









## Annual Report of the EDP General and Supervisory Board 2006 Message from the Chairman



### To the Shareholders

Having being elected by the General Meeting of 30 March 2006 to preside over the EDP General and Supervisory Board, it is with the greatest of pleasure that I take this opportunity to address you in the introduction to the first annual report of this governing body.

In recent years the EDP group has seen several alterations to its model of governance and the composition of the bodies entrusted with managing its businesses, with all the consequences this has entailed. As this subject is covered in the first section of this report, I shall limit myself here to recalling that between 1996 and 2006 there were six different models for the organisation and composition of the Board of Directors, five chief executive officers and thirty two directors, fourteen of whom were executive directors. The latest model consisted of a Board of Directors with three components; five executive and eight non-executive directors, a non-executive Chairman and a Chief Executive Officer.

As it was felt that EDP needed a more rigorous model that was better suited to a more effective form of governance, the shareholders decided to introduce changes. In fact, any changes to the model of governance that did not lead to closer monitoring, supervision and counselling of the Board through a governing body with a head that might, given the nature of its duties, improve on those previously ascribed to the Chairman, would have made little sense and have scarcely been understood by the market.

Therefore, since 30 June 2006, the commencement date for the new EDP governance model, the company possesses:

- An Executive Board of Directors which manages company affairs in accordance with the broad outlines defined by the appropriate governing bodies, using the powers it has been attributed in order to achieve the proposed objectives which will define its assessment targets
- A General and Supervisory Board which must supervise, on a permanent basis, the work
  of the company and controlled companies, advising and assisting the Executive Board of
  Directors and issuing opinions in advance on matters referred to in the Articles of Association.

The work of the General and Supervisory Board and its special committees is described in this report. I will not, therefore, involve myself in the details preferring instead to present my interpretation of the philosophy underlying the current model of governance, a philosophy which I consider essential if its component governing bodies are to carry out their duties in compliance with the letter and spirit of the Articles of Association, the Companies Code and, assuredly, the wishes of shareholders who chose this model in preference to all others, notably the monistic system.

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It should also be noted that the energy sector is facing changes which will accentuate in the near future and cannot fail to have an impact on companies, namely those in the European Union and, in particular, the Iberian Peninsula. On the basis of past experience and future expectations, I am confident that the changes introduced by the General Meeting of 30 March 2006 are here to stay, even though they may require minor adjustments. I am equally confident that the stability of the EDP model of governance will become a cornerstone of the way in which the destiny of this important business group is managed.

EDP has added responsibilities within the Portuguese business scenario, given its status as the largest business group, its importance on the stock exchange, the sector in which it operates, its international standing, the role it plays, and must play, in innovation and sustainability and, above all, the example it may set for other national listed companies.

The governance model is a distinctive component of any capital market, not only due to the fact that it has been defined or transposed into regulatory documents but also because of the genuine desire to make it effective, implement it satisfactorily and foster transparency and interaction between the managerial and the supervisory body. The Portuguese market, given its size and the nature of the majority of the listed companies, will benefit greatly if governance is recognised nationally and internationally as the best means of defending the interests of all shareholders, ensuring that counselling is permanently available to the Executive Board of Directors and superintending it without restrictions.

In accepting the position of Chairman of the General and Supervisory Board, I assumed responsibility for doing everything to make this a prestigious body and to provide it with the conditions whereby the power freely conferred upon it by shareholders could be fully exercised in order to contribute towards the creation of solid value. Therefore I will always strive my utmost to do my duty, beyond the comfortable limits of legal prescriptions, and I do not seek a narrow and convenient interpretation of my statutory powers.

In collaboration with the Chairman of the Executive Board of Directors, who has scrupulously provided me with all the information I have requested and with whom it has been a pleasure to work, this has, therefore, been the direction my work has taken. I have no doubt that once the initial adjustments and the urgent matters that need to be decided at the outset are dealt with, during the first half of 2007 we will have assembled the machinery to enable the plenary meetings, the special committees and, of course, the Chairman of the General and Supervisory Board to work more effectively and efficiently. Furthermore, I am sure that this is what shareholders expect of the General and Supervisory Board and, in particular, of the actions of its Chairman.



The six months of work carried out by the current Executive Board of Directors represent of period of intensive activity, both in terms of ideas — the drawing up of the Strategic and Business plans, the budget and the 12 VCO Projects — and the implementation of various actions, in particular:

- An agreement with the State of Cabo Verde on EDP's withdrawal from Electra share capital.
- The sale of the HidroCantábrico stake in Telecable
- The restructuring and simplification of the structure of EDP holdings in the gas business.
- The acquisition of 50% of Gasnalsa's share capital.
- The sale of part of the EDP stake in REN Rede Eléctrica Nacional, SA
- The sale of the stake in ONI SGPS, SA
- The acquisition of Agrupación Eólica.

Finally I would like to offer a word of thanks:

- To the shareholders who, at the General Meeting of 30 March 2006, did me the great honour of electing me to my present position.
- To the Minister for Economy and Innovation for his constant support regarding the complex issues I was called upon to intervene in.
- To the members of the General and Supervisory Board who have given me their full support and, despite their complicated agendas, have honoured the Board with their presence and valuable contributions
- To the Chief Executive Officer and members of the Executive Board of Directors who spared no efforts to ensure that I was kept informed on the most important issues, even at the expense of the precious time needed for their own management activities.
- To the staff of the General and Supervisory Board Support Office for their hard work and commitment

EDP, 8 March 2007

Aflunda

António de Almeida

Chairman of the General and Supervisory Board

**EDP Models of Governance** 



#### 1. EDP Models of Governance

To help provide an understanding of the new model of governance approved by the General Meeting of 30 March it is worth briefly surveying the main landmarks in EDP governance since 1996 in terms of the governing bodies and what they came to represent:

- 1996: Board of Directors composed of seven executive directors, a chairman and a deputy chairman.
- 1997: Board of Directors composed of five executive directors, and a chairman.
- 1998: Board of Directors composed of seven members, five executive and two non-executive directors and a CEO.
- **2000**: Board of Directors composed of eleven members, seven executive and four non-executive directors and a CEO.
- 2003: Board of Directors consisting of thirteen members, five executive and eight non-executive directors, a non-executive Chairman and a Chief Executive Officer. An Audit Committee consisting of three non-executive directors.
- 2006: Adoption of current model which will be explained in the following paragraphs.

As can be seen, the evolution of the EDP governance model from a purely monist structure such as the one in force in 1997 to the current dual model began in 1988 with the establishment of the first Board of Directors to include non-executive members and was successively consolidated of the years that followed. The creation of the first Audit Committee in 2003, composed entirely of independent directors, is particularly important in this process.



The Creation of the General and Supervisory Board



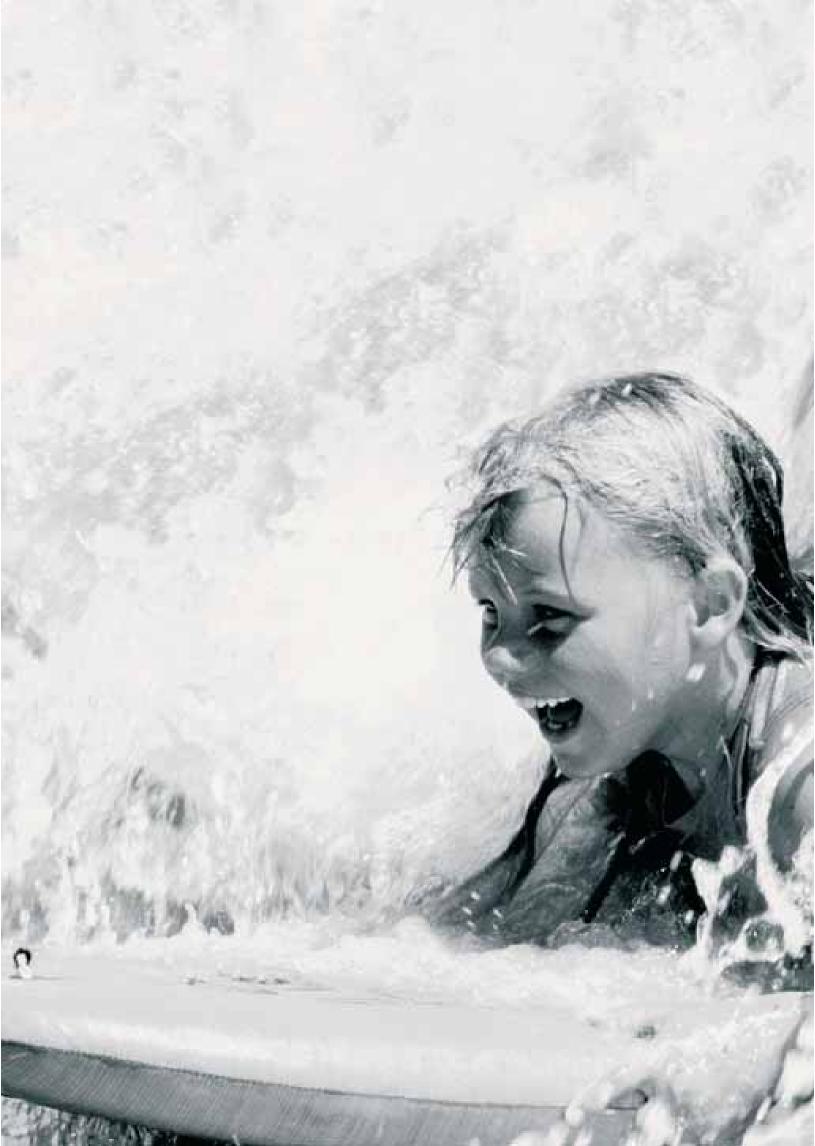
#### 2. The Creation of the General and Supervisory Board

On 30 March 2006, the EDP General Meeting decided to introduce an important change into the structure of the company's governance model, thus realising the shareholders' desire to enhance best practices in governance. It involved replacing the monist system (albeit a model mitigated by the existence of an Executive Committee with powers delegated by the Board of Directors) with a dual model whose most distinctive feature was the existence of General and Supervisory Board and an Executive Board of Directors, serving as essential governing bodies involved in defining and pursuing the higher interests of the company.

Due to legal restrictions the new model of governance only came into force on 30 June 2006, meaning that the former system of governance remained effective during the period 30 March to 30 June. By allowing various members of the future General and Supervisory Board, namely the Chairman of the General and Supervisory Board (serving as the Chairman of the Board of Directors) to serve on the Board as non-executive directors, this was particularly important in establishing a gradual and smooth transition to the new model of governance.

Thus 30 June 2006 symbolised the beginning of a new phase in the EDP Group corporate governance system in which the General and Supervisory Board, due to its nature and proximity to shareholders, plays a leading role as a body which monitors, supervises and provides guidance for EDP activities, in close collaboration with the Executive Board of Directors which is entrusted with the day-to-day management of the company's affairs.

These dual functions, if consciously exercised in a cooperative manner based on the full availability all relevant information, have the virtue of ensuring that the supervisory body maintains a healthy distance from the day-to-day life of the company and the concerns of the current management. This enables it to exercise its functions of monitoring, supervising and advising the company management objectively and without compromise.



The Composition of the General and Supervisory Board



#### 3. The Composition of the General and Supervisory Board

The EDP Articles of Association establish that the General and Supervisory Board must be composed of not less than nine members and must always have more members than directors, the majority of whom must also be independent. Finally, the Chairman of the Board of the General Meeting automatically becomes a member of the General and Supervisory Board.

At the General Meeting of 30 March, the 17 current members of the General and Supervisory Board were elected. However, on 6 June Prof. Rui Pinto Duarte informed the Chairman of the General and Supervisory Board that he did not wish to accept his appointment as a member of this body, due to doubts regarding possible legal incompatibilities in the exercise of his duties.

On 22 February 2007, Dr Carlos Jorge Feijoo Pereira Ribeiro submitted his letter of resignation as a member of the General and Supervisory Board.

The current General and Supervisory Board therefore consists of the following 15 members, 9 of whom were elected as independent members:

- António de Almeida Chairman
- Alberto João Coraceiro de Castro\* Deputy Chairman
- António Francisco Barroso de Sousa Gomes\*
- Carlos Jorge Ramalho dos Santos Ferreira
- Diogo Campos Barradas de Lacerda Machado\*
- Eduardo de Almeida Catroga\*
- José Manuel Archer Galvão Teles\* Chairman of the Board of the General Meeting
- José Maria Espírito Santo Silva Ricciardi
- Manuel Fernando de Macedo Alves Monteiro\*
- Manuel Menéndez Menéndez
- Paulo Jorge de Assunção Rodrigues Teixeira Pinto
- Vasco Maria Guimarães José de Mello
- Vital Martins Moreira\*
- Vítor Domingos Seabra Franco\*
- Vítor Fernando da Conceição Gonçalves\*

Members of the General and Supervisory Board have a three-year mandate, which for the current Board expires at the end of 2008.

<sup>\*</sup> Independent Member



The Duties of the General and Supervisory Board



#### 4. The Duties of the General and Supervisory Board

In the exercise of its duties the main mission of the General and Supervisory Board is to monitor and oversee, on a permanent basis, the management activities of EDP, cooperating with the Executive Board of Directors and the various other governing bodies in order to pursue the interests of the company under the terms stipulated in law and in its Articles of Association. It is therefore responsible for the following:

- Overseeing on a permanent basis the work of the management of the company and of controlled companies and, with regard to this, offering advice and assistance to the Executive Board of Directors, particularly in relation to strategy, achievement of goals and compliance with applicable legal regulations;
- Delivering its opinion on the management report and annual accounts;
- Overseeing, on a permanent basis, the work of the statutory auditor and the external company auditor and, with regard to the former, issuing a pronouncement on its respective election or appointment, removal, independent status and other relations with the company;
- Overseeing on a permanent basis and evaluating internal procedures for accounting and auditing, as well as the efficacy of the risk management system, the internal control system and the internal auditing system, including the way in which complaints and queries are received and processed, whether originating from employees or not;
- Proposing to the General Meeting the removal from office of any member of the Executive Board of Directors:
- Overseeing the definition of criteria and responsibilities required or appropriate for the structures and internal bodies of the company or Group and their impact, in addition to drawing up follow-up plans;
- Arranging, in accordance with the law, for the replacement of members of the Executive Board of Directors in the event of absence or temporary indisposition;
- Providing, on its own initiative or when requested by the Chairman of the Executive Board of Directors, an opinion on the annual vote of confidence in directors referred to in Article 455 of the Companies Code;



- Monitoring and assessing matters relating to corporate governance, sustainability, internal codes of ethics and conduct and compliance with these codes, systems for appraisal and conflict resolution, including those associated to the company's relations with its shareholders, and delivering opinions on these matters;
- Obtaining the financial or other means which it reasonably believes necessary for its work and requesting the Executive Board of Directors to adopt the measures or corrections it deems appropriate, being authorised to use the necessary means to obtain independent advice, if required;
- Receiving regular information from the Executive Board of Directors on significant commercial relations between the company or controlled companies and shareholders with a qualified holding and other related persons;
- Appointing the Remuneration Committee and the Audit Committee;
- Representing the company in its relations with directors;
- Overseeing the activities of the Executive Board of Directors;
- Monitoring compliance with the law and the Articles of Association;
- Selecting and replacing the company's external auditor, giving the Executive Board of Directors instructions for engagement or dismissal:
- Monitoring, as and when it deems appropriate, the bookkeeping, accounts and supporting documents, as well as the status of any assets or securities held by the company;
- Overseeing the preparation and release of financial information;
- Convening the General Meeting when it deems appropriate;
- Approving the respective internal regulations, including rules on relations with the various corporate bodies and company officers;

The Duties of the General and Supervisory Board



In addition to these important supervisory and monitoring activities, under the terms of the Articles of Association the following EDP or EDP-controlled transactions (not defined in the Strategic Plan) require a favourable opinion in advance from the General and Supervisory Board:

- The purchase or transfer of assets, rights or holdings of significant economic value;
- The contracting of funding of significant value;
- The opening or closure of establishments or important sections of establishments and important extensions or reductions in activity;
- Other businesses or operations of significant economic value or strategic importance;
- The establishment or termination of strategic partnerships or other forms of longterm cooperation;
- Division, merger or transformation plans;
- Alterations to the Articles of Association, including moving the registered office and increasing the share capital, if on the initiative of the Executive Board of Directors;

The Chairman of the General and Supervisory Board is granted particular competencies, and is responsible for:

- Representing the General and Supervisory Board;
- Coordinating its activities;
- Convening and presiding over its meetings;
- Striving to ensure that its decisions are executed correctly.

The Chairman of the General and Supervisory Board may, whenever considered appropriate, attend meetings of the Executive Board of Directors without the right to vote and may take part in the discussion of matters to be submitted to the General and Supervisory Board.



The Organisation and Work of the General and Supervisory Board



### 5. The Organisation and Work of the General and Supervisory Board

The organisation of the General and Supervisory Board complies with the law and the EDP Articles of Association and also takes into consideration recommendations on best practices for the governance of listed companies, namely those of the Portuguese Securities Market Commission and the New York Stock Exchange.

The General and Supervisory Board operates through plenary sessions and special committees.

Under the terms of the EDP Articles of Association, ordinary plenary meetings should be held at least once every quarter. However, whenever justified by the emergence of issues of particular importance or urgency, as has been the case, the General and Supervisory Board will also hold extraordinary meetings.

Within the scope of his legal and statutory powers, the Chairman of the General and Supervisory Board is responsible for the organisation and coordination of the work of the General and Supervisory Board and, in particular, for representing it and striving to ensure that its decisions are executed correctly. He is also the key individual responsible for links between the work carried out by this body and the work of the Executive Board of Directors, maintaining direct, permanent contact with its CEO who, in turn, keeps him informed of the main events in the day-to-day management of the company.

The Articles of Association also establish the presence of the Executive Board of Directors CEO at meetings of the General and Supervisory Board without the right to vote and attributes to the Chairman of the latter the right to attend, when considered necessary and also without the right to vote, meetings of the Executive Board of Directors.

Due to the fact that the model of governance and, in particular, the General and Supervisory Board is new, the dynamics of its organisation must be developed, based on the previous experience gained by the General and Supervisory Board itself.



The Committees of the General and Supervisory Board



#### 6. The Committees of the General and Supervisory Board

Given its nature and functions, the General and Supervisory Board has created special committees consisting of members of this Board suitably qualified and experienced in areas of particular importance, whose main mission is the specific supervision, on a permanent basis, of the matters with which they are entrusted in order to ensure that the General and Supervisory Board is informed about certain subjects and that it has an enlightened approach to its processes of deliberation.

The Audit Committee and the Remuneration Committee, were created in response to legal and statutory requirements.

The General and Supervisory Board, specifically through its Chairman, permanently oversees the work of these committees which, in turn, must report back regularly to it and provide information on their activities.

#### 6.1. The Audit Committee

The Audit Committee is a special committee which is responsible for supervising company financial information and overseeing, on a permanent basis, the work of the external auditor, the internal auditor and the internal control systems, with the specific aim of monitoring and supervising, on a permanent basis:

- EDP financial affairs;
- Internal procedures relating to auditing or accounting practices followed by EDP;
- Matters relating to the internal control system for financial information and for risk management procedures;
- The work and independent status of the EDP statutory auditor and external auditor.

The Audit Committee consists exclusively of independent members of the General and Supervisory Board who were elected at the plenary meeting of 13 July 2006.



The members of the Audit Committee are:

- Vítor Fernando da Conceição Gonçalves (Chairman)
- Manuel Fernando de Macedo Alves Monteiro
- António Francisco Barroso Sousa Gomes

#### 6.2. The Remuneration Committee

The Remuneration Committees is a special committee which is responsible for establishing the remuneration policy for the Chairman and the other members of the Executive Board of Directors. It is distinct from the Remuneration Committee appointed by the General Meeting which is responsible for establishing the remuneration policy for the other company officers.

The Remuneration Committee consists mainly of independent members of the General and Supervisory Board who were elected at the plenary meeting of 13 July 2006.

The members of the Remuneration Committee are:

- Alberto João Coraceiro de Castro (Chairman)
- Eduardo de Almeida Catroga
- Paulo Jorge de Assunção Rodrigues Teixeira Pinto

#### 6.3. The Corporate Governance and Sustainability Committee

The Corporate Governance and Sustainability Committee is a special committee with responsibility for matters relating to:

- Corporate governance;
- Strategic sustainability;
- Internal ethical codes and codes of conduct.

The Committees of the General and Supervisory Board



• Evaluation systems and systems for resolving conflicts of interests, namely with regard to relations between EDP and its shareholders.

The Corporate Governance and Sustainability Committee consists mainly of independent members of the General and Supervisory Board who were elected at the plenary meeting of 27 July 2006.

The members of the Corporate Governance and Sustainability Committee are:

- António de Almeida (Chairman)
- Alberto João Coraceiro de Castro
- Vítor Domingos Seabra Franco
- Manuel Fernando de Macedo Alves Monteiro
- Vital Martins Moreira
- José Maria Espírito Santo Silva Ricciardi

#### 6.4. The Selection Committee

The Selection Committee is a special committee with responsibility for matters relating to:

- The definition of suitable criteria and responsibilities to be observed in the structures and internal bodies of EDP and their impact on the respective composition;
- The production of succession plans.

The Selection Committee consists mainly of independent members of the General and Supervisory Board who were elected at the plenary meeting of 27 July 2006.

The members of the Selection Committee are:

- António de Almeida (Chairman)
- Carlos Jorge Ramalho dos Santos Ferreira
- Diogo Campos Barradas de Lacerda Machado



The Activities of the General and Supervisory Board



#### 7. The Activities of the General and Supervisory Board

As it is a new governing body working within a new system of corporate governance, it is natural that an important part of the work of the General and Supervisory Board has been associated with organisational matters, in which it has been supported by the appropriate EDP departments.

This has not, however, prevented the General and Supervisory Board from supervising and eventually monitoring company activities, closely following the more important managerial actions of the Executive Board of Directors, which has kept it informed on the general developments in the company affairs, either in writing or through the direct and constant contact maintained between the Chairman of the General and Supervisory Board and the Chairman of the Executive Board of Directors.

In terms of its responsibilities, during the financial year 2006 the General and Supervisory Board was involved in the main decisions taken by the company, specifically by issuing a prior opinion on matters of strategic importance.

Since 30 June and throughout the 2006 financial year, the General and Supervisory Board has held 6 plenary meetings and two informal meetings to analyse and prepare its prior opinion on the company's Strategic Plan. It is important to note the high level of participation of its members, with only sporadic occasional absences being recorded.

The first meeting of the General and Supervisory Board took place on 13 July. At this meeting, in addition to matters of an organisational nature including the creation of Audit Committee and the Remuneration Committee, a summary analysis was undertaken of the Strategic Plan presented by the Executive Board of Directors. Given the fact that the General and Supervisory Board was required to issue a prior opinion on this and bearing in mind the importance and complexity of the subject, it was decided, that the opinion should only be issued on 26 September, thus allowing members of the Board time to develop a fuller understanding of the issues. Nevertheless, the general outlines of the strategy proposed by the Executive Board of Directors were approved and were presented in London on 19 July.

At its second meeting on 27 July, the General and Supervisory Board, approved its internal regulations within the context of its own organisation and created two more special committees, the Corporate Governance and Sustainability Committee and the Selection Committee. It should also be noted that at this meeting the General and Supervisory Board was consulted by the Executive Board of Directors with a view to obtaining a prior opinion on matters of particular importance to EDP, such as the agreement with the State of Cape Verde regarding EDP's withdrawal from Electra's



share capital, the sale of the shareholding in Telecable by HidroCantábrico and the restructuring and simplification of EDP holdings in the gas business. In addition, the General and Supervisory Board expressed its agreement at this meeting with the opinion of the Audit Committee regarding the EDP accounts for the first half of 2006.

The third meeting took place on 7 September. In addition to overseeing and analysing various matters presented by the Executive Board of Directors, the General and Supervisory Board gave a favourable prior opinion on the proposals of the Executive Board of Directors regarding the acquisition of 50% of Gasnalsa's share capital, an operation that was highly important in developing EDP strategy in this sector.

The fourth meeting was held on 26 September and, as decided on 13 July, its purpose was for the General and Supervisory Board to give its opinion on the EDP 2006-2008 Strategic Plan. The opinion was favourable, and the meeting also addressed a series of additional recommendations to the Executive Board of Directors concerning the elaboration and execution of the Business Plan.

In terms of organisation, the General and Supervisory Board approved a series of parameters associated with the need to issue a prior opinion in order to promote flexibility and dynamism in the managerial activities of the Executive Board of Directors within the spirit of cooperation that must exist between the two bodies in the exercise of their missions, as entrusted to them by shareholders.

The fifth meeting was held on 9 November 2006 with the main aim of analysing the EDP accounts for the third quarter of 2006, the Board having expressed its agreement with the opinion of the Audit Committee with regard to this matter. The Executive Board of Directors requested an opinion on the sale of part of EDP's holding in REN – Rede Eléctrica Nacional, SA, the sale of the stake in ONI - SGPS, SA and the acquisition of Agrupación Eólica.

The sixth and final meeting of the General and Supervisory Board during the 2006 financial year took place on 21 December. Following the opinion issued by the Corporate Governance and Sustainability Committee, the General and Supervisory Board gave a favourable opinion on the 2007 – 2010 Business Plan presented by the Executive Board of Directors which developed the guidelines contained in the EDP Strategic Plan.

The Activities of the General and Supervisory Board



It should also be noted that at the beginning of 2007 an extraordinary meeting was held with the aim of assessing EDP's 2007 Budget. On 25 January, therefore, the General and Supervisory Board, taking into consideration the opinion of the Corporate Governance and Sustainability Committee, proceeded to analyse and provide a favourable opinion on the Budget submitted by the Executive Board of Directors, since it deemed the same to be in line with the EDP 2007-2010 Business Plan for the current year, with slight alterations, complying with the forecasts contained therein for the plan's first year of implementation.



The Activities of the General and Supervisory Board's Committees



### 8. The Activities of the General and Supervisory Board's Committees

#### 8.1. The Audit Committee

Since it was created on 13 July 2006, the Audit Committee has met 11 times. The main objective of these meetings has been to obtain information and analyse various matters associated with its area of responsibility, particularly matters which have a significant impact on the reliability of EDP's financial information.

Within this context, the Audit Committee has sought to recognise the mechanisms and procedures introduced to prevent, or at least detect, situations which affect the organisation's capacity to:

- Produce and disclose financial information that accurately and appropriately represents the company's financial situation;
- Prevent exploitation or undue appropriation of company resources.

To this end, the Audit Committee attended meetings of the Executive Board of Directors at which the quarterly and half yearly company accounts were assessed and met on 27 July and 2 November 2006 to issue a report on these accounts.

At these meetings, which were attended by the Chief Financial Officer, the head of EDP consolidated accounting, the external auditor and the statutory auditor, the Committee carefully analysed the reports submitted by these individuals on auditing issues identified during the course of their work and gathered information on how these matters were being resolved and the extent to which previous recommendations had been implemented.

The Audit Committee also paid particular attention to the nature and scope of the services provided by the external auditing company in order to verify its independent status and whether it complied with the principles and good practices governing the activities of auditing companies and their representatives in relation to their clients. An analysis of the information requested by the Audit Committee on this subject did not reveal the existence of any conflicts of interest or situations affecting the independent status of the auditors during the course of the performance of their duties.



During the final quarter of 2006, the Committee also considered the system for the anonymous reporting of irregularities and initiated a review of the respective regulations, specifically by adapting them to the new model of corporate governance.

Also in 2006, information to be made available through the various company departments was systematised so that the Committee would be able to monitor financial matters effectively and clearly.

In all these matters, whenever it considered it necessary or opportune, the Audit Committee requested that representatives from company departments with responsibilities for the matters in question, the external auditor and the Chief Financial Officer should attend its meetings.

With regard to the internal regulation concerning the requirement to evaluate its activities, the Audit Committee considers that, despite some understandable initial difficulties, its work merits a positive assessment, given that it carried out the duties it had been assigned, by evaluating the accounts, reformulating the system for anonymous reporting of irregularities and monitoring relations with the external auditor.

#### 8.2. The Remuneration Committee

After being appointed by the General and Supervisory Board, on 13 July 2006, the Remuneration Committee held two plenary meetings during the financial year and various informal meetings involving some of its members.

Following the joint decision of the Chairman of the Committee and the Chairman of the General and Supervisory Board, the Remuneration Committee has been assisted by Heidrick & Strugles, acting as consultants, in its task of defining the remuneration policy for members of the Executive Board of Directors. Bearing in mind the complexities involved in establishing this remuneration policy, the Remuneration Committee decided at its first meeting to give priority to defining the fixed component of the remuneration, so that the variable component could be studied in greater detail.

At its second meeting, having obtained comparative information regarding remuneration policies practiced in other PSI 20 companies and in the Eurostox Utilities companies, the Remuneration Committee established the fixed part of the remuneration for the Chairman of the Executive Board of Directors and decided to

The Activities of the General and Supervisory Board's Committees



maintain the current policy and limits for fringe benefits.

It also decided to retain the ratio between the remuneration paid to the Chairman of the Executive Board of Directors and those paid to the other members of this body.

Moreover, following consultation and discussions with the contracted company of consultants, the Remuneration Committee gradually refined its analysis and definition of the variable component of remuneration and is awaiting approval of the 2007 version.

With regard to the internal regulation concerning the requirement to evaluate its activities, the Remuneration Committee considers that, bearing in mind the understandable difficulties arising out the transition to the corporate governance model, it has been able to fulfil its role, although it expects to improve its operational model during 2007.

### 8.3. The Corporate Governance and Sustainability Committee

Since it was formed on 27 July 2006, the Corporate Governance and Sustainability Committee has held three formal meetings and has also maintained informal contacts amongst members regarding matters that fall within their particular area of responsibility. Committee members played an active part in meetings and only sporadic occasional absences were recorded.

Whenever deemed necessary, meetings of the Corporate Governance and Sustainability Committee were attended by the Chairman of the Executive Board of Directors and other members of the executive team who actively collaborated in the work of the Committee, particularly by issuing consultative opinions on the EDP 2007 – 2010 Business Plan and the EDP 2007 Budget.

The first meeting of the Governance and Sustainability Committee took place on 24 October and was dedicated to issues associated with its organisation and the preparation of its plan of activities, including approval of the internal regulations which were ratified by the General and Supervisory Board.

The remaining two meetings following the deliberation by the General and Supervisory Board on 9 November were aimed in particular at preparing the opinion on the EDP 2007-2010 Business Plan presented by the Executive Board of Directors.



The first of these meetings was held on 21 November, when the Committee was obliged to focus its attention on the analysis of the Plan's underlying assumptions, resulting in some methodological recommendations which were eventually accepted by the Executive Board of Directors. The Committee also proceeded to define priority areas for its work which would receive particular attention during 2007. Two specialised working parties were created for this purpose, one group dealing with issues involving corporate governance, conflicts of interest and ethics and the other with sustainability and strategy issues.

The purpose of the second meeting, which was split over two days, (14 and 19 December) was to elaborate an opinion on the EDP 2007-2010 Business Plan, culminating in the presentation of this favourable opinion at the General and Supervisory Board meeting of 21 December.

At the beginning of 2007 a meeting of the Corporate Governance and Sustainability Committee was held on 24 January, with the aim of issuing an opinion on the EDP 2007 Budget which it presented at the General and Supervisory Board meeting of 25 January, pronouncing its approval.

With regard to the internal regulation concerning the requirement to evaluate its activities, the Corporate Governance and Sustainability Committee assessed its work positively, whilst also noting that the financial year had been defined by the process of adapting the organisational structures of the company to the new model of governance. It had also been defined by the adoption of key interim documents on EDP activity during the three-year mandate of the current governing bodies, meaning that the work of the Committee had been taken up, to a great extent, by the issuing of opinions on the EDP 2007-2010 Business Plan and the EDP 2007 Budget. Now the process of approving these documents has been completed, the Corporate Governance and Sustainability Committee will, within the scope of its powers, focus its work on monitoring their implementation. Finally, during the 2007 financial year, the Committee will pay special attention to matters associated with good practice in corporate governance and the prevention and resolution of conflicts of interest.

The Activities of the General and Supervisory Board's Committees



#### 8.4. The Selection Committee

Since it was formed on 27 July 2006, the Selection Committee has held only one formal meeting but has also maintained informal contacts amongst members relating to matters that fall within its particular area of responsibility.

At its meeting of 27 October, the Selection Committee essentially dealt with matters concerning its organisation, namely the approval of its internal regulations, subsequently submitted to and ratified by the General and Supervisory Board, the scope of its activities and the definition of priority areas.

Although it has not yet met again the Selection Committee has begun, through the General and Supervisory Board Support Office, to work in implementing the scope of its organisational and functional activities with the aim of establishing the conditions for effectively commencing, at the beginning of 2007, its task of surveying and categorising the existing situation.

With regard to the internal regulation concerning the requirement to evaluate its activities, the Selection Committee considers that once the work organisation phase is completed, with all the inherent difficulties this entails, it will be able to substantially develop its own functions. It has defined its objectives for 2007 as being the identification and evaluation of procedures and mechanisms through which EDP may proceed with the selection of key staff within the corporate structure, as well as the evaluation of succession plans for the holders of those posts.



Implementation of the Budget



### 9. Implementation of the Budget

The 2006 budget for the General and Supervisory Board, minus the cost of the remunerations of its members which had not been established at the time, was approved at the meeting held on 27 July 2006.

Accounting difficulties arising out of changes to the model of governance, which have now been resolved, prevented any accurate calculation of an effective budget. Accepting as valid the figures that could be calculated to a certain degree of accuracy, there was a downwards deviation of around EUR 180 000, EUR 50 000 of which represented fixed costs. This deviation was essentially due to:

- The delay in setting the office funds and the previous head of office standing down;
- The fact that funds earmarked for training, participation in seminars, congresses and conferences and travel expenses were not used, given the difficulty in reconciling office organisation requirements and the preparation for the various plenary meetings of the General and Supervisory Board and its committees which took place between July and December;
- The less intensive than expected use of consultants and providers of legal support services to the General and Supervisory Board;
- The less intensive than expected use of logistics and procurement expendables directly associated with the level of Board and committee activity for which, at the time when the budget for the second half of 2006 was being prepared, no previous records were available.

Finally, taking into consideration the 2006 budget, it should be noted that the increase in costs due to the new EDP model of governance is not serious, given that a large part of the Support Office staff were company staff and that the costs incurred through remunerations for Board members were equivalent overall to the costs which, under the previous system, were attributed to the non-executive members of the Board of Directors, including the Chairman.



Challenges Facing the General and Supervisory Council in 2007



### 10. Challenges Facing the General and Supervisory Council in 2007

The 2007 financial year and the years which will follow present great challenges for the energy sector and, naturally, for EDP, above all in relation to the gradual liberalisation of the electricity and gas sectors in Portugal and Spain and policies defined by the European Commission with the aim of creating effective conditions whereby, within a reasonable period of time, the European Union will have an energy sector that will be efficient and competitive in meeting energy supply needs.

Given the phenomenon of concentration that we are witnessing in the European Union, the strategic objective is to ensure an autonomous project for EDP which is not anchored exclusively in state holdings, is ambitious and thrives on new and exciting challenges.

Brazil nowadays constitutes a considerable percentage of EDP trade and is a market that will justify certain difficult investment adjustments, with all the risks they entail.

One of the most important aspects of EDP growth is related to renewable energies, particularly wind power which is currently boosted by special price regimes.

With the concentration of EDP's energies on its core businesses practically concluded and the major strategic objectives agreed, the internal rationalisation of resources, which is claiming the close attention of the Executive Board of Directors, now has to be successfully completed.

It would be unwise to think that the current paradigms for activity in the energy sector can be maintained in the long term. The pressure caused by the price of fossil fuels and the fact that reserves are running out, allied to increased consumption and the certainty that science will discover new ways of producing electricity, all imply major changes. EDP must not fail to provide itself with a long-term vision of a new future model for the generation, storage, distribution and supply of electricity.

Given these challenges facing the EDP management and the experience it has already acquired, the General and Supervisory Board intends to perfect its mechanisms for monitoring and supervising the company's activities, especially activities in the above-described fields, within the spirit of transparent and cooperative relations with the Executive Board of Directors. These mechanisms will be particularly important in monitoring implementation of the main instruments of company management which were the object of a prior opinion delivered by the General and Supervisory Board. To ensure efficient monitoring, now that the special committees have been regularised, the whole pre- and post- meeting monitoring process will have to be reconsidered



by the committees, in addition to ensuring that a minimum time for the analysis of available documents is established.

At the General Meeting held on 30 March, shareholders wisely understood that the exercise of the functions attributed to the General and Supervisory Board had to be extended to the Group controlled companies. It was not possible, in 2006, to put this aspect of its activity into operation. In 2007 it is fundamental that the mechanisms that will enable the General and Supervisory Board to exercise this function responsibly are consolidated and regularised.

In terms of corporate governance, with regard to concerns expressed by shareholders, the General and Supervisory Board either directly or through the Corporate Governance and Sustainability Committee will seek to reinforce good governance practices, paying particular attention during the 2007 financial year to the problem of conflicts of interest.

If monitoring and supervision are inseparable from the real-time availability of information, this is even truer of counselling, ultimately the highest service provided by the General and Supervisory Board. The General and Supervisory Board will request this from its Support Office which, in close collaboration with the appropriate departments, will structure instruments to enable it to achieve this objective.

**Acknowledgements** 



#### 11. Acknowledgements

The General and Supervisory Board has unanimously decided to express its thanks to:

- The shareholders for their constant support of the work of the General and Supervisory Board;
- The Minister for Economy and Innovation for his impartial and transparent dedication in analysing and resolving matters concerning EDP affairs;
- The Chairman of the Executive Board of Directors who spared no efforts to ensure that the General and Supervisory Board was always informed on important issues;
- The members of the Executive Board of Directors for their excellent work and results;
- All EDP Group staff, without the anonymous dedication and hard work of whom it would not have been possible to take pride in EDP's leadership;
- The staff of the General and Supervisory Board Support Office for their dedication and efforts to ensure that when work commenced everything functioned as smoothly as possible.

The General and Supervisory Board would also like to extend its appreciation and a special word of thanks to Dr. Carlos Jorge Feijoo Pereira Ribeiro for his exceptional collaboration and involvement in the work of this governing body, as well as wishing him every success in his personal and professional life.



Opinion of the General and Supervisory Board on EDP's 2006 Annual Report and Accounts



#### 1. Activity

Since it took office on 30 June 2006, the General and Supervisory Board (GSB) has carried out the duties assigned to it by law and the articles of association, which involve monitoring, advising and supervising the company's management and the action taken by the Group's executives, by means of:

- Ordinary and extraordinary meetings of the whole board and of its specialised committees:
- Direct contacts by the Chairperson with executive directors and the Chairperson of the Executive Board of Directors (EBD).

The EBD provided the GSB with regular, timely information on:

- Strategic orientations;
- Planning and budgeting;
- Implementation and progress of business;
- Relevant risk management, including regulatory risks;
- The most important transactions and projects.

These included the operations that, under Article 17.2 of the company's articles of association, were subject to prior approval by the GSB but were the EBD's responsibility and other operations that did not fall within this scope but had a significant impact on the Group's value.

We therefore had frequent talks on strategic partnerships, company strategy, with special focus on internationalisation, materially relevant investments and divestitures in installed capacity and non-essential assets, energy policy, the regulatory environment of the company's different geographical areas of operation and changes in fuel prices.

Another matter regularly referred to the GSB was the VCO (Value Creation Office) programme, which has 12 projects for improving internal efficiency, adapting human resources to the company's needs and improving return on capital invested. The CAPEX and OPEX projects are particularly important. The former is designed to improve return on investments and the second to contain the Group's operating costs.



The GSB's Chairperson was continually informed by the Chairperson of the EBD of progress in work on important transactions and of ongoing studies and projects that might need to be scrutinised by the GSB or at least brought to its attention, and of changes in the main economic and financial indicators, even between GSB meetings. The GSB was involved in all decisions materially relevant to the EDP Group and more extensively in those requiring prior approval. It was assisted in its work by oral and written reports from the EBD during and outside meetings of the GSB or its specialised committees.

## 2. Corporate governance

The EBD addresses the company's governance in a chapter of the Institutional Section of its Annual Report and Accounts, as required by CMVM Regulation 7/2001. It describes and assesses:

- Compliance with CMVM requirements on governance and the disclosure of information;
- Principles of fixing the remuneration of the members of the Executive Board.

It has issued a statement of conformity in the chapter on corporate governance in the Institutional Report.

In the course of its work, the Audit Committee analysed and assessed the existence of any conditions, including the terms and conditions of the contractual relationship with EDP, that might jeopardise the independence or impartiality of the external auditors and it concluded that there was no indication to this effect, on the basis of the information received.

The Corporate Governance and Sustainability Committee (CGSC) began the process of:

- Defining the method for identifying, assessing and settling conflicts of interest;
- Studying and implementing mechanisms to minimise the occurrence of conflicts of interests, in the context of the characterisation and analysis of the company's governance practices.

Opinion of the General and Supervisory Board on EDP's 2006 Annual Report and Accounts



Although it has not yet had the opportunity to conduct in-depth analyses, it has found no signs of any circumstances pointing to concrete situations of conflict of interests.

#### 3. Financial statements

The individual and consolidated financial statements were prepared in accordance with the International Financial Reporting Standards (IFRSs), submitted to the GSB by the EBD and reviewed by an external auditor (KPMG), whose opinions show no reservations.

The GSB's Audit Committee and Corporate Governance and Sustainability Committee have reviewed the consolidated annual accounts, the Annual Report and the proposal for the appropriation of profits.

The GSB's Audit Committee also received reports from the external auditor on the individual and consolidated accounts, including the consolidation of inter-company transactions, and compliance with legal requirements applicable to these transactions, with regard to their valuation, and reported nothing indicating:

- That the circumstances reported were not accurate;
- That inter-company transactions were not valued as required by law.

The financial statements, Annual Report and proposal for the appropriation of profits were sent to all members of the GSB, after an in-depth analysis by the Audit Committee, and discussed in detail in the presence of the external auditors, who presented the main auditing issues identified in the course of their work.

The external auditor did not report any sources of distortion of the financial information reported by the directors in the current auditing cycle. Moreover, the GSB had no reason to believe that any sources of this kind might exist.

In its opinion, the Audit Committee found no reason to question or doubt the conclusions of the external auditor's report.

The GSB was informed of the conclusions of the Audit Committee's opinion and the external auditor's report.



### 4. Opinion of the GSB

Taking into account the results of its analysis, as described above, the General and Supervisory Board decided at its meeting on 8 March 2007:

- 1. 1. To consider that EDP's Annual Report and Accounts adequately reflect:
  - The Group's organisation and governance model;
  - Business during the financial year and the results achieved;
  - The company's assets.
- 2. To provide an opinion favouring the approval by this meeting of the 2006 Annual Report and Accounts and proposal for the appropriation of profits submitted by the Executive Board of Directors.
- 3. To congratulate the Executive Board of Directors on its work, the results achieved and the quality of the information provided.

EDP, 8 March 2007

Chairman of the General and Supervisory Board

António de Almeida

Aflunda









