December 31, 2003 and 2004;
- The New Electricity Law was approved in March 2004. According to the MME, the new rules will allow, in the long run, reduce electricity tariffs, while decreasing the risk of blackouts and attracting more investments;
- The good hydrological conditions in the main consumption markets, which affected the prices at which electricity is bought and sold; and
- Total electricity consumption in 2004 grew to 320,772 GWh, exceeding 2003 by 4.5% and representing growth similar to that of Brazil s GDP, which was 4.9%, for the same period.

As a result, the installed capacity in Brazil increased 5.23% on average from 2000 to 2004, and consumption in 2004 was higher than pre-rationing levels. Although the model under the New Electricity Law reduces market risk, its ability to encourage private investment in the electricity sector will depend on how the new regulatory framework is implemented. See Regulation Legal and regulatory framework.

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CORPORATE REORGANIZATION

Energias do Brasil is a holding company that holds the majority of our investments in the Brazilian electric power industry. In October 2002, we completed the first stage of the restructuring, which put our interests in the following companies under the direct control of Energias do Brasil: Energest S.A., or Energest, Enertrade, Bandeirante, EDP Lajeado, FAFEN Energia S.A., or Fafen, and Enerpeixe. On December 31, 2003, Energias do Brasil took the control of IVEN S.A., or IVEN, the company that directly controlled Escelsa and indirectly controlled Enersul. In connection with this process, Energias do Brasil merged Calibre Participações S.A., 135 Participações S.A., EDP 2000 Participações Ltda, and EDP Investimentos Ltda. Following the reorganization of the IVEN holding, Energias do Brasil owns a 69.55% stake in the voting shares and a 23.99% stake in IVEN s total capital. Another action taken was the merger of Enerpro into Energest, consolidating in Energest all activities concerning the development and implementation of generation projects, and also engineering, operation and maintenance services for the generation business units in Brazil. The main goals of these transactions were to simplify the corporate structure of our holdings and capture synergies.

On March 16, 2005, we changed the name of our subsidiary from EDP Brasil S.A., or EDP Brasil, to EDP-Energias do Brasil S.A, or Energias do Brasil. In this annual report Energias do Brasil refers to this subsidiary before and after its name change.

We implemented a second stage of corporate reorganization in order to comply with the New Electricity Law, which required the restructuring of our operations. Under the New Electricity Law, companies and concessionaires that distribute electricity through the interconnected system are restricted from various activities, including engaging in generation activities, transmission activities and the sale of electricity to free customers. Similarly, concessionaires and companies authorized to perform generation or transmission operating in the interconnected system are prohibited from associating with or controlling companies that distribute electricity in the interconnected system. Companies and concessionaires engaged in these restricted activities must restructure their activities and be in compliance by September 2005. For more information on the New Electricity Law, see Regulation.

As a result of these regulations, which effectively required the restructuring of the vertical organization of our operations, and our desire, among other things, to simplify the corporate structure of our Brazilian holdings, optimize the allocation of funds, create liquidity and dispersion of share ownership at the level of Energias do Brasil and make other necessary changes to implement our strategic plan, we implemented the second stage of our corporate reorganization this year.

This corporate organization is designed to:

- simplify the corporate structure of our Brazilian holdings by transferring the direct ownership of all the shares of our Brazilian distribution companies to Energias do Brasil and making Energias do Brasil responsible for the collective financial consolidation and strategic planning;
- optimize the allocation of our funds in order to provide high returns for our shareholders;
- implement corporate governance policies aimed at improving the efficiency and transparency of our decision-making process, such as expanding minority shareholders rights and improving the quality of information disclosure;

make necessary changes to implement our strategic plan for developing our electricity distribution, generation and trading businesses in the existing economic and competitive environment in Brazil, and in accordance with the new regulations of the Brazilian electricity sector;

take advantage of the synergies between our distribution, generation and trading operations in order to improve the return on invested capital; and

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facilitate the restructuring of the vertical organization of our operations, in compliance with the new regulations of the Brazilian electricity sector.

This corporate reorganization included the following transactions, among others:

merging IVEN into Energias do Brasil;

making Enersul a wholly-owned subsidiary of Escelsa by transferring shares issued by Enersul to Escelsa; and

making Escelsa and Bandeirante wholly-owned subsidiaries of Energias do Brasil by transferring the shares issued by such companies to Energias do Brasil.

As a result of our corporate reorganization, minority shareholders of Bandeirante, Escelsa, Enersul and IVEN that did not exercise their withdrawal rights received shares of Energias do Brasil in exchange for their shares in these companies. Following the initial steps of the corporate reorganization of our subsidiaries in Brazil, we launched an initial public offering of Energias do Brasil in July 2005. As a result, shares of Bandeirante and Escelsa ceased to be publicly traded on the day prior to this offering. Our corporate reorganization was also a necessary step in the implementation of the restructuring of the vertical organization of our operations, by separating the distribution, generation and transmission operations of Escelsa and Enersul and organizing our subsidiaries horizontally, as required by the New Electricity Law. This reorganization was approved by ANEEL.

The following chart represents the simplified corporate structure of Energias do Brasil:

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(1) *Percentage of voting capital. Energias do Brasil owns 16.16% of the total capital of, and energy generated by, this company. All other numbers represent the percentage of total capital.*

(2) *Includes Escelsa s generation assets that were transferred CESA after the reorganization.*

(3) *Includes Enersul s generation assets that were transferred to Ochola Participações Ltda. after the reorganization. Ochola s name was changed to Pantanal Energítica Ltda.*

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GENERATION

The electricity generated by our Brazilian subsidiaries is primarily hydroelectric energy. The electricity generated is transmitted through our own systems or by third parties to the electricity distribution companies that distribute the electricity to end users. Our generation companies sell the electricity they generate to electricity traders or distributors under long-term contracts, as determined by ANEEL. The amount of electricity which generation companies are allowed to sell under long-term contracts is referred to as assured electricity.

Our Brazilian generation assets, including those that are integrated with our Brazilian electricity distribution companies, had a total generation capacity of 529.6 MW at December 31, 2004, including our 27.65% share of the installed power output of our Lajeado plant. The following table provides a brief description of our Brazilian generation assets.

Company/Plant	Installed power output (MW)
Lajeado (27.65%)	**249.5**
Escelsa	**193.5**
Alegra	2.1
Fruteiras	8.7
Jucu	4.8
Rio Bonito	16.8
Suíça	30.1
Mascarenhas	131.0
CESA	**26.1**
Viçosa	4.5
Paraíso	21.6
Enersul	**44.6**
Hydroelectric Plants	31.2
Vitor A. De Brito	0.4
São João I	0.7
São João II	0.6
Mimoso	29.5
Thermoelectric Plants	13.4
Coxim	3.6
Corumbá	6.0
Porto Murtinho	3.8
Costa Rica	**16.0**
Total	**529.6**

The volume of electricity produced by our Brazilian generation companies in 2004 totaled 2, 879 GWh, an increase of 8.9% compared to the 2,644 GWh generated in 2003, and an increase of 19.9% compared to the 2,204 GWh generated in 2002.

EDP Lajeado

In late 1997, Energias do Brasil formed a consortium with three Brazilian distribution companies that were awarded a 35-year concession to build a dam and operate a hydroelectric power plant in Lajeado, Brazil. We own 14.36% of the shares and 27.65% of the voting rights in Investco, the company that operates the plant. EDP Lajeado owns the right to sell 27.37% of the energy generated by the Lajeado hydroelectric power plant. Of the total energy generated, 24.75% can be freely traded with other electricity market agents, while the remaining energy must be sold at regulated prices to distribution companies. The Lajeado hydroelectric power plant began full operation in November 2002, following the completion and commissioning of its fifth unit, and has an installed capacity of 902.5 MW. The plant produced 4,320 GWh in 2004.

On December 31, 2004, Investco did not redeem part of the class R shares from Eletrobras scheduled to be redeemed at that time because it did not have sufficient retained results from previous years as required under Brazilian law. Discussions are under

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way between Investco and Eletrobrás in order to find alternatives to resolve the situation. On December 31, 2004, EDP Lajeado recognized a liability and an asset, each amounting to 103.5 million reais (28.6 million on that date), relating to its proportional stake of the shares that were not redeemed by Investco.

With regard to EDP Lajeado, Energias do Brasil recorded a provision of 90 million reais (26 million, as recorded in our consolidated accounts based on the average exchange rate during 2003) in 2003. Energias do Brasil s trading company, Enertrade, entered into a PPA to acquire electricity produced by the Lajeado plant and entered into PPAs with Energias do Brasil s distribution companies with respect to such electricity. At the time these PPAs were entered into, the electricity price permitted under tariff regulations was higher than under regulations subsequently issued by ANEEL, but before ANEEL s approval of the PPAs. Enertrade contested ANEEL s decision and obtained an injunction permitting it to charge prices set forth in the PPAs until there is a decision on the merits. However, Energias do Brasil s distribution companies have not yet obtained such an injunction despite contesting ANEEL s decision and are, therefore, prohibited from passing on to customers the prices in the PPAs. Given the current situation, we have recorded a provision for future losses.

Couto Magalhães

In November 2001, a consortium 49%-owned by Energias do Brasil and 51% owned by Grupo Rede was awarded a concession to build and operate a 150 MW hydroelectric power plant on the Araguaia River in Brazil, the Couto Magalhães power plant. The construction of the project was expected to start in 2003 and its operations during 2006. The project was interrupted due to additional environmental requests by regulators that were not agreed to in the original concession contract, which led to increasing development costs and postponing the start-up of construction, as well as plant operations. These requests negatively impact the economic viability of the project. The consortium has informally requested rescission by the regulator of the concession contract and is now waiting for a formal response.

Peixe Angical

In June 2001, a consortium 95%-owned by Energias do Brasil and 5%-owned by Grupo Rede was awarded a concession to build and operate a 452 MW hydroelectric power plant on the Tocantins River in Brazil, the Peixe Angical power plant. The annual concession rent is 6.8 million reais (2.5 million) for 29 years starting in the seventh year of the 35-year concession. After a one-year suspension, construction of the plant was reinitiated in October 2003, following the completion of an agreement between us and Eletrobrás and BNDES. The agreement included an equity participation of 40% of Furnas and funding of 670 million reais (246 million) approved by BNDES, reducing the amount to be supported by us. At the end of 2004, we had invested 700.1 million reais (193.7 million, as recorded in our consolidated accounts based on the 2004 year-end exchange rate) in this project. Plant operations are planned to begin in 2006.

Fafen

The Fafen thermoelectric plant is located in the Bahia state of Brazil and was developed by Energias do Brasil in a joint venture with Petrobrás Petróleo Brasileiro S.A., or Petrobrás, with 80% owned by Energias do Brasil and 20% owned by Petrobrás. The original aim of the venture was to construct a cogeneration plant that was to supply electricity and steam to the Petrobrás fertilizer plant. Initially, during the early stage of investment in this project, Energias do Brasil expected to develop a wider program that would have included several thermoelectric projects, pursuant to the rules of the Brazilian Government Thermoelectric Program. However, the development of additional thermal power plants was suspended, mainly due to a delay in regulation and the subsequent awareness of higher risks associated with investments in thermoelectric plants in Brazil.

In December 2003, Energias do Brasil recorded a 139 million reais (40 million, as recorded in our consolidated accounts based on the average exchange rate during 2003) impairment to this investment due to the unlikelihood of Fafen selling electricity at prices equivalent to the normative value for thermal plants, i.e., the regulated tariff for electricity from thermal plants, due to regulatory complications in connection with the relevant PPA.

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On December 17, 2004, Energias do Brasil signed a sale and purchase agreement with Petrobrás to sell its 80% shareholding in Fafen for 96 million reais (27 million, as recorded in our consolidated accounts based on the 2004 year-end exchange rate). At the end of 2004, the total investment undertaken by Energias do Brasil, net of accumulated results, amounted to 243 million reais (67 million, as recorded in our consolidated accounts based on the 2004 year-end exchange rate). Due to the above-mentioned 139 million reais impairment taken in 2003, the net impact of this transaction in Energias do Brasil s 2004 results was 8 million reais (2 million, as recorded in our consolidated accounts based on the average exchange rate during 2004) loss.

We currently consider the regulatory conditions associated with the development of thermoelectric projects to have unacceptable levels of risk and uncertainty and, as a result, we made the decision to divest in our stake in Fafen. Given the current regulatory framework in the Brazilian electricity sector, our strategy for the electricity generation activity in this geographical area does not include the development of new thermoelectric projects.

Generation by Escelsa

Escelsa has a concession for six hydroelectric power plants, with a total operating installed capacity of 193.5 MW. These plants are subject to a concession contract signed in 1995. Escelsa is restructuring its generation activities to comply with the New Electricity Law. In addition, Escelsa indirectly controls Castelo Energética S.A., or CESA, which operates two small hydroelectric plants, Viçosa Plant, with installed capacity of 4.5 MW, and the Paraíso I Plant, with installed capacity of 21.6 MW.

Generation by Enersul

Enersul has a concession for four hydroelectric plants and an authorization for three diesel-powered thermoelectric plants, with a total installed power output capacity of 44.6 MW. The hydroelectric plants are subject to Enersul s concession contract signed in 1997. Enersul is restructuring its generation activities to comply with the New Electricity Law. Enersul also holds a concession for control of the Costa Rica PCH, with 16 MW of installed capacity.

Competition

Our generation companies compete in the regulated contract market through auctions for the purchase of electricity for supply to the electricity distributors in the interconnected system. In addition, in the regulated contract market, our generation companies compete by submitting proposals in auctions for new concessions. The winning proposal secures a concession contract and a contract for the sale of electricity for a term of 15 to 30 years.

In the free market, the sale of electricity occurs by negotiation, where prices and conditions are freely agreed upon by the parties. In this free environment, competition exists between generation concessionaires and permit-holders, traders and electricity importers.

DISTRIBUTION

Our principal Brazilian activity is electricity distribution, which represented 89.0% of our total net revenues (before intercompany eliminations) in 2004. In 2004, our Brazilian electricity distribution companies purchased 19,555 GWh, 4.8% less than the 20,535 purchased in 2003. In 2004, our distribution companies in Brazil served more than 2.9 million customers, distributed 22,396 GWh of electricity and had revenue of 3,712 million reais (1,023 million, as recorded in our consolidated accounts based on the 2004 year-end exchange rate).

	Year Ended December 31, 2004			
Company	**Customers (millions)**	**GWh Distributed**	**Revenue (thousands of reais)**	**Revenue (thousands of euros)[(1)]**
Bandeirante	1.3	12,189	1,951	538
Escelsa	1.0	7,178	1,060	292
Enersul	0.6	3,028	701	193
Total	2.9	22,396	3,712	1,023

(1) *As recorded in our consolidated accounts based on the average exchange rate during 2004.*

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Electricity distribution services are provided to a market that is divided into captive customers, who acquire electricity provided by the distributor and pay for their use of the network, and network service customers, who choose a different electricity supplier and pay only for the use of the distribution network. Our Brazilian electricity distribution companies captive customers are classified into five main categories: industrial, residential, commercial, rural and others (which include governmental institutions and public services).

In 2004, residential customers accounted for 25.9% of the total volume of electricity sold by Bandeirante, 22.4% of the total volume of electricity sold by Escelsa and 32.3% of the total volume of electricity sold by Enersul.

In 2004, industrial customers accounted for 49.4% of the total volume of electricity sold by Bandeirante, 47.0% of the electricity sold by Escelsa and 20.5% of the electricity sold by Enersul. Some of the customers who qualified as potentially free opted to become free consumers. Some of these free consumers invested in their own production of electricity, which accounts for the decrease in the volume of electricity sold to industrial customers from 2002 to 2004. Among our Brazilian distribution companies industrial customers, 61 are potentially free consumers, which collectively account for 10.5% of the total volume of electricity distributed by our distribution companies.

Commercial customers accounted for 14.0% of the total volume of electricity sold by Bandeirante, 14.6% of the total volume of electricity sold be Escelsa and 20.6% of the total volume of electricity sold by Enersul in 2004.

In 2004, the number of customers of our Brazilian electricity distribution companies increased by 2.6%, and the total volume of distributed electricity increased by 4.5%. The total volume of distributed electricity represents the sum of electricity sold to end customers or other distributors, and electricity that transits through the distribution networks for consumption by free consumers or delivery to other concessionaires. The growth in distributed electricity corresponded with a period of economic recovery, which also had an impact on residential consumption, particularly in the second half of 2004.

The impact from this period of economic recovery, however, was not felt uniformly throught the concession areas of our Brazilian electricity companies:

These variations in growth are attributable to the particular characteristics of our distributors markets, including the heavy concentrations of industry in the markets served by Bandeirante and Escelsa. The profiles of these more industrial markets also vary Escelsa s market, for instance, is dominated by steel mills whereas Bandeirante s is characterized by broader industrial diversity.

Bandeirante

Energias do Brasil currently holds a 96.5% stake in the share capital of Bandeirante, a distribution company in the Brazilian state of São Paulo that, in 2004, had approximately 1.3 million customers and served a population of approximately 4.4 million. Bandeirante s concession area is located in a region characterized by a high concentration of industry and a strong business presence. Bandeirante s net revenues represented 53% of the total net revenues of our Brazilian electricity distribution companies in 2004. Following the corporate reorganization referred to above, Energias do Brasil will hold 100% of the share capital of Bandeirante.

In 2004, Bandeirante sold 8,812 GWh, a 7.6% decrease from 2003, primarily due to consumption decreases in the industrial segment. Consumption in the residential segment represented 25.9% of total sales volume, an increase of 7.1% from 2003. Consumption in the industrial segment represented 49.4% of total sales volume, a decrease of 16.7% from 2003, reflecting the loss of

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liberalized customers to other energy suppliers. Consumption in the commercial segment represented 14.0% of total sales volume, an increase of 4.7% from 2003. In the other segments, which represent 10.7% of total sales volume, the consumption decrease was 6.1% from 2003. Taking into account electricity distributed to liberalized customers that pay Bandeirante a fee for use of its distribution grid, Bandeirante distributed 12,189 GWh in 2004, a 7.1% increase from 2003.

In 2004, Bandeirante made capital expenditures of 119.9 million reais (33.2 million, as recorded in our consolidated accounts based on the 2004 year-end exchange rate) with a focus on modernization, customer service, improvement of the network s operational conditions in expanding regions and increases in the electricity grid s operational flexibility. As part of a program of modernization, 42.5 million reais (11.8 million, as recorded in our consolidated accounts based on the 2004 year-end exchange rate) was spent in 2004, including expenditures relating to a new operations center and in the new commercial information system.

At the end of September 2003, the company issued new promissory notes in amount of 180 million reais (53 million at the time of the issue) to refinance the notes issued in March 2003.

At the end of 2003, Bandeirante s board of directors approved a long-term loan of U.S.$100 million from the Inter-American Development Bank to finance the expansion of the distribution grid and to improve the general quality of services.

On October 23, 2003, Bandeirante s tariffs were adjusted as part of a periodic tariff review resulting in an increase of 18.08% over the period from 2004-2008. On October 22, 2004, ANEEL retroactively amended this tariff increase from 18.08% to 10.51%. Despite the provisional status of this review (ANEEL will definitively decide the asset base and tariff impact by October 2005), we elected to record the retroactive effects of this measure (covering the period from October 23, 2003 through October 23, 2004) in our financial statements for the third quarter of 2004. The impact of this adjustment on Bandeirante s results before taxes in 2004 was to be approximately 104 million reais (29 million, as recorded in our consolidated accounts based on the average exchange rate during 2004) and the total impact on EDP s net income in 2004 was approximately 66 million reais (18 million, as recorded in our consolidated accounts based on the average exchange rate during 2004).

On October 22, 2004, ANEEL also authorized Bandeirante to increase electricity tariffs for the one-year period commencing October 23, 2004 by an average of 15.95% from the new tariff. In practical terms, this represents an 11.4% increase on the average tariff charged by Bandeirante from October 23, 2004 through October 22, 2005.

In order to improve productivity, Bandeirante has been encouraging its employees to adopt procedures that build a creative and innovative culture that is focused on results and responsive to customers and the market. In 2004, Bandeirante reduced its workforce to 1,202 employees, achieving a customer per employee ratio of 1,059-to-1.

Escelsa

EDP and its subsidiaries currently own 54.76% of Escelsa, a distribution company in the Espírito Santo state of Brazil that, in 2004, had approximately one million customers and served a population of approximately 3.1 million in an area that covers approximately 90% of the total area of the state. Escelsa s net revenues represented 29% of the total net revenues of our Brazilian electricity distribution companies in 2004. Following the corporate reorganization, Energias do Brasil will hold 100% of Escelsa.

In September 2002, a lawsuit with GTD Participações, S.A., or GTD, a Brazilian company, received a favorable decision on the merits in our favor. This decision, however, is subject to an appeal to the High State Court of Rio de Janeiro, which has not yet been decided. Previously, a shareholders agreement with GTD that provided for joint control of Escelsa was in force. The lawsuit was filed by GTD when it contested the termination of this shareholders agreement. GTD attempted to suspend our rights as controlling shareholder, but the judiciary denied this request. We convened an extraordinary shareholders meeting of Escelsa in September 2002 at which we gained control of Escelsa, which control had previously been shared jointly with GTD. In October 2002, we took over the management of Escelsa and appointed new executive officers. Since that time, we have fully consolidated Escelsa. Following the

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decision of the Lower Court of Rio de Janeiro, GTD filed an additional lawsuit in the Federal Court of Rio de Janeiro with a similar complaint, but this time against Brazilian Union and Eletrobras as well, on which no ruling has yet been made.

We and Energias do Brasil entered into agreements with certain minority shareholders of Escelsa (including GTD) and Enersul on April 7, 2005, which we refer to as the minority shareholders agreements. Under the minority shareholders agreements, we and Energias do Brasil agreed to extend rights to minority shareholders that are a party to those agreements that, subject to certain conditions, may be extended to all minority shareholders of Bandeirante, Escelsa, Enersul and IVEN that became our shareholders as a result of the corporate reorganization. These rights will not be extended to shareholders outside of Brazil in jurisdictions where the offering of such rights would be illegal or require registration or qualification under any non-Brazilian law, including the Securities Act. These rights are not extended into the United States or to U.S. persons as defined in Regulation S under the Securities Act.

The electricity required by Escelsa s distribution grid in 2004 totaled 8,254 GWh, an 0.84% increase from the previous year. In order to meet market demand, Escelsa s hydroelectric plants generated 1,056 GWh internally, which represents 12.8% of the electricity required. Escelsa purchased the remaining 5,646 GWh from other suppliers. In addition, 1,552 GWh produced by other generators passed through Escelsa s grid.

Escelsa s total electricity sales volume was 5,615 GWh in 2004, representing a 4.7% decrease from 2003 due mainly to decreased electricity sales volume to the industrial segment. Consumption by the residential segment represented 21.2% of the total sales volume, a decrease of 0.3% from 2003. Consumption by the industrial segment represented 44.5% of total sales volume, a decrease of 9.0% from 2003, which reflects the loss of liberalized customers to other energy suppliers. Consumption by the commercial segment represented 13.8% of the total sales volume, an increase of 2.8% from 2003. The energy supply sold to other electric utilities represented 5.4% of the total sales volume, a decrease of 4.2% from 2003. Finally, sales to other segments represented 15.1% of the total sales volume, a decrease of 3.6% from 2003. Taking into account electricity distributed to liberalized customers, which pay Escelsa a fee for use of its distribution grid, Escelsa distributed 7,178 GWh in 2004, a 0.13% decrease from 2003.

Every three years, Escelsa s tariffs are reviewed according to its concession contract for the purpose of reassessing the fair return on capital employed. In August 2004, ANEEL reduced Escelsa s final regulatory remuneration base figure, used for the 2001 revision, from 980.0 million reais (359.8 million) to 796.6 million reais (292.5 million). With this new base amount, the 2001 adjustment rate of 19.9% was reduced to 17.8%. This reduction, when applied to sales that occurred in the period from August 2001 to August 2004, resulted in a 56.7 million reais (15.6 million, as recorded in our consolidated accounts based on the average exchange rate during 2004) reduction in the tariffs for the period of August 7, 2004 to August 6, 2005 and a 5.1% decrease in the adjustment rate applied in 2004. The effect on this reduction was recognized in 2004 by recognizing a charge to revenues of 11.2 million reais (3.1 million, as recorded in our consolidated accounts based on the average exchange rate during 2004), a non-operating expense of 35.8 million reais (9.9 million, as recorded in our consolidated accounts based on the average exchange rate during 2004) and a financial expense of 9.7 million reais (2.7 million, as recorded in our consolidated accounts based on the average exchange rate during 2004). As a result, the average revision of Escelsa s tariffs in August 2004 (as defined on a provisional basis) was approximately 5.0%, representing the net effect of a 6.3% repositioning increase, an additional 3.7% increase relating to the *Conta de Variação de Valores de Items da Parcela A*, an account for non-controllable tariff cost adjustments, or CVA, and other factors and a 5.1% decrease to offset the effects of the reduction of the 2001 regulatory remuneration base amount. In August 2005, ANEEL approved Escelsa s final average 2004 tariff increase, amending the previous respositioning increase from 6.3% to 8.6%. As a result and within the scope of the 2005 annual tariff adjustments, ANEEL granted Escelsa a 6.9% average tariff increase starting August 7, 2005.

Escelsa s 920.9 million reais (338.1 million) regulatory remuneration base, used for the 2004 tariff revision, is still provisional and ANEEL is expected to review it by the time of the next adjustment.

In 2004, Escelsa had capital expenditures of 108.6 million reais (30.0 million, as recorded in our consolidated accounts based on the 2004 year-end exchange rate), of which 64.4 million reais (17.8 million, as recorded in our consolidated accounts based on the 2004 year-end exchange rate) were technical costs related to the expansion and improvement of the distribution grids, new substations and company modernization. The remaining 44.2 million reais (12.2 million, as recorded in our consolidated accounts based on the 2004 year-end exchange rate) were financial costs related to the expenditures capitalized in Escelsa s assets.

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Escelsa s workforce totaled 1,231 employees at the end of 2004, 5.7% less than in 2003. Esclesa continues to increase the customers per employee ratio, reaching 799-to-1 in 2004 from 742-to-1 in 2003, an improvement of 7.7%.

Enersul

EDP and its subsidiaries indirectly hold a controlling stake in Enersul, a distribution company in the Mato Grasso do Sul state of Brazil, that, in 2004, had approximately 640,000 customers and served a population of approximately 2.1 million in an area that covers approximately 92% of the total area of the state. Enersul s net revenues represented 19% of the total net revenues of our Brazilian electricity distribution companies in 2004. Following the corporate reorganization, Energias do Brasil will control 100% of Enersul.

Enersul s total energy sales volume for 2004 was 2,844 GWh, representing a 1.2% increase from 2003. Sales to the residential segment represented 32.1% of the total sales volume, an increase of 4.6% from 2003. Sales to the industrial segment represented 20.4% of the total sales volume, a decrease of 11.4% from 2003. Sales to the commercial segment represented 20.6% of the total sales volume, an increase of 6.8% from 2003. The energy supply sold to other electric utility companies represented 0.4% of the total sales volume, a decrease of 60.3% from 2003. Finally, sales to other segments represented 26.6% of the total sales volume, an increase of 7.0% from 2003. Enersul had 639,751 customers at the end of 2004, an increase of 4.2% compared to 2003. Taking into account electricity distributed to liberalized customers, which pay Enersul a fee for use of its distribution grid, Enersul distributed 3,028 GWh in 2004, a 6.0% increase from 2003.

In April 2003, ANEEL approved a tariff increase for Enersul of 42.26% as part of a periodic tariff review. Of this amount, 32.59% has already been applied to the current tariff and the remainder, 9.67%, will be added to the tariff over the years from 2004 to the next review in 2007. In April 2004, in addition to the annual adjustment and the application of the first deferred installment of the 2003 revision, totaling 17.02%, ANEEL raised the initial rate for Enersul s 2003 tariff revision from 42.46% to 43.59% due to the company s recognition of adjustments to its operating costs. In April 2005, ANEEL issued a final determination regarding Enersul s revision for 2003, including an increase of the regulatory remuneration base amount from 751.9 million reais (276.1 million) to 781.5 million reais (286.9 million), resulting in a further increase of the revision rate for 2003 from 43.59% to 50.81%. As a result, Enersul s 2004 tariff adjustment totaled 20.7%, consisting of 14.8% for the basic tariff adjustment rate, 2.5% for the final 2003 tariff revision, 2.7% relating to the CVA parcels and 0.7% for financial adjustments.

In 2004, Enersul had capital expenditures of 93.7 million reais (25.9 million, as recorded in our consolidated accounts based on the 2004 year-end exchange rate) focused on modernizing, improving and expanding the company s distribution grid. In 2003, Enersul wrote off 22 million reais (7 million at the time of the write-off) related to the market value of Campo Grande s gas turbine acquired in 2001, as Enersul terminated this project and decided to sell the turbine. In September 2004, Enersul sold Campo Grande gas turbine for a total amount of 43 million reais (12 million at the time of the sale) with capital loss of 9 million reais (3 million, as recorded in our consolidated accounts based on the 2004 year-end exchange rate).

Although at the end of 2004, Enersul s workforce was 898 employees 4.4% less than in 2003, the company was able to improve its ratio of customers to employees to 712-to-1 in 2004 from 653-to-1 in 2003.

Competition

The electricity distribution network operates as a legal monopoly, and services are compensated by the tariff for use of the distribution system, or TUSD. Thus, clients located in the concession areas of our electricity distribution companies, both captive and free, must use our distribution network to gain access to electricity, paying our distribution companies through the TUSD.

TRADING

Our Brazilian energy trading operations, which focus primarily on serving free consumers both inside and outside of the concession areas of our Brazilian electricity distribution companies, are conducted by Enertrade.

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Free consumers are certain industries and other large customers that are permitted under current Brazilian regulations to choose their electricity supplier in the free market. Enertrade manages contacts between our Brazilian generation and distribution businesses and engages in electricity trading. In addition, Enertrade seeks to capture business from liberalized clients that move away from our distribution companies as sources of supply and sell to other liberalized clients. Since the New Electricity Law provides that liberalized clients may only purchase electricity from generators or traders, we expect that the shift of these clients away from our distribution companies will continue.

In 2004, Enertrade traded electricity with our companies and with the companies of the free market. The volume of electricity sold by Enertrade in 2004 totaled 4,849 GWh, including transactions with related parties, representing an increase of 77% over the 2,737 GWh sold in 2003 and an increase of 282% over the 1,270 GWh sold in 2002. Enertrade purchased 1,073 GWh from EDP Lajeado in 2004, the same amount purchased in 2003. The average prices of energy sold and purchased by Enertrade in 2004 were, respectively, 68.25 reais per MWh and 55.76 reais per MWh.

With respect to our Brazilian generation assets, Enertrade participates in auctions held by the Electricity Trading Board (*Câmara de Comercialização de Energia Elétrica*), or CCEE, for the sale of surplus electricity generated by our Brazilian generation assets, and purchases electricity required to cover insufficient reserves.

With respect to the free market, Enertrade acquires new customers not only by seeking out the customers of our distribution companies who wish to migrate to the free market, but also by seeking potentially free consumers outside our distribution concession areas. In 2004, there was significant demand from large customers seeking electricity in the free market.

The following table shows the volume of electricity traded by Enertrade during the periods indicated.

	2002	2003	2004
		(in GWh)	
Third parties	1,270	2,272	2,468
Companies of our Brazilian group		465	2,381

Competition

Enertrade, and other electricity trading companies, compete for the acquisition of electricity from various sources, and there is no restriction applicable to the purchase of electricity from generation companies that belong to the same economic group. Trading companies also compete in the trading and intermediation of the sale of electricity to free consumers. Our main trading competitors are AES Infoenergy Ltda., CPFL Comercialização Brasil S.A., Delta Comercializadora de Energia Ltda. and NCEnergia S.A.

RELATED ACTIVITIES

The following is a description of our companies that engage in other activities:

Energest. The management of our existing and future generation assets will be consolidated in this company following the restructuring of the vertical organization of our operations.

Enercorp. This company holds the records of feasibility studies for certain generation ventures, and was merged into Energest during 2005.

ESC 90. This company is a cable TV service concessionaire that operates in the Cities of Vitória and Vila Velha, both in the State of Espírito Santo. ESC 90 billed 24.9 million reais in services for 2004.

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Escelsapar. This company performs information technology and internet services exclusively for companies of our group.

Ampla, formerly CERJ

In 1996, we formed a consortium with Chilectra and Endesa that acquired approximately 70% of the stock of Companhia de Eletricidade do Rio de Janeiro, S.A., or CERJ, an electricity distribution company in the Rio de Janeiro state of Brazil. During 2004, CERJ changed its name to Ampla. EDP, S.A. currently owns 7.70% of Ampla, reflecting reductions in our stake as a result of capital increases in which we did not participate.

REGULATION

Legal and regulatory framework

The Brazilian Constitution provides that the development, use and sale of electricity may be undertaken directly by the federal government or indirectly through the granting of concessions, permissions and authorizations. Historically, the Brazilian electricity industry has been dominated by generation, transmission and distribution concessionaires controlled by the federal and state governments. In recent years, the Brazilian government has taken a number of measures to reform the electricity industry. Generally speaking, these measures have been taken with a view toward increasing the role of private investment and eliminating existing barriers to foreign investment, thus increasing overall competition in the electricity industry.

Initiated in 1995, the reform carried out in the energy industry established the rules for the execution of concession agreements between concessionaires and the Brazilian government, the requirement of a public bidding process for the granting of concessions related to energy facilities and services and competition in generation activity, following a transition period to a competitive market foreseen at that time. Due to difficulties faced during the implementation of these reforms, combined with an aversion to risk caused by the rationing program that occurred in 2001, the current Brazilian government launched a new reform in the energy industry with a view toward securing the future supply of electricity and reasonable tariffs.

In March 2004, the Brazilian government enacted the New Electricity Law that significantly changed the regulatory structure of the Brazilian energy sector. The New Electricity Law is intended to reform the Brazilian electricity market in order to provide incentives to private and public entities to build and maintain the country s generation capacity and to assure the supply of electricity within Brazil at low tariffs through competitive electricity public auctions. Additionally, it significantly expanded the oversight of the federal government, through the MME, over the entire electricity sector, through changes in planning criteria, in the forms of commercialization and in the role of the current sector agents, and mainly by granting it responsibilities previously given to ANEEL (an independent federal agency that regulates the electricity industry).

The New Electricity Law has been supplemented by subsequent decrees as of May 2004, and is subject to further amendment through regulations issued by ANEEL and MME. The constitutionality of the New Electricity Law is currently being challenged in the Brazilian Supreme Court. It is expected that the Brazilian Supreme Court will decide in favor of the constitutionality of the new law.

Following the adoption of the New Electricity Law, the MME has taken over certain duties that were previously the responsibility of ANEEL, including the drafting of guidelines governing the award of concessions and the issuance of directives governing the bidding process for the construction and operation of hydroelectric plants. The MME may, at its discretion, however, delegate such tasks to ANEEL. ANEEL s primary responsibility now is to regulate and supervise the electricity industry in line with the policy to be dictated by the MME and to respond to matters that are delegated to it by the federal government.

The New Electricity Law

The New Electricity Law introduced material changes to the regulation of the Brazilian power industry, in order to provide incentives to private and public entities to build and maintain the country s generation capacity and to assure the supply of electricity

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within Brazil at low tariffs through competitive electricity public auctions. The key features of the New Electricity Law include:

- the creation of a parallel environment for the trading of electricity, with (i) one market for the purchase of electricity destined for distribution companies, called the regulated contracting market, operated through electricity purchase auctions; and (ii) another market based on competition for the generators, free consumers and electricity trading companies, called the free contracting market;
- a requirement that distribution companies purchase electricity sufficient to satisfy 100% of demand;
- the creation of an electricity reserve for all electricity traded through contracts;
- restrictions on certain activities of electricity distribution companies to ensure that they focus only on their core business, to guarantee more efficient and reliable services to their customers;
- restrictions on self-dealing to encourage electricity distribution companies to purchase electricity at lower prices rather than buying electricity from related parties;
- continued compliance with contracts executed prior to the New Electricity Law, in order to provide stability to transactions carried out before its enactment;
- a prohibition against sales of electricity by distributors to free consumers at non-regulated prices; and
- a prohibition against distributors engaging directly in electricity generation and transmission operations.

In addition, the New Electricity Law excludes Eletrobrás and its subsidiaries from the National Privatization Plan, which was created by the Brazilian government in 1990 to promote the privatization of state-owned companies. Although the New Electricity Law is already in effect, as are the directives described below, several important aspects of this model have yet to be regulated.

Ownership limitations

In 2000, ANEEL established new limits on the concentration of certain services and activities within the electricity industry. Under these limits, with the exception of companies participating in the National Privatization Program (which need only comply with such limits once their final corporate restructuring is accomplished) no electricity industry company (including both its controlling and controlled companies) may (i) own more than 20% of Brazil s installed capacity, 25% of the installed capacity of the South/Southeast/Central-West region or 35% of the installed capacity of the North/Northeast region, except if such percentage corresponds to the installed capacity of a single generation plant, (ii) own more than 20% of Brazil s distribution market, 25% of the South/Southeast/Central-West distribution market or 35% of the North/Northeast distribution market, except in the event of an increase in the distribution of energy exceeding the national or regional growth rates or (iii) own more than 20% of Brazil s trading market with final consumers, 20% of Brazil s trading market with non-final consumers or 25% of the sum of the above percentages.

Distribution tariffs

Distribution tariff rates are subject to review by ANEEL, which has the authority to adjust and review tariffs in response to changes in energy purchase costs and market conditions. When adjusting distribution tariffs, ANEEL divides the costs of distribution companies between (i) costs that are not the under control of the distributor, or non-manageable costs, and (ii) costs that are under the control of distributors, or manageable costs. The readjustment of tariffs is based on a formula that takes into account the division of costs between the two categories.

Non-manageable costs include, among others, the following:

costs of electricity purchased for resale pursuant to Initial Supply Contracts;

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costs of electricity purchased from Itaipu;

costs of electricity purchased pursuant to bilateral agreements that are freely negotiated between parties; and

certain other charges for the transmission and distribution systems.

Manageable costs are determined by subtracting all the non-manageable costs from the distribution company s revenues.

Each distribution company s concession agreement provides for an annual readjustment of tariffs. In general, non-manageable costs are fully passed through to consumers by the tariff. Manageable costs, however, are restated for inflation in accordance with the IGP-M index. After the initial three to five years following a periodic tariff review, depending on each concession agreement (Escelsa, 3 years; Bandeirante, 4 years; Enersul, 5 years), the IGP-M index must be reduced by a factor determined by ANEEL in order for distribution companies to share with their consumers gains of productivity, the so-called X Factor.

The X Factor is determined by ANEEL in accordance with three components: (i) expected gains of productivity from increase in scale; (ii) consumers evaluation through ANEEL s Consumer Satisfaction Index; and (iii) the cost of the labor force. Tariffs are readjusted annually to reflect the effects of inflation on tariffs. Every period, as noted in the relevant concession agreement, there is a periodic review of the tariffs rates (*revisão tarifária periódica*) in which the tariff is reviewed with a view toward assuring the necessary revenues to cover efficient operational costs and adequate remuneration of prudent investments. In addition, concessionaires of distribution are entitled to extraordinary review of tariffs (*revisão extraordinária*), on a case-by-case basis, to ensure the financial equilibrium of the concession and to compensate for unpredictable costs, including taxes, which significantly change their cost structure.

Impact of the New Electricity Law on our Brazilian operations

The impact of the New Electricity Law on our Brazilian operations depends on the complete implementation of the rules. In the case of our Brazilian generation assets, it is not expected to have a major impact because most of our companies have already signed PPAs that have been approved by ANEEL, leaving only a limited exposure in the new environment.

Regarding our distribution assets, the main risks relate to the forecast of the energy consumption for the five-year period and the potential exposure to the regulated contracting environment. The distribution companies will participate in electricity auctions that could be settled up to five years prior to the beginning of the supply of electricity to their consumers. However, the regulations establish limits on the transfer of electricity purchasing costs to final customers, where the distribution companies assume the financial risk on deviations to the estimated demand.

The auction process under the New Electricity Law

As of 2004, with the implementation of the new model created by the New Electricity Law, distributors may only purchase electricity through auctions in the regulated contracting market. Currently, electricity purchase contracts in the regulated contracting market are revised annually

according to the Amplified Consumer Price Index, or IPCA, on dates corresponding with our distributors tariff adjustments.

In the free contracting market, prices and tenors are freely negotiated between the parties. In the regulated contracting market, prices are set in auctions organized by the CCEE. The electricity purchased in these auctions is based on the projected electricity needs of the distributors. Generators that sell electricity in the regulated contracting market auctions enter into contracts with all of the distributors in the interconnected system that participated in the auction.

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As the quantities of electricity purchased under initial contracts are reduced during the transition to the New Electricity Law model and our electricity needs increase, we must purchase more electricity through the auctions in the regulated contracting market. Under the New Electricity Law, distribution companies cannot transfer costs to customers for electricity purchases that exceed 103% of demand, as adjusted in accordance with the applicable regulations. Our success in this process will therefore be reflected in our margins related to the service provided for the use of the distribution grid to the extent that the full allocation of our electricity purchasing costs will depend upon our accurate projection of demand.

TELECOMMUNICATIONS

OVERVIEW

In March 2000, we announced a strategic decision to pursue the telecommunications business. This decision provided us with an opportunity to leverage our existing resources and expertise and to build on our initiatives in the telecommunications and information technology businesses. In Portugal, our telecommunications and related activities are conducted by ONI. The current shareholder structure in ONI is as follows: EDP 56.607%, BCP 23.062%, Brisa S.A. 17.176%, GALP Serviços 3.114% and GALP Energia 0.041%.

In 2004, ONI had revenues of 325.4 million, of which 10.0 million was generated from services provided to the EDP Group, and an operating loss of 45.9 million compared with, in 2003, revenues of 331.1 million, of which 15.3 million was generated from services provided to the EDP Group, and an operating loss of 68.7 million.

In the first quarter of 2003, ONI revised its organizational structure to better achieve the goals and strategies defined for its business segments. This process was concluded in the fourth quarter of 2003, by the merger of ONI Grandes Redes, ONI Sistemas de Informação, ONI One, ONI Solutions, Shopping Direct and Brisatel into ONI Telecom.

On July 14, 2005, ONI announced that it had signed an agreement to sell its entire stake of Comunitel (wireline Spain) to Tele2 Telecommunication Services, S.L. for 215 million. The successful completion of this transaction will enable ONI to focus on its wireline Portugal business, while also allowing ONI to significantly reduce its financial debt. Following this transaction, ONI s businesses are now focused on wireline Portugal.

Wireline Portugal comprises:

- ONI Telecom, a wholly-owned subsidiary of ONI, which is a licensed telecommunications company that develops and provides wireline communication services to corporate and residential clients and also serves as a carrier s carrier, selling capacity to other communications companies.

- uCall, a 60%-owned subsidiary of ONI offering call center services, which fulfills ONI s needs in back office support, as well as providing services to companies outside the ONI group.

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As of December 31, 2004, ONI had approximately 1,101 employees, with 56% based in wireline Portugal and 44% based in wireline Spain.

TELECOMMUNICATIONS MARKET

In accordance with EU requirements, the Portuguese government has taken significant steps during the past several years to open the telecommunications market to competition. In 1997, Portuguese regulations took effect that permitted us and others to install and provide infrastructure for telecommunications services. On January 1, 2000, Portugal opened the entire telecommunications sector to competition.

As of January 1, 2001, alternative carriers have been permitted to offer local and regional indirect calls, and as of June 30, 2001, customers have been allowed to keep their existing phone numbers while changing to a different access operator. Although number portability now exists in Portugal, ONI believes that some additional technical issues need to be addressed by ICP-Autoridade Nacional de Comunicações, or ICP-ANACOM, to make number portability a more efficient process. ICP-ANACOM is expected to pass a regulation relating to these issues following a consultation process carried out in March 2004.

In January 2002, liberalization of the telecommunications sector advanced a step further with the long promised unbundling of the local loop (ULL). However, technical and administrative restrictions by the historical monopoly telecommunications operator Portugal Telecom, or PT, did not allow for widespread use of this technology, effectively preventing the new operators from exploiting this new opportunity.

COMPETITION

In the fixed line business area, ONI is competing for market share primarily with PT, which historically held a monopoly on fixed line services in Portugal. Currently, in the first stages of liberalization of this area, PT continues to hold a dominant position in this market. Other fixed line operators in Portugal include Novis, controlled by Sonae.Com and France Telecom, and Jazztel. Based on data released by ICP-ANACOM, in the fourth quarter of 2004 new operators accounted for 18.0% of the total minutes in the fixed line area.

Indirectly, fixed line operators also face strong competition from cellular telephone service providers, particularly in the voice segment. Cellular services in Portugal are currently provided by TMN, Vodafone Portugal and Optimus.

We also face significant competition in data transmission services and as an Internet Service Provider, or ISP. Numerous operators compete in these areas, including SAPO, a PT ISP, and Clix, a Sonae.Com ISP.

TELECOMMUNICATIONS ACTIVITIES

Infrastructure

ONI has in place an extensive infrastructure to provide telecommunications services, which includes approximately 1,300 kilometers of fiber optic cable owned by ONI and 6,000 kilometers of fiber optic cable leased to REN, EDIS and Transgás, including multiple strings, for a total of approximately 125,000 kilometers of fiber optic owned by ONI and 40,000 kilometers of fiber optic leased to EDPD, REN and Transgás. As a result, the total length of fiber optic available to ONI, in Portugal, is approximately 165,000 kilometers. ONI currently has approximately 300 points of presence, (PoPs) and 2 network central offices, in Lisbon and Porto. At the end of 2000, ONI linked its fiber optic network to Iberdrola s network, creating two new connections to Spain and adding to the existing connection with the network of Comunitel.

The incorporation of Brisatel s assets in the ONI group in October 2001 added approximately 1,300 kilometers of fiber optic cable (of which approximately 1,120 kilometers are already installed) to the fiber optic cable that we had already in place at the time. Brisatel also added 95 PoPs and two international links with RENFE, the Spanish railroad operator, which required a restructuring of ONI s PoPs to avoid unnecessary redundancy. The incorporation of Brisatel s assets in the ONI group allowed ONI to create

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additional redundancy for the backbone connections between Lisbon and the north of the country, thereby improving the quality of the service provided to its clients.

ONI expects to increase consumer connections to its existing fiber optic backbone to provide telecommunications services. ONI has efforts underway to develop digital powerline technology and is currently conducting pilot tests.

Telephone and data services

ONI Telecom commenced operations in January 2000 as a voice and data fixed-line operator concurrent with the opening of competition in Portugal. We continue to provide services in this area through ONI. ONI Telecom s initial activities were focused on fixed-line voice services for businesses and high-value customers. ONI currently expects to develop other products and services, including value-added voice services, data transmission, and integrated voice, data and video services.

In Portugal, at December 31, 2004, ONI had approximately 94,000 active clients generating demand for approximately 2.7 million minutes per day, or an aggregate of 991 million minutes in 2004 (including transit, calling cards and special services). In comparison, in 2003 ONI s fixed line operation in Portugal accounted for approximately 939 million minutes of voice traffic.

According to a report by ICP-ANACOM for the fourth quarter of 2004, ONI holds an overall market share in fixed line telephone traffic of approximately 5%, which corresponds to approximately 22% among the new fixed line operators in Portugal.

In Spain, our subsidiary Comunitel and its subsidiary Ola Internet generated approximately 2.079 million minutes of voice traffic in 2004.

Internet access services

ONI has high capacity platforms to provide Internet access services and is operating as an ISP. In 2004, in Portugal ONI generated 1.1 million minutes per day for an aggregate of approximately 418 million minutes, which represents a decrease from 638 million minutes in 2003, due to a loss of clients during 2004 and also to the transfer of clients from dial-up to ADSL.

In July 2002, ONI launched an Asynchronous Digital Subscriber Line, or ADSL, product that allows high speed Internet access over regular telephone lines and that can be installed by end users over their existing telephone lines.

REGULATION

Our activities in the telecommunication area subject us to a number of regulatory regimes, including licensing requirements and operating restrictions. ONI holds licenses for the establishment and operation of public telecommunications networks (ICP-05/99-RPT, granted June 14, 1999) and the provision of Fixed Telephony Service (ICP-001/99-SFT, granted August 10, 1999). ONI also holds a registration for the provision of public use telecommunications services (Register-006/99 dated January 20, 1999). ONI was awarded two licenses for the use of frequencies aimed at fixed wireless access in the 3.6-3.8 Mhz and 24.5-26.5 Ghz bands (ICP-01/99-FWA and ICP-05/99-FWA granted December 29, 1999). In 2003, ONI requested the revocation of the 3.6-3.8 Mhz band license. The difficulties of installing terminal equipment in buildings and the lack of scale, together with other technological difficulties, made the operation of a fixed wireless network difficult and uneconomical in most cases. The Portuguese telecommunications regulator has developed a public consultation process for the review of the FWA licenses regime and new tariffs have been fixed by the government with significant decreases.

Legislative and regulatory measures have been taken in recent years to change the telecommunications market in Portugal from a monopoly held by PT to a fully open and competitive market. PT operates under a concession, which granted to it the right for 30 years from March 20, 1995, renewable thereafter for successive periods of 15 years upon agreement by the government and PT, to

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provide, among other things, domestic and international public fixed voice telephone services and leased lines and to install and operate the related basic telecommunications network in Portugal. By the end of 2002, the government released the infrastructures that constitute the basic telecommunications network from public domain and sold them to PT, pursuant to the amendment of the terms of the concession introduced by Decree law no. 31/2003, of February 17, 2003.

The EU adopted in 2002 a number of directives (known as the Review 99 Telecom package) relating to the telecommunications market, the latest of which is Directive 2002/77/CE, of September 16, 2002, that set forth the parameters for regulating telecommunications sectors in EU member countries. This package was implemented in Portugal through the Electronic Communications Law (Law no. 5/2004, of February 10, 2004), also known as Regicom. This law revoked Law no. 91/97, of August 1, 1997, as amended by Law no. 29/2002, of December 6, known as the Basic Law of Telecommunications, which had been adopted in Portugal in anticipation of the full opening of competition in the Portuguese telecommunications market. In accordance with EU Legislation, this law established the principle of telecommunications liberalization, therefore abolishing the exclusive rights of PT and provided that the Portuguese telecommunications market would be fully opened to competition as of January 1, 2000.

Legislative framework

Following the revocation of the Basic Law of Telecommunications, the Electronic Communications Law now provides the legislative framework and basis for telecommunications regulation in Portugal. The Portuguese government enacted this law in order to comply with and implement a number of directives on telecommunications adopted by the EU Council of Ministers on March 7, 2002 (part of the Telecom Package). The other key elements of the framework of laws and regulations that apply to the telecommunications sector in Portugal are:

- regulations to be adopted by the Portuguese telecommunications regulator to implement and give effect to different provisions of the Electronic Communications Law (provisionally, certain provisions of the regulations approved under the former Basic Law of Telecommunications have been kept in effect until the new regulations are approved);

- decree laws not revoked by the Electronic Communications Law and concerning in particular the use of radio frequencies, the approval and free circulation of terminal and radio equipment and the telecommunications infrastructures in buildings regime;

- directives, recommendations, and policies of the EU;

- legislation establishing and defining the competencies of the *ICP-Autoridade Nacional de Comunicações*, or ICP-ANACOM, as the Portuguese telecommunications regulator and the Ministry of Public Works, Transport and Communications, or MOPTC, as the government entity with basic responsibility for telecommunications policy in Portugal; and

- ICP-ANACOM determinations and regulations issued on the basis of specific powers granted by specific legislation, which follow the relevant market analysis developed in accordance with the new EU regulatory framework.

Broadly, the Electronic Communications Law introduced, among other things, (i) new rules on access to telecommunications infrastructure, (ii) increases of administrative fines and (iii) the reinforcement of the powers and autonomy of ICP-ANACOM, namely by granting it powers to approve and publish legally binding regulations, to define the relevant telecom markets and to identify companies with significant market power.

Due to the approval of the Electronic Communications Law, which entirely superseded the Basic Law of Telecommunications and almost all previous ancillary legislation, different regulations have been passed, including the implementation of a new municipal tax for rights of way, the access to the PT network, the definition of the relevant markets to be subject to ex-ante regulation, and the identification of companies with significant market power and their inherent obligations.

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Extensive regulation has been adopted on issues like ULL (unbundling of the local loop), mobile and fixed network termination fees and ADSL wholesale offers. More regulation is expected in 2005 concerning, among other things, the implementation of new wholesale offers by PT, in particular the interconnection flat rate and the telephone access resale wholesale offer, and the review of current procedures and administrative charges related to carrier pre-selection and number portability and PT s offer of leased lines.

With respect to data protection in electronic communications networks, Law no. 41/2004, of August 18, 2004, has implemented the corresponding EU directive.

The Portuguese regulator

Although MOPTC retains basic responsibility for telecommunications policy in Portugal, ICP-ANACOM, acting under new statues approved by Decree law no. 309/2001, of December 7, 2001, is allowed to act with great autonomy and is entrusted with a wide range of responsibilities regarding the regulation, supervision and representation of the telecommunications sector. The Electronic Communications Law also defines the main objectives of regulation and gives ICP-ANACOM the main competencies foreseen in the new EU legal framework.

Licensing and registration

The new EU Licensing Directive prohibits any limitation on the number of new entrants in telecommunications markets, except as required to ensure an efficient use of radio frequencies. The licensing regime is based on general authorizations as opposed to individual licenses. However, it permits national regulatory authorities to make the granting of numbering and radio frequency resources subject to individual usage rights.

To facilitate implementation of the EU Licensing Directive, the Electronic Communications Law introduced a new concept regarding access to the telecommunications market. According to the relevant provision, telecommunications services normally fall under a general authorization regime (*Regime de autorização geral*). This, in turn, requires that the entities that provide telecommunications services in Portugal are obligated to (i) provide ICP-ANACOM with a summary and description of the services they intent to offer, (ii) communicate the date planned for the launch of their activity and (iii) provide certain identification elements under terms defined by ICP-ANACOM and recently published. After the provision of this information to ICP-ANACOM the companies may immediately start their activity.

If the provision of the relevant services requires individual rights of use of frequencies or numbering, these rights can only be granted through an open, transparent and non-discriminatory procedure. The specific rules applicable to this procedure will be established by ICP-ANACOM, unless it relates to services to be made available for the first time in a specific frequency band, or relates to frequencies available for the first time and involves a competitive selection between several interested parties. In cases for which the service is available for the first time, the government will be responsible for approving the relevant applicable regulations.

Pricing and fees

Telecommunications operators in Portugal other than PT are free to establish the prices for their services. PT entered into a pricing convention with ICP-ANACOM and the former DGCP, the Portuguese commerce and prices Department in the Ministry of Economy, which established price caps on PT s prices for fixed telephone services (i.e., installation charges, line rental fees and prices for domestic and international telephone calls), leased lines and telex. Prices must be transparent, cost oriented and non-discriminatory and must be published in the Official Gazette.

Operators and service providers must pay administrative fees to ICP-ANACOM, established by MOPTC. The amount of these fees remains to be determined, as the relevant fees due under the Basic Law of Telecommunications are no longer applicable under the Electronic Communications Law. The granting of numbering resources will also be subject to administrative fees that are different than those under the previous legal framework. The possibility for competitive bidding or auction procedures for the allocation of numbers and frequencies is also considered in the Electronic Communications Law.

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Interconnection

Interconnection regulation is now generally regulated by the Electronic Communications Law. The basic principle is that operators are free to negotiate the technical and commercial terms and conditions applicable to interconnection agreements. However, it has also granted ICP-ANACOM a wide range of powers not only to intervene in dispute resolution or by its own initiative and to fix ex-ante conditions (including with respect to networks of new competitors, which has been recently implemented), but also to introduce certain conditions deemed necessary to modify existing interconnection agreements.

Internet

At present, there is limited Portuguese and EU legislation specifically covering the provision of Internet services, apart from the general rules established by the Electronic Communications Law, although there are laws and regulations relating to certain specific aspects of Internet activities, including the use of domain names, digital signatures, electronic invoices and data protection. In addition, the EU adopted what is known as the E-Commerce Directive, which sets out basic principles for regulating electronic activities in the EU. There are also a number of pending legislative and regulatory proposals in Portugal and in the EU.

Internet advertising activities are subject to the relevant restrictions of the Portuguese Advertising Code, to Portuguese legislation applicable to home advertising and, more recently, to Decree law no. 7/2004, of January 7, 2004, or the E-Commerce Law implementing the corresponding EU e-Commerce Directive, as described below. In addition, sales through the Internet can be considered a form of retail sales and subject to Decree law no. 143/2001, of April 26, 2001, pursuant to which a consumer has the right to cancel a contract within 14 business days to 3 months, depending on the extent to which the seller has complied with the information requirements established by this decree law.

On June 8, 2000, in order to ensure the free circulation of electronically provided services, including commerce between Member States, the EU adopted the E-Commerce Directive (2000/31/EC). This Directive sets out two main principles: services electronically provided by an ISP established within a Member State are required to comply with the legal requirements of such Member State (country of origin principle); and any Member State may not, as a rule, restrict the electronic services provided from another Member State (principle of mutual recognition). Portugal has recently implemented this directive in the E-Commerce Law (approved by Decree law no. 7/2004, of January 7) and, although exceptions apply to several matters such as tax, competition, personal data, gambling activities and notarial acts, this law sets out the main rules applicable to the provision of services using Internet and online contracting.

On December 21, 1998, the EU approved a plan, known as the Action Plan, to promote safer use of the Internet by combating illegal and harmful content on global networks. While some member countries have adopted this Action Plan, to date Portugal has not.

It is also possible that cookies, or pieces of electronic information used to track demographic information and to target advertising, may become subject to increased levels of legislation limiting or prohibiting their use. The E-Commerce Law did not, however, clarify this issue.

In addition, because of the global nature of the Internet, our Internet activities may be deemed subject to the laws or regulations of other countries.

FINANCIAL RESULTS

As a recent entrant in the telecommunications sector, during its first five years of operations ONI has incurred significant operating costs in connection with developing and sustaining its business while, at the same time, increasing revenues as a result of its growing customer base. ONI had revenues for 2004 of 325.4 million, of which services provided to the EDP Group amounted to 10 million, and an operating loss of 45.9 million. In comparison, ONI had revenues for 2003 of 331.1 million, of which services provided to the EDP Group amounted to 15.3 million, and an operating loss of 68.7 million. ONI s 2004 operational capital expenditures for fixed line communications in Portugal and Spain were approximately 33.5 million (which excludes 20 million

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capitalized as an intangible asset, i.e., the right to use the fiber optic leased to EDIS) compared with approximately 28.6 million in 2003. ONI s total assets at the end of 2004 were 775 million compared with 835 million at the end of 2003.

ONI s current assessment of expenditures in the telecommunications area anticipates an investment by ONI of approximately 100 million for the period 2005-2007 almost exclusively for network infrastructure and client connections and equipment, although the amount of investments may change as ONI s plans develop.

In view of the applicability of Article 35 of the Portuguese Companies Code, which requires that the shareholders equity of a company may not be lower than 50% of its share capital (and in such case requires the company to increase its shareholders equity to be at least two-thirds of its share capital), by the end of 2004, ONI incorporated 324.1 million of accumulated losses into its share capital and subsequently issued 24.0 million of new shares, which were subscribed through the incorporation of shareholders loans, resulting in a new share capital of 100 million.

OTHER INVESTMENTS AND INTERNATIONAL ACTIVITIES

We have a 30% shareholding in REN, the operator of Portuguese electricity transmission grid. The other shareholder of REN is the Portuguese Republic, which purchased its 70% holding in REN from us in late 2000. For more information on REN and the Portuguese transmission network, please see Portugal Transmission and Portugal Generation.

On October 26, 2004, we signed a call option agreement with IPR and IPBV for the purchase of a 20% shareholding and related shareholder loans in Turbogás and of a 26.667% shareholding and related shareholder loans in Portugen. On March 16, 2005, we exercised the call option and acquired the shareholdings and related shareholder loans for a total consideration of 51,984,977. As a result of this transaction, we now hold a shareholding of 40% in Turbogás, while IPBV holds the remaining 60%. In addition, we became a shareholder of Portugen with a 26.667% shareholding, while the other shareholder is International Power Portugal Holdings S.G.P.S., S.A. with a 73.333% shareholding. Turbogás was incorporated in 1994 with the sole purpose of carrying out the development, construction and operation of a combined-cycle gas fired power station at Tapada do Outeiro, in Portugal, with a total installed capacity of 990 MW. Presently, Turbogás sells all the energy it produces to the Portuguese PES through REN under a long-term PPA. Portugen is the entity in charge of the operation and maintenance of this power station.

We have a 10% interest in Tejo Energia, which was incorporated in October 1992 and acquired the Pego thermal power plant from us in November 1993. The other shareholders of the company are International Power (45%), Endesa Europa (35%) and EDFI (10%). The Pego plant has two coal units with an installed capacity of approximately 300MW each. Presently, Tejo Energia sells all the energy it produces to the PES through REN under a long-term PPA.

We have a direct and indirect interest of approximately 8.62% in Elcogas, S.A. (4.31% through EDP Participações, and 4.31% through Hidrocantábrico), a consortium that includes, in addition to us, Electricité de France, Endesa, Iberdrola, International Power and others. Elcogas, S.A. was formed to build and operate a 300 MW integrated gasification combined cycle plant in Puertollano, Spain. This plant burns gas obtained from the coal gasification process.

We hold a 21% interest in a consortium that indirectly owns an 80.88% interest in the capital of Empresa Eléctrica de Guatemala S.A., or EEGSA, which is an electricity distribution company in Guatemala. In 2004, EEGSA had approximately 750,000 customers, a sales volume of 3,697 GWh and a service area of 6,200 square kilometers. EEGSA is Central America s largest distribution company. In 2004, EEGSA generated

304.2 million in revenues and had a net income of 24.3 million. The consortium is made up of EDP, Iberdrola and Teco Energy, a Florida electric company.

We also own a 21.19% stake in CEM Companhia de Electricidade de Macau, S.A., or CEM, the electric utility company of Macau, and have an active role in CEM s management. In 2004, CEM had approximately 200,000 customers and sold 2,093 GWh of

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electricity. In 2004, CEM had revenues of 212.4 million and net income of 43.3 million. CEM has the concession for generation, transmission and distribution in Macau until December 2010. CEM serves a population of approximately 450,000 in an area of 28 square kilometers.

In late 1999, we formed a consortium, 60% owned by us and 40% owned by AdP-Águas de Portugal, which was chosen by the government of Cape Verde to acquire a 51% interest in Electra, for which we paid 27 million. Electra produces and distributes electricity and water in Cape Verde. In 2004, Electra produced 219 GWh of electricity, compared to 199 GWh in 2003, and distributed 147 GWh to 71,243 customers in an area of 4,030 square kilometers. Also in 2004, Electra produced 4.1 million cubic meters of water and distributed 2.8 million cubic meters of water to 25,102 customers. Electra had revenues of 31.7 million and a net loss of 4.4 million in 2004.

SUBSIDIARIES, AFFILIATES AND ASSOCIATED COMPANIES

Apart from EDP Produção, EDPD, Hidrocantábrico, our Brazilian companies and ONI, we have a number of subsidiaries that provide various services to our other companies. Some of these subsidiaries also provide services to third parties. These entities contributed 91 million in revenues in 2004.

EDP Valor integrates some of our service companies with the objective of achieving cost reductions within EDP through the consolidation of resources and the centralizing of purchasing activities. Since the first quarter of 2002, EDP Valor has extended its services to EDP Produção and EDPD.

Edinfor Sistemas Informáticos, S.A. develops, operates and markets software and systems, and also provides consulting and vocational training in information technology. Edinfor holds a 100% interest in ACE-SGPS, which is a holding company for Portuguese companies that provide management, strategic and information systems consultancy, corporate turnaround and organization restructuring services and other services. Following the sale of 60% of our stake in Edinfor to LogicaCMG in April 2005, we now hold 40% in Edinfor. 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. Under the terms of this sale, we may have the option to sell our remaining 40% interest in Edinfor to LogicaCMG after two years.

Affinis Serviços de Assistência e Manutenção Global, S.A. provides home services and contractor management to residential and corporate customers through a network of skilled professionals. In the residential area, Affinis offers home services including the planning, installation, maintenance and repair of electrical, gas, plumbing and structural systems and the replacement of household appliances. In the corporate area, Affinis provides technical assistance with respect to many of the services provided in the residential area.

Item 5. Operating and Financial Review and Prospects

OVERVIEW

COMPANY OVERVIEW

Our principal business is the generation and distribution of electricity in Portugal and Spain (the Iberian Peninsula), which we consider to be, and refer to in this annual report, as our domestic market. We are also involved in activities related to our core energy business both in our domestic market, such as the distribution and supply of natural gas, and in Brazil, where we exercise control over three distribution companies and own interests in generation. In addition, we hold interests in other complementary businesses, such as an approximately 56% stake in ONI, a fixed line telecommunications operator in Portugal and Spain.

FACTORS IMPACTING OUR BUSINESS

Our businesses, financial condition and operating performance have been and will continue to be primarily affected by:

- the macroeconomic conditions in the countries in which we operate, which influence the overall level of demand for electricity and gas;

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changes in the regulatory frameworks in the countries in which we operate, which can affect the tariffs that we are permitted to charge for electricity and gas;

our level of operating costs, which consist primarily of depreciation and amortization, fuel costs and costs of purchased electricity and gas, and wages and salaries; and

the volatility of the Brazilian real against the euro, which influences our reported results and the value of our consolidated assets and liabilities.

Economic factors

The level of demand for electricity in countries in which we operate is directly related to the general level of economic activity in those countries.

Over the last decade, Portugal has experienced a stronger rate of economic growth than many other EU Member States. From 1994 through 2004, Portugal s real gross domestic product, or Portugal s GDP, grew at an average annual rate of 2.5%, as compared with an average of 2.1% for all 15 Member States of the EU. Portugal, like other European countries, was affected by a recession from 1992 through 1994. Since 1996, however, the Portuguese economy has recovered and growth in Portugal s GDP has exceeded the EU average. The structure of Portugal s economy has been undergoing significant changes, as higher value-added sectors, such as manufacturing and services, have gained in relative importance compared to lower value-added sectors, such as agriculture. In 2004, Portugal s GDP increased by about 1.0% compared to a growth rate of 1.8% in the euro zone. Portugal s GDP declined by 1.0% in Portugal in 2003 and grew by 0.4% in 2002. The slowdown in the Portuguese economy in 2003 was mainly the result of international economic factors, principally the difficulty experienced in the euro zone and North America as these areas attempted to stage economic recoveries, lower demand in Portugal and a decline in EU exports as a result of the appreciation of the euro against the U.S. dollar. In addition, budgetary restrictions in several EU countries prevented the adoption of expansionary economic policies. Despite the unfavorable macroeconomic environment, electricity consumption in Portugal grew by 6.1% in 2004, one of the fastest growing rates in the euro zone, driven by a cold winter and a particularly warm summer.

In Spain, where we currently have a 95.7% ownership stake in Hidrocantábrico, GDP growth was 2.7% in 2004, compared to 2.4% in 2003 and 2.0% in 2002. In 2004, Spain had one of the highest-performing European economies, significantly above the EU average, despite the difficult international economic environment in 2004, particularly in Europe. Electricity consumption growth in the Spanish market was 4.0% during 2004, compared with growth of 5.8% in 2003.

During 2002, Brazil experienced a series of events that had a negative effect on its economy. On the international front, the troubled state of several of the major economies of Latin America, especially Argentina s default on its debt obligations and the Argentine government s decision to remove the peg of the Argentine peso to the U.S. dollar, raised fears that Argentina s economic difficulties would spread to Brazil. On the domestic front, the Brazilian economy was significantly affected by the energy rationing program implemented by the Brazilian government, the weakening of demand in Brazil and the uncertainty surrounding the results of the October 2002 presidential elections, which raised concerns over the continuity of a number of economic reforms. In 2003, Brazil experienced a positive turnaround in its economy, reflected in inflation indicators and currency exchange rates. This turnaround was largely due to improved liquidity in international financial markets, the economic growth of Brazil s main commercial partners (China, Argentina and the United States of America), adherence to the targets of inflation policy, agreement on primary surplus levels with the IMF and improvement in Brazil s trade balance, which reached U.S.$24,800 million in 2003. In 2002, the real depreciated 52.2% against the U.S. dollar, reflecting the increased financing requirements and a decrease in the inflow of foreign capital. In 2003 and 2004, the real appreciated 18.2% and 8.7%, respectively, against the U.S. dollar, following the macroeconomic turnaround and the monetary policy implemented by the government. As a consequence, the Brazilian real reached 3.53 reais per U.S. dollar in 2002

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compared with 2.89 reais and 2.65 reais at the end of 2003 and 2004, respectively. Brazilian GDP grew 1.93% in 2002, decreased by 0.22% in 2003 and increased again in 2004 by 4.9%.

Despite improvements in certain economic indicators and in currency exchange rates, the tight monetary policy pursued by the Brazilian government in 2003 adversely affected the domestic economy. However, in 2004, the effects of a less restrictive monetary policy began to produce results and economic growth became more visible. In September 2004, the Brazilian Central Bank began to implement a policy of increasing interest rates, since inflation indicators were not converging toward the targets set for 2005. As a result, the Brazilian economy is not expected to grow in 2005 at rates seen in 2004. According to the Brazilian Central Bank, market estimates indicate that Brazil s GDP will grow by approximately 3.3% in 2005.

Regulatory factors

Since the 1990s, the policy of successive Portuguese governments has been to remove barriers to trade, privatize state-owned companies and liberalize key economic sectors, such as telecommunications, transportation and energy and power. Prior to 1988, we had a nearly complete monopoly of the electricity generation, transmission and distribution business in Portugal. Since 1988, however, competition has increased in the generation business and is expected to continue to do so during the next few years as the EU competition policy is implemented. In 1999, the regulator implemented measures to encourage competition in the distribution of electricity in Portugal, and since August 18, 2004, all consumers have been able to choose their supplier. To learn more about these measures, you should read Item 4. Information on the Company Portugal Generation Competition.

Tariffs are set by the regulator pursuant to a periodic registration of regulatory parameters. In November 2001, the regulator published the regulatory framework for the 2002-2004 regulatory period. For 2002, in nominal terms, tariffs increased across all voltage levels by an average of 2.2% from the 2001 levels. For 2003, in nominal terms, tariffs increased across all voltage levels by an average of 2.8% from the 2002 levels. In real terms, adjusted for inflation, very high-, high- and medium-voltage tariffs have declined by an average of 3.4% over the period 1999 to 2004. The tariffs for low-voltage customers also declined, in real terms, by an average of approximately 3.1% over the same period. For 2004, in nominal terms, tariffs have increased across all voltage levels by an average of 2.1% from the 2003 levels. In real terms, very high-voltage tariffs have increased 1.6% between 2003 and 2004, high-voltage tariffs remained stable, medium-voltage tariffs decreased by 0.1% and low-voltage tariffs increased 0.1%. For 2005, in nominal terms, tariffs increased across all voltage levels by an average of 2.3% from 2004 levels. In real terms, very high-voltage tariffs have decreased 2.1% between 2004 and 2005, high-voltage tariffs and medium-voltage tariffs decreased by 0.6% and low-voltage tariffs decreased 0.2%. Tariffs in 2004, in real terms, decreased 0.4% on average across all voltage levels. Tariffs in 2004, in real terms, increased 0.21% on average across all voltage levels. To learn more about these tariffs, you should read Item 4. Information on the Company Portugal Tariffs.

In late 2000, the Portuguese government purchased a 70% interest in REN from us. The government s decision to purchase a controlling stake in REN from us was a part of the government s reorganization of the PES in accordance with the European trend toward greater liberalization. As part of this liberalization, the government sought to separate the company managing the national grid from generation and distribution companies, which the government in the decree law stated is the most suitable model of operation and would bring greater transparency and competition to the electricity sector. The decree law relating to the REN purchase permits us to purchase the sites of the power plants used in the Binding Sector in the event REN chooses not to use such sites and plants at the conclusion of the applicable contract for the expansion of the Binding Sector, thereby permitting us to continue to operate the plant in the Non-Binding Sector. The decree law also provides that, in the event we sell our remaining shares in REN, the government will have the first right to acquire these shares. Currently, our 30% interest in REN is accounted for under the equity method of accounting.

In Spain, following the trend of privatization and liberalization in other regulated sectors, a new regime was introduced in 1997 by Law 54/97 whereby management, transmission and distribution of electricity remained the only regulated activities in the electricity sector. Furthermore, in order to accomplish a complete unbundling between generation and transmission activities, accounting separation was established for companies carrying out both activities. Under this framework, a wholesale market run by OMEL was established for generation activities. Customers above a determined voltage threshold were allowed to choose their electricity supplier, while REE, a state controlled entity, remained responsible for the technical management of the transmission grid.

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In recent years, further measures have been implemented to enhance competition, and since January 1, 2003 all customers can choose their electricity supplier. In other words, they can decide to remain regulated and subject to the electricity tariff or enter into a contract with a supplier at a market rate.

Pursuant to Law 54/97, the regulated electricity tariffs are determined by a Spanish governmental Royal Decree on an annual basis. The tariff may be amended if special circumstances warrant doing so, once the legal requirements have been complied with and the necessary reports are obtained. In 2002, a new method of tariff calculation was adopted for the period 2003-2010. Electricity companies that were in operation as of December 31, 1997 can recover a fixed amount of competition transition costs. This enables these companies to recover part of the costs borne by electricity generators during a period of transition to a competitive market until 2010. The regulated electricity tariff is based upon an average tariff or reference tariff, which includes all the applicable tariffs and costs. These tariffs are not specifically linked to an inflation-indexed formula. The system of regulated tariffs is used to determine the price of the supply of electricity and access to the transportation and supply networks. The regulated supply tariff is based upon a range of general tariffs, which are determined by the supply tension and the use of the power contracted.

For 1999, in nominal terms, the average tariff in Spain decreased by 5.57%. The decline of the average tariff continued until 2002, when the new method of calculation was adopted. The average tariff then increased for 2003, 2004 and 2005 by 1.65%, 1.72% and 1.71%, respectively. However, the reference tariff has decreased in real terms, adjusted for inflation, every year since 1992. Thus, the cumulative variation of the tariff in real terms reflects a 44.5% reduction since 1993.

The New Electricity Law introduced material changes to the regulation of the Brazilian power industry, in order to provide incentives to private and public entities to build and maintain the country s generation capacity and to assure the supply of electricity within Brazil at law tariffs through competitive electricity public auctions. Unlike Brazilian electricity distribution concessionaires, Brazilian generation concessionaires generally lack provisions in their concession contracts for fixed tariffs or mechanisms for adjustment and revision of tariffs. Under initial contracts, the tariffs set between the generators and the respective electricity distribution companies are subject to approval by ANEEL. Under bilateral contracts, prices are freely negotiated between the parties. Limitations on the transfer of costs for contracts executed after the enactment of the New Electricity Law are based on the annual reference value, which corresponds to the average electricity prices determined at A-5 and A-3 auctions, calculated for all Brazilian electricity companies. These transfer restrictions ultimately limit the electricity prices charged by generators, since the prices cannot be higher than the normative value or the annual reference value and still remain competitive and eligible for ANEEL approval. Following the enactment of the New Electricity Law, generators can only sell their electricity to distributors through public auctions conducted by ANEEL and the CCEE.

Brazilian distribution tariffs are adjusted annually by ANEEL, pursuant to a parametric formula provided for in each distribution company s concession contract. When adjusting distribution tariffs, ANEEL segregates the costs of the distribution concessionaires between costs that are beyond the control of the distributor (known as Portion A costs) and costs that are within the control of the distributor (known as Portion B costs). The rules for calculating the transfer of electricity-purchasing costs to customers tariffs have not been altered by the New Electricity Law with regard to electricity purchase contracts executed prior to March 16, 2004, with limits based on normative values determined by ANEEL. The transfer calculation criteria for contracts to purchase electricity executed after that date have been changed.

Electricity trading in Brazil is governed by Law no. 9,648, of May 27, 1998, as amended, and in Decree no. 2,655, of July 2, 1998, as amended. Trading is subject to a competitive regime in which several agents may participate, including the generators operating under either the public service or independent production classifications, and the agents trading or importing electricity. Unlike distribution and transmission services prices in Brazil, which are regulated, electricity trading prices are freely negotiated based on market conditions.

Factors affecting the comparability of our results of operations

In the first half of 2002, we acquired 39.5% of Hidrocantábrico and started proportionally consolidating the company as of June 1, 2002 at the 40% level. Our 2002 consolidated financial statements included Hidrocantábrico s contribution for the last seven

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months of 2002, whereas in 2003 and 2004, our consolidated financial statements include Hidrocantábrico s contribution for the full year. As at December 31, 2004, the referred subsidiary was consolidated under the full consolidated method.

In October 2002, we gained operational control over Espirito Santo Centrais Electricas, S.A., or Escelsa, a Brazilian electricity distributor located in Espirito Santo State. Escelsa owns 65% of Emprea Energetica do Mato Grosso do Sul, S.A., or Enersul. Until the end of September 2002, we accounted for Enersul using the equity method, and from October 1, 2002, fully consolidated both Escelsa and Enersul. Despite the fact that this change in the consolidation method had no impact on our reported net profit, it did have an impact on our consolidated financial statements.

Operating margin

Our operating margin and net profit in 2004 increased by 16.9% and 15.5%, respectively, from 2003. In 2003, our operating margin and net profit in 2003 increased by 39.6% and 13.7%, respectively, from 2002. In 2002, operating margin and net profit decreased by 3.7% and 25.6%, respectively, from 2001.

The increase in our 2004 operating margin was the result of improved performance in our Portuguese electricity generation and distribution businesses and in our Brazilian operations. The key factors that contributed to this performance were EDP s exposure to high-growth electricity markets, the successful implementation of the Human Resources Restructuring Program that cut personnel costs at EDPD by 8%, additional generation capacity from two new units at the Ribatejo CCGT plant (+800MW) and an additional 214 MW of wind farms in Iberia, a strong tariff increase granted to our distribution companies in Brazil by the Brazilian electricity regulator and the twelve months consolidation of Naturcorp following its acquisition in July 2003.

The increase in 2003 operating margin was influenced by the consolidation changes between 2002 and 2003 mentioned above relating to Hidrocantábrico, Escelsa and Enersul. If we had fully consolidated these companies for 12 months of 2002, our operating margin would have increased 23.8% in 2003. This increase is partly explained by the strong growth rates in electricity consumption across all of the countries in which we operate, an increase in the regulated revenues of EDPD, tariff increases granted to our distribution companies in Brazil by the Brazilian electricity regulator and better operating performance of ONI as a result of the implementation of a cost reduction plan and following discontinuation of ONI Way in 2002. The decrease in operating margin in 2002 was partially due to the effects of lower electricity distribution tariffs in Portugal following the start of the 2002-2004 tariff period and the combination of lower consumption in areas served by Bandeirante, Escelsa and Enersul following the electricity rationing program of the Brazilian government, and a severe devaluation of the real against the euro. A devaluation in the real negatively affects our consolidated results, as the results of our Brazilian companies are translated into euros in our consolidated results.

The 13.7% increase in net profit from 2002 to 2003 was due to a 39.6% increase in operating margin discussed above and lower extraordinary losses due to a one-time write-off in 2002 of our investment in ONI Way, in connection with the divestment of ONI s Universal Mobile Telephone Service, or UMTS, business. The factors positively affecting net profit were partially offset by higher financial charges and lower contributions from minority interests resulting from the proportional consolidation of Hidrocantábrico for 12 months in 2003 compared with seven months in 2002.

We do not expect one-time items to materially affect our results in 2005. Although we will continue to experience lower tariffs in our distribution business, we are optimistic that the regulator may allow us to include in our regulatory cost base significant restructuring costs related to our human resources, which we began to implement in the last quarter of 2003.

Our costs are influenced by inflationary trends, fluctuations in fuel costs and hydrological conditions. In years with less favorable hydrological conditions, or drier conditions, use of thermal power can increase significantly, causing our spending on fuel to increase substantially. In years with more favorable hydrological conditions, or wetter conditions, the opposite result occurs. To smooth the impact on earnings and customer prices, the hydro account was established. The hydro account is discussed below in Hydrological correction account, 2004 compared with 2003 Operating costs and expenses, and note 24 to our consolidated financial statements.

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Our profit and loss account is prepared on the total-cost basis typically used by major Portuguese companies. Costs related to our personnel and materials incurred for assets under construction that are capitalized as part of fixed assets and will be amortized in future periods are classified in the income statement as expenses, and a corresponding amount is credited to Own work capitalized.

CRITICAL ACCOUNTING POLICIES

Our reported financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of our consolidated financial statements. Our critical accounting policies, the judgments and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered in reviewing our consolidated financial statements and the discussions below in Results of Operations.

A critical accounting policy is one that is both important to results of operations and financial condition and requires management to make critical accounting estimates. An accounting estimate is an approximation made by management of a financial statement component or account. Accounting estimates reflected in our financial statements measure the effects of past business transactions or events, or the present status of an asset or liability. Accounting estimates included in the accounting policies presented in the consolidated financial statements require assumptions about matters that are highly uncertain at the time the estimate is made. Additionally, different estimates that could have been used, or changes in an accounting estimate that are reasonably likely to occur, could have a material impact on the financial statements. The inherent uncertainty of some matters can make judgments subjective and complex. The effects of estimates and assumptions related to future events cannot be made with certainty. Our estimates are based upon historical experience and on assumptions that management believes to be reasonable in the circumstances. These estimates may change with changes in events, information, experience, and our operating environment. The following critical accounting policies and estimates are those used in the preparation of our audited consolidated financial statements.

PPAs

We entered into several PPAs which are treated as leases under U.S. GAAP. The evaluation of whether an arrangement contains a lease within the scope of Statement 13 and EITF 01-8 is based on the substance of the arrangements. The PPAs include agreements that, although not nominally identified as leases, meet the definition stated in the above-mentioned statements, in particular that a lease transfers substantially all of the benefits and risks related to the property to the lessee. In substance, these contracts explicitly identify the power plants with which we produce power exclusively for REN and cannot use any other power plant to supply power to REN. Additionally, these contracts convey the right to use the power plants and require that the total production is acquired by REN, the entity which is the lessee.

The PPAs are considered as capital leases for U.S. GAAP purposes due to the fact that the contracts transfer the risks and rewards of usage to the lessee during the period of the lease term, transfer the ownership of the property to REN at the end of the lease term and the lease terms are the same as the useful lives of the power plants. As permitted under Portuguese GAAP, these assets are classified as tangible fixed assets and amortized on straight-line basis at rates accepted by the tax authorities or for general purposes business, which reflect the economic useful lives of each category of fixed assets.

On January 27, 2005, in accordance with Decree law no. 240/2004, we signed agreements for the early termination of the PPAs. The termination agreements effects are suspended until a set of conditions is met which includes the commencement of MIBEL which assures the sales of generated electricity, and the attribution of non-binding production licenses. When the conditions set out allow for the effective termination of the PPAs, under U.S. GAAP the power plants will be accounted in a similar manner as the current accounting under Portuguese GAAP.

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Hydrological correction account

The hydrological correction account, or hydro account , was established by Decree law no. 338/91 and constitutes a legally mandated mechanism for compensating the variable costs of electricity generation. This accrual was set up mainly in 1994 through a charge against income during the period that we were owned by the Portuguese state. Despite the separation of REN from EDP in 2000, further regulation (through Decree law no. 98/2000) maintained the requirement to keep this account on our balance sheet.

The main objective of the hydro account is to avoid imbalances in the electricity sector due to changes in variable costs incurred as a result of hydrological conditions. Accordingly, since the tariffs cannot be modified immediately to reflect the changes in variable costs incurred as a result of hydrological conditions, this account is used to compensate the volatility in variable operating costs of power generators in the PES for unfavorable hydrological conditions, such as when thermal generation increases and, consequently, expenditures on fuel and electricity imports increase substantially. In years with abundant rainfall, the opposite occurs. In this context, and with a view toward avoiding major distortions in operating results due to favorable or unfavorable hydrological conditions, the hydro account is adjusted upwards or downwards based upon average hydrological conditions.

As mentioned above until 2000 REN was part of the EDP Group and therefore the movements of the hydro account were within the EDP Group. Since the separation of REN in June 2000, we (at the holding company level) pay or receive cash from REN, which is booked against the hydro account. The net movement in the hydro account between December 31, 2000 and December 31, 2004 was approximately 1 million. We record a charge for the financing cost associated with the amount of the accumulated balance of this account, which is recognized in earnings under Portuguese GAAP. REN uses the amount received or paid to compensate the operators in the PES (a significant majority of which are our subsidiaries) in accordance with the objectives of the hydro account as described above. As such, REN is effectively a flow-through entity for purposes of the hydro account. For Portuguese GAAP purposes, the operators in the PES who receive or pay cash to REN account for it against earnings.

The Portuguese government approves the amount of the accumulated balance and the movements during the year on an annual basis. REN is engaged to calculate the amounts to be received or paid by us in relation to the hydro account.

In prior years, for Portuguese GAAP purposes, the balance continued to be reported as a liability in accordance with local legislation. For U.S. GAAP purposes, the portion of the liability established through 1994 was eliminated with an offsetting increase to shareholders equity. In essence, this increase to shareholders equity was equivalent to accounting for accrued income. Thus, in periods up to December 2003, it was considered that the amount recorded as an asset would be recoverable through future benefits flowing to the EDP Group. Subsequent to 1994, payments and receipts by EDP to REN are treated as increases or decreases of the liability under both Portuguese and U.S. GAAP.

During 2004, Decree law no. 240/2004 was issued, with the purpose of regulating the early termination of the PPAs, a step toward the liberalization of the energy market within the Iberian Peninsula. This decree law states that with the introduction of the free trading market, which is currently expected to occur within the next twelve months, the government will be required to introduce a new regulation regarding the purpose and scope of the hydro account as well as the mechanisms to compensate producers for their increased risks resulting from the early termination of PPAs.

As a result of the introduction of this regulation mandated by the above-mentioned decree law, and in light of the above-mentioned government announcement, our board of directors and management consider that it is probable that the hydrological correction mechanism will be terminated. At such date the liability recorded for the hydro account, including the balance relating to pre-1994 activity, will be payable to a

third party to be nominated by the regulator. Moreover, since this regulation can only be introduced simultaneously with the effective liberalization of the energy market in the Iberian Peninsula, our board of directors and management consider that the accrued income accounted as an asset will cease to have any future economic benefits. Therefore, at the end of 2004, we recorded a full valuation allowance against the asset recorded in our U.S. GAAP accounts in the amount of 315 million as at December 31, 2004.

Impairment of long-term assets

Tangible and intangible fixed assets are reviewed for impairment if events or changes in circumstances indicate that the carrying amount may not be recoverable. Goodwill is reviewed for impairment at the end of the first complete financial year after the relevant acquisition, and thereafter, if events or changes in circumstances indicate that the carrying amount may not be recoverable. When conducting a review for impairment, consideration is taken of the regulated and contractual aspects of our operations.

Uncertainties exist when assessing the recoverability of the carrying amounts of the tangible and intangible fixed assets, as the assessment is based on the best information available at that date.

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Allowance for uncollectible accounts

Estimated provisions for uncollectible accounts receivable are based on management s assessment of the probable collection of customer accounts, aging of accounts receivable, bad debt write-offs, and other factors. Certain circumstances and events can cause actual bad debt write-offs to vary from assumptions used in estimating uncollectible account provisions; these include general economic conditions, industry trends, deterioration of major customer credit worthiness, and higher defaults. This evaluation process is subject to numerous estimates and judgments. Changes in these estimates could lead to a different provisions and consequently different amounts of net income.

Employee retirement benefits

We have a commitment to complement the retirement and survivors pensions of the employees subject to the A.C.T. (collective labor agreement) to the extent that these are not covered by the government s social security plans. Those employees have the option of taking early retirement, subject to certain conditions relating to pre-defined age and length of service requirements being met. Retired employees retain the right to medical assistance based upon similar conditions as those pertaining to employees still on the active payroll. The entitlement to these benefits is usually based on the employee remaining in service up to retirement age. The expected costs of these benefits are accrued over the period of employment, using valuations performed by independent qualified actuaries. The pension plans are generally funded by payments from the EDP Group companies, taking into account the actuarial assumptions agreed with the independent qualified actuaries.

There are numerous uncertainties inherent in estimating employee retirement benefits and assumptions that are valid at the time of estimation, but may change significantly when new information becomes available. Fluctuations in the rates and other assumptions used for the actuarial valuations may, ultimately, result in actuarial gains or losses that, in accordance with the relevant accounting criteria, will be recognized in the financial statements.

Deferred income taxes

Deferred income taxes, recoverable and payable, have been included in our balance sheet as deferred tax assets and liabilities for the expected future tax consequences attributable to differences between the financial statement carrying amount of assets and liabilities and their tax bases.

There are certain uncertainties inherent in estimating deferred income taxes, namely the ability to generate future taxable income by those companies that have recognized deferred tax assets in the periods in which the temporary differences revert in the income statement.

We consider if an allowance should be recognized based on the weight of available evidence and whether it is more likely than not that some portion or all of the deferred tax asset will not be realized.

Deferred tax liabilities and assets are adjusted in the period of enactment for the effect of an enacted change in tax laws or rates. These facts could lead to a change in our earnings for future periods.

Revenue recognition

Revenues from retail electricity sales are recognized when monthly billings are made to customers for energy sold, based upon meter readings performed on a cycle basis during each month, together with historical consumptions individually by customer. In order to properly match revenue with related expenses (power costs, distribution expenses, etc.), estimated unbilled revenues are accrued for electricity provided from meter read dates to each month-end. Such estimated unbilled revenues are based on our net system load, the number of days from meter reading to the end of each calendar month, and current retail customer rates.

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Regulatory assets and liabilities and tariff adjustments

In activities subject to regulation, the criteria of allocation of income and expense to each accounting period may be different from the criteria applicable to non-regulated activities. For accounting purposes, when the regulator establishes a criteria of allocating income and expense to future years, then a regulatory asset or liability is recognized in the financial statements, which otherwise would be booked as profit or loss of the year.

Regulatory assets relate to deferred costs defined and regulated by the regulator, which should be recovered through the increase of electricity tariffs during subsequent periods. Regulatory liabilities relate to future decreases in income defined and regulated by the regulator, which should have an impact on customers through the decrease of electricity tariffs during the subsequent periods.

In Portugal, the tariffs of electricity supplied to clients in the Binding Sector are determined by the regulator. Tariffs for clients outside the Binding Sector are negotiated and contracted on an individual basis. Tariffs in the electricity distribution business are subject to a price cap mechanism. These earnings are subject to a gross profit restriction and after being subject to confirmation or approval by the regulator are adjusted in future tariffs revenues. We estimate those future tariff revenues or adjustments and defer or accrue the recognition of the revenues until future periods in our Portuguese GAAP accounts. Even though the tariff adjustments are subject to formal approval by the regulator, these amounts are recorded under other assets or other liabilities in the accompanying balance sheet prepared under Portuguese GAAP. In the U.S. GAAP financial statements, these assets or liabilities recorded for the regulated activities in Portugal are eliminated because, in substance, we believe that the tariff adjustments regulation does not meet in full the criteria set out in SFAS 71. Even though the scope criterion of SFAS 71 is met with respect to the regulated activities in Portugal, due to the uncertainty in relation to future income being in an amount at least equal to the capitalized cost or a situation of a permanent roll forward of cost with current year costs being deferred and prior cost being recovered in each period, the asset recognition criteria as defined in SFAS 71 is not met. As a result, tariff adjustments related to Portuguese activities are not reflected in U.S. GAAP accounts and therefore are included as a reconciling item in the reconciliation from local to U.S. GAAP. However, the assets or liabilities resulting from the tariff adjustments mechanism set out by the regulator regarding our activities in Brazil meets the requirements of SFAS 71 and therefore are accounted for on that basis. The assets and liabilities considered by the Companies in Brazil as regulatory assets are fully compliant with the regulator (ANEEL - Agência Nacional de Energia Eléctrica). Eligible costs are specifically determined by the regulator and are recoverable through the recovery rates. Resulting from measures taken by the Brazilian government and by the regulator in 2001, our companies in Brazil are subject to the application of SFAS 71. In December 2001, in order to compensate the companies, an agreement with the Brazilian government was reached for all the entities operating in the sector, which allows the increase of regulated rates for a period of six years. Considering SFAS 71 and EITF 92-7, Energias do Brasil only considered regulatory assets based on two years projections of current level consumption.

The board of directors makes certain assumptions as to the recovery of the regulatory assets based on regulations issues, current legislation or past experience. If the probability of recovery is less than likely, the regulatory asset is written off against the cost of the year in Portuguese GAAP accounts.

Investments

We adopted the International Accounting Standard 39 *Recognition and Measurement of Financial Instruments* effective as of fiscal year 2003. Consequently, we classify our investments in accordance with this international accounting standard, particularly with regard to the types of financial instruments and their recognition and measurement, carrying them under the following categories of investments: trading, available for sale and held to maturity. The classification depends on the purpose for which the investments were acquired. Our board of directors determines the classification of these investments on the date of acquisition and re-assesses this classification on a regular basis.

Trading account securities

Investments acquired primarily for the purpose of being traded in the very short-term are classified as trading securities and are recorded as current assets. For the purpose of our financial statements, short-term is defined as three months. Realized and unrealized gains and losses resulting from changes in the fair value of trading securities are recorded in the profit and loss account during the period in which they occur.

Available for sale securities

For listed companies, valuations are at market quotation at balance sheet date. For unlisted securities, the value is based on valuation models that may require assumptions or judgment in making estimates of fair value. For these unlisted companies, more pessimistic assumptions would have resulted in higher estimated potential losses, which would in turn have negatively impacted shareholders equity. Unrealized gains and losses resulting from changes in the fair value of the available for sale securities are recorded in shareholders equity. Realized gains and losses are recorded in the income statement. If any of the available for sale securities are considered other than temporarily impaired, the relevant security is written down to fair value with impact in earnings and the fair value becomes the security s new adjusted cost basis.

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Under U.S. GAAP, a decline that is considered other than temporary is based generally on factors including (i) the length of time and extent to which the fair value of the security has been below cost and (ii) the financial condition and near term prospects of the issuer of the security. These factors involve assumptions and estimates on the part of management. Changes in fair value of securities due to impairment can adversely affect our results for a period in which such changes occur and, therefore, the reported results would be adversely affected if less favorable assumptions or different estimates were used.

Derivatives

Derivatives are initially measured in our consolidated balance sheet at cost and subsequently carried at fair value. The method of recognition of the resultant gain or loss depends on whether the derivative is related to a hedge relationship.

We identify derivatives as either: (i) hedging the fair value of the recognized liabilities or (ii) hedging the exposure to variability in expected future cash flows that are attributable to a particular risk. Changes in the fair value of derivatives identified as fair-value hedging instruments and qualifying as effective, are recognized as a gain or loss in the profit and loss account together with the changes in the fair value of liability for which the hedging risk was taken. Changes in the fair value of derivatives identified and classified as cash-flow hedging instruments are recognized against reserves, and the ineffective portion of the hedge is recognized immediately in the profit and loss account. The amounts recorded against reserves are transferred to the profit and loss account and classified as income or expense during the period in which the hedge cash flows impacted on the profit and loss account.

Any transaction which, despite its purpose of economic hedging in accordance with our risk management policies, is not classified as hedging in accordance with IAS 39, is treated as trading and the gains and losses are recognized in the profit and loss account during the period to which they relate.

To achieve hedge accounting on the date of commencement of the transaction, we document the relationship between the hedging instruments and the hedged items, as well as the respective risk-management objectives and strategies underlying the respective hedging transactions. This process includes the identification of all derivatives as hedging instruments and the related liabilities. We also document the hedge s effectiveness, at the inception of the hedge and during the life of the hedge, whether the derivatives used in the hedging transactions are highly effective to compensate the fair value or the cash flows of the hedged items.

Valuation of financial instruments with no ready markets

Fair values are determined based upon externally verifiable model inputs and quoted prices. All financial models, which are used for updating our published financial statements, must be validated and periodically reviewed by qualified personnel independent of the area that created the model.

Impairment losses that are considered other-than-temporary are recognized in earnings. We conduct regular reviews to assess whether other-than-temporary impairments exist. These determinations require certain assumptions as to the financial condition of specific issuers, market value and other conditions. The use of different assumptions could produce different results. Changes in the fair value of instruments are recognized in earnings. If available, quoted market prices provide the best indication of value. If quoted market prices are not available for fixed-maturity securities or derivatives, we discount the expected cash flows using market interest rates appropriate with the credit quality and

maturity of the investment. Alternatively, matrix or model pricing may be used to determine an appropriate fair value.

The determination of market or fair value considers various assumptions and factors, including time value and volatility factors, underlying options, warrants, and derivatives; price activity for equivalent synthetic instruments; counterpart credit quality; the potential impact on market prices or fair value of liquidating our positions in an orderly manner over a reasonable period of time

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under current market conditions; and derivative transaction maintenance costs during the period. Changes in assumptions could affect the fair values of portfolios.

Restatements

Under Portuguese GAAP, if a current year balance is reclassified or adjusted, the reporting entity is not allowed to restate the comparable prior year balance. Under U.S. GAAP, unless specifically prescribed in accounting guidance, the reclassification or adjustment of a current year balance will result in a corresponding reclassification or adjustment in the prior year balance to make the information comparable.

The reconciliation to U.S. GAAP for each of the two years ended December 31, 2003 and as of December 31, 2002 and 2003 has been restated to reflect the following:

i) ***Minority Interests.*** Under both Portuguese GAAP and U.S. GAAP, in prior years, the losses attributable to minority interests that exceeded the equity capital attributable to minority interests in subsidiaries had been recorded as negative minority interests in the balance sheet. In the income statement, the referred losses attributable to minority interest were charged to the minority interest in the proportion of their shareholding. Under Portuguese GAAP, and beginning January 1, 2004, we adopted a new accounting policy by which the negative minority interest in the balance sheet resulting from the accumulated losses attributable to minority interests which exceed the equity capital attributable to minority interests in subsidiaries are debited against equity when there is no binding obligation of the minority interests to cover such losses. In the income statement, under Portuguese GAAP, losses continue to be attributed to minority interest in the proportion of their shareholding. Under U.S. GAAP, as there is no binding obligation of the minority interest to cover such losses, such losses which exceed the equity attributable to the minority interest are charged to the majority interest, therefore the net income of the prior years has been restated to allocate the losses attributable to minority interests in 2002 and 2003 to the majority interest (EDP). If future earnings do materialize, the majority interest is credited to the extent of such losses previously absorbed.

ii) ***Concession Subsidies.*** Under Portuguese GAAP, the amount classified as deferred income related to assets under concession in Brazil is not amortized. However, the assets under concession are amortized on a straight line basis over the concession period. Under U.S. GAAP, the amortization of the accrued income should be recorded using the same period as the assets amortization. As this amount was not amortized in prior years under U.S. GAAP, we made a restatement to correct this issue in the income statement and in shareholders equity of each reported period.

iii) ***Guarantees.*** Under U.S. GAAP, a guarantor is required to recognize, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing the guarantees. In 2003, we made a provision with a charge against equity, even though it is unlikely that any disbursement related to those guarantees will have to be made. An adjustment is made under U.S. GAAP as a restatement at December 31, 2003 to reverse the provision that was made in the prior year.

iv) ***Other Comprehensive Income.*** In relation to other comprehensive income, in prior years, a reconciliation between the opening and closing balance of other comprehensive income was not presented in the notes to the financial statements in accordance with SFAS 130. SFAS 130 requires that the total of other comprehensive income be disclosed separately from retained earnings. We have included the information required for the total of other comprehensive income for each of the reported periods and has restated the balances to comply with the requirements of SFAS 130. While this restatement had an impact on the total value of other comprehensive income, it had no impact on the total value of shareholders equity.

For more information on our restatement of certain U.S. GAAP financial information for each of the two years ended December 31, 2003 and as of December 31, 2002 and 2003, please see note 42.ii to our consolidated financial statements.

RESULTS OF OPERATIONS

In 2002, following the conclusion of our acquisition of a 39.5% stake in Hidrocantábrico, we proportionally consolidated the results of Hidrocantábrico from June through December. On October 10, 2002, we gained control over the Brazilian distribution companies Escelsa and Enersul. As a result, we consolidated the results of Escelsa and Enersul from October through December 2002. We currently control 54.76% of Escelsa and 35.70% of Enersul. In December 2002, we decided to discontinue ONI Way s UMTS operations, a decision which was reflected by a write-off of ONI Way and the consequent increase in Other non-operating expenses (income) due to the creation of a non-recurring provision of 280.9 million.

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 a minority shareholder in Gas de Euskadi exchanged its holding for shares in Naturcorp, resulting in a decrease in Hidrocantábrico s ownership of Naturcorp from 62% to 56.8%. Naturcorp started to be fully consolidated in Hidrocantábrico as from August 2003. In December 2004, we acquired an additional 56.2% stake in Hidrocantábrico, which resulted in an increase in our shareholding to 95.7% of Hidrocantábrico s outstanding share capital. Hidrocantábrico was fully consolidated in our consolidated financial statements beginning in January 2005.

Years Ended December 31, 2004, 2003 and 2002

The following table sets forth our revenues by geography and activity for 2002, 2003 and 2004. For more information concerning our revenues, see note 29 to our consolidated financial statements.

	Sales of Electricity	Other sales	Services rendered	Total
		(millions of EUR)		
Year ended December 31, 2002				
Portugal				
Generation	1,425.4	18.7	18.2	1,462.3
Distribution and supply	3,503.4	1.7	33.1	3,538.2
Spain				
Generation	145.1	2.5	0.8	148.3
Distribution and supply	150.1	7.6	6.3	164.0
Gas	0	10.5	1.1	11.5
Brazil				
Distribution and supply	668.6	0	0	668.6
Telecommunications	0	46.7	274.1	320.8
Information technology	0	35.5	188.5	224.0
Services and other adjustments	(16.5)	(11.2)	(123.5)	(151.2)
EDP Group	5,876.2	112.0	398.4	6,386.6
Year ended December 31, 2003				
Portugal				
Generation	1,318.9	19.7	26.6	1,365.2
Distribution and supply	3,610.6	1.9	60.2	3,672.8
Spain				
Generation	256.8	2.0	1.1	259.9
Distribution and supply	287.7	28.9	12.4	329.0
Gas	0	75.9	10.1	86.0

Brazil				
Generation	27.4	2.3	11.5	41.3
Distribution and supply	929.0	0	37.6	966.6
Telecommunications	0	7.3	323.8	331.1
Information technology	0	27.0	159.3	186.3
Services and other adjustments	(134.2)	(4.9)	(121.6)	(260.6)
EDP Group	6,296.1	160.3	521.2	6,977.5
Year ended December 31, 2004				
Portugal				
Generation	1,481.3	21.2	38.4	1,540.9
Distribution and supply	3,842.8	2.7	26.4	3,872.0
Spain				
Generation	250.1	7.1	3.5	260.7
Distribution and supply	266.1	7.0	14.8	287.9
Gas	0	184.0	14.6	198.5
Brazil				
Generation	28.3	2.8	10.5	41.6
Distribution and supply	1,038.4	0	73.9	1,112.2
Telecommunications	0	8.1	317.3	325.4
Information technology	0	23.4	151.2	174.6
Services and other adjustments	(456.6)	(7.2)	(128.2)	(592.1)
EDP Group	6,450.3	249.0	522.4	7,221.7

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The following table sets forth our operating costs and expenses and our results of operations as a percentage of total revenues:

	Year ended December 31,		
	2002	2003	2004
Total revenues	100%	100%	100%
Raw materials and consumables	57.7%	56.2%	55.6%
Personnel costs	9.8%	9.3%	8.9%
Depreciation and amortization	11.6%	12.1%	11.0%
Supplies and services	10.6%	9.1%	9.0%
Own work capitalized	(3.8)%	(3.4)%	(3.6)%
Concession and power-generation rental costs	2.5%	2.5%	2.6%
Provisions	1.6%	1.1%	1.6%
Other operating expenses (income)	(0.1)%	0.1%	0.2%
Total operating costs and expenses	89.8%	87.0%	85.3%
Operating margin	10.2%	13.0%	14.7%
Net interest and related expenses	3.5%	5.1%	4.6%
Other non-operating income / (expenses)	2.2%	0.2%	2.3%
Profit before tax	4.5%	7.6%	7.7%
Consolidated net profit	5.2%	5.5%	6.1%

2004 COMPARED WITH 2003

Revenues

Our total revenues for 2004 increased by 3.5% to 7,221.7 million from 6.977.5 million in 2003, due primarily to a 232.2 million increase in electricity sales from our distribution and supply activities in Portugal resulting from a 6.1% increase in

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consumption, a 162.4 million increase in electricity sales from our generation activity in Portugal as a result of the entry into industrial service of the first two units of the new Ribatejo CCGT plant, higher energy charges under the PPAs as a result of increased use of thermal generation, and a 108.1 million increase in other sales from the proportional consolidation of the Basque gas company, Naturcorp, as from August 2003.

Sales of electricity. Our total electricity sales increased 2.4% to 6,450.3 million in 2004, representing 89% of our total revenues, from 6,296.1 million in 2003, mainly due to a 6.4% increase in electricity sales from our distribution and supply activities in Portugal to 3,842.8 million in 2004 from 3,610.6 million in 2003 and from the 12.3% increase in electricity sales from our generation activity in Portugal to 1,481.3 million in 2004 from 1,318.9 million in 2003. This increase was partially offset by a 5.2% decrease in electricity sales from Spain to 516.2 million in 2004 from 544.4 million in 2003, partly due to lower Spanish electricity pool prices during most of 2004 when compared with 2003.

Electricity sales in Portugal from generation, distribution and supply activities, which represented 83% of our total consolidated electricity revenues, increased by 8% to 5,324.1 million in 2004 from 4,929.5 million in 2003, with an increase in electricity sales from both our distribution and supply and our generation activities.

Electricity sales from our generation activity in Portugal increased 12.3% from 1,318.9 million in 2003 to 1,481.3 million in 2004. Approximately 80.6% of our Portuguese generation electricity sales are based on long-term PPAs between each of its power plants and REN, as the single buyer for the PES. The PPAs include an energy charge component that remunerates EDP Produção s plants operating in the PES for fuel consumed by producing electricity. Given that 2004 was characterized by lower hydroelectricity levels than 2003 (a hydroelectric coefficient of 0.81 in 2004 compared with a hydroelectric coefficient of 1.33 in 2003), EDP Produção s thermal power plants were utilized more, which, combined with an increase in coal prices, resulted in higher fuel costs and thus in higher revenues from the variable component of the PPAs that remunerates EDP Produção s for fuel consumption. Electricity sales from our Portuguese generation activity also benefited from the beginning of industrial service of the first two 392 MW units of our new Ribatejo CCGT plant, the first in February 14, 2004 and the second on November 2, 2004. Both units combined output to the system amounted to 3,419 GWh.

Electricity sales from our distribution and supply activities in Portugal increased 6.4% from 3,610.6 million in 2003 to 3,842.8 million in 2004, due to a 6.1% increase in demand to 41,315 GWh in 2004 from 38,955 GWh in 2003. This increase was primarily due to a 4.7% increase in low-voltage consumption due to a warm summer and a particularly cold winter. The increased demand was also due to a 7.6% increase in high-voltage and medium-voltage consumption due to the fact that cogenerators opted to sell to the PES most of the energy they produced at special regime prices, later buying back any electricity needed at lower prices. Electricity sales volume in the PES, which in 2004 represented approximately 84% of Portuguese electricity demand, decreased 1% as some medium-voltage consumers opted to become non-binding consumers, accordingly, in the Non-Binding Sector, electricity distributed increased 67.1% to 6,763 GWh in 2004 from 4,048 GWh in 2003.

Beginning with the new tariff regime in Portugal that became effective in 1999, tariffs are fixed by the regulator in advance of each year based in part on estimated data for variables such as demand and cost. If there are differences between the estimated data and the actual data during a period, an adjustment is made to the tariff in a subsequent period to account for these differences.

In 2004, the aggregate tariff adjustment for EDPD was a negative adjustment of 92.1 million. This figure includes a negative adjustment of 13.2 million from the tariff adjustment for 2004, a negative adjustment of 21.3 million accounting for the repositioning of the 2003 tariff adjustment and a negative adjustment of 57.7 million accounting for the repositioning of the 2002 tariff adjustment. In 2003, the aggregate tariff adjustment was 77.9 million. This figure includes a positive adjustment of 77.0 million relating to the tariff adjustment for 2003, a positive adjustment of 17.9 million from a revision made to the tariff adjustment for 2002, a negative adjustment of 10.2 million relating to the accounting for the repositioning of the 2002 tariff adjustment and a negative adjustment of 6.7 million from the accounting for repositioning of 2001 tariff adjustment.

Electricity sales in Spain fell 5.2% to 516.2 million in 2004 from 544.4 million in 2003, mainly due to the fact that in 2003 Hidrocantábrico sold electricity to the Non-Binding System in Portugal, whereas in 2004 this activity was substantially reduced. Additionally, Hidrocantábrico was affected by a decrease in the average price at which it sells its generation output in the Spanish

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pool. Nevertheless, in 2004 Hidrocantábrico was able to account for 9.5 million as a receivable in partial compensation for electricity sold below pool reference prices in 2004.

Electricity sales in Brazil increased 11.5% to 1,066.6 million in 2004 from 956.4 million in 2003, primarily due to a 77% increase in the volume of electricity sold by our supply company in Brazil (Enertrade) and 2003 and 2004 tariff revisions and adjustments in our distribution companies, including, in particular, a 18.08% average tariff increase for Bandeirante (as of October 22, 2003) and a 17.02% average tariff increase for Enersul (as of April 8, 2004). Electricity sales to direct clients, as distinguished from access clients which are only charged on access tariff, in Brazil fell due to the switch of some industrial consumers to the liberalized market, where consumers must pay for the use of the distribution grid (accounted for as services rendered) and by the devaluation of the Brazilian real against the euro.

Other sales. Our other sales activities, including sales of natural gas, steam, ash, information technology products, telecommunications equipment and sundry materials, generated revenues of 249.0 million in 2004 compared with 160.3 million in 2003, due primarily to the proportional consolidation, since August 2003, of gas sales of Naturcorp on the same basis as Hidrocantábrico (i.e., at the 40% level in 2003 and 2004). Within the line item Other sales , gas sales in Spain in 2003 were accounted for within Hidrocantábrico s distribution and supply (reflecting gas sales by Hidrocantábrico Energia) and gas (reflecting gas sales by Naturcorp) functions. In 2004, most gas sales in Spain were accounted for within Hidrocantábrico s gas function, reflecting the fact that most of Hidrocantábrico s gas clients were supplied by Naturcorp during this period.

Services rendered. Activities generating these revenues include electricity-related services, services related to information technology systems, telecommunications and engineering, as well as laboratory, training, medical assistance, consulting and multi-utility services and other services. Our revenues from other services increased slightly to 522.4 million in 2004 from 521.2 million in 2003, due to increased sales provided to access clients by the electricity distribution and supply activity in Brazil.

Revenues from services provided by the electricity activity in Portugal decreased 25.4% to 64.8 million in 2004 from 86.9 million in 2003, due to several factors relating to the ongoing liberalization process in Portugal. Services provided in Spain contributed 23.6 million and 32.9 million in 2003 and 2004, respectively, following the proportional consolidation of Naturcorp since August 2003. Our operations in Brazil contributed 84.4 million to our consolidated revenues from services in 2004, following the increased number of liberalized clients in our concession area, who must pay for the use of the distribution grid. Telecommunications services decreased 2.0% to 317.3 million in 2004 from 323.8 million in 2003. Revenues from our information technology activity declined 5.1% from 159.3 million in 2003 to 151.2 million in 2004 due primarily to a slowdown in the information technology sector in Portugal.

Operating costs and expenses

Our total operating costs and expenses increased by 1.5% to 6,163.2 million in 2004 compared to 6,071.8 million in 2003, mainly due to the 6.1% increase in electricity consumption in Portugal which drove the Portuguese distribution and supply electricity purchases up 9.3% to 2,635.9 million in 2004, and to the proportional consolidation of Naturcorp and higher fuel costs at EDP Produção following a dry year in which thermal generation was increased at the expense of hydroelectric power. These effects more than offset the positive impact of lower operating costs at ONI.

Operating costs at our Portuguese electricity business increased 5.9% to 4,560.3 million in 2004 from 4,306.3 million in 2003. This increase was partially offset by the presentation of compensation of depreciation of partly funded fixed assets in our consolidated financial statements that prior to 2004 was presented as other non-operating income, while in 2004 we started to present this income as an operating item. This portion of

depreciation is primarily due to new electricity connections made in prior years that were financed largely with customer payments, which are recorded as deferred income and, as the assets are depreciated, a portion of the amount is taken into income and offset by a corresponding depreciation charge. The 5.9% increase in operating costs was mainly due to higher fuel costs, reflecting the increase in international fuel prices and decreased use of hydroelectric power, and higher electricity purchases, following the 6.1% hike in consumption in Portugal. The increase in operating costs was mitigated by the continuing effects of the restarting of our Human Resources Restructuring Program in 2003, which resulted in a 9.6% decrease in 2004 compared

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to 2003 in personnel costs at our Portuguese distribution and supply activities. However, this reduction is not completely reflected in our consolidated financial statements as costs in certain Portuguese subsidiaries relating to early retirees are netted against related provisions in our consolidated financial statements. The reduction at EDPD follows both a decrease in personnel costs with early retirees, reflecting a larger proportion of such costs being paid by the state social security system, and a decrease in active personnel costs through the Human Resources Restructuring Program.

Operating costs in our Spanish energy business increased 12.3% to 665.7 million in 2004, mainly due to the proportional consolidation of Naturcorp since August 2003. In Brazil, the operating costs increased 8.9% to 959.5 million in 2004, primarily due to an increase in electricity volume sold by Enertrade. Operating costs at ONI decreased 7.1% from 399.8 million in 2003 to 371.3 million in 2004, benefiting from a cost-cutting program and a reduction in the number of employees.

As a percentage of revenues, total operating costs and expenses decreased to 85.3% in 2004 from 87.0% in 2003, due primarily to lower depreciation expenses net of the compensation of depreciation of partly funded fixed assets, lower personnel costs and lower costs of raw materials and consumables, in each case, as a percentage of revenues.

Raw Materials and Consumables. The major components of our raw materials and consumables are the costs of energy purchased, fuel costs and costs of other materials. Our raw materials and consumables costs increased 2.5% to 4,017.3 million in 2004 from 3,921.0 million in 2003, primarily due to higher electricity purchases resulting from the 6.1% increase in consumption in Portugal, the proportional consolidation of Naturcorp and to higher fuel costs at EDP Produção resulting from a reduction in use of hydroelectric generation due to a dry year and an increase in coal prices.

Our costs of energy purchased decreased 1.7%% to 3,303.1 million in 2004 from 3,360.3 million in 2003.

Generation, distribution and supply activities in Portugal represented 81.4% of our costs of energy purchased in 2004 compared with 73.7% in 2003. Electricity purchases from generation in Portugal decreased 13.9 million in 2004 to 51.4 million, due to the fact that during 2004, the EDP Produção energy management department made purchases in the Spanish pool, thus replacing purchases made in 2003 from small hydroelectric producers operating in the Non-Binding Sector. Our costs of purchased electricity in distribution and supply activities in Portugal primarily include purchases made by EDPD from REN, as well as purchases from private generators and small independent producers. The energy that EDPD purchases from REN is supplied to the PES. In 2004, electricity purchases in distribution and supply increased 9.3% to 2,635.9 million from 2,412.5 million in 2003, reflecting the higher electricity purchases resulting from the 6.1% increase in consumption in Portugal.

Costs of energy purchased in Spain by Hidrocantábrico increased 9.7% to 395.3 million in 2004 compared with 360.5 million in 2003, reflecting the consolidation of Naturcorp for the first time in August 2003.

Costs of purchased electricity in Brazil increased 7.4% in 2004 to 705.2 million from 656.5 million in 2003, due to an increase in electricity volume sold by our electricity supply company in Brazil (Enertrade), which was partly offset by the depreciation of the Brazilian real against the euro.

Our fuel costs increased 37.2% to 546.0 million in 2004 from 398.0 million in 2003. In 2004, fuel costs from generation in Portugal represented 76.4% of our fuel costs and increased 33.5% to 417.1 million in 2004 from 312.3 million in 2003. This increase in fuel costs reflects an increase

in fuel utilization by EDP Produção associated with a higher recourse to thermal generation due to a dry year and an increase in coal prices.

In order to account for the variability of hydrological conditions in Portugal and its impact on generation costs in the PES, we use a hydrological correction account, which is recorded on our balance sheet. The hydro account is an accounting mechanism established by Portuguese law. Because 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. In years with favorable hydrological conditions, there is an increase in hydroelectric generation, whereas in years with unfavorable hydrological conditions there is a decrease in hydroelectric generation. We cannot modify the tariff we charge to take into account the

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changes in variable costs incurred due to hydrological conditions. The hydro account is reinforced, through cash payments by REN, 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 increased generation costs in the PES. These upward or downward adjustments to the hydro account are made based upon the economic reference cost calculated on the basis of an average hydrological year and observed fuel prices.

As of December 31, 2004, the hydro account amounted to 364.2 million, reflecting a decrease of 23.3 million compared to December 31, 2003, which primarily reflects 32.6 million paid to REN, partially offset by 9.3 million in interest. In 2003, the hydro account increased 63.4 million to 387.5 million. This difference was primarily a result of 2003 having been an exceptionally wet year (hydro coefficient of 1.33), while 2004 was a dry year (hydro coefficient of 0.81).

The Portuguese government determines the level of reference of the hydro account based upon the least favorable period of hydrological conditions during the previous 30 years. In doing so, the government determines an amount expected to be adequate to withstand unfavorable hydrological conditions that may occur in the future. The government has determined that the hydro account must not exceed the level of reference. The level of reference of the hydro account was 387.5 million for 2004, 2003 and 2002. In 2003, the hydro account exceeded the reference level, causing us to record the excess 19.4 million under non-operating income in 2003. The reference level was not exceeded in 2004.

We record as an annual expense deemed interest credited to the hydro account corresponding to the average interest rate paid on our euro-denominated borrowings for the applicable year. For more information on the hydro account, you should read note 24 to our consolidated financial statements.

Fuel costs in Spain amounted to 124.5 million in 2004, which represented 22.8% of our fuel costs compared with 85.5 million in 2003. In 2004, fuel costs in Spain were affected by an increase in imported coal prices.

The major components of our costs for other materials are the costs of cables, meters, transformers and other goods for resale, which are included under the item Raw materials and consumables Other materials. These costs increased to 168.1 million in 2004 from 162.7 million in 2003. A majority of these costs are credited to Own work capitalized and the remainder is applied to maintenance of the distribution networks. See Own work capitalized below. Costs for other materials from generation, distribution and supply activities in Portugal represent 76.3% of our total costs for other materials. Costs of materials from our generation activity in Portugal increased 15.5% in 2004 to 4.0 million from 3.5 million in 2003. Costs related to our distribution and supply activities in Portugal increased 11.6% to 124.2 million in 2004 from 111.3 million in 2003 because of the investments made on the EDPD distribution grid to improve service quality.

Costs of other materials in Spain decreased 12.9 million to 3.5 million in 2004 compared with 16.3 million in 2003. Costs from other materials in Brazil decreased 1.6 million to 8.6 million in 2004 from 10.2 million in 2003. Cost of sales for telecommunications increased 0.7 million in 2004 to 7.3 million from 6.6 million in 2003. Raw materials and consumables costs relating to our information technology activities decreased 17.0% to 20.3 million in 2004 from 24.5 million in 2003, reflecting the slowdown of the Portuguese information technology sector on Edinfor s activities related to finishing, graphics and equipment sales.

Personnel costs. Personnel costs, which consist mainly of wages and salaries and social security and pension fund contributions, decreased 0.6% in 2004 to 642.6 million from 646.6 million in 2003 due to the continuing effects of the Human Resources Restructuring Program restarted in 2003 at the Portuguese electricity business. However, as discussed above, this reduction is not completely reflected in our consolidated financial statements.

Personnel costs in the Portuguese electricity business decreased 7.8% to 477.3 million in 2004 from 517.4 million in 2003 as a result of the continuing effects of the Human Resources Restructuring Program, mostly with respect to EDPD. As a percentage of total personnel costs, electricity business costs in Portugal decreased in 2004 to 74.3% from 80.0% in 2003. Personnel costs in generation in Portugal decreased 1.5% to 118.5 million in 2004 from 120.3 million in 2003. Personnel costs in distribution and supply in Portugal decreased 9.6% to 358.8 million in 2004 from 397.1 million in 2003, reflecting the reduction in the number of employees at the distribution business. Following ERSE s approval, in August 2003, regarding the pass-through to final tariffs of up

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to 485.7 million of restructuring costs associated with early retirements and negotiated dismissals, we decided to continue with our Human Resources Restructuring Program, which had been suspended. Additionally, apart from the Human Resources Restructuring Program, we signed agreements to bring forward the permanent retirement age of early retirees, with the result that the state social security system become responsible for a larger proportion of retirement costs.

In the Spanish energy business, personnel costs were 38.4 million in 2004 compared to 37.1 million in 2003. This increase was primarily due to the proportional consolidation of the Basque gas business, Naturcorp, commencing in August 2003. Personnel costs in the Spanish gas business increased to 7.0 million in 2004 from 4.2 million in 2003.

Personnel costs in the Brazilian electricity business decreased 0.7% to 63.5 million in 2004 from 64.0 million in 2003, which primarily reflects the depreciation of the Brazilian real against the euro in 2004.

Personnel costs in our telecommunications activities increased 6% to 54.0 million in 2004 from 51.0 million in 2003, while personnel costs in our information technology activities decreased 9.6% to 60.1 million in 2004 from 66.4 million in 2003, reflecting a reduction in the number of employees and successful wage negotiations.

Depreciation and amortization. Since the beginning of 2004, depreciation and amortization charges have been presented net of income related to the compensation of depreciation of partly funded fixed assets. Prior to 2004, we presented this income as an other non-operating income. This income is primarily related to new electricity connections made in prior years that were financed largely with customer payments, which are record as deferred income and, as these assets are depreciated, a portion of the amount is recorded as income and offset by a corresponding depreciation charge. This change in accounting presentation partly explains the decrease in depreciation and amortization charges of 5.9% to 795.5 million in 2004 from 845.6 million in 2003. The compensation of depreciation of partly funded fixed assets amounted to 79.6 million in 2004. This line item is discussed in note 31 to the consolidated financial statements.

Depreciation and amortization charges net of the compensation of depreciation of partly funded fixed assets in the Portuguese electricity business decreased 9.3%, or 54.1 million, to 529.2 million in 2004 from 583.3 million in 2003 due to the change in the accounting presentation described above, which mainly affects the generation and distribution and supply activities in Portugal. The compensation of depreciation of partly funded fixed assets in the Portuguese electricity business amounted to 77.4 million in 2004.

In the Spanish energy business, depreciation and amortization charges net of the compensation of depreciation of partly funded fixed assets increased to 68.2 million in 2004 from 60.1 million in 2003. This increase is primarily due to the proportional consolidation of the Basque gas business, Naturcop, since August 2003 and to the increase in wind farm capacity. Net depreciation and amortization charges in the Spanish gas business increased to 11.8 million in 2004 from 7.5 million in 2003.

Depreciation and amortization charges net of the compensation of depreciation of partly funded fixed assets in the Brazilian electricity business increased 1.7 million to 60.0 million in 2004 from 58.3 million in 2003.

Depreciation and amortization charges net of the compensation of depreciation of partly funded fixed assets relating to telecommunication activities decreased 11.8% to 64.2 million in 2004 from 72.7 million in 2003, reflecting lower investment needs. Investment required for the expansion of the network and acquisition of direct access infrastructure has already been completed.

In 2004, depreciation and amortization charges net of the compensation of depreciation of partly funded fixed assets relating to information technology activities increased 14.5% to 27.8 million from 24.3 million in 2003, primarily due to the investment in 2003 in the acquisition of new equipment for a data processing center.

Supplies and services. These costs consist of supplies and services provided to us by external suppliers, and include external maintenance and repairs, specialized services, communication, rents, insurance and other services.

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External maintenance and repairs consists of work on our power plants, substations and transmission and distribution networks that we subcontract to others. Other specialized services includes technical services such as auditing, legal, consulting and revenue collection services. Communication services include telecommunications, postal, delivery and courier services. The cost of these external supplies and services increased 2.7% to 649.5 million in 2004 from 632.5 million in 2003.

Supplies and services in the Portuguese electricity business increased 8.7% to 310.4 million in 2004 from 285.6 million, and as a percentage of our total supplies and services these costs increased to 47.8% in 2004 from 45.2% in 2003. Supplies and services relating to generation activity increased 10.3 million to 85.3 million in 2004 from 75.0 million in 2003 partly due to a higher activity level from EDP Produção s subsidiary for maintenance services, O&M Serviços, higher telecommunication costs associated with the power plants remote control, higher charges from EDP Valor (the shared services unit of EDP) and management fees from EDP S.A. Supplies and services relating to distribution and supply activity increased 6.9% to 225.1 million in 2004 partly due to an increase in management fees from EDP, S.A. and our shared services company, EDP Valor, and also due to an increase from IT logistics and related services from Edinfor.

In the Spanish energy business, supplies and services costs increased to 54.1 million in 2004 from 36.9 million in 2003. This increase in 2004 is primarily due to the allocation of the administrative costs of EDP S.A. to each activity, and to the proportional consolidation of the Basque gas business, Naturcop, since August 2003. Supplies and services costs in the Spanish gas business increased to 9.1 million in 2004 from 5.4 million in 2003.

Supplies and services relating to the electricity business in Brazil increased 15.7% to 72.0 million in 2004 from 62.2 million in 2003, mainly due to inflation and to the implementation of a new customer care and service system to improve client management and preventive maintenance programs.

Supplies and services in our telecommunications activities decreased 8.9% to 241.8 million in 2004 from 265.3 million in 2003 due to lower direct activity costs related to telecommunication services provided to our clients, resulting from the continued focus on efficiency, which enabled ONI to achieve savings in fixed network expenses, advertising and specialized projects, and from lower interconnection costs and a decrease in the cost of leased lines.

Supplies and services related to our information technology activities decreased 10.1% to 63.0 million in 2004 from 70.1 million in 2003, mainly as a result of the on-going efforts to control costs and the termination of a contract with IBM, which was no longer needed as Edinfor invested in a new data processing center.

Own work capitalized. Own work capitalized consists of amounts that correspond to costs related to personnel and materials and other external supplies and services incurred for projects under construction that are capitalized and will be amortized in future periods. These amounts generally consist of consumption of materials, direct internal costs, general administrative overheads and financial charges. Own work capitalized increased 9.8% to 258.8 million in 2004 from 235.6 million in 2003.

Own work capitalized in the Portuguese electricity business in 2004 represented 88.1% of our total own work capitalized (compared to 94.7% in 2003). In 2004, it increased 2.2% to 228.0 million from 223.0 million in 2003. Own work capitalized in our generation activity in Portugal decreased to 31.1 million in 2004 from 38.2 million in 2003 following the construction of the Ribatejo CCGT plant. Own work capitalized in the distribution and supply activities in Portugal increased to 196.8 million in 2004 from 184.8 million in 2003, reflecting EDPD s investments in the distribution grid to improve service quality.

In the Spanish energy business, Own work capitalized increased by two fold to 8.0 million in 2004 from 4.0 million in 2003. This increase is primarily due to the construction of the Albacete wind farm (124 MW).

A table setting forth the components of Own work capitalized for the past three years is provided in note 33 of our consolidated financial statements.

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Concession and power-generation rents. Concession and power-generation rental costs, which consist mainly of rents paid by EDPD to municipalities for concessions to distribute low-voltage electricity, increased to 190.2 million in 2004 from 175.6 million in 2003. The amount of rents payable to municipalities for concessions is set by government regulation and is based on the amount of low-voltage electricity consumed in the respective municipal areas in the previous year. The 8.3% increase in concession and power-generation rental costs for 2004 compared to 2003 was primarily due to an increase in the average concession fee paid by our distribution company to the Portuguese municipalities, from 7.25% to 7.50% of previous year s low-voltage sales, and to the 7.2% increase in low-voltage sales between 2002 and 2003.

Provisions. Provisions increased to 114.1 million in 2004 from 75.7 million in 2003, primarily due to a provision related to Bandeirante in account for the retroactive effect of a decision by ANEEL that provisionally reduced the size of Bandeirante s regulatory asset base. This reduction resulted in a reduction of the tariff increase that had been granted in the last tariff revision in October 2003, from 18.08% to 10.51%. ANEEL stated that it would confirm or amend this provisional reduction at some point between October 2004 and October 2005. Bandeirante booked a provision to account for the retroactive impact of ANEEL s decision. This line item is discussed in note 34 to the consolidated financial statements.

We systematically record the provision for doubtful accounts receivable from third parties and municipalities based on the age of the receivables and our collection history. We do not record a provision with respect to accounts receivable from other public entities since historically we have not experienced a problem in collecting these receivables. Accounts receivable are written off when a customer is declared bankrupt by a court of law because we receive the tax benefit of the write-off only when the customer is actually declared bankrupt. Consequently, we have a significant amount of accounts receivable that are fully provided for but have not been written-off. For more information on this provision, you should read note 42.i(i) to the consolidated financial statements.

Until the end of 2002, increases in provisions for doubtful accounts were reflected in our consolidated statements of income in the line item Provisions and were included in the determination of operating income while decreases were included in the line item Other non-operating expenses (income), net below the operating income. Beginning in 2003, at the electricity distribution activity in Portugal, both increases and decreases in provisions for doubtful accounts are included in the line item Provisions.

Provisions in the Portuguese electricity business increased to 60.4 million in 2004 from 55.5 million in 2003 (and as a percentage of our total provisions, decreased to 53.0% in 2004 compared to 73.4 % in 2003). Provisions in distribution and supply activities increased to 48.6 million in 2004 from 42.8 million in 2003 mainly due to the fact that 2003 provisions benefited from a change in EDPD s accounting procedures (provisions for doubtful clients were netted against the non-operating gains resulting from the reversal of this provision), which was not the case in 2004, as most of the non-operating gains with provisions resulted from the write-off of existing debts. In the telecommunication activity, provisions decreased 1.2 million to 3.9 million in 2004.

Other operating expenses/(income). This item primarily includes taxes other than income taxes and other operating income (net). The item increased to a 12.8 million expense in 2004 from a 10.3 million expense in 2003.

Operating margin

As a result of the factors discussed above, our operating margin increased 16.9% to 1,058.4 million in 2004 from 905.7 million in 2003. Operating margin from our core electricity business in Portugal increased 16.5% to 852.6 million in 2004 from 731.7 million in 2003, primarily due to an increase in electricity consumption of 6.1%, the beginning of operations at the Ribatejo CCGT plant and the reduction in personnel costs following the implementation of the Human Resources Restructuring Program. Operating margin from our Spanish energy business

decreased 1.0% to 81.4 million in 2004 from 82.2 million in 2003. Operating margin from Brazilian electricity activities increased 67.5 million to 194.3 million in 2004, mainly as a result of the 4.5% increase in electricity consumption and tariff increases in 2003 and 2004, mitigated by the provisional decision by ANEEL to reduce Bandeirante s 2003 tariff increase, which resulted in an increase in provisions to account for the retroactive effect of the decision. Operating margin from telecommunication activities improved by 22.8 million to a 45.9 million loss in 2004 from a 68.7 million loss in 2003, mainly due to cost-cutting and a reduction in depreciation, reflecting the end of the depreciation period of part of ONI s

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assets and a decrease in investment needs. Operating margin from information technology activities decreased 56.7% to 4.0 million in 2004 from 9.3 million in 2003 due to a slowdown in the Portuguese information technology sector.

Interest and related income/(expenses), net

Our net interest and related income/(expenses) consist of interest and related income and expenses. These net expenses decreased to 335.3 million in 2004 from 359.0 million in 2003 (and decreased as a percentage of our total revenues to 4.6% in 2004 compared to 5.1% in 2003). This line item is discussed in note 36 to the consolidated financial statements.

Net interest expenses decreased 10.4% to 299.8 million in 2004 from 334.4 million in 2003 following the reduction of our financial debt. Contributions from equity method investments increased 7.8 million to 41.0 million in 2004, partially because results for 2003 were negatively impacted by 8.8 million in accumulated losses from Electra. This investment was fully provisioned at the end of 2003. Net exchange differences moved from a net unfavorable 10.7 million difference in 2003 to a net favorable 12.4 million difference in 2004, mainly due to 9% annual appreciation of the Brazilian real against the dollar in 2004, affecting the dollar-denominated debt of the Brazilian subsidiaries. Investment income decreased 6.3 million to 30.5 million in 2004 following the sale of our Iberdrola stake in the second half of 2003, which in 2003 provided 16.8 million in dividends, mitigated by GALP more than doubling its dividend distribution in 2004 to 13.3 million in 2004 from 6.2 million in 2003 and higher dividends received from our stake in MillenniumBCP following the distribution of an ordinary 0.06 dividend in April 2004 and an additional 0.03 interim dividend in November 2004.

Other non-operating income/(expenses)

We had other non-operating expenses of 164.7 million in 2004 compared to other non-operating expenses of 14.4 million in 2003, partly due to the change in the accounting presentation of the compensation of depreciation of partly-funded fixed assets, which, as described above under Operating Costs and Expenses, prior to 2004 was presented as other non-operating income, and currently is presented as an operating item. In 2004, this item amounted to 79.6 million (presented in the depreciation and amortization line item see note 31 to the consolidated financial statements for more information on this line item) in comparison with 79.8 million in 2003.

Other non-operating results include a reduction in the value fixed assets in 2004 relating to the 11.0 million write-off of assets related to the decommissioning of the Tapada do Outeiro power plant following the end of its PPA, a 7.6 million Brazilian real (2.1 million) loss on the sale of Fafen in Brazil to Petrobras, a 35 million loss from impairments in goodwill of Edinfor and ACE (an IT business) registered following the valuation that preceded the agreement to sell 60% of Edinfor to LogicaCMG for 81 million. The sale of Retecal by Hidrocantábrico resulted in a 10.0 million capital gain.

The net increase in provisions for contingencies and liabilities amounted to 51.2 million in 2004 from 56.7 million in 2003. In 2004, the figure is mainly with respect to ONI, which reversed a 40.0 million tax credit booked in 2002 from the sale of ONI Way to Vodafone. The use of this tax credit is being reviewed by the authorities and as soon as Vodafone begins benefiting from it, the gain will be booked. ONI also booked in 2004 a 5.0 million provision relating to three years of depreciation (2002 and 2003 having not been booked) of the right to use the Transgás fiber optic network that had been halted in 2002 because of disagreements between ONI and Transgás regarding the value of the contract. The 2003 figure includes the use of a provision that was created by Escelsa to mitigate the anticipated market loss on its dollar-denominated assets and to the reversal of a provision in 2003 that had been created for the value of joint investments in hydroelectric sites (Aguieira, Raiva and Alqueva), which were offset by the creation of a 119.2 million provision to account for possible devaluation and contingencies in Brazil and Cape Verde, specifically regarding the possible reduction of the tariff expected from the Fafen (37.9 million) and Lajeado (24.3 million) industrial projects,

the loss of equity at Electra (27.0 million) and other contingencies (30.0 million).

Net corrections to previous years in 2004 amounted to a 24 million loss and include a 9.9 million loss relating to ANEEL s revision of Escelsa s August 2001 tariff revision and 6.2 million relating to ANEEL s provisional revision of Bandeirante s October 2003 tariff revision. For 2003, the figure amounted to a 31.6 million loss and mostly related to a 35.9 million loss associated with

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an agreement with the Portuguese state over the amount invested in joint projects for hydroelectric sites (Aguieira, Raiva and Alqueva).

In connection with the Human Resources Restructuring Program, in 2004, EDP recorded 25.1 million in human resources rationalization costs, relating to negotiated dismissals (with respect to EDPD, this cost is permitted by regulator to be passed through to final tariffs) and compensation paid to early retirees that accepted acceleration of the legal retirement age.

Provision for income taxes

Our provision for income taxes is determined on the basis of the estimated taxable income for the period. Income taxes provided for in 2004 were 256.8 million compared with 239.3 million in 2003. The reference income tax rate in Portugal was 25% in 2004 compared with 30% in 2003. In addition, a municipal surcharge of up to 10% of the base rate is typically levied by the municipality in which the income is earned.

Provision for deferred income taxes

Deferred income taxes are recognized in our consolidated financial statements in accordance with local accounting standards. Our provision for deferred income tax is determined, using the balance sheet liability method, on the temporary differences between the book values of assets and liabilities and their respective taxable bases. The taxable base of assets and liabilities is determined so as to reflect the consequences of taxation resulting from the way in which we expect, on the balance sheet date, to recover or to pay the recorded amount of our assets and liabilities. In determining deferred tax, the rate used is the one in effect or otherwise applicable on the balance sheet date. Recognized deferred tax assets are reduced to the recoverable amount that can be compensated against future expected profits.

In 2004, our provision for deferred income taxes amounted to a 97.2 million benefit and, in 2003, to a 43.7 million benefit. This difference is mainly explained by the fact that, in 2004, the deferred income tax relating to tariff deviations in the electricity distribution business in Portugal was in the form of a benefit amounting to 44.4 million, while in 2003, deferred income tax related to tariff deviation was a 22.4 million charge (tariff deviations in 2004 amounted to a 92.1 million expense and in 2003 to a 77.9 million income).

Our effective tax rate is different from the reference income tax in Portugal each year, due to permanent differences arising mainly from amortization of goodwill and concession rights and amortization resulting from revaluation of fixed assets that are not deductible for income tax purposes. Our effective tax rate was 28.6% in 2004, compared with 36.7% in 2003. In 2003, the effective tax rate was partly affected by the losses before taxes in our telecommunications business (EDP recorded lower losses in 2004), which tax benefit is not accounted under this line item. For more information on provision for deferred income taxes, you should read note 38 of our consolidated financial statements.

Consolidated net profit

As a result of the factors discussed above, our consolidated net income for 2004 increased 15.5% to 440.2 million from 381.1 million in 2003.

2003 COMPARED WITH 2002

Revenues

Our total revenues in 2003 increased by 9.3% to 6,977.5 million from 6,386.6 million in 2002, due primarily to the increase in electricity sales, which in 2003 represented approximately 90.2% of our total revenues compared with 92.0% of total revenues in 2002. In 2003, revenues as well as the other items in our consolidated profit and loss account were affected by the proportional (40%) consolidation of Hidrocantábrico for twelve months, which in 2002 was proportionally consolidated for seven months, and the full consolidation of Escelsa and Enersul for twelve months, which in 2002 were equity consolidated for the first nine months and fully consolidated in the last quarter of the year. We have consolidated revenues from Hidrocantábrico in the amount of 662.5 million in 2003 and 321.4 million in 2002. Escelsa and Enersul contributed 435.8 million in 2003 and 100.8 million in 2002.

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Sales of electricity. Our total electricity sales increased by 7.1% to 6,296.1 million in 2003 from 5,876.2 million in 2002 mainly due to the consolidation effects of Hidrocantábrico, Escelsa and Enersul noted above.

Electricity sales in Portugal from generation and distribution and supply activities, which represented 78.3% of our total consolidated electricity revenues, remained stable at 4,929.5 million in 2003 from 4,928.8 million in 2002, with the increase in electricity sales from distribution and supply activities being offset by a decline in electricity sales from generation activity.

Electricity sales from our distribution and supply activities in Portugal increased 3.1% from 3,503.4 million in 2002 to 3,610.6 million in 2003 due to a 5.5% increase in the Portuguese electricity system demand from 36,931 GWh in 2002 to 38,955 GWh in 2003 and due to the fact that, in nominal terms, tariffs increased across all voltage levels by an average of 2.8% in 2003 from the 2002 levels. The 5.5% increase in electricity sales volume was primarily due to a 4.9% increase in low-voltage consumption, which occurred as a result of a cold winter and a particularly warm summer in 2003, as well as due to a 10.2% increase in very high-voltage and high-voltage consumption following an increase in the number of our industrial clients, after EDPD gained four large industrial clients. Electricity distribution in the PES decreased 3.0% to 34,907 GWh in 2003 from 35,973 GWh in 2002, whereas in the Non-Binding Sector, electricity distributed increased by more than fourfold to 4,048 GWh in 2003 from 958 GWh in 2002 due to the fact that some medium-voltage consumers opted to become Qualifying Consumers.

In 2003, the aggregate tariff adjustment was 77.9 million. This figure includes a positive adjustment of 77.0 million from the 2003 tariff adjustment, a positive adjustment of 17.9 million from a revision made to the tariff adjustment of year 2002, a negative adjustment of 10.2 million from the 2002 tariff adjustment reposition and a negative adjustment of 6.7 million from the 2001 tariff adjustment reposition. In 2002, the aggregate tariff adjustment was 70.5 million. This figure includes a positive adjustment of 50.0 million relating to the application of the new tariff regulation in 2002, and a positive adjustment of 20.5 million relating to the 2000 tariff adjustment reposition.

Electricity sales from our generation activity in Portugal decreased 7.5% from 1,425.4 million in 2002 to 1,318.9 million in 2003. Approximately 89% of EDP Produção s generation revenues are based on long-term PPAs between each of its power plants and REN as the single buyer for the Portuguese PES. The PPAs include an energy charge component that remunerates EDP Produção s plants operating in the PES for fuel consumption incurred by producing electricity. Given that 2003 was a wet year, EDP Produção s thermal power plants were less utilized and we incurred lower fuel costs, resulting in lower revenues from the variable component of the PPAs that remunerate for fuel consumption.

Electricity sales in Spain increased to 544.4 million in 2003 from 295.1 million in 2002, primarily due to the proportional consolidation of Hidrocantábrico for twelve months in 2003 compared to seven months in 2002. Other factors that influenced this increase were higher electricity revenues in 2003 from Hidrocantábrico s supply activity that were partially offset by lower Spanish electricity pool prices during 2003.

Electricity sales in Brazil increased to 956.4 million in 2003 from 668.6 million in 2002, primarily due to the full consolidation of Escelsa and Enersul for twelve months in 2003 compared to three months in 2002. Other factors that influenced this increase were tariff revisions that affected our distribution companies in Brazil during 2003, namely a 14.68% average tariff increase for Bandeirante (as of October 22), a 17.30% average tariff increase for Escelsa (as of August 6) and a 32.59% average tariff increase for Enersul (as of April 8). These tariff increases were partially mitigated by the devaluation of the Brazilian real against the euro beginning in the first half of 2002.

Other sales. Our other sales activities generated revenues of 160.3 million in 2003 compared with 112.0 million in 2002, due primarily to the inclusion since August 2003 of gas sales of Naturcorp, which was proportionally consolidated in our accounts on the same basis as Hidrocantábrico. As a result, the contribution of the Spanish activities to the consolidated revenues from other sales activities increased to 105.3

million in 2003 from 20.1 million in 2002. This increase more than offset an 84.4% decrease in revenues from telecommunications equipment sales from 46.7 million in 2002 to 7.3 million in 2003, due to the completion of a

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major contract, and a 23.9% decrease in sales from our information technology activity from 35.5 million in 2002 to 27.0 million in 2003, due to a decrease in demand for IT solutions, as result of the economic slowdown that resulted in lower investments by corporations in information technology systems.

Services rendered. Our revenues from services increased to 521.2 million in 2003 from 398.4 million in 2002, due to the changes in EDP s consolidation of Hidrocantábrico, Escelsa and Enersul, as noted above, and increased sales by EDP Comercial, Bandeirante and ONI. Revenues from services provided by the electricity activity in Portugal increased to 86.9 million in 2003 from 51.3 million in 2002, mainly due to an increase at EDP Comercial resulting from the ongoing liberalization process in Portugal. Services provided in Spain by Hidrocantábrico contributed 6.2 million and 15.0 million in 2002 and 2003, respectively, following the proportional consolidation of Hidrocantábrico for twelve months in 2003. Our operations in Brazil contributed 49.1 million to our consolidated revenues from services in 2003, as a result of the full year consolidation of Escelsa and Enersul, as well as Bandeirante s contribution following the increased number of liberalized clients in its concession area that have to pay for the use of Bandeirante s distribution grid. The 18.2% increase in telecommunications services to 323.8 million in 2003 from 274.1 million in 2002 resulted from higher voice telecommunications services provided by ONI. Information technology activity revenues from services provided declined 15.5% from 188.5 million in 2002 to 159.3 million in 2003, due primarily to the Portuguese economic slowdown in 2003.

Operating costs and expenses

Our total operating costs and expenses increased by 5.8% to 6,071.8 million in 2003 compared to 5,737.9 million in 2002, mainly due to the consolidation effects already mentioned above relating to Hidrocantábrico, Escelsa and Enersul. These consolidation effects more than offset lower fuel costs at EDP Produção, following a wet year in which thermal generation was reduced in favor of hydro power, lower operating costs at Bandeirante associated with the depreciation of the Brazilian real against the euro beginning in June 2002, and lower costs at ONI, primarily as a result of the cost-cutting program and a reduction in the number of employees.

Hidrocantábrico s contribution to our total operating costs and expenses in 2003 totaled 592.6 million compared to 283.3 million in 2002 (seven months of proportional consolidation), while Escelsa and Enersul contributed 372.9 million in 2003 compared to 85.6 million in 2002 (three months of full consolidation). In addition, total operating costs at Hidrocantábrico reflect the consolidation of five months of Naturcorp in 2003 and the start of Castejón CCGT s operations in October 2002.

As a percentage of revenues, total operating costs and expenses decreased to 87.0% in 2003 from 89.8% in 2002 due primarily to lower costs of purchased electricity and fuel.

Raw Materials and Consumables. Our raw materials and consumables costs increased 6.3% to 3,921.0 million in 2003 from 3,687.1 million in 2002 due to the consolidation of Hidrocantábrico, Escelsa and Enersul, as noted above. These consolidation effects more than offset lower fuel costs at EDP Produção, following a reduction in use of thermal generation due to a wet year, and a decrease in the cost of sales of telecommunications equipment.

Our costs of purchased electricity increased 11.8% to 3,360.3 million in 2003 from 3,005.5 million in 2002, due to the consolidation effects of Hidrocantábrico, Escelsa and Enersul, as noted above.

Generation and distribution and supply activities in Portugal represent 73.7% of our costs of purchased electricity. Electricity purchases from generation in Portugal increased 28.1 million in 2003 to 65.3 million due to an increase in electricity purchases of small hydro producers operating in the Non-Binding Sector as these producers are allowed to acquire energy up to their installed capacity in order satisfy energy procurements of the Non-Binding Sector. Our costs of purchased electricity in distribution and supply activity in Portugal primarily include purchases made by EDPD from REN, as well as purchases from private generators and small independent producers. The energy that EDPD purchases from REN is supplied to the binding sector. In 2003, electricity purchases increased 1.1% to 2,412.5 million in 2003 from 2,386.4 million in 2002, mainly due to a 4% increase in the average tariff charged on power purchases from REN, offset by a 3.0% decrease in the Portuguese binding system electricity consumption. For more

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information on these purchases of electricity, you should read Item 4. Information on the Company Portugal Electricity System Overview The Independent Electricity System and Generation Competition.

Costs of purchased electricity in Spain by Hidrocantábrico represented 360.5 million in 2003 compared with 154.1 million in 2002. This increase is mostly due to consolidation effects. In addition, in 2003, Hidrocantábrico s costs of purchased electricity reflect the first time consolidation of five months of Naturcorp in 2003 and the start of Castejón CCGT s operations in October 2002.

Costs of purchased electricity in Brazil increased 34.9% in 2003 to 656.5 million from 486.5 million. This increase is primarily due to the consolidation of Escelsa and Enersul, as noted above. In 2003, Escelsa and Enersul contributed 251.1 million compared with 57.5 million in 2002. Costs of purchased electricity at Bandeirante decreased 16.8% to 357.0 million in 2003 from 429.1 million in 2002, mainly due to the depreciation of the Brazilian real against the euro.

Our fuel, steam and ashes costs decreased 14.5% to 398.0 million in 2003 from 465.5 million in 2002. In 2003, fuel costs from generation in Portugal represented 78.5% of our fuel costs and decreased 32.9% to 312.3 million from 465.5 million in 2002. This decrease in fuel costs reflects a decline in fuel utilization by EDP Produção associated with a lower use of thermal generation due to a wet year.

At December 31, 2003 the hydro account amounted to 387.5 million, an increase of 63.4 million, which includes 71.9 million charged to REN. In 2002, the hydro account decreased by 63.4 million to 324.1 million. This difference was primarily a result of 2003 having been an exceptionally wet year (hydro coefficient of 1.33), while 2002 was a dry year (hydro coefficient of 0.76). To learn more about the effect of hydrological conditions on our business, you should read Item 4. Information on the Company Portugal Generation.

The level of reference of the hydro account was 387.5 million for 2003, 2002 and 2001. In 2003, the hydro account exceeded the reference level causing us to record the excess 19.4 million under non-operating income. In 2002, the hydro account did not exceed the reference level, hence we did not record an excess in non-operating income in 2002.

Fuel costs in Spain at Hidrocantábrico amounted to 85.5 million in 2003 compared to 39.3 million in 2002, primarily due to the consolidation effects as noted above. In addition, fuel costs at Hidrocantábrico reflect the start of operations of Castejón s CCGT power plant (October 2002) noted above.

The major components of our costs for other materials are the costs of cables, meters, transformers and other goods for resale, included under the item Raw materials and consumables Other materials. These costs decreased to 162.7 million in 2003 from 216.0 million in 2002. A majority of these costs are credited to Own work capitalized and the remainder is applied to maintenance of the transmission and distribution networks. See Own work capitalized.

Costs for other materials from generation, distribution and supply activities in Portugal represent 70.5% of our costs for other materials. Costs of materials from our generation activity in Portugal decreased 21.1% in 2003 to 3.5 million. Regarding our distribution and supply activities in Portugal, these costs increased 39% to 111.3 million in 2003 from 80.1 million in 2002 because 2002 costs with materials were lower than normal due to stocks write-offs.

Costs of other materials in Spain from Hidrocantábrico increased 11.7 million to 16.3 million in 2003 compared with 4.6 million in 2002. This increase is the result of the consolidation effects noted above.

Costs from other materials in Brazil increased 6.2 million to 10.2 million in 2003 from 4.0 million in 2002. This increase is the result of the above-mentioned consolidation effects of Escelsa and Enersul. In 2003, Escelsa and Enersul contributed 5.9 million to our costs with other materials, compared with 1.1 million in 2002.

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Cost of sales for telecommunications decreased 46.8 million in 2003 to 6.6 million from 53.4 million in 2002, following the discontinuation of UMTS operations in December 2002. In addition, the decrease in the cost of sales reflects the completion of a major equipment supply contract in 2002.

Raw materials and consumables relating to our information technology activities decreased 22.7% to 24.5 million in 2003 from 31.6 million in 2002, partially reflecting the economic slowdown of the Portuguese economy that, as mentioned above, affected the information technology revenues.

Personnel costs. Personnel costs increased 3.5% in 2003 to 646.6 million from 624.8 million in 2002, mainly as a result of the consolidation changes noted above.

Personnel costs in the Portuguese electricity business increased 3.5% to 517.4 million in 2003 from 500.1 million in 2002 following the 2.7% average salary increase. As a percentage of total personnel costs, electricity business in Portugal remained stable in 2003 and 2002 at 80%. Personnel costs in generation in Portugal increased 0.7% to 120.3 million in 2003 from 119.6 million in 2002 as a result of an increase in average salaries, partially offset by a reduction of 111 employees toward the end of 2003. Personnel costs in distribution and supply increased 4.3% to 397.1 million in 2003 from 380.6 million in 2002 reflecting the increase of pension premiums and the average salary increase.

In Spain, personnel costs at Hidrocantábrico were 37.1 million in 2003 compared to 18.3 million in 2002. This increase is primarily due to the proportional consolidation of twelve months in 2003 compared to seven months in 2002. Additionally, the inclusion of Naturcorp in Hidrocantábrico s accounts since August 2003 also contributed to this increase.

Personnel costs in Brazil increased 61.6% to 64.0 million in 2003 from 39.6 million, primarily due to the full consolidation of Escelsa and Enersul for twelve months in 2003 compared to three months in 2002. In addition, the average salary increase in our Brazilian subsidiaries was approximately 10%, which also contributed to the increase. However, both of these effects were partly offset by the strong depreciation of the Brazilian real against the euro beginning in June 2002.

Personnel costs in our telecommunications activities decreased 43.2% to 51.0 million in 2003 from 89.7 million in 2002, reflecting the discontinuation of the UMTS project toward the end of 2002 and the reduction in the number of employees achieved primarily at the fixed line business in Portugal.

Personnel costs in our information technology activities decreased 12% to 66.4 million in 2003 from 75.5 million in 2002, due to the ongoing staff restructuring process and successful wage negotiations.

Depreciation and amortization. Depreciation and amortization in 2003 increased to 845.6 million from 739.5 million in 2002, primarily due to the consolidation changes noted above.

Depreciation and amortization charges in the Portuguese electricity business increased 3.8%, or 21.4 million, to 583.3 million in 2003 from 561.9 million in 2002 (and as a percentage of our total depreciation and amortization charges, it decreased 69.0% in 2003 compared to 76.0% in 2002). Depreciation and amortization charges in generation increased 2.7% to 234.4 million in 2003 from 228.2 million in 2002. Depreciation and amortization in distribution and supply activities increased 4.6% to 348.9 million in 2003 from 333.6 million in 2002, due to the transfer of an information technology system from our information technology services provider company, Edinfor, to EDPD and greater investments made in the distribution network.

In Spain, Hidrocantábrico s contribution to our depreciation and amortization charges increased to 60.1 million in 2003 from 26.9 million in 2002, primarily due to the proportional consolidation of Hidrocantábrico for twelve months in 2003 compared to seven months in 2002. In addition, the inclusion of Naturcorp since August 2003 and the depreciation of the investment made in Castejón CCGT since October 2002 also contributed to this increase.

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Depreciation and amortization charges in the Brazilian electricity business increased to 58.3 million in 2003 from 34.2 million in 2002 mainly due to the full consolidation of Escelsa and Enersul for twelve months in 2003 compared to three months in 2002. This increase was partly offset by the depreciation of the Brazilian real against the euro.

Depreciation and amortization charges relating to telecommunication activities increased 8.8% to 72.7 million in 2003 from 66.9 million in 2002 as a result of the acquisition in Spain of cable access rights, primarily during 2002, and the investments made in Portugal in connection with the expansion of the network in 2002 and the acquisition of direct access infrastructure.

In 2003, depreciation and amortization charges relating to information technology activities increased 28.4% to 24.3 million from 18.9 million in 2002, primarily due to the IT project ISU/Communications that began depreciating in 2003.

Supplies and services. The cost of external supplies and services decreased 6.3% to 632.5 million in 2003 from 675.1 million in 2002.

Supplies and services in the Portuguese electricity business increased 1.2% to 285.6 million in 2003 from 282.1 million, and as a percentage of our total supplies and services it increased to 45.2% in 2003 from 41.8% in 2002. Supplies and services relating to generation activity increased 2.0 million to 75.0 million in 2003, benefiting from a reduction in insurance costs, steady maintenance costs and tighter management discipline. Supplies and services relating to distribution and supply activity increased 0.7% to 210.6 million in 2003 due to the transfer of services, which were being performed internally by EDPD, to our shared services company, EDP Valor. This effect was offset by a decrease in maintenance costs due to both the renegotiation of contracts, which are no longer on a retainer basis, and a more efficient use of internal resources.

Supplies and services costs relating to Hidrocantábrico decreased to 36.9 million in 2003 from 41.1 million in 2002, primarily due to the fact that in 2002 the electricity transmission and distribution tariffs paid by Hidrocantábrico s supply unit were accounted under supplies and services, while in 2003 these tariffs started to be accounted under purchases of electricity.

Supplies and services relating to the electricity business in Brazil increased to 62.2 million in 2003 from 36.0 million in 2002 mainly due to the full consolidation of Escelsa and Enersul for twelve months in 2003 against three months in 2002. In addition, the full operations of the hydro power plant Lajeado beginning in November 2002 and the complete year of the cogenerator Fafen, also contributed to this increase.

Supplies and services in our telecommunications activities decreased 9.7% to 265.3 million in 2003 from 293.7 million in 2002 primarily due to the cost-cutting program. The major savings were in advertising costs, specialized works and fixed network costs.

Supplies and services related to our information technology activities decreased 6.7% to 70.1 million in 2003 from 75.1 million in 2002, mainly as a result of the effect of economic slowdown in the information technology business and the transfer of an information technology asset to our Portuguese electricity distribution unit.

Own work capitalized. Own work capitalized decreased 2.5% to 235.6 million in 2003 from 241.8 million in 2002.

Own work capitalized in the Portuguese electricity business represented 94.7% in 2003 of our total own work capitalized (against 77.7% in 2002). In 2003, it increased 18.7% to 223.0 million from 188.0 million in 2002. Own work capitalized in our generation activity in Portugal increased to 38.2 million in 2003 from 26.2 million in 2002 following the investments in TER CCGT and Venda Nova II hydro power plant. Own work capitalized in the distribution and supply activities in Portugal increased 14.2% to 184.8 million in 2003 from 161.8 million in 2002 primarily due to higher investments in the distribution grid.

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In 2003 and 2002 Hidrocantábrico contributed 4.0 million and 2.7 million to own work capitalized, respectively, primarily due to the proportional consolidation of twelve months in 2003 compared to seven months in 2002.

Own work capitalized in our telecommunication activities was almost non-existent in 2003 compared to 30.2 million accounted for in 2002. The 2002 figure is related to the UMTS project, which was discontinued by the end of 2002.

Own work capitalized relating to information technology decreased 33.5% to 8.4 million in 2003 due to the fact that 2002 figures reflect the capitalization of costs on the development of an information technology system for EDPD, that was completed in the end of 2002.

A table setting forth the components of own work capitalized for the past three years is provided in note 33 to our consolidated financial statements.

Concession and power-generation rents. Concession and power-generation rental costs increased to 175.6 million in 2003 from 158.2 million in 2002. The 11.0% increase in concession and power-generation rental costs between 2002 and 2003 is primarily due to the increase in the average concession fee paid by our generation activity to the Portuguese municipalities, from 7.00% to 7.25% of previous year s sales, and the 6.3% increase in low-voltage, special low-voltage and public lighting sales.

Provisions. Provisions decreased to 75.7 million in 2003 from 100.6 million in 2002, primarily due to a decrease in provisions for doubtful accounts charges and healthcare liabilities provision charges.

Until the end of 2002, increases in provisions for doubtful accounts were reflected in our consolidated statements of income in the line item Provisions and were included in the determination of operating income, while decreases were included in the line item Other non-operating expenses (income), net below the operating income. Beginning in 2003, at the electricity distribution activity in Portugal, both increases and decreases in provisions for doubtful accounts are included in the line item Provisions.

Provisions in the Portuguese electricity business decreased to 55.5 million in 2003 from 76.9 million in 2002 (and as a percentage of our total provisions, it decreased 73.4% in 2003 compared to 76.4% in 2002). Provisions in generation increased 1.1 million to 12.7 million in 2003. Provisions in distribution and supply activities decreased to 42.8 million in 2003 from 65.3 million in 2002, due to the accounting of the provision decreases in this line item since 2003, at the distribution business level, as noted above.

Other operating expenses/(income). This item includes primarily taxes other than income taxes and other operating income (net), which decreased to a 10.3 million expense in 2003 from 5.7 million income in 2002. This decrease is partly related to other operating expenses in Brazil, which increased to 18.6 million in 2003 from 6.3 million in 2002 due to the regulatory contributions to the Energy Development Account in 2003, as well as the full consolidation of Escelsa and Enersul for twelve months in 2003 compared to three months in 2002. The Energy Development Account was created in Brazil largely to promote the competitiveness of some generation technologies, including wind farms, small hydro plants, biomass plants and thermal facilities using natural gas and domestic mineral coal.

Operating margin

As a result of the factors discussed above, our operating margin increased 39.6% to 905.7 million in 2003 from 648.7 million in 2002. Operating margin from our core electricity business in Portugal increased 12.5% to 731.7 million in 2003 from 650.3 million in 2002, primarily due to a successful costs control program. In Spain, Hidrocantábrico contributed 82.2 million to our consolidated operating margin in 2003 compared to 38.1 million in 2002. In addition to the changes in consolidation noted above, Hidrocantábrico benefited from the first-time consolidation of Naturcorp. Operating margin from Brazilian electricity activities increased 65.4 million to 126.8 million in 2003. This increase is partly due to the changes in consolidation related to Escelsa and Enersul noted above. These companies contributed 62.8 million to our operating margin in 2003 compared to 15.2 million in 2002.

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In addition, Brazilian electricity activities benefited from tariffs increases and recovery in Brazilian consumption. Operating margin from telecommunication activities improved by 86.2 million to a 68.7 million loss in 2003 from a 154.8 million loss in 2002, due to the discontinuation of UMTS operations, an increase in voice traffic, lower interconnection costs and rigorous cost cutting. Operating margin from information technology activities decreased 26.3 million to 9.3 million in 2003 from 35.6 million in 2002 due to the slowdown of the Portuguese economy.

Interest and related income/(expenses), net

Our net interest and related income/(expenses) consist of interest and related income and interest and related expenses. These net expenses increased to 359.0 million in 2003 from 222.8 million in 2002 (and increased as a percentage of our total revenues to 5.1% in 2003 compared to 3.5% in 2002). This variation was mainly influenced by the consolidation changes noted above. Hidrocantábrico contributed a 62.4 million net expense in 2003 compared to a 37.7 million net expense in 2002, reflecting the 40% proportional consolidation of Hidrocantábrico since June 2002. From January until May 2002, we accounted for 5.4 million income from the application of the equity method in respect of Hidrocantábrico. Escelsa and Enersul contributed a 8.8 million income in 2003 compared with a 37.3 million income in 2002, reflecting full consolidation of the Escelsa and Enersul since October 2002. This was offset by a 102.9 million expense from the application of the equity method in respect of Escelsa and Enersul, which we accounted for in the period from January to September 2002.

During 2002, we recognized 56.4 million of positive foreign exchange differences on U.S. dollar assets that we acquired for the sole purpose of covering foreign exchange differences on the U.S. dollar debt of our Brazilian subsidiaries. By the end of 2002, we used these U.S. dollar assets in the purchase of approximately 83% of Escelsa s U.S. dollar bond issue. These Escelsa bonds were acquired at below par value, resulting in an 89.2 million financial gain. In 2003, we recognized negative foreign exchange differences of 65.0 million in respect of the Escelsa bonds as a result of the Brazilian real s increase in value against the U.S. dollar.

Net expense from interest on debt increased due to the consolidation changes and to the financial gain registered on Escelsa bonds in 2002, as noted above. This increase was partly offset by lower interest rates associated with our debt in 2003.

Contributions from equity method investees were positively influenced in 2003 as a result of higher contributions from REN and CEM. Investment income decreased 8.2% to a 36.7 million income in 2003 from a 40.0 million income in 2002, due to lower dividends received from BCP.

Amortization of investments (goodwill) increased as a result of the consolidation changes, the acquisition of Naturcorp by Hidrocantábrico and, for the first time in 2003, amortization of a client portfolio acquired by Comunitel.

Other non-operating income/(expenses)

We had other non-operating expenses of 14.4 million in 2003, compared to other non-operating expenses of 138.9 million in 2002 (which reflected ONI Way s write-off), primarily due to a 56.7 million expense in 2003 related to non-operating provisions net of provision utilizations and a 47.8 million expense associated to costs with human resources rationalization in Portugal. These losses in 2003 were partially offset by non-operating income of 79.8 million related to the reversal of depreciation of fixed assets that were funded by third parties, mostly related to our Portuguese electricity distribution activity, and 19.4 million related to the hydrological correction mechanism explained above (we did not

record such income in 2002).

We recorded a net expense of 56.7 million in 2003 related to non-operating provisions net of provision utilizations compared with a net income of 58.1 million recorded in 2002. The net expense recorded in 2003 reflects a 114.7 million provision for financial assets in order to cover for contingencies and possible devaluations in Brazil and Cape Verde and 72.5 million income related to the reduction of provisions for financial assets and other risks and contingencies. For more information on non-operating provisions net of utilizations you should read note 34 to the consolidated financial statements.

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An income item of 79.8 million was registered in 2003, compared to 71.8 million in 2002, for the portion of depreciation due primarily to new electricity connections made in prior years that were financed largely with customer payments. We record the amount of these payments initially as deferred income and as the assets are depreciated over 30 years, a portion of the amount is taken into income and offset by a corresponding depreciation charge.

As the primary supplier of low-voltage electricity in Portugal, we have in the past been obliged to provide electricity to municipalities for street lighting and other public buildings even in situations where the recipient municipalities were not paying their bills on a timely basis. Although we have not encountered significant collection problems in recent years, prior to 1988 collection problems were encountered with certain municipalities and we still have on our books receivables from municipalities related to electricity and other services provided prior to 1988. These receivables consist of amounts receivable from a small number of municipalities that have not signed a concession agreement with us and with which a payment plan has not been agreed and amounts receivable from municipalities that have signed a concession agreement and have agreed to a deferred payment plan.

Provision for income taxes

Income taxes provided for in 2003 were 239.3 million compared with 171.2 million in 2002. The reference income tax rate in Portugal was 30% in 2003 and 2002. In addition, a municipal surcharge of up to 10% of the base rate is typically levied by the municipality in which the income is earned.

Provision for deferred income taxes

In 2003, our provision for deferred income taxes amounted to a 43.7 million benefit, whereas in 2002 the provision for deferred income taxes amounted to a 0.6 million charge. This difference is mainly explained by the fact that in 2002 we booked the deferred tax effect of a charge, in the amount of 29.6 million, related to the capital gain arising from the acquisition of the Escelsa U.S. dollar bonds below par value; and we also experienced a 5.6 million decrease in the deferred income tax charge related to tariff deviations in the electricity business in Portugal. This difference is also explained by the fact that in 2003 we booked the deferred tax effect of a benefit, in the amount of 8.3 million, related to an extraordinary provision for the investments in Brazil and Cape Verde and associated contingencies.

Our effective tax rate is different from the reference income tax in Portugal each year due to permanent differences arising mainly from amortization of the goodwill and concession rights, amortization resulting from revaluation of fixed assets and tariff deviations in the electricity business that are not deductible for income tax purposes. Our effective tax rate was 36.7% in 2003, compared with 59.9% in 2002. The effective tax rate in 2003 reflects impairment charges relating to Brazil that were not tax deductible, while the 2002 effective tax rate reflects higher charges relating to the write-off of our investment in ONI Way that were not tax deductible.

Consolidated net profit

As a result of the factors discussed above, our consolidated net income for 2003 increased 13.7% to 381.1 million from 335.2 million in 2002.

LIQUIDITY AND CAPITAL RESOURCES

We manage and control our funding and treasury activities centrally at the EDP, S.A. level, except with respect to ONI and our businesses in Spain and Brazil. At EDP, S.A., the account balances of our subsidiaries are netted in EDP, S.A. s accounts and centralized payments are made for the entire EDP Group. In Portugal, there are no legal or economic restrictions on the ability of our subsidiaries to transfer funds to EDP, S.A. Our subsidiaries in Portugal do not enter into their own financing arrangements except for our cogeneration subsidiary, EDP Cogeração, which finances some of its own projects, ONI and Edinfor.

Our primary source of liquidity is cash generated from operations. Net cash provided from operating activities was 1,643.3 million in 2004, compared with 1,773.6 million in 2003 and 897.7 million in 2002.

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Total cash and cash equivalents, net of bank overdrafts, at December 31, 2004 amounted to 278.0 million compared with 287.5 million at December 31, 2003 and 214.0 million at December 31, 2002.

Net cash used in investing activities was 2,271.7 million in 2004, compared with 529.1 million in 2003, and 1,141.4 million in 2002, representing a 329.3% increase in 2004 and a 53.6% decrease in 2003. The increase in 2004 compared with 2003 reflects the acquisition of an additional 56.2% stake in Hidrocantábrico s share capital. The decrease in 2003 compared with 2002 reflects our sale in 2003 of our investment in Iberdrola and Hidrocantábrico s acquisition of Naturcorp and, in 2002, our acquisition of Hidrocantábrico. See Item 4. Information on the Company History and Business Overview Group capital expenditures and investments for further information on our capital expenditures and investments.

Net cash from financing activities in 2004 was 644.2 million compared with net cash used in financing activities of 1,143.9 million in 2003 and net cash from financing activities of 415.5 million in 2002. The increase in net cash from financing activities in 2004 was due to our rights offering. The increase in net cash used in financing activities in 2003 was mainly due to debt reduction, partially resulting from the liquidity achieved by the sale of our investment in Iberdrola.

As of December 31, 2004, EDP, S.A. had available committed credit facilities of 1,477.4 million and a fully underwritten 350 million commercial paper program. In July 2004, we established a 1,300 million five-year revolving credit facility, to be used for general corporate purposes. This credit line permits drawings of one, two, three and six months at agreed margins over the euro interbank offered rate, or Euribor, based on a rating grid. We believe that the combination of this negotiated credit line and our commercial paper program provides an adequate source of liquidity for our operations. Our credit facility agreements do not impose financial ratio requirements and events of default clauses are not based on credit rating, so that their availability is not impacted by downgrades or declines in financial ratios or other measures of financial performance.

Our consolidated indebtedness, including bonds, long-term bank loans, commercial paper and bank overdrafts, was 8,598.8 million at December 31, 2004 compared with 7,492.7 million at December 31, 2003 and 7,994.1 million at December 31, 2002. During 2004, in line with our objective of extending the average life of our debt portfolio, we entered into a 15 year loan contract with the European Investment Bank in the amount 200 million. As of December 31, 2004, debt at EDP, S.A. and EDP Finance B.V. amounted to 5.553 million, corresponding to 64.6% of our total debt. Our debt management guidelines continue to be focused on controlling financial costs and reducing our exposure to foreign exchange risk.

At December 31, 2004, the weighted average interest rate of our indebtedness at EDP, S.A. and EDP Finance B.V. was flat when compared with 3.58% at December 31, 2003. At December 31, 2002, the value was 3.67%. At December 31, 2004, total debt held by EDP, S.A. and EDP Finance B.V. was denominated in euros (or hedged using cross currency swaps), and we therefore do not have currency exchange rate risk relating to this debt. At December 31, 2004, approximately 71% of our total long-term indebtedness at EDP, S.A. and EDP Finance B.V. carried a floating rate, but 37% of it was hedged against interest rate risk through collar structures. For more information on our interest rate risk, please see Item 11. Quantitative and Qualitative Disclosures About Market Risk Interest Rate Risk. At December 31, 2003, approximately 68% of our total long term indebtedness carried a floating rate.

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TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

Our contractual obligations and commercial commitments consist primarily of credit facilities, as described above. The following table provides details regarding our contractual and commercial obligations subsequent to December 31, 2004:

Payments Due and Amount of Commitment by Expiration Period

	December 31,						
	Total	**2005**	**2006**	**2007**	**2008**	**2009**	**Thereafter**
	(millions of EUR)						
Long-term debt	6,741.0		1,487.0	1,269.4	792.0	1,152.0	2,040.6
Short-term debt	1,857.8	1,857.8					
Total contractual cash obligations	8,598.8	1,857.8	1,487.0	1,269.4	792.0	1,152.0	2,040.6
Guarantees	575.0	122.5	25	45		22.5	360
Total	9,173.8	1,980.3	1,512.0	1,314.4	792.0	1,174.5	2,400.6

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 requirements develop. For more information on our planned capital expenditures you should read Item 4. Information on the Company History and Business Overview Group capital expenditures and investments.

PENSIONS AND BENEFITS

We maintain a defined benefit pension plan for all our active and retired employees included in the Collective Labor Agreement, or the A.C.T., for Portuguese group companies created in 1994 with the restructuring of EDP. Pension benefits are based on the employees years of service and the compensation level at the end of their employment period, less Portuguese social security benefits. The normal retirement age is 65. However, employees at least 60 years of age with 36 years of service, or employees of any age with 40 years of service, may elect early retirement. Employees electing early retirement are entitled to full pension benefits that are calculated on the same basis as that for employees retiring at the normal retirement age. Our policy has been to make contributions to the plan based on the availability of funds while making the minimum annual contributions required by applicable regulations. Some companies not a part of the A.C.T, such as the Brazilian and Spanish companies, also have complementary social benefits to their own social security systems, either as a defined benefit plan (Bandeirante, for example) or a defined contribution plan (Escelsa and Hidrocantábrico, for example).

We also provide comprehensive medical coverage, in addition to that provided by the Portuguese national health system, for retired employees, including those who have taken early retirement, and their dependents. Additionally, we provide a death benefit to retirees survivors. We administer the program internally and assume the full cost of funding the program net of employee contributions, amounting to approximately 10% of the total medical expenses covered.

At December 31, 2004, our provisions for pension and medical benefit liabilities were 796.4 million compared with 562.3 million at December 31, 2003 and 608.2 million at December 31, 2002. The provisions for medical benefits and pensions in 2004 were 468.9 million and 327.6 million, respectively, compared with 412.6 million and 149.6 million, respectively, in 2003, and 396.7 million and 211.5 million, respectively, in 2002, which amounted to 608.2 million in total. We expect to fund pension liabilities from our internal resources.

INFLATION

Inflation in Portugal, as measured by changes in the Portuguese CPI, averaged 2.3%, 3.3% and 3.6% in 2004, 2003 and 2002, respectively. During the period from 1994 through 2004, changes in the Portuguese CPI averaged 3.3% per annum, ranging from a high of 5.4% in 1994 to a low of 2.2% in 1997.

To reflect the impact of inflation, Portuguese GAAP and regulations permit companies to revalue their fixed assets. Accordingly, we revalued our assets in 1992 based on an assessment of the remaining useful life and modern equivalent asset value of the assets at December 31, 1992. In accordance with Portuguese GAAP, depreciation of fixed assets is computed on the revalued amounts, with depreciation in respect of the original acquisition cost and 60% of the revaluation increment being deductible for corporate income tax purposes. Under U.S. GAAP, fixed assets may not be stated at more than their historical acquisition cost.

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PORTUGUESE GAAP COMPARED WITH U.S. GAAP

Our financial statements have been prepared in accordance with Portuguese GAAP, which varies in certain significant respects from U.S. GAAP. The principal differences between Portuguese GAAP and U.S. GAAP as they relate to us concern:

- the revaluation of fixed assets, as discussed above under Inflation;
- the capitalization of overheads and foreign exchange differences in connection with the construction of fixed assets;
- the capitalization of research and development costs, advertising costs, maintenance and repair, and reorganization costs;
- the hydro account;
- the deferral of certain costs, profit distributions to management and employees and employee termination benefits;
- the accounting for employee retirement benefits;
- the reversal of allowances for certain doubtful accounts;
- the capital treatment of contracts for the purchase of capacity and electricity;
- the accounting for investments, including REN;
- the accounting for the sale proceeds from the disposal of REN;
- the accounting for Hidrocantábrico;
- the accounting for derivative instruments;
- the depreciation of goodwill;
- the tariff adjustments and other regulatory assets;
- losses attributable to minority interests;

assets under concession in Brazil;

guarantees; and

comprehensive income.

We include in the cost of assets constructed for our own use a portion of our general and administrative overhead. Assets constructed prior to 1995 also include the net foreign exchange differences, both gains and losses, which resulted from loans denominated in foreign currencies contracted to fund the capital expenditures. Under U.S. GAAP, these amounts are not included in the cost of the asset and are recorded in income in the period in which they are incurred.

We capitalize and amortize research and development costs, advertising costs, major maintenance and repair costs, and reorganization costs. Under U.S. GAAP, these amounts are included as expenses in the period incurred.

The main objective of the hydro account is to avoid imbalances in the electricity sector due to changes in variable costs incurred as a result of hydrological conditions. Accordingly, since the tariffs cannot be modified immediately to reflect the changes in variable costs incurred as a result of hydrological conditions, this account is used to compensate the volatility in variable operating costs of power generators in the PES for unfavorable hydrological conditions, such as when thermal generation increases and, consequently, expenditures on fuel and electricity imports increase substantially. In years with abundant rainfall, the opposite occurs. In this context, and with a view toward avoiding major distortions in operating results due to favorable or unfavorable hydrological conditions, the hydro account is adjusted upwards or downwards based upon average hydrological conditions.

Until 2000 REN was part of the EDP Group, therefore the movements of the hydro account were within the EDP Group. Since the separation of REN in June 2000, we (at the holding company level) pay or receive cash from REN, which is booked against the hydro account. The net movement in the hydro account between December 31, 2000 and December 31, 2004 was approximately €1 million. We record a charge for the financing cost associated with the amount of the accumulated balance of this account, which is recognized in earnings under Portuguese GAAP. REN uses the amount received or paid to compensate the operators in PES (a significant majority of which are our subsidiaries) in accordance with the objectives of the hydro account as described above. As such, REN is effectively a flow-through entity for purposes of the hydro account. For Portuguese GAAP purposes, the operators in the PES who receive or pay cash to REN account for it against earnings.

The Portuguese government approves the amount of the accumulated balance and the movements during the year on an annual basis. REN is engaged to calculate the amounts to be received or paid by us in relation to the hydrological correction account.

In prior years, for Portuguese GAAP purposes, the balance continued to be reported as a liability in accordance with local legislation. For U.S. GAAP purposes, the portion of the liability established through 1994 was eliminated with an offsetting increase to shareholders equity. In essence, this increase to shareholders equity was equivalent to accounting for accrued income. Thus, in periods up to December 2003, it was considered that the amount recorded as an asset would be recoverable through future benefits flowing to EDP Group. Subsequent to 1994, payments and receipts by EDP to REN are treated as increases or decreases of the liability under both Portuguese and U.S. GAAP.

During 2004, Decree law no. 240/2004 was issued, with the purpose of regulating the early termination of the PPAs, a step toward the liberalization of the energy market within the Iberian Peninsula. This decree law states that, with the introduction of the free trading market, which is currently expected to occur within the next twelve months, the government will be required to introduce a new regulation regarding the purpose and scope of the hydro account as well as the mechanisms to compensate producers for their increased risks resulting from the early termination of PPAs.

As a result of the introduction of this regulation mandated by the above-mentioned decree law, and in light of the above-mentioned government announcement, our board of directors and management consider that it is probable that the hydrological correction mechanism will be terminated. At such date the liability recorded, including the balance relating to pre-1994 activity, will be payable to a third party to be nominated by the regulator. Moreover, since this regulation can only be introduced simultaneously with the effective liberalization of the energy market in the Iberian Peninsula, our board of directors and management consider that the accrued income accounted as an asset will cease to have any future economic benefits. Therefore, at the end of 2004, we recorded a full valuation allowance against the asset recorded in our U.S. GAAP accounts in the amount of €315 million as at December 31, 2004.

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As part of our profit sharing plan, we distribute a bonus to management and employees. Under Portuguese GAAP, this distribution is reflected in the period in which formal shareholder approval is obtained and is recorded as a reduction of retained earnings or other reserves. U.S. GAAP requires that these distributions be recorded as compensation expense in the period they are earned.

We and some of our subsidiaries have pension obligations, in connection with both defined benefit and defined contribution plans, and also have medical benefits for retired employees. Costs for defined contribution plans are expensed when incurred. Both under Portuguese GAAP and U.S. GAAP, unrecognized actuarial gains and losses are amortized under the corridor method. The corridor method does not allow actuarial net gains or losses up to ten percent of the greater of the projected benefit obligation or the value of plan assets to be recognized or amortized as part of the annual net pension cost. The value of the unrecognized actuarial gains or losses that exceeds the value of ten percent, as defined above, will be amortized over the average remaining service period of the employees. Obligations and annual expenses for medical benefits and defined benefit pension plans are determined on actuarial basis. Thus, differences in accounting for these obligations generally originate from the date of application of the corridor method, which results in a different value for the unrecognized actuarial gains and losses, as well as for the recognition of the additional pension minimum liability.

From 1998 to 2000, we reached agreements with several municipalities on the terms of the future settlement of outstanding debts, and, for Portuguese GAAP, reversed at that time the corresponding bad debt provision. Under U.S. GAAP, the collection of the receivables had previously been considered not probable and consequently had been fully provided. Therefore, under U.S. GAAP, the provision for doubtful debts was written-back based on the actual collections and on the estimated recoverable amount of outstanding receivables.

We entered into several PPAs with REN which are treated as leases under U.S. GAAP. The evaluation of whether an arrangement contains a lease within the scope of Statement 13 and EITF 01-8 is based on the substance of the arrangements. Those PPAs include terms that, although not nominally identified as leases, meet the definition stated in the above-mentioned statements, in particular, that a lease transfers substantially all of the benefits and risks related to the property to the lessee. In substance, the PPAs explicitly identify the power plants with which we produce power exclusively for REN, and we are prohibited from using any other power plant to supply power to REN. Additionally, the PPAs convey the right to use the power plants and require that the total production is acquired by REN.

The PPAs are considered as capital leases for U.S. GAAP purposes due to the fact that the PPAs transfer the risks and rewards of usage to the REN during the period of the lease term, transfer the ownership of the property to REN at the end of the lease term and the lease terms are the same as the useful lives of the power plants. As permitted under Portuguese GAAP, these assets are classified as tangible fixed assets and amortized on straight-line basis at rates accepted by the tax authorities or for general purposes business, which reflects the economic useful lives of each category of fixed assets.

On January 27, 2005, in accordance with Decree law no. 240/2004, we signed agreements for the early termination contracts of PPAs. The termination agreements effects are suspended until a set of conditions is met which includes the commencement of MIBEL, which assures the sales of generated electricity and the attribution of non-binding production licenses. When the stated conditions allow for the effective termination of PPAs, under U.S. GAAP the power plants will be accounted in a similar manner as the current accounting under Portuguese GAAP.

We constructed and sold the Pego and Tapada de Outeiro power plants in 1993 and 1998, respectively. Before 1999, at the time of the sales, REN signed PPAs with the producers in the Binding Sector by which the capacity and electricity of the plants were fully

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contracted to the Binding Sector represented by REN. Under the PPAs, REN is required to make specified minimum payments whether or not it is able to take delivery of the electricity. As permitted under Portuguese GAAP, REN recorded the sales of the power plants and it also recorded the minimum contracted payments as an expense of the respective periods. U.S. GAAP would require the sales to be treated as sale lease-back transactions and the power purchase agreements to be recorded as capital leases. Prior to the sale of REN to the Portuguese government, the contracts with Tejo Energia and Turbogás were recorded in this manner.

Our investment in REN and appropriation of the attributable equity and earnings of REN are affected by certain accounting differences between U.S. GAAP and Portuguese GAAP. These differences include: revaluation of fixed assets, overheads capitalized, deferred costs, employee termination benefits, distribution to management and employees, power purchase agreements and deferred income taxes.

Under Portuguese GAAP, since the sale proceeds from the disposal of our 70% interest in REN were equal to the net book value of the interest sold, no gain or loss was recorded on the transaction. Under U.S. GAAP, the net book value of the interest sold would be lower as a result of the accounting differences between Portuguese GAAP and U.S. GAAP; therefore, the proceeds received from the disposal of REN would exceed the net book value of the interest disposed, resulting in a gain on disposal and the remaining investment in REN would be reduced accordingly.

Until December 2004, our 39.5% holdings in the voting rights of Hidrocantábrico plus the existing shareholders agreement allowed the investment to be consolidated as a joint venture on a proportionate basis under Portuguese GAAP. Under U.S. GAAP this investment would be accounted for under the equity method. Hidrocantábrico s shareholders equity and net income have been adjusted to U.S. GAAP before applying the equity method to our accounts. As of December 31, 2004, we acquired an additional investment of 56.2% in Hidrocantábrico, increasing our investment to 95.7%. Consequently, at December 31, 2004, Hidrocantábrico was consolidated under the full consolidated method, both under Portuguese GAAP and U.S. GAAP.

Until 2002, derivative financial instruments were not recognized in the financial statements under Portuguese GAAP. Under U.S. GAAP, derivative financial instruments would be recognized in the balance sheet at market value. For instruments that do not qualify for hedge accounting under FAS 133, as implemented on January 1, 2001, the movements in the market value are included in our net profit. Upon adoption of FAS 133 on January 1, 2001, no transition adjustment was recorded as all derivatives existing at that date were previously recorded at fair market value in the balance sheet for U.S. GAAP. As of the date of our adoption of IAS 39 in 2003, in Portuguese GAAP consolidated financial statements derivative financial instruments are recognized in our consolidated balance sheet at market value, and those that do not quality for hedge accounting are included in net profit. FAS 133 compliant hedge relationships were designated and documented from January 1, 2004.

Under Portuguese GAAP, goodwill is amortized over the estimated useful life not exceeding 20 years. From January 1, 2002, U.S. GAAP requires that goodwill, including previously existing goodwill, and intangible assets with indefinite useful lives are not amortized but are tested for impairment annually. Concession rights in Brazil continue to be amortized, as these are intangible assets with finite lives.

In activities subject to regulation, the criteria of allocation of income and expense to each accounting period may be different from the criteria applicable to non-regulated activities. For accounting purposes, when the regulator establishes a criteria of allocating income and expense to future years, then a regulatory asset or liability is recognized in the financial statements, which otherwise would be booked as profit or loss of the year.

Regulatory assets relate to deferred costs defined and regulated by the regulator, which should be recovered through the increase of electricity tariffs during subsequent periods. Regulatory liabilities relate to future decreases in income defined and regulated by the regulator, which should

have an impact on customers through the decrease of electricity tariffs during the subsequent periods.

In Portugal, the tariffs of electricity supplied to clients in the Binding Sector are determined by the regulator. Tariffs for clients outside the Binding Sector are negotiated and contracted on an individual basis. Tariffs in the electricity distribution business are subject to a price cap mechanism. These earnings are subject to a gross profit restriction and after being subject to confirmation or approval by the regulator are adjusted in future tariffs revenues. We estimate those future tariff revenue or adjustments and defer or accrue the recognition of the revenues until future periods in our Portuguese GAAP accounts. Even though the tariff adjustments are subject to formal approval by the regulator, these amounts are recorded under other assets or other liabilities in the accompanying balance sheet prepared under Portuguese GAAP. In the U.S. GAAP financial statements, these assets or liabilities recorded for the regulated activities in Portugal are eliminated because, in substance, we believe that the tariff adjustments regulation does not meet in full the criteria set out in SFAS 71. Even though the scope criterion of SFAS 71 is met with respect to the regulated activities in Portugal, due to the uncertainty in relation to future income being in an amount at least equal to the capitalized cost or a situation of a permanent roll forward of cost with current year costs being deferred and prior cost being recovered in each period, the asset recognition criteria as defined in SFAS 71 is not met. As a result, tariff adjustments related to Portuguese activities are not reflected in U.S. GAAP accounts and therefore are included as a reconciling item in the reconciliation from local to U.S. GAAP. However, the assets or liabilities resulting from the tariff adjustments mechanism set out by ANEEL regarding our activities in Brazil meets the requirements of SFAS 71 and therefore are accounted for on that basis. The assets and liabilities considered by our companies in Brazil as regulatory assets are fully compliant with ANEEL. Eligible costs are specifically determined by the regulator and are recoverable through the recovery rates. Resulting from measures taken by the Brazilian government and by ANEEL in 2001, our companies in Brazil are subject to the application of SFAS 71. In December 2001, in order to compensate the companies, an agreement with the Brazilian government was reached for all the entities operating in the sector, which allows the increase of regulated rates for a period of six years. Considering SFAS 71 and EITF 92-7, Energias do Brasil only considered regulatory assets based on two years projections of current level consumption.

Under both Portuguese GAAP and U.S. GAAP, in prior years, the losses attributable to minority interests that exceeded the equity capital attributable to minority interests in subsidiaries had been recorded as negative minority interests in the balance sheet. In the income statement, the referred losses attributable to minority interest were charged to the minority interest in the proportion of their shareholding. Under Portuguese GAAP, and beginning in