BRITISH ENERGY GROUP PLC
Form 20-F
July 28, 2005
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# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 20-F

**(Mark One)**

¨ Annual report pursuant to Section 12(b) or 12(g) of the Securities Exchange Act of 1934 (*Fee required*)

or

x **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended March 31, 2005 *(No Fee required)***

or

¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from N/A to N/A *(No Fee required)*

**Commission file number 1-14990**

# BRITISH ENERGY GROUP PLC

**(Exact Name of Registrant as Specified in Its Charter)**

**Scotland**

**(Jurisdiction of Incorporation or Organization)**

**Systems House, Alba Campus, Livingston EH54 7EG**

**(Address of Principal Executive Offices)**

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

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

| **Title of each class** | **Name of each exchange on which registered** |
|---|---|
| Ordinary shares of 10p each ( ordinary shares ) | London Stock Exchange |

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 period covered by the annual report.

| | |
|---|---|
| Ordinary shares of 10p each | 561,315,459 shares |
| Warrants for Ordinary Shares of 10p each | 28,999,342 warrants |
| Non-voting special rights redeemable preference share of £1 | 1 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.

(1) x (2) x

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 ¨ Item 18 x

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**Introduction**

In this annual report, except as otherwise specified, British Energy , the British Energy Group , the Company , the Group , we , u our refer to British Energy Group plc or, in the context of events prior to January 14, 2005 (the Restructuring Effective Date ), British Energy plc (the former ultimate holding company of the Group now re-registered as a private limited company and re-named British Energy Limited) ( BE Ltd ) and its subsidiaries, and any of their respective predecessors in business, as the context may require. We were incorporated under the United Kingdom Companies Act 1985, as amended (the Companies Act ) on July 2, 2004.

Our registered office is located at Systems House, Alba Campus, Livingston, EH54 7EG, Scotland, and our telephone number is 011 44 1506 408700. Our website address is www.british-energy.com. The information on our website is not a part of this annual report.

**Exchange Rates**

We publish our financial statements in pounds sterling. In this annual report, references to pounds sterling , £ , pence or p are to UK currency, references to US dollars , US$ or $ are to US currency, references to Canadian dollars , or C$ are to Canadian currenc and references to Euros or are to the currency of the European Union. Amounts in this annual report stated in US dollars, unless otherwise indicated, have been translated from pounds sterling solely for convenience and should not be construed as representations that the pound sterling actually represent such US dollar amounts or could be converted into US dollars at the rate indicated or any other rate. The Noon Buying Rate for pounds sterling on July 22, 2005 was £1.00 = $1.75. For certain information about exchange rates between pounds sterling and US dollars, see Item 3. Key Information Exchange Rates .

**Technical Terms**

This annual report refers to certain technical terms used to measure output of electricity and the production of electricity over time. The basic unit for the measurement of electricity output is a kilowatt ( kW ). The basic unit for the measurement of electricity production is a kilowatt-hour ( kWh ); that is, one hour of electricity production at a constant output of one kilowatt. One thousand kilowatts are a megawatt ( MW ) or, in terms of production, a megawatt-hour ( MWh ). One thousand megawatts are a gigawatt ( GW ) or, in terms of production, a gigawatt-hour ( GWh ). One thousand gigawatts are a terawatt ( TW ) or, in terms of production, a terawatt-hour ( TWh ).

Unless stated otherwise, references to statutes, regulations, government or regulatory bodies or officers of government refer to the appropriate statutes, regulations, bodies or officers of the United Kingdom.

**Special Note Regarding Forward-looking Statements**

This annual report contains certain forward-looking statements as defined in Section 21E of the US Securities Exchange Act of 1934. Such forward-looking statements include, among others:

- the anticipated development of the UK electricity industry, the future development of regulation of the UK electricity industry, the effect of these developments on our business, financial condition or results of operations, and
- other matters that are not historical facts concerning our business operations, financial condition and results of operations.
- EBITDA does not reflect the cash flow associated with the Nuclear Liabilities Fund ( NLF ) cash sweep arrangements, (see Item 4 Information On The Company).

These forward-looking statements involve known and unknown risks, uncertainties and other factors which are in some cases beyond our control and may cause our actual results or performance to differ materially from those expressed or implied by such forward-looking statements. For a discussion of some of the risks associated with these forward-looking statements, see Item 3. Key

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Information Risk Factors . Due to the uncertainties and risks associated with these forward-looking statements, which speak only as of the date hereof, we are claiming the benefit of the safe harbor provision referred to in Section 21E of the US Securities Exchange Act of 1934.

**Non-GAAP Financial Measures**

***EBITDA***

EBITDA means earnings before interest, taxes, depreciation and amortization. EBITDA is a supplemental measures of our liquidity that is not required by, or presented in accordance with accounting principles generally accepted in the United States ( US GAAP ). EBITDA is not a measurement of our liquidity under US GAAP and should not be considered as an alternative to cash flow from operating activities as a measure of our liquidity.

Nevertheless, EBITDA has limitations as analytical tools, and you should not consider it in isolation from, or as a substitute for analysis of, our financial condition or results of operations, as reported under US GAAP. Some of these limitations are:

- EBITDA measure does not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments;
- EBITDA measure does not reflect changes in, or cash requirements for, our working capital needs;
- EBITDA measure does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and EBITDA measure does not reflect any cash requirements for such replacements;
- EBITDA measure does not reflect certain non-cash items;
- other companies in our industry may calculate these measures differently than we do, limiting their usefulness as a comparative measure.

Because of these limitations, EBITDA should not be considered as measures of discretionary cash available to us to invest in the growth of our business. We compensate for these limitations by relying primarily on our US GAAP results and using EBITDA only as supplemental measures.

***Realized Price***

We calculate our realized price for electricity by dividing UK turnover (net of energy supply costs and miscellaneous income) by total output. Realized price is not derived in accordance with US GAAP and should not be exclusively relied upon when evaluating our business. Realized price constitutes a non-GAAP financial measure because we eliminate energy supply costs (i.e., the cost of transmitting electricity to our customers) and other items from total turnover. We make these adjustments to turnover because we believe that they allow our management team and our investors to better understand the net price that consumers are paying for our electricity.

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**ITEM 3. KEY INFORMATION**

## RISK FACTORS

### OPERATING RISKS

***If we do not find alternative sources of income as our power stations start to close we may not be able to recover our costs from our sales revenue.***

Five of our Advanced Gas Cooled Reactor ( AGR ) power stations are, based on current scheduled accounting closure dates, due to close by 2014. This will reduce our current nuclear generating capacity by 61.5 per cent. There can be no assurance that plant life extensions will be achievable at any of our AGR power stations or at our Pressurized Water Reactor ( PWR ) power station. Our ability to find alternative sources of income is restricted by the compensatory measures we have agreed to undertake in connection with the European Commission s approval of the State Aid elements of the Restructuring (as defined in Item 4 Information On The Company Restructuring) and by certain other agreements entered into pursuant to the Restructuring. If our remaining assets do not generate income in line with our expectations (for example as a result of earlier than anticipated closure of a nuclear power station), our costs (including the costs of maturing pension schemes) may exceed our revenue and this may adversely affect our financial results and our ability to pay dividends and may require us to close the remainder of our AGR and/or PWR power stations earlier than anticipated.

***Our future profitability is dependent upon several factors, some of which are outside our control.***

*Costs structure and variable electricity prices*

The operation of our nuclear power stations is characterized by high fixed costs. Additionally, some of our costs are not borne by our non-nuclear competitors because they are unique to the nuclear power generation industry.

Our ability to generate sufficient turnover at sufficient margin to cover our fixed costs is dependent, in part, on favorable electricity prices, fuel costs (both of uranium used in the fabrication of fuel for our nuclear power stations, and the costs of coal in the case of our coal-fired power station at Eggborough in Yorkshire, England (the Eggborough power station or Eggborough )) and our sales and trading strategy. Electricity prices depend on a number of market factors, including, the impact of worldwide demand for fossil fuel, UK demand for power and environmental legislation. Because our costs are primarily fixed in nature, they cannot be reduced significantly in periods of low electricity prices. Therefore, in these circumstances it is possible that we may not produce sufficient revenue from our electricity sales and/or trading activities to cover our generation costs.

In addition, increasing vertical integration in the electricity sector is likely to affect the liquidity of the markets in which we trade and the volatility of those markets. This in turn may affect the revenue from our electricity sales or trading and may adversely impact our

proposed trading going forward.

*Unplanned outages*

Unplanned outages at our AGR and/or PWR power stations and/or the Eggborough power station result in lost generation and, due to our contractual obligations to deliver electricity at pre-established prices and/or quantities, we may, therefore, be required to purchase replacement electricity volume in the open market which may be at unfavorable prices. Given the complexity of operating nuclear and fossil fuel power stations, we do not believe that we will be able to completely eliminate the risk of unplanned outages and we cannot predict the timing or impact of these outages with any certainty.

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Therefore, there is no assurance that we will be profitable or generate sufficient cash to fund our operations. For further risks relating to unplanned outages see the risk described immediately below.

***Unplanned outages at our nuclear power stations could adversely affect our revenues and profitability.***

Historically, our nuclear output has been adversely affected by unplanned outages and unplanned reductions in output. We believe that the loss of output is indicative of a deterioration of the materiel condition of plant over time in part caused by inadequate investment over recent years which had resulted in an increase in our maintenance backlog and failure to carry out required maintenance on a timely basis.

Further, some of our unplanned outages flow from human errors in the operation and maintenance of our plant.

Plant unreliability can result in significant costs being incurred through the short-term electricity market and the balancing mechanism which is used by the transmission system operator to ensure that generation and demand are matched. If our stations fail to produce the amount of electricity that we have contracted to supply or have otherwise already traded in the wholesale market, we may have to enter into the short-term market or accept the prices prevailing in the balancing mechanism to meet any such shortfall in output. Prices in the short-term market and imbalance mechanism may be very high, particularly in periods of tight capacity margins for generating plant in the UK, and the unplanned outages of our stations may limit available supply and therefore raise prices in these markets.

***The Performance Improvement Program ( PiP ) may be constrained by our cash resources and there is no assurance that the hoped for benefits of PiP will materalize. This may adversely affect our prospects in the long term.***

Although we are attempting to improve our plant reliability through increased investment and the implementation of PiP, there is no guarantee that we will be able to identify and/or remedy the causes of plant unreliability. Even if we can identify the causes, there is no certainty that we will be able to implement cost effective solutions or PiP in such a way as to maximize the potential benefits that PiP may afford due to the requirements to maximize the output of our plants. The amount we are able to spend on PiP will be affected by the availability of our cash resources and, in the future in certain circumstances, may be restricted or prohibited by our arrangements with the Nuclear Liabilities Fund ( NLF ). Furthermore, our ability to undertake the proposed expenditure may be affected by requirements to undertake urgent remedial work at one (or more) of our nuclear power stations.

***Our nuclear stations utilize sea water for condensing the steam from the turbines and for cooling the reactor pressure vessel and turbine-generator auxiliaries. These systems are essential to support generation and a failure of them could result in lost generation, adversely affecting our revenues and profitability.***

In financial year 2003/04, the failure of a cast iron pipe carrying sea water at Heysham 1 resulted in unplanned losses of some 3.2 TWh. Hunterston B, Hartlepool and Hinkley Point B and to a much lesser extent Dungeness B, Heysham 2 and Torness nuclear power stations also use cast iron pipe work for carrying sea water.

We consider that this cast iron pipework has previously suffered as a result of insufficient maintenance and lack of investment. To address the problem, we have developed a strategy to

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systematically replace the existing cast iron pipe work at these nuclear power stations with steel pipe work coated with a corrosion resistant barrier. The corrosive nature of sea water may affect other parts of our pipe work systems, although inspection and maintenance strategies are in place to mitigate this risk. This program of work started in 2004 and the work has been substantially completed at Hartlepool. It is planned to continue through 2005/06 and 2006/07 to complete work at the other stations. There can be no assurance that there will not be further unplanned losses if any failure occurs before the planned program of work is completed.

***Problems of potentially damaged boiler closure unit pre-stressing tendons and bolts and subsequent inspection requirements at our Hartlepool and Heysham 1 nuclear power stations could negatively affect our profitability or revenues.***

At our AGR stations, tendons (comprised of steel wires) are used to maintain the integrity of the pre-stressed concrete pressure vessel. During fiscal year 2004/05 we identified corrosion induced failure in a small number of individual tendon wires at Hartlepool. The access for inspection and repair to these tendons was straightforward, and hence repairs were considered to be undemanding.

However, steel pre-stressing wires are used to fulfil a similar safety functional requirement to assure the integrity of the boiler closure units (which are housed within the concrete pressure vessels) at our Hartlepool and Heysham 1 nuclear power stations. As a result of the discovery of corrosion induced failure of the tendon wires (as described above), the Nuclear Installations Inspectorate ( NII ) (the UK body which administers nuclear site licenses) concluded that boiler closure unit steel wires could also suffer from corrosion induced failure. Due to the belief that their failure was highly unlikely, the boiler closure unit wires, unlike the pressure vessel tendon wires, were not designed with an engineered facility for inspection and therefore are more difficult to inspect. To address the NII s concerns with these wetted enclosures we completed a limited inspection of the boiler closure unit tendon top anchorages and limited sections of the tendon wires at three of our Hartlepool and Heysham 1 reactors and have demonstrated as far as can be determined, that the tendon wires are intact and free from corrosion. These three reactors returned to service in December 2004. None of our other reactors is affected by this issue.

However, we may wish, or be required by the NII, to make further more detailed inspections at these three reactors. Techniques are being developed for such inspections and preliminary trials were deployed successfully during an outage on one reactor at Heysham 1 earlier this year. The techniques are aimed at minimizing the level of intrusion and loss of output.

A further risk associated with boiler closure units was identified during an outage at Heysham 1 in May this year. This is the potential for stress corrosion cracking of the primary holding down bolts. There are forty-eight bolts per boiler closure unit and the risk of stress corrosion cracking is associated with the presence of water and carbon dioxide ( $CO_2$). Work programs are ongoing to develop our understanding of, and to address, this risk.

***A significant engineering fault or a design flaw at one of our nuclear power stations, or one which is generic to a class of nuclear power stations, could decrease our revenues and increase our costs.***

A major engineering fault at one of our nuclear power stations for example, affecting gas circulators, boiler closure units, reactor coolant pumps or pipework systems, could result in the closure of that station ahead of its expected closure date. Furthermore, engineering faults or safety risks arising from a design problem that is generic to a particular type of nuclear plant could result in the closure of all our nuclear power stations of the same nuclear plant design ahead of their expected

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closure dates. The early closure of one nuclear power station or any one type of nuclear power station would result in a loss of planned future output and income and result in costs associated with the closure of the affected nuclear power station or stations.

To deal with the potential of a major engineering fault, we have extensive inspection and testing programs in place in order to evaluate the physical condition of our nuclear power stations. These programs periodically identify certain technical issues for resolution. However, there is no assurance that our inspection process will identify all significant problems and the identification of technical issues with respect to our nuclear power stations may require us to incur significant expenditure for repairs or replacement of parts or equipment. This may result in lost output and income due to the outages necessary to complete such repairs or replacements.

There is also a risk that we may, through our ongoing review of our safety cases (i.e. Periodic Safety Reviews ( PSRs )) or our ongoing investigations and research activities, identify a significant shortfall. Such a shortfall may relate to a safety case argument or supporting analysis or revised material properties or other plant performance aspect, which undermines a critical element or elements within a safety case. The resolution of the issue may entail plant shutdown, reduced power operation or extensive plant modifications.

***Problems of graphite core brick cracking and reduced boiler life could negatively affect our profitability and the lifetime of our AGR power stations.***

Graphite core brick cracking and reduced boiler life could lead to prolonged outages for testing and, potentially, early station closures at certain of our AGR power stations. These risks are explained in greater detail below.

*Graphite core brick cracking*

The graphite cores in the AGRs are made up of a large number of graphite bricks arranged in layers. Over the course of the nuclear power generation process, the graphite bricks suffer from degradation.

Analysis has shown that this degradation can result in a significant number of the graphite bricks developing single or multiple cracks. We are not aware of any technique for eliminating the cracks. Such cracking could lead to the distortion of the core structure and the reduction of the AGRs operational capacity.

While our understanding of this issue continues to develop, there is uncertainty as to the level of tolerance of graphite bricks to multiple cracks that can be demonstrated and which may be acceptable to us or to the NII. As such, the development of a safety case supporting the continued operation of the reactor may not be possible. The potential impact of this risk is that the currently assumed station lifetime may not be achieved and any further extensions to station lifetime may not be possible.

We carry out periodic inspections on the AGR cores during statutory outages and continue to develop safety cases that demonstrate the tolerance of graphite core brick cracking. However, until we fully understand whether it is possible to devise ways to control or minimize the consequences of further graphite core brick cracking, our plants may require increased levels of, or more frequent, inspections to support our safety cases. This could result in prolonged statutory or unplanned outages, or a refusal by the NII to permit us to operate a particular reactor.

Additionally, graphite brick inspections at Hartlepool nuclear power station during 2004 revealed double, axial cracking in two graphite bricks in one of the reactors. This type of cracking had not been anticipated by our analytical models. A revised safety case was required to support the return to service of the Hartlepool and Heysham 1 nuclear power stations (which are of a very similar design) and this safety case placed increased emphasis on inspection and monitoring of the graphite core. We

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have undertaken further inspections of graphite bricks at these power stations. The revised safety case could potentially require longer than anticipated statutory and refueling outages to enable further inspections of the graphite bricks in future years and this will adversely affect our profitability.

*Boiler life*

The boilers at our AGR power stations consist of multiple steel tubes over which the hot reactor gas flows in order to boil the water that flows through the tubes. Actual or potential failure or fouling of any of the boiler tubes could result in prolonged outages in order to complete inspection or repairs or lead to station closure. Outages may also arise as a result of inspections necessary to demonstrate the integrity of the boilers.

If a boiler tube were to fail, action would be taken to permanently seal-off the leaking tube from the incoming water supply. This may result in a permanent reduction in boiler performance and, consequently, our ability to generate electricity. If, ultimately, we are not able to repair the boiler tubes, it may not be possible for us to demonstrate a safety case for the continued operation of that reactor and the assumed station lifetimes at that time may not be achieved.

In addition to the general problem of boiler tube leaks at each of our AGR power stations, specific design issues at some of our stations could lead to further significant threats to boiler life. At Hartlepool and Heysham 1, the design adopted is unique in that a central cylindrical segment called a spine supports the boiler. The spine construction incorporates the main water inlet and is fabricated from different materials selected to suit the specific operating conditions. The various elements that make up the spine are welded together to form one fabricated section. A small number of these welds are susceptible to high temperature re-heat cracking. Failure of these welds could result in collapse of the boiler with consequential damage to the reactor pressure vessel and other reactor internal components. The boiler spine design and layout makes physical inspection or repair of the vulnerable welds difficult. The safety case for boiler operations is therefore extremely complex and has required us to develop novel methods of analysis to establish the safety justification. If further material analysis and remote inspection fails to strengthen the current safety case, this could shorten station life at some of our nuclear power stations.

***Obsolescence of some of our equipment, component parts and computer systems (for example, our data processing systems) that are required to operate our power stations and monitor plant stability could result in higher operating costs, unplanned losses or the closure of our power stations.***

The first of our nuclear power stations became operational in 1976 and the Eggborough power station became operational in 1968. As a result, it is becoming increasingly difficult to source replacement parts for some older equipment and to find engineers qualified to service certain equipment, in particular our aging computer and other information technology systems that were installed at or about the time the plants were constructed. We may not be able to maintain our older equipment on a cost effective basis or at all. The increasing obsolescence of some of our parts and systems and/or the inability to secure replacements could result in an increase in unplanned losses, longer planned outages, significantly higher repair costs and/or the closure of our stations.

***The condition of some of the plant, equipment and components at our power stations is subject to gradual deterioration over time. This could result in higher operating costs, unplanned losses and/or the closure of our power stations.***

The impact on the condition of some of the plant, equipment and components at our power stations of operations and natural processes such as erosion and corrosion tends to increase as such plant, equipment and components grow older. While we attempt to implement inspection and

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maintenance practices such that we repair or replace such plant, equipment and components before they fail, there is no guarantee that we will be successful or that we will be able to identify all such relevant issues in advance and consequently we may experience unplanned losses which will adversely impact on our profitability.

In addition, the Group s insurances contain standard exclusions and restrictions and the material damage and business interruption cover does not therefore provide cover for damage caused by, for example, losses due to erosion, corrosion, stress corrosion or cracking. Consequently, we may not be able to claim under our material damage and business interruption cover in such circumstances.

***The failure of our AGR fuel could result in decreases in our output and revenues.***

AGR fuel is contained inside a stainless steel fuel can which acts as the primary barrier for any fission products produced by the fuel during operation. If the steel fuel can cracks, then the fission products will leak into the $CO_2$ that is used to cool the reactor. As many of these fission products are radioactive, any major leakage into the $CO_2$ will potentially contaminate large parts of the reactor which in turn will lead to major operational difficulties. It is therefore important to minimize fuel failures.

We have experienced on average one fuel failure per year across our fleet of AGR stations in the period 1976 to 2000. From 2001 to date, we discovered 28 further AGR fuel failures. Seven of these arose in 2005. The risk posed to the operation of the AGR fleet by failed fuel has therefore increased over this period, noting that the risk is judged to be primarily to our ability to operate profitably although implications for nuclear safety also require to be managed. The most significant economic risk is currently at Dungeness B, where a failure type exists which has the potential to contaminate the reactor, threatening continued operation.

Depending on the cause of fuel failures, or in the event of a very high level of uncertainty of the root cause and/or the associated consequences of failure we may have to shut down one or more of our nuclear reactors. In order to do so, we are, in certain cases, reliant upon services provided to us by Nexia Solutions, part of the British Nuclear Fuels plc group ( BNFL ). BNFL is a company wholly owned by the UK Government (the Government ). If they were unable or unwilling to provide such services, we may be unable to determine the cause of such failures. Any nuclear power station closure or prolonged outage could adversely affect our business and profitability.

***Our business depends on equipment and service suppliers of a specialized nature. If they fail to provide necessary equipment and services on a timely basis, discontinue their products or services and/or seek to charge us prices that are not competitive, this could adversely affect our business and/or profitability.***

We depend upon a small number of specialized suppliers for essential products and services which are unique or highly specialized to our industry. Consequently, if our suppliers are unable or unwilling to deliver products and services on a timely basis and at reasonable prices, or if their products are found to be faulty or outside specification, this may impact negatively on our ability to continue to operate our power stations economically (or at all), and would have an adverse effect on our financial condition and results of operations. In addition, as our plants age, the costs associated with the sourcing of spare parts are likely to increase.

Our AGR fuel is fabricated by BNFL, the only supplier of AGR fuel in the world. To protect against any short term disruptions in supply we maintain a stock of fuel elements at each of our AGR power station, (in addition to any stock held by BNFL). This, along with the fuel in our reactors, is sufficient to maintain normal operations for between three to six months. However, we cannot rule out a more extended disruption in fuel supply which could result in reductions in our output. The availability and quality of tie bars, $CO_2$ and other gasses is also important in maintaining output.

Our spent AGR fuel is delivered to BNFL which provides spent fuel management services at its Sellafield site in Cumbria, England ( Sellafield ). We are able to store approximately nine months

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arisings of spent fuel at each nuclear power station and, with the storage facilities usually holding approximately six months spent fuel, this leaves approximately three months additional capacity in the event of any short term interruptions in the movement of spent fuel to Sellafield. Typically storage facilities are therefore around two-thirds full at any time, although currently stocks of spent fuel are higher than this. If a nuclear power station s spent fuel storage facilities became full, the station could theoretically continue to generate electricity but the volume of electricity produced would gradually reduce as the fuel in the reactor was consumed. It would not be possible to load additional fuel into the reactor until at least the equivalent quantity of stored spent fuel was despatched to Sellafield.

On April 21, 2005 British Nuclear Group Limited ( BNG ) a subsidiary of BNFL, reported that a pipe had failed in one of the heavily shielded cells, known as the feed clarification cell, in the thermal oxide reprocessing plant ( THORP ) at Sellafield. This resulted in a quantity of dissolved nuclear fuel being released into a sealed, contained area. THORP receives and reprocesses spent or used nuclear fuel from our AGRs and also from Light Water nuclear reactors. Reprocessing separates out the components of used fuel which comprises 96 per cent. Uranium, about 1 per cent. Plutonium and some 3 per cent. waste. Both the Uranium and Plutonium can be recycled into fresh fuel.

Since this event was reported, BNG have completed recovery of the escaped liquid back into primary containment. A Board of Inquiry was established by BNG and has reported. BNG have stated that they are confident that they have the capability of returning THORP to service.

BNG have assured us that the necessary steps will be taken to maintain continuity of AGR receipts at Sellafield, both during the current period of uncertainty regarding THORP and through to the end of life of our AGR stations. We understand that the Nuclear Decommissioning Authority (the body established to oversee and manage the clean up of the UK s civil nuclear sites ( NDA )) share similar views to BNG. There are no feasible alternative options to Sellafield for the long term management of our spent fuel which could be deployed on realistic timescales.

Our front end and back end contracts with BNFL provide that in the event it ceases to carry on business in the relevant services or notifies us that it is otherwise unwilling or permanently unable to provide the services it has contracted for, it will offer us assistance to seek to ensure continuity of supply. This assistance is dependent on the terms of the relevant contract. It can include provisions of access and rights to use relevant intellectual property and in certain contracts facilities.

In the case of certain of our contracts for the provision of services, the liability of the service provider is capped and consequential losses that may be suffered by us are excluded. While these are not unusual contractual provisions, the consequences to us of a breach or non-performance by a service provider may be severe (for example certain agreements are required to be in place to meet nuclear site license requirements and may be difficult to replace) and we would almost certainly not be able to recover the loss we may suffer as a result of breach or non-performance by these counterparties.

Our turbines, generators and certain other plant components are designed, manufactured and maintained by a small number of key suppliers. We are reliant upon certain of these suppliers for the supply of parts and for servicing and maintenance. If they fail to provide parts and/or perform servicing or maintenance to an appropriate quality, this could result in the shutdown or catastrophic failure of one or more of our turbines, generators or other plant components.

***Certain of our office facilities are at risk from fire, flood and explosion which may lead to business interruption***

Certain of our offices contain concentrated groupings of suitably qualified and experienced staff and computer systems that are necessary for the efficient operation of our business. If these facilities

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were to be substantially damaged by fire, flood or explosion then we may experience difficulties in maintaining business continuity, for example in our trading operations and work management support, which could adversely affect our profitability and cash.

***We employ a large number of agency staff at our power stations and in our support functions.***

We depend on a large number of agency staff to support our power stations and other corporate functions. Consequently if we are unable to employ an adequate number of suitably experienced staff as required or the employment agencies used by us seek to charge us prices that are not competitive, this could adversely affect our business and/or profitability.

***The unavailability of component parts could adversely affect our revenues and profitability.***

The failure of certain components in use at our power stations could result in unplanned outages to effect repairs. The duration of the outages is influenced by, among other things, the lead-time required to manufacture and procure replacement components. Certain components (e.g. turbine rotors and transformers) are complex and may take several months to manufacture. To reduce the impact of the failure of such items we hold spare components at our power stations and in a central storage facility. We also participate in spares clubs where the cost of holding expensive replacement components is shared with other parties. Although we aim to optimize our spares holdings we cannot guarantee that we will always have ready access to the required component in the event of a failure and we may incur extended unplanned outages while we obtain the required component.

***We continue to face liquidity risks associated with the seasonality of our business and the provision of collateral to our counterparties.***

The UK electricity market is characterized by lower demand in the summer months and therefore comparatively lower market prices, which leads us, where possible, to plan statutory outages in this period. Accordingly, positive cash flow is reduced through the combined effect of lower prices and output. In addition, the historic high volatility of market prices increases the liquidity risk as a result of collateral calls due to increases in market prices. We may also receive requests to provide collateral (or increased collateral) from counterparties who do not currently require collateral (or who have not exercised their contractual right to have contractual obligations fully supported by collateral). While we closely monitor these risks and continue to adopt mitigation strategies through trading and procurement operations, it is possible that these strategies will not be as effective in minimizing these risks as planned.

***We have entered into a trading strategy that seeks to reduce the price risk associated with the cost of our electricity generation. However, this may result in an increase in collateral requirements if market prices rise. In addition, should various other unforeseen events occur which place demands on cash flow, our financial resources may prove to be insufficient.***

We have entered into short-term and medium-term trading contracts and other financial products with market counter parties and short-term and medium-term sales contracts with other industrial and commercial customers to hedge a significant proportion of our output against downward movements in market price. However, as a result of this, our cash flow benefits from market price increases are reduced while the level of collateral calls made by trading counterparties increases to cover their mark to market

exposure.

Our trading strategy uses diverse routes to market and aims to maintain an appropriate balance between the importance to us of maintaining a high degree of certainty of our revenues and collateral requirements, as well as continuing to take steps to identify and manage cash flow risks and manage cash resources. However, we cannot be certain that the level of funding available to us will be sufficient to meet our needs to hedge the market risks we face.

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***Lack of liquidity in the wholesale market for electricity may adversely affect us or require us to alter our trading strategy.***

Liquidity in the wholesale electricity market is dependent on there being a sufficient number of counterparties willing to trade actively in the market and with us. Changes to the market structure, and yet further consolidation of the existing generation and supply businesses, could result in a reduction in the number of active participants in the market with whom we are able to trade. This may affect our ability to sell all of our output.

This could also reduce the level of liquidity in the traded market to such an extent that we are no longer able to rely on wholesale market trading as a means of hedging our short-to-medium term exposure to wholesale electricity market prices and balancing our portfolio. We also rely on reported prices from a liquid traded market to deliver reliable reference prices which are used within a number of our indexed price contracts. Thus a lack of liquidity could result in us incurring higher hedging or balancing costs to achieve our trading objectives, if the reported price is not a fair reflection of the cost of electricity production.

We have also sought to increase the use of financial instruments such as options as a means of hedging our trading risks. Our ability to use such products may be limited by the availability of a liquid and transparent market in such instruments.

***We may suffer financial loss as a result of parties to whom we supply under contracts defaulting due to bankruptcy or other financial hardship.***

We are a net seller of electricity and receipts for electricity delivered are normally received about one month in arrears; consequently there is a risk of financial loss arising from the financial difficulties of our counterparties. In addition, movements in the market price from the time a particular sale (or purchase) contract for electricity or other energy-related commodities was agreed expose us to risks of loss in the event of default. Additional costs of having to replace these contracts at the prevailing market price will be incurred if market prices have fallen in the case of sales contracts (or risen in the case of purchase contracts).

***Proposed arrangements governing the cost of electricity transmission in the UK could reduce our ability to trade profitably in the future.***

On January 17, 2003, the United Kingdom s Gas and Electricity Markets Authority ( GEMA ) directed that a modification should be implemented to the Balancing and Settlement Code ( BSC ) to introduce zonal marginal transmission losses, with effect from April 2004 in England and Wales. On January 30, 2003, the Government issued a consultation paper on whether these changes were appropriate for Great Britain as a whole, and concluded on June 27, 2003 that they were not minded to include zonal losses as part of the initial reforms to the BSC.

There is a risk that a proposal to introduce zonal charging for losses will be made following the implementation of the British Electricity Transmission and Trading Arrangements ( BETTA ) (which extended the market arrangements already applicable in England and Wales to Scotland) on April 1, 2005. Under such a proposal, some generators would pay for a proportion of transmission losses for which they were not previously responsible. The proposal would be unfavorable to generating plants located in the north of England and Scotland which make up a significant portion of our generating capacity. Therefore there is a risk that, given the geographical distribution of our power stations, we might be significantly adversely affected by such a proposal.

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***While our understanding of potential contaminated land liabilities at our power stations continues to grow, we have yet to fully implement risk management systems at all sites that will allow us to monitor liabilities at those sites and develop more informed assessments of any such liabilities. Consequently, we are currently unable to predict the likely cost of all our contaminated land liabilities.***

With the exception of Dungeness B, where an extensive remedial operation in response to historic spillages of diesel to ground has now been completed, we currently have only limited data from physical site investigations to support our assessments of contaminated land liability at our power stations. However, an independent expert review was recently carried out to review the potential for any significant contaminated land at our nuclear power stations. This expert review, completed in January 2002, suggested that there were no obviously significant problems but it did highlight areas of vulnerability to contamination at a number of our sites and the need to establish groundwater monitoring networks and allied procedures at each.

Work is now underway to establish these networks and once complete they should further facilitate both our assessment of any such potential liability and any necessary review of local management procedures.

A ground contamination risk assessment carried out at the Eggborough power station has concluded that the site has significant potential to affect local groundwater quality and is vulnerable to contamination migrating from neighboring landfill sites. Although no significant contamination problems have been observed at the Eggborough power station to date, we cannot be certain that none will occur in the future and therefore cannot exclude the risk of significant unforeseen clean-up costs.

***Certain types of nuclear liabilities arising at our power stations are not covered by the scope of the Nuclear Liabilities Funding Agreement ( NLFA ) or the Historic Liabilities Funding Agreement ( HLFA ) entered into in connection with our Restructuring***

These include those liabilities which are adjudged to have arisen as a result of our compliance standards (including our safety or environment standards) falling below those of the minimum performance standard or minimum contracting standard agreed under the NLFA or HLFA respectively, or by the implementation of operational changes made by us other than to meet current or reasonably anticipated legal or regulatory requirements or to comply with practices and procedures both considered by, and acceptable to, the relevant regulators and will thus remain for our account. While the definitions of minimum performance standard or minimum contracting standard may be known it is not currently certain how such minimum performance standards would be interpreted or applied. It may also be difficult to be certain whether the implementation of operational changes would be considered to meet reasonably anticipated legal or regulatory requirements or to comply with practices and procedures both considered by, and acceptable to, the relevant regulators. Consequently, the nature or quantum of these liabilities is uncertain.

***The potential hazards of nuclear operations (including nuclear operations carried out by other operators in the UK and elsewhere in the world) could expose us to the risk of, amongst others, material liabilities, lost revenues and increased expenses***

Our operations use and generate radioactive and hazardous substances that have the potential to seriously impact human health and the environment. There are particular risks associated with the operation of nuclear power stations. These include accidents, the breakdown or failure of equipment or processes or human performance, including our safety controls, and other catastrophic events such as earthquakes, fire and flood that could result in the dispersal of radioactive material over large areas, thereby

causing injury or loss of life and extensive property or environmental damage. Certain of these events, including those arising as a result of third party acts, such as acts of terrorism or war, are not

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within our control. Liabilities we may incur, and interruptions in the operation of a nuclear power station caused by these events or associated with any of the radioactive or hazardous materials involved, could significantly reduce our revenues and increase our expenses. Insurance proceeds may not be adequate to cover all liabilities incurred, lost revenue or increased expenses. Analogous incidents occurring at other nuclear power stations elsewhere in the world may result in similar losses regardless of our having no control or influence over such incidents.

***The continued operation of the Eggborough power station is subject to a number of factors which could increase our costs and decrease our revenues. In particular, introduction of the EU Emissions Trading Scheme ( ETS ) and Large Combustion Plant Directive ( LCPD ) are major environmental initiatives which will have an important impact on the Eggborough power station as they seek to reduce carbon dioxide and other emissions.***

Eggborough power station was constructed in the 1960s and is approaching the end of its originally anticipated operating life. It has been, and will continue to be, operated as a flexible mid merit plant and this will increase the wear and tear on component parts and has the potential to accelerate the end of its economic life. Eggborough has also been, and will continue to be, subject to routine and other maintenance and repair. In order to continue its economic operation, and to comply with environmental and other regulations, it has also been, and may in future be, necessary to make modifications to Eggborough. We believe that we are likely to be required to make further repairs and/or modifications to Eggborough as its age increases and, insofar as such requirements are currently understood, such requirements are already in our plans.

We cannot guarantee that we will be able to make any required repairs or modifications to Eggborough power station either economically or at all including pursuant to our legal obligations under the documentation entered into in connection with our Restructuring. Similarly, we cannot be certain that any such repairs or modifications will successfully rectify any problems and/or allow the continued operation of the Eggborough power station without interruption or at all. This may result in lost output and could adversely affect our revenues and profitability.

The ETS commenced on January 1, 2005 and its effect is to impose a cost on the emissions of carbon dioxide from power stations and other industrial processes. The LCPD is due to become effective on January 1, 2008 and, in replacing the previous Large Combustion Plant Directive, will further restrict the limits of permitted emissions by Eggborough. Certain issues relating to the application of this legislation in the UK are not yet resolved and therefore we cannot be certain of: (i) the impact on output; (ii) the likely costs associated with any required engineering or structural changes to the Eggborough power station which may be required to ensure compliance; or (iii) how the legislation will affect the electricity generation market and, in particular, the price of electricity in the medium-to-long term.

***Our business is subject to extensive and unique regulations.***

As an owner and operator of nuclear and coal-fired power stations, we are subject to extensive governmental regulations. We are subject to, among others, nuclear safety, electricity market, security and environmental regulations of the UK, the EU and other governmental authorities. Unexpected or adverse changes in these regulatory regimes could adversely impact our business and profitability. Changes in regulations governing, and/or the personnel regulating, nuclear safety in the UK may result in the modification, suspension or revocation of our licenses to operate nuclear power stations, or require us to incur substantial additional cost for capital expenditure and/or services and labor.

A feature of the nuclear licensing regime is that we must conduct PSRs at each of our nuclear power stations every 10 years which may affect how, and for how long, we operate our stations and may result in significant additional costs. We must also obtain the approval of the NII to restart a

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nuclear power station after a statutory outage and after an unplanned outage to address an emergent issue that has affected the reactor s safety case. In granting permission to re-start, the NII take comfort from the level of British Energy s knowledge and understanding of reactor performance. Consequently, wherever outage inspections indicate potential issues outside of the predicted norm, there is a heightened risk that delays to re-start may occur as a result of the regulator s intervention. The refusal of the NII to approve, or any delay in gaining approval from the NII, to continue or restart the operation of any of our nuclear power stations, would adversely affect future revenues and reduce our ability to trade profitably.

We are revising certain aspects of the safety cases at our AGR power stations in the light of developing regulatory standards. Whilst we are dedicating significant resources to resolving these outstanding safety case points, there can be no assurance that one of these issues may not lead the NII to refuse consent to restart one of our reactors following a statutory or unplanned outage or require it to communicate to us that it would oppose our restarting a reactor on its return from a refueling outage. If the NII takes such action, this, too, would affect future revenues and reduce our ability to trade profitably.

Our operations are regulated and subject to audit by the Office for Civil Nuclear Security ( OCNS ). The OCNS annual report published in July 2005 (entitled: The State of Security in the Civil Nuclear Industry and Effectiveness of Security Regulation April 2004 - March 2005) outlines the changes in the strategy for securing the safety of the UK s nuclear power stations. We are working with the OCNS, along with other nuclear operating companies, to introduce, where necessary, enhancements to our security arrangements which has resulted and will result in increased security costs. The OCNS annual report for the year ended March 2005 was published on July 25, 2005.

***A failure to comply with, or the incurrence of liabilities under, environmental, health and safety economic and competition laws and regulations to which we are subject, or a failure to obtain or maintain required environmental, health and safety regulatory approvals, could adversely affect our business or our ability to trade profitably.***

We are subject to various environmental and health and safety, economic and competition laws and regulations governing, amongst other things: (i) the generation, storage, handling, release, use, disposal and transportation of hazardous and radioactive materials; (ii) the emission and discharge of hazardous materials into the ground, air or water; and (iii) decommissioning and decontamination of our facilities and the health and safety of the public and our employees. Regulators in the UK, including the NII, Environment Agency (the EA ) and the Scottish Environment Protection Agency ( SEPA ), the Office of Gas and Electricity Markets ( OFGEM ), the Financial Services Authority and the Office of Fair Trading ( OFT ) administer these laws and regulations. Additionally, the European Community ( EC ) administers European laws and regulations.

We are also required to obtain environmental and safety permits from various governmental authorities for our operations. Certain permits require periodic renewal or review of their conditions and we cannot predict whether we will be able to renew such permits or whether material changes in permit conditions will be imposed. Therefore, we may not have been, or may not at all times in the future be, in complete compliance with such laws, regulations and permits. In this regard, following a number of minor incidents in 2003, the EA have indicated that there will be increased scrutiny by them over us. The cost of complying with such laws, regulations and permits may also increase. Violations of these laws, regulations or permits could result in plant shutdowns, fines and/or litigation being commenced against us or other sanctions. Other liabilities under environmental laws, including clean-up of radioactive or hazardous substances, can be costly to discharge. Environmental liabilities or failure to comply with environmental laws could also lead to negative publicity and significant damage to our reputation.

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While we cannot predict with any certainty the nature of developments in environmental regulation and control, we anticipate that the direction of future changes will be towards stricter controls. In view of the age and history of many sites we own or operate, we may incur liability in respect of sites that are found to be contaminated, together with increased costs of managing or cleaning up such sites. Site values could be affected and potential liabilities and clean-up costs may make disposal of potentially contaminated sites more difficult. It is possible that any clean-up costs would have an adverse effect on our business or our financial condition or results of operations.

Environmental and health and safety laws are complex, change frequently and have tended to become more stringent over time. Whilst we have budgeted for future capital and operating expenditures to comply with current environmental and health and safety laws, it is possible that any of these laws will change or become more stringent in the future. Therefore, our costs of complying with current and future environmental and health and safety laws, and our liabilities arising from past or future releases of, or exposure to, radioactive or hazardous substances, could adversely affect our business or our operating or financial performance.

Violations of economic or competition laws or regulations could result in the imposition of fines, the revocation of licenses to operate within the UK electricity market or the voiding of agreements.

***The proximity of certain of our nuclear power stations to Magnox stations could result in potentially harmful materials in the ground migrating across the boundary onto our own sites. UK law currently provides that, unless we can provide adequate evidence to the contrary, any liability associated with such material under our sites would belong to us even though its initial occurrence there is beyond our control. Radiological contamination from neighboring Magnox plant may render one or more of our sites radioactive and could prevent its operation.***

Each of Hunterston B, Dungeness B, Hinkley Point B and Sizewell B is located close to Magnox nuclear power stations owned by the NDA. Groundwater monitoring networks are now in place at Hunterston B, Dungeness B and Sizewell B that should allow the migration of potentially contaminating material from the neighboring sites to be identified. Although the need has been identified, an equivalent network has yet to be established at Hinkley Point B.

The statutory regime governing contaminated land in the UK provides, broadly, that if the person who is alleged to have caused a contaminated land liability cannot be identified, the land owner/occupier will be held liable for the costs of remedying the problem. Therefore, we cannot be certain that the costs of complying with this regime will not adversely affect our business or our operating or financial performance, as it may not always be possible to identify another operator as a responsible party.

***We are involved in a dispute that if resolved or determined against our interests could adversely affect our profitability and our available cash.***

On February 12, 2004, the consortium that purchased our 82.4 per cent. interest in Bruce Power LP and its 50 per cent. share in Huron Wind Limited Partnership (collectively Bruce ) served a notice on us alleging a breach of certain warranties and representations relating to tax and to the condition of plant at the Bruce power station.

The tax claim relates to the treatment of expenditures at the Bruce plant during the period of our ownership which is currently under review by the Canadian tax authorities. While we have proposed a treatment that could result in a material tax rebate, the consortium claims that the allowance of the expenditures for that period would cause it to lose future deductions.

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The claim relating to the condition of the plant is based upon alleged erosion of certain parts of the steam generators including support plates through which boiler tubes pass. It is alleged that this erosion resulted in an extended outage at one unit at the plant in order to carry out repair works and loss of revenues and costs of approximately C$64.5 million. The consortium also claims that the alleged erosion may reduce the operating life of the unit and/or or result in expenditures for further repairs. We have rejected the foregoing claims and intend to defend them if they are pursued further. In accordance with accounting standards, no provision has been made in the financial statements at March 31, 2005 for either claim.

If the Bruce plant claim is resolved against us, it could have an adverse effect on our results of operation and our available cash.

***We do not currently own the rights of support for the land under the Eggborough Power Station.***

Eggborough does not enjoy a protected right of support. As a result, there is presently no restriction on coal mining taking place in circumstances whereby the stability of the Eggborough power station could be affected. We have tried, without success, to negotiate an acceptable pillar of support agreement with UK Coal Mining Limited ( UKC ) (the holders of a license from the Coal Authority to mine coal).

If UKC were to mine under or in proximity to the Eggborough power station in circumstances affecting its stability, then extensive liabilities would fall on UKC pursuant to the Coal Mining Subsidence Act 1991. Under this Act, the coal operator is required to carry out remedial works and/or make payments for the consequences of the mining damage.

We submitted an application to the Secretary of State for Trade and Industry ( Secretary of State ) pursuant to the Mines (Working Facilities and Support) Act 1966 for restrictions to be imposed on the working of minerals under part of land affecting Eggborough, and land adjacent to it as may be necessary to secure sufficient support. Our application was not successful. As a consequence, the stability of Eggborough may be adversely affected if UKC were to mine under or in proximity to it. If this were to occur, it may not be possible to continue the operation of Eggborough power station, or substantial repairs could be required, adversely affecting our financial condition.

***Our right to use certain ash and water pipelines which benefit Gale Common ash disposal site near Eggborough and the Eggborough power station is not registered with the Land Registry and is based solely on statutory declarations. In the event that our right to use any part of these pipelines is successfully challenged, we would be unable to continue to benefit from them and the operation of Gale Common and Eggborough power station would be adversely affected.***

Title to the use of much of the ash pipeline at Eggborough power station, the water pipeline from Gale Common to the River Aire and sections of the Eggborough cooling water pipes is not granted by deed nor referred to on the relevant registers at the Land Registry and is based solely on statutory declarations for a period from 1974 (in relation to the water pipelines) and from 1983 (in relation to the ash pipelines and cooling water pipes). The evidence contained in the statutory declarations will only be an effective step towards establishing title by long use provided that no contrary evidence comes to light which cannot be satisfactorily explained and no arguments are upheld based on lack of relevant knowledge of the existence of the pipelines by landowners. We cannot guarantee that we will be able to establish title by long use and therefore that if the pipelines were disconnected due to successful objections to their use by one or more of the affected landowners, the consequent interruption of the use of the pipelines, the need to obtain new rights and the work required to relocate them would not be detrimental to the operation of Eggborough power station.

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In addition, title to the use of the remainder of the ash pipeline and of the cooling water pipes is based on the grant of licenses, many of which are terminable on notice of various lengths but frequently of six months or less. If they were terminated and the pipelines disconnected, the consequent interruption of the use of the pipelines, the need to obtain new rights and the work required to relocate them could be detrimental to the operation of Eggborough power station.

***The cost of providing pensions benefits to employees is subject to changes in pension fund values, changing demographics and changes to pension legislation, and might have a material adverse effect on our financial results.***

We operate two pension schemes that provide defined benefits to eligible members and beneficiaries. The actuarial valuations of the two pension schemes as at March 31, 2004 disclose funding deficiencies (on the actuarial bases used in the valuations) in the two schemes at that date of £375,800,000 and £8,800,000 respectively. The investment performance of our pension fund assets may have an adverse effect on our business. The cost of providing pension benefits could increase as a result of changes in pension fund asset values and changing demographics, including longer life expectancy of the schemes beneficiaries. We may be required to recognize a charge to our profit and loss account to the extent that the pension fund values are less than the total anticipated liability under the plan. In addition, we are required to contribute additional amounts to our pension funds to address any difference between pension fund values and accrued liabilities. We cannot assure you that such charges or payments will not have an adverse effect on our financial condition.

We have also granted the Secretary of State an option (the Option Agreement ) to acquire our nuclear power stations in order to decommission them or extend their operating lives. The Option Agreement provides for, amongst other things, arrangements in respect of pensions of employees following the exercise of the option. This is a matter that is to be addressed at a date closer to the relevant nuclear power station s scheduled closure date. It is not possible to say what, if any, effect the arrangements, when agreed, will have on our financial position.

A high proportion of our pension schemes investments are held in equities. One consequence of this investment policy, and the methodology and assumptions used for determining our pension schemes liabilities under FASB Standard No. 87, *Employers Accounting for Pensions* ( SFAS 87 ), is that the difference between the market value of the fund s assets and their SFAS 87 liabilities is expected to be volatile, resulting in potentially significant movements in the balance sheet position and the statement of total recognized gains or losses. The values of our pension schemes assets and liabilities are likely to be high in relation to our market capitalization and any UK GAAP adjustment equivalent to SFAS 87 could have a material impact on the level of distributable reserves under UK GAAP and therefore our ability to pay dividends.

***Our inability to attract and retain senior management and employees who are highly qualified nuclear specialists could adversely affect our business***

The success of our operations depends largely on our ability to attract and retain senior management and employees who are highly skilled in nuclear sciences, operating nuclear and fossil power plants and also individuals with a proven accounting background and strong commercial skills in trading within our sector. In addition, our internal restructuring and the implementation of PiP may require us to hire further additional staff. It should be noted that there is a limited pool of candidates with these credentials and competition amongst employers is intense. Some of the candidates may come from the international market, where total compensation payable to senior executives may be significantly higher than in the domestic market. We may not always be successful in hiring or retaining the best candidate. Inability to attract or retain the relevant people could have a significant impact on our ability to operate and could adversely affect our business.

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***We have a complex relationship with the Government documented by a number of detailed and structurally intricate agreements. These agreements may inhibit the way we operate our business. If this is the case, our financial results and performance may be adversely affected.***

The arrangements we have entered into relating to the Restructuring, are complex and intricate, including the way in which we are classified by the Government and, in many cases, have yet to be tested. If these arrangements prove to be onerous in practice this may inhibit our ability to operate our plant effectively and/or to maximize opportunities for revenue generation and/or output enhancement. The complexity of the arrangements and the possibility that they may prove to be cumbersome may also affect the morale of our employees and their willingness or ability to develop innovative solutions.

Furthermore, the NLF cash sweep may inhibit us from pursuing opportunities to enhance the value of our asset base, for example, by undertaking technical evaluations and improvements in relation to lifetime extensions (for additional information on the NLF cash sweep see Item 4 Restructuring The Nuclear Liabilities Fund).

***Our business is affected by a number of restrictions which restrict our ability to develop new sources of income.***

As a result of the compensatory measures undertaken in relation to the State Aid Approval (See Item 4 Restructuring Approval of State Aid Approval) we undertook not to increase our existing operational nuclear generating capacity or fossil fuel generation capacity in the European Economic Area ( EEA ) and, not to acquire large scale registered hydro-electric generating capacity in the UK, prior to September 23, 2010. Furthermore, the arrangements we have entered into with the Government, details of which are described in the risk factor with the heading beginning: The decision of the European Commission, that, so far as the Restructuring involves the grant of State Aid by the Government prohibit us from making expenditure in certain circumstances without its consent. In addition, the restrictive covenants under the bonds issued in connection with the Restructuring (the New Bonds ) and the receivables facility agreed with Barclays Bank plc on August 25, 2004 as subsequently amended and restated (the Receivables Facility ) prohibit us from making, amongst other things, material acquisitions. These restrictions significantly limit our ability to develop new sources of income. See also the Risk Factor above: If we do not find alternative sources of income as our power stations start to close we may not be able to recover our costs from sales revenue .

Further information on the restrictions affecting the Eggborough power station is set out below in Risk Factor beginning: As part of the Restructuring we entered into new agreements in relation to the Eggborough power station .

***Our levels of debt could adversely affect our financial condition or results of operations and prevent us from fulfilling our obligations under the New Bonds***

Our total consolidated gross debt as of March 31, 2005 was £676 million which is to be repaid by 2022. This level of debt could have important consequences, for example, it could:

- require us to dedicate a substantial portion of our cash flows from operations to payments on our debt, which will reduce our cash flow available to fund capital expenditures, working capital, research and development and other general corporate purposes;

place us at a competitive disadvantage compared to our competitors who may have less debt than we do;

limit our flexibility in planning for, or reacting to, changes to our industry;

increase our vulnerability, and reduce our flexibility to respond to general and industry-specific adverse economic conditions; and

affect our ability to borrow additional funds, increase the cost of any such borrowing and/or limit our ability to raise equity funding.

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***We require a significant amount of cash to make payments on the New Bonds and to service our debt. Our ability to generate sufficient cash depends on a number of factors, many of which are beyond our control.***

Our ability to make payments on, and to refinance, our debt depends on our future operating performance and ability to generate sufficient cash subject to the collateral requirements under our trading arrangements. We are therefore dependent, to some extent, on general economic, financial, competitive, market, legislative, regulatory and other factors, many of which are beyond our control, as well as the other factors discussed in these Risk Factors.

Historically, we have serviced our debt and met our other cash requirements with cash flows from operations and the refinancing of debt. Although we believe that our expected cash flows from operating activities, together with cash in hand and available borrowings, will be adequate to meet our anticipated liquidity and debt service needs, we cannot be sure that our business will generate sufficient cash flows from operating activities, or that future debt and equity financing will be available to us in an amount sufficient to enable us to pay our debts when due, including the New Bonds, or to fund our other liquidity needs.

If our future cash flows from operations and other capital resources are insufficient to pay our obligations as they mature or to fund our liquidity needs, we may be forced to:

reduce or delay our business activities, capital expenditures and research and development;

sell assets;

obtain additional debt or equity capital; or

restructure or refinance all or a portion of our debt, including the New Bonds, on or before maturity.

We may not be able to accomplish any of these alternatives on a timely basis or on satisfactory terms, if at all. In addition, the terms governing the New Bonds and certain agreements governing our decommissioning and other arrangements with the NLF (the Nuclear Liabilities Agreements ), will limit our ability to pursue any of these alternatives. If we obtain additional debt financing, the related risks we now face will increase.

***We are subject to restrictive covenants***

The terms governing certain of our financing arrangements, in particular the New Bonds, the Receivables Facility and the Nuclear Liabilities Agreements contain certain provisions that restrict our ability and the ability of our subsidiaries to do, amongst other things, any of the following:

Make dividends, distributions, investments, and other restricted payments;

Enter into asset sales; and

Incur indebtedness, give guarantees or enter into lease-back transactions.

These limitations are subject to exceptions and qualifications that may be important. These restrictive covenants could adversely affect our ability to finance our future operations or capital needs or engage in other business activities that may be in our best interests.

In addition to limiting our flexibility in operating our business, a breach of these covenants could cause a default under the terms of other financing agreements we may enter into or have entered into causing all the debt under those agreements to be accelerated. If this were to happen, it would adversely affect our financial condition and our ability to continue operating as a going concern.

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***The amount of insurance cover we are mandatorily required to maintain in relation to nuclear liabilities by virtue of the Nuclear Installations Act 1965 (the NIA ) will increase significantly and there is no assurance that cover for nuclear liability for acts of terrorism will be available from the British Nuclear Pool of insurers (the Nuclear Pool ) in future.***

In early 2004 the Government signed an international treaty amending the existing international conventions dealing with third party liability in the field of nuclear energy with the effect that, amongst other things, the liability of nuclear operators for events involving nuclear material or ionizing radiation which cause damage or personal injury is likely to be increased to 700 million. Furthermore, the definition of nuclear damage is likely to be expanded to include, amongst other things, economic loss. It is likely that the NIA will be amended to increase the level of insurance cover we are required to maintain from the existing £140 million to 700 million. Whilst the Directors believe the insurance market will have sufficient capacity to offer cover for these increased limits, there is no assurance that such cover will be available when required nor that the cost of the insurance will increase in line with the increases in liability limit on a straight-line basis. Our insurers may also seek exclusions and/or higher levels of retention which may affect the ability to make a claim if required to do so.

Cover for nuclear liability by act of terrorism has been obtained for the year ended March 30, 2006 from the Nuclear Risk Insurers Limited. The limit for this cover and the right of recovery by insurers mirrors that under the NIA in respect of nuclear liability. In the period since the terrorist attacks in the World Trade Center in New York in 2001, insurers have remained cautious about offering terrorism cover for UK risks. As a result of this, Nuclear Risk Insurers Limited indicated that it would not provide cover for nuclear liability by act of terrorism without agreement from the Government that the Government would provide reinsurance cover. This arrangement is subject to annual review and has been forthcoming for the last three years. There is no assurance that the Government will be able to do so in the future.

***As part of the Restructuring we entered into new agreements in relation to the Eggborough power station. These agreements place certain constraints on the funding of Eggborough and grant the bank syndicate which provided the project finance for Eggborough (the Eggborough Banks ) certain rights.***

The Restructuring imposed certain constraints on the funding of Eggborough power station by the Group in the period from the Restructuring Effective Date until March 31, 2010 including: (i) specifying the operating and maintenance costs that may be met; and (ii) imposing an approximately £70 million cap (subject to certain de minimis exceptions) on capital investment (the Relevant Cap ).

In the event that: (i) an operating and/or maintenance cost is not specified; or (ii) capital investment work over and above the Relevant Cap is required, such costs and/or investment will be treated as Restricted Payments (as defined in the terms and conditions of the New Bonds) under the New Bonds (as such costs and investment work would have to be funded by British Energy Power and Energy Trading Limited ( BEPET ) (one of our subsidiaries), which is a Restricted Subsidiary for the purposes of the New Bonds) unless the limitation on Restricted Payments in the New Bonds has been suspended (by reason of the New Bonds attaining an investment grade rating from Moody s Investor Services and at least one other rating agency at the relevant time).

Post March 31, 2010, under the New Bonds any funding of Eggborough Power Limited (our subsidiary which owns Eggborough power station) ( EPL ) by the British Energy Group is limited to amounts: (i) required for EPL to operate and maintain Eggborough in accordance with the standards of a reasonable and prudent operator and comply with its obligations under an amended Credit Agreement ( the Amended Credit Agreement ) (and associated documentation) agreed with the Eggborough Banks and (ii) to fund capital expenditure, the primary purpose of which is the maintenance (including non-recurring maintenance) and/or repair of a capital nature at Eggborough.

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Any additional funding in this period will be treated as Restricted Payments under the New Bonds unless the limitation on Restricted Payments in the New Bonds has been suspended (by reason of the New Bonds attaining an investment grade rating from Moody s Investor Services and at least one other rating agency at the relevant time).

In addition, under an agreement relating to contributions made to the NLF by the British Energy Group (the Contribution Agreement ) capital expenditure at Eggborough power station is limited to amounts the primary purpose of which is maintenance or repair or is otherwise required to enable output to continue at a level consistent with historical performance levels (unless our cash exceeds the thresholds set out in the Contribution Agreement).

Inability to meet operating and/or maintenance costs and/or to fund capital investment at Eggborough as a result of the restrictions described above may result in loss of output and could adversely affect our revenues and profitability.

As part of the Restructuring, certain options (the Eggborough Options ) were granted to the Eggborough Banks. In addition, the Eggborough Banks will benefit from the security granted over the Eggborough power station (the Eggborough Security ). As a result, the New British Energy Group may cease to own the shares in, or assets of EPL on: (A) where the Eggborough Options are enforced (i) March 31, 2010; or (ii) at any time prior to August 31, 2009, on or after the occurrence of an event of default that is continuing under the Amended Credit Agreement and/or (B) where the Eggborough Security is enforced, on or at any time after the occurrence of an event of default that is continuing under the Amended Credit Agreement.

***The New Bonds, New Shares and Warrants are subject to restrictions on transfer.***

Although our securities are listed on the United Kingdom Official List and traded on the London Stock Exchange, the securities are subject to certain restrictions on transfer in the United States. The securities have not been and will not be registered under the United States Securities Act of 1933 (the Securities Act ). New ordinary shares issued pursuant to the Creditors Scheme and new ordinary shares and warrants to subscribe for new ordinary shares within five years of the Restructuring issued pursuant to the Members Scheme (respectively New Shares and Warrants ) were issued pursuant to an exemption from the registration requirements of the Securities Act pursuant to Section 3(a)(10) of the Securities Act. (For further information on the New Shares and Warrants the Creditors Scheme and the Members Scheme, see Item 4 Information on the Company Restructuring Principal Terms of the Restructuring). The New Shares issued upon exercise of the Warrants constitute restricted securities in the US and were not issued in the US. Furthermore, to the extent that a person receiving New Shares is deemed to be an affiliate (within the meaning of Rule 144 under the Securities Act) of the Company or British Energy, the New Shares they hold will be restricted securities and may be transferred in the United States only in accordance with the provisions of Rule 144, Rule 145 and Section 4(2) of the Securities Act or outside the United States pursuant to Regulation S under the Securities Act or another applicable exemption from the registration requirements of the Securities Act. The New Bonds are also restricted securities and may be transferred in the United States only in accordance with the provisions of Rule 144, Rule 144A and Section 4(2) or outside the United States pursuant to Regulation S under the Securities Act or another applicable exemption from the registration requirements of the Securities Act and in accordance with the transfer restrictions of the New Bonds. It is the obligation of holders of the securities to ensure that sales of securities within the United States or other countries comply with applicable securities laws. The foregoing transfer restrictions could impact on the selling price of the securities and the ability of the holders of the securities to sell the securities.

***The decision of the European Commission that, as far as the Restructuring involves the grant of State Aid by the Government, such aid is compatible with the Common Market and the objectives of the Euratom Treaty (the State Aid Approval ) may be appealed against by certain***

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***interested third parties to the Courts of the European Union (the EC Court ). If such an appeal is successful, it may result in the annulment of the whole or part of the State Aid Approval or the possible imposition of further conditions on the Group. Interested third parties may also seek an order from the EC Court for an order that the arrangements whereby the Government provides aid to the Group be suspended, provided that they can establish they have an interest in the case and that the suspension is urgent. Interested third parties may also complain to the European Commission or bring actions in the courts in England or Scotland that the Group or the Government are not complying with one or more of the conditions to the State Aid Approval. Any of these events could adversely affect our business or profitability.***

The State Aid Approval may be appealed to the Court of First Instance of the European Communities (the CFI ) by any interested third party provided that it can show that it is directly and individually concerned by the State Aid Approval. A party will be directly and individually concerned by the State Aid Approval, where it can show, for example, that its competitive position in the market was or may be adversely affected by it. An interested third party whose competitive position is not adversely affected by the State Aid Approval may also be able to show in other ways it is directly and individually concerned by the State Aid Approval. The government of another Member State may also appeal against the State Aid Approval to the CFI. In each case the application for the appeal must be filed within two months and ten days from either: (i) the date when the interested third party or the government of the Member State receives a full copy of the non-confidential version of the State Aid Approval from the European Commission; or (ii) from the date of the publication of the non-confidential version of the State Aid Approval in the Official Journal of the European Union, where the interested third party has not already received a copy of State Aid Approval directly from the European Commission. The deadline for an appeal under (i) has now expired. The non-confidential version of the decision was published on June 6, 2005 and therefore the deadline for any appeal under (ii) expires on August 16, 2005. An appeal to the CFI may result in the State Aid Approval being annulled in whole or in part on grounds of procedural or substantive issues. Any such appeal will be defended by the European Commission. The Government and we may intervene to support the European Commission in defending the State Aid Approval. The arguments raised by us and/or the Government must support the European Commission s conclusions. The process that led to the State Aid Approval was conducted almost exclusively between the Government and the European Commission; we were not directly involved in it except to a limited extent. Nevertheless, we believe that the State Aid Approval should not be annulled in whole or part on appeal, but we cannot give an assurance that that is the case.

The applicant may also request the CFI to suspend in whole or in part the State Aid Approval or apply for other interim measures pending the outcome of the appeal. The CFI may make such orders with or without conditions attached, where the applicant can show that: (i) it has an interest in the State Aid Approval and, when the point is raised, that its application for the annulment of the State Aid Approval is not manifestly inadmissible; (ii) there is urgency to suspend the State Aid Approval so as to prevent the applicant suffering serious and irreparable damage (the applicant needing to show that the damage is foreseeable with a sufficient degree of probability and cannot ultimately be financially compensated); (iii) it has a prima facie case for the annulment of the State Aid Approval; and (iv) the balancing of the interests of the different parties calls for the State Aid Approval to be suspended or other measures to be imposed. In light of the above, we do not believe that any interested third party would succeed in suspending, or obtaining any other interim measures against the State Aid Approval.

A decision of the CFI can be appealed to the European Court of Justice (the ECJ ) but only on points of law. In the event of an appeal against the State Aid Approval in the CFI or the ECJ being successful and the State Aid Approval being annulled in whole or in part, the European Commission would have to issue a new decision taking into account the judgment(s). The effect of a successful appeal, the details of any subsequent decision and the impact that it might have on our business s profitability or financial position is impossible to predict.

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An interested third party may also complain at any time to the European Commission that either the Government or we are in breach of any of the conditions imposed by the State Aid Approval. There can be no assurance that the European Commission may not, as a result of any investigation it makes into the complaint, order the recovery of any aid which has been unlawfully given as a result of a breach and/or modify the conditions of the State Aid Approval or impose additional ones.

An interested third party which can show sufficient interest (under English law) or both title and interest to sue (under Scottish law) can also bring an action in a court in the appropriate jurisdiction alleging that either the Government or we are in breach of any of the conditions imposed by the State Aid Approval. The court could decide to consult with the European Commission or to refer questions to the ECJ insofar as it considers them to be necessary to interpret or apply the provisions of the State Aid Approval that may be in dispute. There can be no assurance that the court would not order that the arrangements whereby the Government provides aid to the Group be suspended pending compliance with the State Aid Approval and the court could order any aid given in breach of the State Aid Approval to be recovered from the Group by the Government. However, we consider this to be unlikely in view of the fact that the court would have to consider the balance of convenience to the parties in the case as a whole and must have regard to the wider public interest which in this case would, in our view, be in favor of us.

Any such appeals or other procedures may have an adverse effect on the Group and our shareholders.

***The State Aid Approval may restrict the amounts the Government may be permitted to pay to us in respect of our liabilities under certain historic spent fuel contracts and assumed by it under the Historic Liabilities Funding Agreement. This may, in the longer term, adversely affect our financial position.***

The State Aid Approval provides that the Government is permitted to fund the payment of: (a) liabilities related to the cost of management of spent fuel loaded into our AGRs up until the Restructuring Effective Date (historic spent fuel), up to £2,185 million (which is calculated in real terms as at March 2003 in December 2002 money values); (b) the costs of certain other liabilities set out in the HLFA which are not however taken into account to calculate the £2,185 million cap; and (c) any shortfall of the NLF as regards the payment of liabilities related to our nuclear assets decommissioning and uncontracted liabilities. The State Aid Approval states that as soon as expenditure corresponding to: (i) the nuclear decommissioning and uncontracted liabilities referred to above; and (ii) the costs of the certain other liabilities set out in the HLFA referred to under (b) above, exceed £1,629 million (in December 2002 money values), the Government shall submit enhanced additional reports (on an annual basis) to the European Commission demonstrating that the Government payments are restricted to meeting these liabilities, and that proper steps have been taken to limit expenditure to the minimum necessary to meet those liabilities.

Article 4 of the State Aid Approval provides that for the purposes of computing the £2,185 million cap and the £1,629 million threshold in December 2002 money values, the Government shall use the reference and discount rate published by the European Commission for the UK updating this rate every five years.

The historic spent fuel contracts between BNFL and British Energy provided for contractual payments to be subject to adjustment based on the UK retail prices index ( RPI ). The Government therefore proposed to the European Commission that RPI, together with a fixed discount rate, be applied in calculating whether payments under the HLFA reach the £2,185 million cap in (December 2002 money values). The European Commission s position, reflected in its decision, is that the reference and discount rate it sets for the UK from time to time should be used in calculating whether

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the cap is reached. There is a risk that applying the European Commission s reference rate to payments made under the HLFA may result in a greater figure than the method proposed to the European Commission by the Government. If this were to occur, the Government s obligation to pay amounts under the HLFA would be limited by the cap unless and until the State Aid Approval was modified.

***Our trading contracts and certain of our other contracts may be subject to credit support obligations, such as the posting of collateral. We may have to post additional amounts of cash as collateral to support our trading activities, which could reduce the amount of cash available for other purposes or exceed our available cash resources.***

In part because of our credit status, we need to maintain credit support arrangements in respect of our obligations under certain trading contracts by posting collateral to support our obligations under these agreements. In the case of a significant proportion of our contracts, the financial obligations to be covered by the alternative credit support are generally related to the prevailing wholesale price of electricity. During a period of rising market prices, the amount of collateral that we are required to post will generally increase. In periods of rising market prices, the increase in the level of collateral that we could be required to post may result in us having to reduce expenditures in other areas, including capital expenditures and could exceed our available cash resources.

**Selected Financial Data**

The following table sets forth selected consolidated financial and other data. We refer to the periods prior to Restructuring Effective Date as Predecessor Company and to the periods subsequent to that date as Successor Company. The balance sheet data as of March 31, 2001, 2002, 2003, 2004, as of January 14, 2005 and the statement of operations for the years ended March 31, 2001, 2002, 2003, 2004 and for the period from April 1, 2004 to January 14, 2005 for the Predecessor Company, and the balance sheet data as of March 31, 2005 and the statement of operations data for the period from January 15 to March 31, 2005 for the Successor Company are derived from our audited consolidated financial statements.

As a result of the completion of the Restructuring on January 14, 2005, our financial statements after than date are not comparable to our financial statement for prior periods because of the differences in the bases of accounting and the capital structure for the Predecessor Company and the Successor Company. Operating results for the period from April 1, 2004 to January 14, 2005 for the Predecessor Company and for the period from January 15 to March 31, 2005 for the Successor Company are not necessarily indicative of the results for the year ended March 31, 2005.

In February 2003 we disposed of our interest in Bruce and in December 2003 we sold our 50 per cent. interest in AmerGen Energy Company, a joint venture with Exelon Generation Company LLC ( Exelon ) which operated three nuclear power stations in the United States ( AmerGen ).

Loss and earnings per share (basic and diluted) and weighted average number of shares of the Predecessor Company reflect share amounts of our old ordinary shares. Following completion of the Restructuring a new capital structure is in place with effect from Restructuring Effective Date.

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| | Successor | Predecessor | | | | |
|---|---|---|---|---|---|---|
| | January 15, 2005 through March 31, 2005 | April 1, 2004 through January 14, 2005 | Year Ended March 31, 2004 | 2003 | 2002[6] | 2001[6] |
| | | | | | (Unaudited) | (Unaudited) |
| | (in £ millions, except earnings per share and per ADR[7] and weighted average number of ordinary shares) | | | | | |
| **Statement of Operations Data:** | | | | | | |
| Operating revenues | 482 | 1,222 | 1,516 | 1,528 | 1,701 | 2,124 |
| Operating losses | (160) | (187) | (190) | (7,624) | N/A | N/A |
| (Loss)/income from continuing operations | (122) | (227) | (78) | (7,853) | (274) | (124) |
| Net (loss)/income | (122) | (226) | 7,562 | (7,800) | (343) | (124) |
| Pro forma net (loss)/income as if SFAS 143 has been applied effective April 1, 2001[1] | | | (4,660) | 112 | | |
| Basic and diluted (loss)/earnings per ordinary share | | | | | | |
| From continuing operations | (22)p | (38)p | (13)p | (1,305)p | (46)p | (21)p |
| From discontinued operations[2] | | | | 9 p | 3 p | |
| Cumulative effect of change in accounting principle | | | 1,269p | | (14)p | |
| Net (loss)/income | (22)p | (38)p | 1,256p | (1,296)p | (57)p | (21)p |
| Basic and diluted (loss)/earnings per ADR[2] | | | | | | |
| From continuing operations | | (28,281)p | (975)p | (97,836)p | (3,432)p | (1,575)p |
| From discontinued operations[3] | | | | 660 p | 210 p | |
| Cumulative effect of change in accounting principle | | | 95,175p | | (1,080)p | |
| Net (loss)/income | | (28,281)p | 94,200p | (97,176)p | (4,302)p | (1,575)p |
| Weighted average number of ordinary shares *(millions)* | 561 | 602 | 602 | 602 | 598 | 597 |
| **Balance Sheet Data (at end of period):** | | | | | | |
| Property, plant and equipment | 3,923 | 1,158 | 1,128 | 997 | 8,259 | 8,082 |
| Total assets | 7,876 | 2,588 | 2,560 | 2,175 | 10,250 | 9,766 |
| Other liabilities and long-term debt | (5,574) | (2,685) | (2,517) | (10,122) | (10,367) | (9,756) |
| Net assets (liabilities) | 1,417 | (1,739) | (1,469) | (9,230) | (1,145) | (736) |
| Shareholder s equity (deficit) | 1,417 | (1,739) | (1,469) | (9,230) | (1,145) | (736) |
| Capital stock | 56 | 370 | 370 | 370 | 370 | 370 |
| **Cash Flow Information:** | | | | | | |
| Cash flow from operating activities | 111 | (98) | 158 | 273 | 349 | 176 |
| Cash flow from investing activities | 31 | (65) | (6) | (247) | (334) | 52 |
| Cash flow from financing activities | (25) | | (7) | (165) | 22 | (39) |
| **Other Financial Information:** | | | | | | |
| Operating loss | (160) | (187) | (190) | (7,624) | N/A | N/A |

| | | | | | | |
|---|---|---|---|---|---|---|
| Depreciation and amortization | 73 | 87 | 101 | 300 | N/A | N/A |
| EBITDA[4][5] | (87) | (100) | (89) | (7,324) | N/A | N/A |

(1) We have calculated the proforma net (loss)/income as if SFAS 143 had been applied from April 1, 2001. We have not calculated the pro forma impact for any prior periods.

(2) Calculated based on a ratio of 75 ordinary shares for one ADR. On March 18, 2003, we increased the ratio of four ordinary shares for one ADR to the current ratio of 75 ordinary shares for one ADR. Our ADRs were suspended in September 2004 and delisted in December 2004.

(3) Revenue for discontinued operations which related to Bruce Power (our interest in which was sold on February 14, 2003) are set out on a 100 per cent. holding basis. Our share in Bruce Power was 82.4 per cent. prior to the disposal.

(4) In the year ended March 31, 2003, we incurred an impairment charge of £6,680 million in connection with property plant and equipment.

(5) EBITDA represents earnings before interest, taxes, depreciation, and amortization and is not a GAAP measure in the United States and should not be considered in isolation or as a substitute for, or as an alternative to, net income, operating income, cash flow from operations, other cash flow data or any other performance measures prepared in accordance with US GAAP. The following table provides a reconciliation of EBITDA to cashflows from operating activities.

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| | Successor | Predecessor | | | | |
|---|---|---|---|---|---|---|
| | January 15, 2005 through March 31, 2005 | April 1, 2004 through January 14, 2005 | Year Ended March 31, | | | |
| | | | 2004 | 2003 | 2002[6] | 2001[6] |
| | | (in £ millions) | | | (Unaudited) | |
| EBITDA | (87) | (100) | (89) | (7,324) | N/A | N/A |
| Share of profit on joint venture and business disposals | | 1 | (149) | 78 | N/A | N/A |
| Other non cash movements | 187 | (38) | 208 | 6,798 | N/A | N/A |
| Other income/expense adjustments to operating cash flows | 46 | (9) | 111 | (292) | N/A | N/A |
| Movements in provisions for liabilities and charges | 26 | 232 | 136 | 245 | N/A | N/A |
| Working capital | (61) | (184) | (59) | 768 | N/A | N/A |
| Cash flow from operating activities | 111 | (98) | 158 | 273 | N/A | N/A |

For additional information regarding the use of EBITDA, see Presentation of Financial and Other Data Non-GAAP Financial Measures EBITDA.

(6) In the years ended March 31, 2002 and 2001, we prepared our accounts on a UK GAAP basis and only reconciled Net Income/Loss and Shareholders Equity to US GAAP. As such, certain information is not available on a US GAAP basis and has been denoted with N/A .

(7) American Depositary Receipt of BE Ltd.

***Dividends***

The Board of Directors of BE Ltd did not declare any dividends for the years ended March 31, 2003, 2004 or 2005. In prior fiscal years, we paid interim and final dividends in January and July respectively. We do not anticipate declaring dividends in respect of the financial year ending March 31, 2006. (See Item 4. Information about the Company Restructuring ). The following table sets out the dividends paid on ordinary shares and ADRs in respect of the past five fiscal years, excluding any associated UK tax credit in respect of such dividends.

| | Year ended March 31, | | | | |
|---|---|---|---|---|---|
| | 2005 | 2004 | 2003 | 2002 | 2001 |
| | | | (in pence) | | |
| Pence per ordinary share[1] | | | | | |
| Interim | | | | 2.7 | 2.7 |
| Final | | | | 5.3 | 5.3 |
| Total | | | | 8.0 | 8.0 |

| | Year ended March 31, |
|---|---|

| | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| | | | (in dollars) | | |
| US dollar per ADR:[1][2][3][4] | | | | | |
| Interim | | | | 3.00 | 3.00 |
| Final | | | | 5.63 | 5.63 |
| Total | | | | 8.63 | 8.63 |

(1) References to ordinary shares in this table are to ordinary shares in BE Ltd. For more information see Item 4 Information On The Company Restructuring. Dividends per share and per ADR exclude any associated UK tax credit available to certain holders of ordinary shares and ADRs. Dividends paid by the Depositary in respect of ADRs are paid in US dollars based on a market rate of exchange that differs from the Noon Buying Rate.

(2) Calculated on a ratio of 75 ordinary shares for one ADR.

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(3) Dividends have been translated from pounds sterling into US dollars, solely for the convenience of the reader at the Noon Buying Rate in effect at the date of payment.

(4) BE Ltd s ADRs were suspended from trading on the New York Stock Exchange ( NYSE ) on September 28, 2004 and were subsequently permanently delisted in December 2004.

***Exchange Rates***

Dividends have been paid in pounds sterling. Exchange rate fluctuations have affected the US dollar amounts received by owners of the ADRs on conversion by the Depositary of such cash dividends. In addition, fluctuations in the exchange rate between pounds sterling and US dollars affected the US equivalent of the quoted pounds sterling price of ordinary shares on the Daily Official List of the London Stock Exchange.

The following table sets forth, for the periods and dates indicated, the noon buying rate in The City of New York as certified for customs purposes by the Federal Reserve Bank of New York, which we refer to as the Noon Buying Rate, for cable transfers in British pounds sterling, expressed in US dollars per British pound sterling. We provide these rates for your convenience only, and they are not the rates of exchange we used to prepare our consolidated financial statements included elsewhere in this annual report. We are not representing that British pounds sterling amounts have been or could be converted into US dollars at any of the exchange rates indicated.

| Year ended December 31, | High | Low | Average[1] | Period |
|---|---|---|---|---|
| 2000 | $ 1.68 | $ 1.55 | $ 1.62 | $ 1.60 |
| 2001 | $ 1.65 | $ 1.40 | $ 1.50 | $ 1.50 |
| 2002 | $ 1.50 | $ 1.37 | $ 1.44 | $ 1.45 |
| 2003 | $ 1.78 | $ 1.55 | $ 1.64 | $ 1.78 |
| 2004 | $ 1.95 | $ 1.75 | $ 1.84 | $ 1.92 |

| Month 2005 | High | Low |
|---|---|---|
| January | $ 1.91 | $ 1.86 |
| February | $ 1.86 | $ 1.92 |
| March | $ 1.93 | $ 1.87 |
| April | $ 1.92 | $ 1.87 |
| May | $ 1.90 | $ 1.82 |
| June | $ 1.80 | $ 1.84 |
| July (through July 22, 2005) | $ 1.78 | $ 1.73 |

(1) The average of the Noon Buying Rates on the last business day of each month during the relevant period

Except as we specify otherwise, we converted exchange rate translations in this annual report at the rates in effect on March 31, 2005, which correspond to the rates we used to prepare our consolidated financial statements.

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## ITEM 4. INFORMATION ON THE COMPANY

### OVERVIEW

We are a company incorporated in Scotland under the Companies Act. Our date of incorporation was July 2, 2004.

Our principal activities are the generation, sale and trading of electricity all of which we consider as one reporting segment. We are the UK s largest generator of electricity, producing around one fifth of the UK s electricity requirement and employing approximately 5,400 staff. We own and operate eight nuclear power stations and one coal-fired power station in the UK. Of our nuclear power stations, seven are AGR power stations (Dungeness B, Hartlepool, Heysham 1, Heysham 2, Hunterston B, Hinkley Point B and Torness) and the eighth (Sizewell B) is our sole PWR power station. Our nuclear power stations have a combined capacity of approximately 9,600 MW. Eggborough, our coal-fired power station in Yorkshire has capacity of approximately 2,000 MW. During the year ended March 31, 2005, our power stations produced total output of 67.4 TWh, which was comprised of output of 59.8 TWh from our nuclear power stations and 7.6 TWh from Eggborough power station. British Energy Power and Energy Trading Limited ( BEPET ), one of our subsidiaries arranges the balancing of our electricity generation and supply. Our direct supply business is one of the largest suppliers of electricity to the UK s industrial and commercial sector.

We generated revenue of £482 million during the period from January 15 to March 31, 2005 and £1,222 million for the period from April 1, 2004 to January 14, 2005 resulting in operating losses of £160 million and £187 million, respectively. During the year ended March 31, 2004, we generated revenue of £1,516 million, resulting in an operating loss of £190 million. For the year ended March 31, 2003, we generated revenue of £1,528 million and an operating loss of £7,624 million which includes impairment charges of £6,680 million.

We use a variety of routes to market in the UK, including direct sales to industrial and commercial customers contracting in the wholesale market, together with sales of balancing and ancillary services to the National Grid Company ( National Grid ). For a description of our sales activities see the paragraph below headed Electricity Sales . Our business is subject to a high degree of regulation in a number of areas, including nuclear and industrial safety, electricity generation, trading and supply, and the environment. For a description of our regulatory environment, see the paragraph below headed Regulation .

For discussion of significant customers, refer to Note 17 of our consolidated financial statements.

For information and discussion on significant divestments, see Item 5 Operating and Financial Review and Prospects .

### HISTORICAL EVENTS

BE Ltd was privatized by the UK Government in July 1996. As well as operating our nuclear power stations in the UK it subsequently acquired Eggborough power station in England in 2000, and, through AmerGen, an interest in three US nuclear

plants. Through Bruce Power LP, in which we held a 82.4 per cent. interest, we also leased the Bruce A and B nuclear power stations in Ontario, Canada. Following BE Ltd s announcement of September 5, 2002 we implemented a financial restructuring see below under the heading Restructuring .

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**ORGANISATIONAL STRUCTURE**

The diagram below illustrates our organizational structure.

**RESTRUCTURING**

The financial restructuring (the Restructuring ), as further described below was completed on January 14, 2005, (sometimes also referred to as the Restructuring Effective Date ) and our shares commenced trading on the London Stock Exchange on January 17, 2005 ( Admission ). The background to, and implementation of the Restructuring is described below.

**Background to the Restructuring**

On September 5, 2002, we announced that we had initiated discussions with the Government with a view to seeking immediate financial support and to implement a longer-term financial restructuring in the face of:

- the failure of our negotiations with BNFL which had been initiated by us to link prices paid under our fuel contracts with BNFL to wholesale electricity prices, with the aim of reducing the proportion of our costs which were fixed; and
- our Board s review of the longer term prospects of the Group.

These discussions with the Government resulted in the Government providing the Group with a credit facility intended to provide working capital to meet the Group s immediate requirements and to allow us to stabilize our trading position. This facility ceased to be available for drawings following the issue of State Aid approval on September 22, 2004.

On November 28, 2002 when we announced that we had agreed certain restructuring principles with Government, we highlighted some of the commercial and structural factors which had caused or compounded our financial difficulties, some of which the Restructuring has sought to address. These are set out below:

- our nuclear fleet in the UK had high fixed costs of production when compared with other generators of electricity (including the costs of supplies and services under our contracts with

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BNFL); as a merchant generator with no retail supply business we were (and remain) heavily exposed to declines in wholesale electricity prices. Significant contracts for direct sales to industrial and commercial customers were closely linked to the wholesale electricity price which meant the business was unable to withstand the significant reduction in wholesale electricity prices which fell by over 35 per cent. over the two years to September 2002. The exposure to declines in electricity prices is now partially hedged within certain parameters by the contracts described below under the paragraph headed: New BNFL Contracts (although at current wholesale electricity price levels we are now making additional payments to BNFL as provided for in the New BNFL Contracts);

our wholesale electricity price exposure at the time was exacerbated by a power purchase agreement and two contracts for differences which magnified our exposure to baseload electricity prices. The claims of the counterparties to these arrangements were compromised pursuant to the Restructuring in exchange for New Shares and New Bonds;

we have an obligation under our nuclear site licenses to decommission our nuclear power stations at the end of their useful lives. These liabilities were estimated to have a net present value ( NPV ) of £1.3 billion as at March 31, 2005. Certain of the decommissioning liabilities were covered by the Nuclear Generation Decommissioning Fund Limited ( NDF ) to which we contributed. However, there was no certainty that this fund, at the level of contributions we were making, would be sufficient to cover all of the liabilities to which it related. This uncertainty has been substantially mitigated by the new arrangements with the Secretary of State described below under the paragraph headed: The Nuclear Liabilities Fund which became effective upon the Restructuring Effective Date;

our operations generate liabilities in respect of nuclear fuel and waste estimated at £2.3 billion for discounted contracted liabilities and £0.8 billion for discounted uncontracted liabilities (in each case as at March 31, 2005). Some of these liabilities were covered by long term contracts with BNFL, with the balance remaining uncontracted. These uncontracted liabilities were long term in nature and therefore subject to uncertainty. There was no guarantee that our business would generate sufficient funds to cover these contracted and uncontracted liabilities. This uncertainty has been substantially mitigated by the New BNFL Contracts and the new arrangements with the Secretary of State described below in the paragraphs headed: New BNFL Contracts and The Nuclear Liabilities Fund;

Eggborough power station, which we acquired out of Group funds in March 2000, also suffered from the reduction in wholesale electricity prices through 2001 and 2002 and the narrowing differential between winter and summer prices. The acquisition was refinanced with a project finance loan on July 13, 2000 and it was difficult for us to fund the repayments required. The debt owed to the providers of the project finance loan was compromised under the terms of the Restructuring in exchange for, amongst other things: (i) New Shares; (ii) New Bonds; (iii) payments under an amended and restated version of the project finance loan made on substantially the same terms as the New Bonds (such that the proportion of our debt secured on the Eggborough power station will represent a significantly smaller part of our overall indebtedness); and (iv) options to purchase the shares in, or assets of, EPL on March 31, 2010 or, prior to August 31, 2009, at any time on or after the occurrence of an event of default under the amended and restated project finance loan that is continuing (the lenders have the right to assign and/ or transfer all (but not part) of their rights under those options, subject to a pre-emption right in favor of the Group);

we had investments in the US and Canada but these had not yet generated dividends and, in the case of Canada, required significant investment. As a result, they had stretched our financial resources. These assets have been disposed of; and

as at September 30, 2002, the Group had indebtedness of £1,050 million (including £490 million in connection with the Eggborough power station and approximately £408 million of

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unsecured existing bonds) with significant debt repayment obligations to be made in cash and, as a result of the loss of our investment grade rating in September 2002, our cash requirements increased significantly to meet the collateral requirements of trading counterparties.

The restructuring principles agreed with the Government in November 2002 formed the basis for the Restructuring and required, amongst other things, that we enter into a binding restructuring agreement with our creditors by September 30, 2003. Accordingly, on October 1, 2003, we announced that we had entered into binding agreements setting out the terms of the proposed Restructuring with certain key creditors (the Creditor Restructuring Agreement ), and the Secretary of State (the Government Restructuring Agreement ). These agreements set out the principal terms of the Restructuring and the circumstances in which the Secretary of State would support the Restructuring.

**Principal terms of the Restructuring**

The Creditor Restructuring Agreement dated as of September 30, 2003 was entered into by BE Ltd, certain other British Energy Group companies, Enron Capital & Trade Europe Finance LLC ( ECTEF ), Teesside Power Limited ( TPL ), Total Gas & Power Limited ( Total ), (Total, TPL and ECTEF collectively, the Significant Creditors ), The Royal Bank of Scotland plc ( RBS ), the members of the ad hoc committee of holders of our then outstanding guaranteed bonds (the Old Bonds , Bondholders and the ad hoc committee respectively) and BNFL. By October 31, 2003, Bondholders, representing, in aggregate with RBS, 88.8 per cent. of the combined amount owing to Bondholders and RBS, had also entered into the Creditor Restructuring Agreement, along with all the lenders and swap providers in the syndicate of Eggborough Banks (each an Eggborough Bank ).

The Government Restructuring Agreement was entered into by BE Ltd, certain other British Energy Group companies, the Secretary of State, the NDF (subsequently enlarged into and renamed the Nuclear Liabilities Fund Limited or NLF) and the Trustees of the Nuclear Trust on October 1, 2003. This Agreement set out the circumstances in which the Secretary of State would support the Restructuring and the agreements to be entered into with the British Energy Group and, in certain cases, the NLF, which gave effect to the proposals for the funding of certain of the Group s qualifying uncontracted nuclear liabilities and qualifying decommissioning costs and certain contracted liabilities for historic spent fuel (namely, spent fuel arising from fuel loaded into our AGRs prior to the Effective Date (being the date immediately following the day on which the conditions to the effectiveness of the New BNFL Contracts were satisfied or waived)) described under the paragraph headed: The Nuclear Liabilities Fund.

The Restructuring involved the Bondholders, the Eggborough Banks, RBS and the Significant Creditors compromising their claims against the British Energy Group in exchange for, amongst other things, the issue to those creditors of New Bonds of British Energy Holdings plc ( Holdings plc ) and New Shares of the Company. As a part of the implementation of the Restructuring, the Bondholders and RBS compromised their claims through a Court-approved scheme of arrangement under section 425 of the Companies Act (the Creditors Scheme ). The Significant Creditors extinguished all, and the Eggborough Banks extinguished part, of their claims against the British Energy Group pursuant to the various arrangements under the Creditor Restructuring Agreement and related documents.

In order to implement the Restructuring, BE Ltd cancelled its ordinary shares and A shares, and became a wholly-owned subsidiary of Holdings plc by means of a Court-approved scheme of arrangement under section 425 of the Companies Act (the Members Scheme ) which required the approval of BE Ltd shareholders. BE Ltd obtained the approval of its ordinary and A share shareholders at an extraordinary general meeting held on December 22, 2004, and the sanction of the Court on January 14, 2005.

As a result of the approval of the Members Scheme, and subject to certain restrictions relating to non-United Kingdom shareholders, shareholders in BE Ltd were entitled to receive New Shares and

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Warrants. Shareholders who completed and returned the relevant form(s) of Election ( Shareholder Election ) were entitled to receive:

| | |
|---|---|
| for every 50 Ordinary Shares | 1.0 New Share and 2.1 Warrants |
| for every 50 A Shares | 1.0 New Share and 2.1 Warrants |

in respect of BE Ltd shares held at 6.00 pm (Greenwich Mean Time) on January 13, 2005.

If a shareholder did not make a valid shareholder election, the relevant New Shares and Warrants were sold in the market at the best price reasonably obtainable in the market and the net proceeds were remitted to the relevant shareholder. The average price for the New Shares and Warrants sold in this way was £2.55 for New Shares and £1.62 for the Warrants.

The New Shares are ordinary shares in the Company having the rights attaching to them which are set out in the summary of the articles of association of the Company in Item 10 Additional Information.

For the purposes of the allocation of the New Bonds and New Shares among creditors pursuant to the terms of the Restructuring, it was agreed that creditor claims, or, in the case of the Eggborough Banks, their unsecured claims, would be treated as having the following values:

| **Creditors as at October 1, 2003** | **Claim amount (approx.)** | |
|---|---|---|
| | | **(£m)** |
| Bondholders | £ | 407.9 |
| RBS | £ | 37.5 |
| Eggborough Banks | £ | 210.0 |
| TPL | £ | 159.0 |
| Total | £ | 85.0 |
| ECTEF | £ | 72.0 |

BE Ltd and the other parties to the Creditor Restructuring Agreement agreed the allocation of the New Bonds and New Shares to be issued pursuant to the Restructuring in respect of unsecured claims based upon the claim amounts set out above, and taking into account a number of factors, including the identity of the relevant debtor and the amounts owed between British Energy and its principal subsidiaries. The allocation of New Bonds and New Shares to creditors and BE Ltd shareholders was as follows.

**Name of Shareholder in British Energy Group plc**

**(including Creditors and their respective allocations at Restructuring)[(1)]**

| | New Shares | | New Bonds (to Creditors only)[2] |
|---|---|---|---|
| | No. of Shares (in m, approx.) | % of issued share capital[4] | (£ in m, approx.) |
| Bondholders | 286.1 | 51.0 | 154.0 |
| RBS | 26.2 | 4.7 | 14.2 |
| TPL | 78.8 | 14.0 | 43.5 |
| Total | 42.1 | 7.5 | 23.3 |
| ECTEF | 37.2 | 6.6 | 20.0 |
| Eggborough Banks | 76.6 | 13.7 | 20.0[3] |
| BE Ltd Shareholders | 14.0 | 2.5 | 0.0 |
| **TOTAL** | **561.0** | **100.0** | **275.0** |

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(1) TPL, Total and ECTEF later assigned certain of their respective interests under the Creditor Restructuring Agreement and their respective claims against the British Energy Group to Deutsche Bank AG London ( Deutsche Bank ) which, consequently, became a Significant Creditor. We are aware that a proportion of these interests may subsequently have been sub-participated to third parties. Furthermore, RBS subsequently assigned its interest as a creditor under the Creditors Scheme to Deutsche Bank.

(2) In addition, the NLF received £275 million of New Bonds and a right to receive the NLF Cash Sweep Payment together with further amounts payable under the Contribution Agreement (see Item 4 Restructuring The Nuclear Liabilities Fund).

(3) Excludes £150 million bond-equivalent payments through the Amended Credit Agreement (see item 4 Restructuring Eggborough Arrangements).

(4) Percentage of issued share capital immediately following Admission excluding the impact of the NLF Cash Sweep Payment, the Warrants and Employee Options. Citigroup Global Markets Limited acted as sponsor and financial adviser for the listing of our New Shares and New Bonds.

The further principal elements of the Restructuring were as follows:

**Eggborough Arrangements**

The Eggborough Banks, as creditors with the benefit of a letter of credit issued by RBS (the RBS Letter of Credit ) and security over, amongst other things, the shares in, and assets of, EPL were repaid approximately £37.5 million pursuant to the RBS Letter of Credit and replaced the balance of their existing secured and unsecured claims with a right to receive £150 million under the Amended Credit Agreement on substantially the same payment terms as the New Bonds, together with £20 million of New Bonds issued by Holdings plc, and 13.7 per cent. of the New Shares in the Company.

In addition, the Eggborough Banks were granted: (i) options exercisable at any time prior to August 31, 2009 under which they may acquire the shares in, or assets of, EPL on March 31, 2010 in consideration for, amongst other things, £104 million (subject to certain adjustments depending on the condition of the Eggborough power station on March 31, 2010) and the cancellation of the outstanding payments under the Amended Credit Agreement at such time; and (ii) options under which they may acquire the shares in, or assets of, EPL at any time prior to August 31, 2009, on or after the occurrence of an event of default under the Amended Credit Agreement that is continuing in consideration for a fee (which varies depending on the type of event of default) and the cancellation of the outstanding payments under the Amended Credit Agreement at such time (each an Eggborough Option ). The Eggborough Banks are entitled to assign and/or transfer all (but not part only) of their rights under the Eggborough Options to a third party, subject to a pre-emption right in favor of the British Energy Group under which a member of the British Energy Group may purchase such rights at 105 per cent. of the price offered by the relevant third party. The Eggborough Banks continue to benefit from the security they previously held and certain new security which secures, amongst other things, the Eggborough Banks rights under the Amended Credit Agreement and the Eggborough Options. As a result, on and at any time after the occurrence of an event of default under the Amended Credit Agreement that is continuing, the Eggborough Banks shall have the right to:

(i) prior to August 31, 2009, exercise an Eggborough Option or enforce their security referred to above; or

(ii) on or post August 31, 2009, enforce their security.

EPL s payments under the Amended Credit Agreement are funded by the British Energy Group and consequently the recovery of the Eggborough Banks on enforcement of their security should effectively equal the outstandings under the Amended Credit Agreement at the relevant time even in circumstances where the shares in, or assets of, EPL are worth less than such outstandings.

If the Eggborough Banks were to give notice of their intention to exercise an Eggborough Option, we would seek alternative ways of performing the services that the Eggborough power station

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provides, either through entering into contracts with third parties or by purchasing an equivalent power station. We would also seek to mitigate our trading risks by adopting a revised trading strategy.

**The Nuclear Liabilities Fund**

Under arrangements with the Secretary of State entered into on January 14, 2005, the former NDF was enlarged into and renamed the NLF which will fund, subject to certain exceptions, the British Energy Group s qualifying uncontracted nuclear liabilities and qualifying decommissioning costs. The Secretary of State has agreed to fund: (i) qualifying uncontracted nuclear liabilities and qualifying decommissioning costs to the extent they exceed the assets of the NLF; and (ii) subject to certain exceptions, contracted liabilities for historic spent fuel. As at March 31, 2005, the market value of the NLF was £782 million. To the extent there is any surplus in the NLF, this amount will be paid to the Secretary of State. The British Energy Group is responsible for funding certain excluded or disqualified liabilities and will, in certain circumstances, be required to compensate or indemnify the NLF and the Secretary of State in relation to such liabilities. Our obligations under these arrangements with the Secretary of State are guaranteed by certain members of the British Energy Group.

In consideration for the assumption of these liabilities by the Secretary of State and the NLF, Holdings plc issued £275 million in New Bonds to the NLF. The British Energy Group will make various ongoing payments to the NLF including an annual contribution initially equal to 65 per cent. of the British Energy Group s adjusted net cash flow (calculated on the basis set out in the summary of the Contribution Agreement in Item 10 Additional Information Material Contracts (the NLF Cash Sweep Payment )). This percentage may be adjusted for certain corporate actions but may never exceed 65 per cent. The British Energy Group also make the following payments to the NLF: (i) fixed decommissioning contributions equal to £20 million per annum (stated in March 2003 money values and indexed to RPI but tapering off as the nuclear power stations are currently scheduled to close); and (ii) £150,000 (stated in March 2003 money values and indexed to RPI) for every tonne of uranium in PWR fuel loaded into the Sizewell B reactor after the Restructuring Effective Date.

The NLF has the right from time to time to convert all or part of the NLF Cash Sweep Payment into Convertible Shares (the NLF Conversion Right). On a full conversion, the NLF would hold up to 65 per cent. of the thereby enlarged equity share capital of the Company. However, the terms of the Convertible Shares include a limit on the voting rights attaching to such shares equal to the maximum amount which can be held by the NLF without triggering a mandatory offer under the United Kingdom Takeover Panel s City Code on Takeovers and Mergers, being currently 29.9 per cent. of the voting rights of the Company (and, for this purpose, taking into account the voting rights attributable to any other ordinary shares of the Company held or acquired by any person acting in concert with the NLF). This voting restriction applies for so long as the Convertible Shares are held by the NLF. The Convertible Shares will convert automatically into ordinary shares in the Company on transfer to a third party but are not convertible at the election of the NLF prior to such transfer.

There are restrictions under the terms of the Contribution Agreement on the manner in which the NLF may exercise the NLF Conversion Right or dispose of any of the shares arising on such exercise.

In November 2004, the Secretary of State confirmed that she had no intention to direct the NLF to exercise the NLF Conversion Right but reserved the right to do so. We understand that the Secretary of State intends to ensure that prior to the giving of any direction to the NLF to exercise the NLF Conversion Right or to dispose of the shares issued pursuant to such exercise, the Secretary of State (and/or the NLF at his direction) would take financial advice and would take such advice as to the market impact of the conversion or disposal (including the desirability of avoiding multiple sales of small amounts of shares). The Secretary of State also (a) agreed for a period of six months following Restructuring not to direct the NLF to exercise the NLF Conversion Right

or to dispose of any shares in

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the Company and (b) confirmed there was no current intention to direct the NLF to exercise the NLF Conversion Right following the expiry of that six month period. This period expired on July 14, 2005 and the Government keeps all aspects of its financial interest in British Energy under regular review.

The Secretary of State has an option to acquire for £1 each nuclear power station and related station assets (subject to certain exclusions) for the purpose of decommissioning or continuing the operation of those nuclear power stations beyond the date of closure of those stations assumed by the Group (which date will include any changes to such dates in our financial statements following the extension of current station lifetimes). An option to continue to operate a nuclear power station may (unless the British Energy Group has given notice that it will close the station early) only be exercised at any time up to and including the date which is two years before the scheduled closure date of the station but transfer of the station pursuant to the exercise of the option cannot complete until the scheduled closure date of the station, at the earliest. The Secretary of State also had an option to acquire the Group s interests in United Kingdom Nirex Limited ( Nirex ) which it did not exercise, but acquired Nirex from all its shareholders, including our interest, on April 1, 2005 under different arrangements.

**New BNFL Contracts**

On March 31, 2003 and May 16, 2003 respectively, we exchanged contracts with BNFL covering front end (i.e. fuel preparation before it enters the reactor) and back end (i.e. handling, storage and ultimate disposal of spent fuel) AGR fuel services required to give effect to the Restructuring. The amendments (set out in deeds of amendment agreed in March 2003 (the March 2003 Deeds of Amendment ) to the front end contracts (the Existing AGR Fuel Supply Agreements ) became effective on April 1, 2003 but, with the exception of the new arrangements for the supply of uranics to British Energy Generation Limited ( BEG ) (our licensed nuclear generating subsidiary), could have been terminated if the Restructuring had not been completed. The new front end post 2006 contracts (the Post 2006 AGR Fuel Supply Agreements ) were conditional upon completion of the Restructuring. The amendments to the previous back end fuel services arrangements (the BNFL Historic Contracts ) and the new back end fuel services arrangements (in respect of fuel loaded into our AGRs after the Restructuring Effective Date ( New Spent Fuel ), ( New Spent Fuel Agreements ) were also conditional upon completion of the Restructuring and became effective on the Restructuring Effective Date.

The principal payment terms of the Existing AGR Fuel Supply Agreements (as amended by the March 2003 Deeds of Amendment) and the Post 2006 AGR Fuel Supply Agreements are as follows:

(i) a payment of £28.5 million fixed per annum until March 31, 2006, but discounted on a linear basis in accordance with the market baseload price of electricity to a minimum payment of £13.5 million per annum at a market price of £15.0 per MWh. The fixed starting price falls to £25.5 million thereafter and is also subject to the discounting mechanism; and

(ii) a payment of £191,000 per tonne of uranium in AGR fuel delivered.

With respect to the New Spent Fuel Agreements we are required to pay:

(i) a payment of £150,000 per tonne of uranium in AGR fuel, payable on loading of such New Spent Fuel into one of our AGRs;

(ii) a rebate/surcharge against the payment mentioned in (i) above equivalent to 50 per cent. of the difference between the market baseload price of electricity in a year and £16.0 per MWh multiplied by the MWh produced by the AGR fleet in that year. The market baseload price of electricity used in the calculation will not be less than £14.8 and not more than £19.0 per MWh; and

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(iii) if the market baseload price of electricity exceeds £19.0 per MWh, a surcharge against that payment equivalent to 25 per cent. of the difference between the market base load price of electricity in a year and £19.0 per MWh multiplied by the MWh produced by the AGR fleet in that year. The market baseload price of electricity used in that calculation will not be less than £19.0 and not more than £21.0 per MWh.

Unlike under our previous arrangements with BNFL, whereby we retain title to and therefore remain responsible for the ultimate disposal of our spent fuel, and which will still apply to the Historic Fuel Agreements (under which BNFL provide spent fuel management services although the costs of disposal will be covered under the provisions of the Nuclear Liabilities Agreements), BNFL will assume title to New Spent Fuel on delivery to BNFL from our AGR power stations.

All of the above monetary amounts (for AGR fuel supply and the New Spent Fuel Agreements) are stated in July 2002 and 2002/2003 money values and are indexed to RPI.

The pricing provisions in the New BNFL Contracts highlighted above are intended to enable us to reduce the proportion of our fuel costs which are fixed by providing for a discount when the market baseload price of electricity is below a specified amount and a surcharge when above this amount. As electricity prices have risen substantially since October 2003, we are now making additional payments to BNFL under the new arrangements for spent fuel management in the form of the surcharge referred to above. This will continue for so long as electricity prices remain above £16.0 per MWh (in 2002/2003 money values and indexed to RPI).

**Sale of our interests in Bruce Power and AmerGen.**

On February 14, 2003 we announced that we had completed the disposal of our 82.4 per cent. interest in Bruce Power LP to a consortium for C$627 million, subject to a possible additional sum contingent on the restart of two of the reactor units sold. In this regard we have received a payment of C$30 million and may be entitled to additional sums. On February 12, 2004, we received a notice of claim under the master purchase agreement alleging breach of certain warranties and representations relating to tax and the condition of plant. Further information on this claim is set out in Item 4 Legal Proceedings.

In addition to the consideration payable by the consortium under the master purchase agreement, up to a further C$100 million was payable to British Energy contingent upon the restart of two of the Bruce A units under a trust agreement (the Trust Agreement ) entered into on the same date. Had the first unit restarted by June 15, 2003, C$50 million would have been released to British Energy and an additional C$50 million would have been released to British Energy had the second unit restarted by August 1, 2003. An amount of C$5 million was to be deducted from the C$50 million payable in respect of each unit for its failure to restart by the scheduled restart date or by the first day of each successive calendar month following the scheduled restart date. The Group received C$20 million on March 22, 2004 and C$10 million on May 25, 2004 in partial consideration under the Trust Agreement. British Energy commenced arbitration proceedings in Ontario against the Ontario Provincial Government ( the Province ) in December 2004 seeking the payment of additional consideration under the Trust Agreement on the basis that Bruce A Units 3 and 4 restarted earlier than the dates claimed by the Province. No additional amounts appear on our balance sheet at March 31, 2005 because of uncertainties regarding their realization. The amounts recoverable (if any) in respect of the restarted units will be substantially lower than the maximum C$100 million but the amounts and timing of the payments have still to be confirmed.

On December 23, 2003 we completed the disposal of our 50 per cent. interest in AmerGen to Exelon for US$277 million, subject to adjustment. These adjustments resulted in an agreed settlement of working capital adjustments primarily relating to the value of nuclear fuel and tax, with $9.5 million being payable to Exelon in two equal installments in February and September 2005.

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**Conditions to the implementation of the Restructuring**

The implementation of the Restructuring was subject to three stages of conditionality, namely:

conditions which needed to be satisfied prior to the proposal of the Creditors Scheme and the Members Scheme to the trustees of the Old Bonds (the Old Bond Trustees ) and RBS and BE Ltd shareholders, respectively (the Initial Conditions );

subsequent to the satisfaction of the Initial Conditions, conditions which needed to be satisfied before the Creditors Order and, following the approval of the Members Scheme, the Members Order, were filed with the relevant authority for registration (the Filing Conditions ); and

finally, the Creditors Scheme and the Members Scheme becoming Effective (the Restructuring Condition ).

On September 24, 2004, the Secretary of State received the State Aid Approval. On October 12, 2004, we announced that the other Initial Conditions to the implementation of the Restructuring had been satisfied. In relation to the Filing Conditions, the Restructuring was conditional on, amongst other things, the Secretary of State not having determined and notified British Energy in writing that, in her opinion, the British Energy Group (including for this purpose the Company and Holdings plc) would not be viable in all reasonably foreseeable conditions without access to additional financing (other than financing which the Secretary of State was satisfied had been committed and would continue to be available when required). The Filing Conditions and the Restructuring Condition were both satisfied on January 14, 2005.

**State Aid Restrictions on our ability to operate**

The European Commission has confirmed that the giving of State Aid in connection with the Restructuring is compatible with the Common Market. As part of the State Aid Approval, we have been required to agree to certain measures and conditions with the Government which will govern our business ( Compensatory Measures ).

The key Compensatory Measures are:

not, until September 23, 2010, to own or acquire any rights of control over:

(i) additional operational nuclear generating capacity in the EEA, (which would not include contracts to operate and maintain nuclear plants where we have no interest in the electricity output), without the prior approval of the European Commission; or

(ii) registered, operational, fossil-fuelled generating capacity in the EEA or large hydro- electric generating capacity in the UK, which in aggregate exceeds a capacity of 2,020 MW (although some relaxation of this restriction has been agreed to provide for a transitional period in cases where the Eggborough power station ceases to be available to

us);

to establish and maintain our existing nuclear generation activities, electricity direct supply business ( DSB ) and electricity trading business in separate subsidiaries by April 1, 2005;

not to allow our existing nuclear generation business to provide a cross-subsidy to our non-nuclear generation activities or any other business of the Group; and

not, for a period of six years, to price the energy element of our DSB contracts below the prevailing wholesale price, save for in exceptional market circumstances (to be determined by an independent expert).

The State Aid Approval requires the Government to ensure that the restructuring plan as communicated to the European Commission is fully implemented.

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The Directors expect, on the basis of how we currently conduct our operations and discussions with relevant authorities and regulatory bodies, that the obligation not to allow our nuclear generation business to cross subsidize our non-nuclear or other businesses, will not have a material adverse effect on the financial results of our business. We have no current intention to sell any of our output at below the wholesale price and therefore do not consider that the requirement that we do not price the energy element of our DSB contracts below the prevailing market price will have any effect on our business. For further detail on the impact of the other restrictions referred to above, see Item 3 Risk Factors Our business is affected by a number of restrictions which restrict our ability to develop new sources of income .

The State Aid Approval provides that the Government is permitted to fund the payment of: (a) liabilities related to the cost of management of spent fuel loaded into our AGR power stations prior to the Restructuring Effective Date ( historic spent fuel ) up to a specified level; (b) the costs of certain other liabilities set out in the HLFA (these costs, however, are not taken into account in calculating the above specified level); and (c) any shortfall of the NLF as regards the payment of liabilities related to our nuclear assets decommissioning, and uncontracted liabilities. The State Aid Approval states that as soon as expenditure corresponding to (i) the nuclear assets, decommissioning and uncontracted liabilities referred to above and (ii) the costs of the certain other liabilities set out in the HLFA referred to above exceed a specified threshold, the Government shall submit enhanced additional reports (on an annual basis) to the European Commission demonstrating that the Government payments are restricted to meeting these liabilities, and that proper steps have been taken to limit expenditure to the minimum necessary to meet those liabilities. In these circumstances, we are required to provide additional information and assistance to the Government (including payment of auditors costs and expenses).

We have agreed with the Secretary of State to implement the Compensatory Measures pursuant to a deed of undertaking (the Deed of Undertaking ). The separation of our DSB and electricity trading businesses into separate subsidiaries was completed by the April 1, 2005 deadline. In relation to the requirement to consolidate our nuclear generation activities in a single subsidiary by April 1, 2005, we were unable to obtain all the necessary consents by that date. The consolidation took place on July 1, 2005 and until that date, specific alternative arrangements which had a similar effect and which were agreed with the UK Government under the Deed of Undertaking were in place. Under the Deed of Undertaking, we have also undertaken not to dispose of all or part of our nuclear generation business or our DSB, or carry out any corporate restructuring of the British Energy Group, without the Secretary of State s prior approval (such approval not to be unreasonably withheld), if such disposal or restructuring may cause the Secretary of State to be in breach of his obligations under the State Aid Approval.

Pursuant to the terms of our various agreements with the Secretary of State and Government controlled entities, we are subject to the following key restrictions on our operations:

not to announce or pay any dividend or distribution or make any acquisition unless our cash exceeds the amount specified in the Contribution Agreement at the end of the financial period preceding the dividend, distribution or acquisition and would or would be likely to exceed the specified amount at the end of the financial period in which such dividend, distribution or acquisition is to be made;

not to incur any expenditure other than expenditure:

(i) in relation to Agreed Collateral Purposes (as defined in the summary of the Contribution Agreement in Item 10 Material Contracts), outage costs, working capital requirements, debt servicing and operating costs; or

(ii) the primary purpose of which is the maintenance (including non-recurring maintenance) of, or capital repairs to, our nuclear power stations and/or the Eggborough power station, or is intended to enable aggregate annual output of our

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nuclear power stations at a level which is around the highest output of the nuclear power stations in any of the preceding five financial periods (subject to a minimum of 68.0 TWh) adjusted as nuclear power stations close (provided that the permission to incur expenditure to enable aggregate nuclear output at this level does not permit capital investment in excess of £20 million per annum, without the approval of the Secretary of State, where the principal purpose of such expenditure is to enable the extension of scheduled closure dates of any of our nuclear power stations); and/or to enable output at the Eggborough power station at a level consistent with historical performance levels,

unless: (a) our cash exceeds the amount specified in the Contribution Agreement at the end of the financial period preceding the expenditure and would or would be likely to exceed the same at the end of the financial period in which such expenditure is to be made; or (b) it consists of specified expenditure for which the required funds have previously been allocated to a notional reserve in accordance with the terms of the Contribution Agreement;

if we achieve an investment grade rating, although we may reduce the Target Amount of the Cash Reserves (that is, initially, £490 million plus the amount by which cash employed as collateral exceeds £200 million), we may not pay any distribution or make any acquisition of any undertaking if we know or have reasonable grounds to believe that doing so would or would be likely to result in the loss of such investment grade rating, save to the extent that such distribution or acquisition would not reduce the aggregate amount of our cash and any committed facilities (which are available for, and intended and expected by the Board to be used for the same purposes for which our cash may be applied) below the amount specified in the Contribution Agreement;

at an operational level, not to make any operational change at our nuclear power stations which might increase the net present value of the Costs of Discharging Liabilities (as defined in the NLFA) by in excess of £1 million (in March 2003 money values and indexed to RPI) without notifying the NDA under the NLFA;

we are required in certain circumstances to obtain the approval of the NDA under the NLFA before implementing certain operational changes at any of our nuclear power stations, for example those which might increase the NPV of the Costs of Discharging Liabilities by in excess of £10 million (in March 2003 money values and indexed to RPI);

we are required, in certain circumstances to obtain the approval of the NDA under the NLFA to, amongst other things, extensions to the scheduled closure dates of our nuclear power stations (and consent must be given where the economic benefits accruing to the NLF or the Secretary of State are reasonably likely to exceed the incremental nuclear liabilities arising as a consequence), our decommissioning plans, our contracting strategy (and certain large contracts) for decommissioning our nuclear power stations and discharging uncontracted liabilities;

we are required to seek the prior approval of the Secretary of State to exercise certain strategic rights under the BNFL Historic Contracts or to make amendments to any of our agreements with BNFL if these impact on the level of historic liabilities;

we may not enter into material transactions with affiliates unless on arm s length terms (subject to similar exceptions as are contained in the terms and conditions of the New Bonds) and we are (until a certain date but no later than March 31, 2014) subject to a negative pledge not to create security interests (subject to similar exceptions as are contained in a negative pledge covenant of the New Bonds) without the prior written consent of the NLF and the Secretary of State unless at the same time equal security is granted to the NLF and the Secretary of State to secure amounts that are or may become payable under the NLFA, HLFA, Contribution Agreement and certain other agreements.

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we must comply with certain conduct of business obligations during the periods in which the options can be exercised under the Government Option Agreement, including, amongst others: (i) operating our nuclear power stations in the ordinary and usual course and, in the period immediately prior to the scheduled closure date of those nuclear power stations, restricting certain actions which may affect the Secretary of State s ability to exercise the options to decommission or continue operation of those stations; (ii) not to enter into certain contracts or commitments for capital expenditure (except where approved under the Contribution Agreement or the NLFA); or (iii) not to grant security over our nuclear power stations without the consent of the Secretary of State.

In addition, the terms of the Special Share held by each of the Secretary of State and the Secretary of State for Scotland restrict us from disposing of our shares in BEG and British Energy Generation (UK) Limited (our subsidiary which was, until July 1, 2005, the nuclear licensee for our nuclear power stations in Scotland ( BEG (UK) ), and restrict BEG from disposing of any of its nuclear power stations, without the prior consent of the holder of the relevant Special Share (such consent only to be withheld, if, in the holder s opinion, the disposal would be contrary to the interests of national security).

Further, we are subject to restrictive covenants as set out in the terms and conditions of the New Bonds, including, amongst others, the following:

we are prohibited from incurring financial indebtedness (other than certain permitted financial indebtedness) and from issuing guarantees of financial indebtedness unless the consolidated fixed charge coverage ratio (as defined in the New Bonds) is in accordance with the ratio set out therein. Permitted financial indebtedness includes up to £75 million of additional debt, of which £60 million may be secured;

we may not pay dividends unless the Target Amount is met and no event of default or potential event has occurred and is continuing. In addition, we may not make certain other restricted payments unless the consolidated fixed charge coverage ratio referred to above is met and the amount of the payment does not exceed 50 per cent. of consolidated net income for the relevant period;

there are limitations on the ability to repurchase our own shares and on investments, asset sales and sale and leaseback transactions;

there are also restrictions on transactions with affiliates, but transactions with BNFL, EPL and the NLF are permitted provided that they comply with certain requirements as set out in the terms and conditions of the New Bonds;

we are subject to a negative pledge, subject to customary exceptions;

there are also certain restrictions on the conduct of our business. The intention is to allow us the flexibility to continue our existing business of generating and selling electricity and we are also permitted to trade electricity within Europe and to decommission our nuclear power stations (or those previously owned by us); and

if the Target Amount is reduced as permitted by the Contribution Agreement, or if we otherwise have surplus cash as a result of asset sales or if the Eggborough Break Option (as defined in the terms and conditions of the New Bonds) is exercised, then we are obliged to apply this excess cash (once the surplus exceeds £10 million) in redeeming the New Bonds.

If the New Bonds attain an investment-grade rating from at least two rating agencies (one of which must be Moody s Investor Service) and provided that no event of default or potential event of default is subsisting, then most of the restrictive covenants described above will be suspended, although they will be reinstated if the investment-grade rating from such agencies is withdrawn.

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Finally, a receivables financing facility agreement between BEG and Barclays Bank PLC dated August 25, 2004 (as subsequently amended and restated) (the Receivables Facility Agreement ) contains detailed covenants for the benefit of the facility provider, which mirror those under the New Bonds. British Energy Direct Limited ( BEDL ) replaced BEG in the Receivables Facility Agreement (and BEG became a guarantor) on April 1, 2005 when the direct supply business was transferred from BEG to BEDL. In addition to detailed covenants mirroring the New Bond terms, the Receivables Facility Agreement also contains a financial interest coverage covenant (assessed on a consolidated group-wide basis) and covenants relating to the conduct of the electricity supply business customary for a receivables facility.

We do not believe that the restrictions on our expenditure under these agreements, in particular the restrictions in the Contribution Agreement, prohibit spending on PiP (as currently envisaged) at the levels previously announced.

**Requisitioned EGM and Delisting of BE Ltd s Ordinary Shares, A Shares and American Depository Receipts**

On September 3, 2004 two groups of shareholders, together holding 10.22 per cent. of BE Ltd s ordinary shares, requisitioned an Extraordinary General Meeting of BE Ltd (the Requisitioned EGM ). Those groups of shareholders were Polygon Investment Partners LLP ( Polygon ) and Brandes Investment Partners LLC ( Brandes ) and their respective associates. We were, as a result, obliged under the Companies Act to call the Requisitioned EGM. One of the resolutions proposed by Polygon and Brandes would have had the effect, if passed, of requiring BE Ltd to seek shareholder approval prior to applying for the cancellation of its listings in London and New York. If we had subsequently been required, under the terms of the Creditor Restructuring Agreement, to take steps to cancel the London listings of BE Ltd s shares, but could not have done so as a result of a failure to achieve such shareholder approval, we believe, having taken legal advice, that we would have been likely to have been in breach of the Creditor Restructuring Agreement.

We announced on September 23, 2004 that the Requisitioned EGM would be held on October 22, 2004 and that as a result of this attempt to frustrate the Restructuring, we would be applying to the UKLA to cancel the listings of BE Ltd s ordinary and A shares. As a consequence, and as announced on September 23, 2004, the NYSE suspended trading in our ADRs prior to the opening of trading on September 28, 2004. At that time, the NYSE also instituted delisting proceedings. We appealed unsuccessfully against the NYSE s decision, and on December 6, 2005 the NYSE affirmed the decision to delist BE Ltd s ADRs. The delisting from the NYSE does not affect our status as a SEC registrant under the US Securities Exchange Act 1934, or our periodic reporting obligations.

On September 24, 2004 we announced (i) the unanimous recommendation of the Board to shareholders to vote against the resolutions proposed by Polygon and Brandes at the Requisitioned EGM, (ii) that we intended to seek an extension to the Creditor Restructuring Agreement long stop date of January 31, 2005 for the Restructuring and (iii) that, in accordance with the Creditor Restructuring Agreement, we would execute a business transfer agreement whereby the Company s assets would, conditional on the Restructuring becoming effective, be transferred to a new intermediate holding company of the restructured British Energy Group.

On September 30, 2004 Polygon announced that it would withdraw its support for the Requisitioned EGM. Polygon stated that, having considered our circulars on the matter, they believed there was no commercial logic for it supporting the resolutions to be considered at the Requisitioned EGM and consequently confirmed that they would vote against the resolutions and not further oppose the Restructuring. The Requisitioned EGM took take place on October 22, 2004 and all of the resolutions were defeated.

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Since neither BE Ltd nor the Company were able to satisfy the relevant listing criteria for the NYSE on Admission, no new ADRs were issued on Admission. Holders of ADRs received the New Shares and/or Warrants to which they were entitled.

**Rating of Bonds**

We held discussions with Fitch Ratings, Moody s Investor Services and Standard & Poor s Rating Services (together the Rating Agencies ) with regard to obtaining credit ratings for the £550 million of New Bonds issued to certain of our creditors and to the NLF upon completion of the Restructuring pursuant to the terms announced on October 1, 2003.

Preliminary discussions were held with the Rating Agencies in advance of agreement on the terms of the Restructuring and it was stated in our announcement made on October 1, 2003 that one rating agency had provided an indicative rating for the New Bonds of investment grade and two rating agencies had provided indicative ratings at non-investment grade.

On September 23, 2004, we announced that the Rating Agencies had updated their analysis and that all three agencies had now provided indicative non-investment grade ratings for the Company. Upon Restructuring, the Rating Agencies issued new ratings for the New Bonds as follows.

| | Rating |
|---|---|
| Moody s Investor Services | Ba3 |
| Standard & Poor s | BB |
| Fitch Ratings | BB- |

These ratings do not apply to the additional £150 million of bond-equivalent payments that were issued to certain lenders to EPL through the Amended Credit Agreement, which will not be rated. We maintain a close dialogue with the Rating Agencies, including twice yearly meetings and attendance at investor presentations.

**Relationship with Government**

In a statement to the United Kingdom Parliament on November 28, 2002 the Secretary of State set out the limits of the support which the Government was prepared to provide to the Restructuring in order to support its overriding objectives of securing the safety of British Energy s nuclear power stations and the security of electricity supply in the United Kingdom.

As a result of these objectives, the Government, both directly and through the NLF, availed itself of a number of rights granted to it under the Government Restructuring Agreement (pursuant to those provisions of the Nuclear Liabilities Agreements which had effect prior to the Restructuring Effective Date) to protect its significant financial interest in the Group. However, the Restructuring was implemented on the basis that the Board will manage the business of the Group going forward, albeit within these constraints.

During the period prior to the Restructuring Effective Date, we kept the Secretary of State closely informed of, amongst other things, our financial and trading prospects. We also provided the Secretary of State with reports and other information as required under the Government Restructuring Agreement and the Creditor Restructuring Agreement. Post-Restructuring, we are required to continue to supply certain information to the Secretary of State and the NLF. We are also required under the terms of the Nuclear Liabilities Agreements, amongst other things, to provide the Secretary of State with all the information he would reasonably need to monitor the financial health of the Group (including monthly

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cashflow information covering the period 18 months ahead) and to only adopt trading policies which are prudent in light of the Group s on-going financial resources and obligations and to comply with such trading policies. As a result of these requirements, the Company has agreed to provide the Secretary of State and DTI with, amongst other things, periodic reports on its business performance and strategic and business plans and for there to be regular meetings and communication between the Secretary of State and senior executives and the Board on a range of topics. Over time, the frequency and content of the reporting may be reviewed.

**Office of National Statistic Classification and the National Audit Office Conclusion**

On September 24, 2004, the Office of National Statistics ( ONS ) announced its provisional classification decision that, for the purposes of production of the United Kingdom National Accounts ( National Accounts ), British Energy had been classified as in the public sector. As explained in the announcement, the National Accounts are produced to describe activities in a national economy, including transactions taking place between sectors of that economy. The ONS is responsible for the National Accounts which are compiled in accordance with international standards. In assessing the status of British Energy as a public sector body, the ONS stated that it took into account (amongst other things) the powers to be conferred on the Government as a result of the Restructuring.

The National Audit Office ( NAO ) has independently concluded, on the basis of the circumstances extant as at September 21, 2004, that British Energy should be accounted for following the Restructuring Effective Date as a quasi-subsidiary of the DTI.

The Company is a public limited company owned by its shareholders and operates within an extensive contractual framework established as part of the Restructuring. The most significant contract, in terms of the limitations it places on our business, is the Contribution Agreement between the Secretary of State and the Company. Within this contractual framework the Company is managed independently by the Board which continues to direct the finances and operating policies of the group and is subject to the normal private sector disciplines, fiduciary duties and Companies Act requirements.

In the light of the level and type of interaction we have with the Government we have concluded that for the purposes of FAS57 the Government constitutes a related party. For further information, see our Consolidated Financial Statements and the related notes beginning on page F-1.

**Business Strategy**

Our business strategy is constrained by, amongst other things, the terms of the Contribution Agreement, the New Bonds, the Receivables Facility Agreement and the compensatory measures we have agreed to in connection with the State Aid Approval. Therefore, we expect to execute the following strategy:

**Achieve World Class Nuclear Performance.** Our principal business objective is to improve operational performance the reliability and output of our nuclear fleet and to reduce the level of unplanned nuclear losses. Implementation of PiP is the key factor in achieving this aim.

**Improve our Financial Stability.** Our ability to take advantage of market conditions is impacted by the requirement to post collateral. We expect this to improve as cash balances increase through time. However, in the short term, we aim to improve financial stability through improved trading risk management and greater use of financial products to minimize the impact of collateral requirements. An improvement in our credit rating is not expected in the near term and will require us to demonstrate, amongst other things, sustained improvements in the reliability of our power stations over time.

**Pursue life extensions.** We continue to pursue life extensions for our stations. The first of these decisions is with respect to Dungeness B. The technical and commercial work required is progressing well and a decision is expected to be made this fall. Progress on improving the

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materiel condition of our nuclear power stations and other specific plant investments, and on developing the required safety cases may allow us to support the extension of station operating lives. (See Item 4 Our Business Station Lifetimes).

Overall we are aiming to raise our standing in the worldwide nuclear community by demonstrating increasing capability to the World Association of Nuclear Operators ( WANO ) and the Institute of Nuclear Power Operations ( INPO ) as a basis of establishing our credentials as an operator and manager of choice.

As our nuclear power stations close, our ability to invest in new business development opportunities may be further restricted due to a lack of sufficient cash resources and this issue may be exacerbated should some of our nuclear power stations be required to close earlier than the estimated closure date used in our financial statements.

**RECENT DEVELOPMENTS**

We reported an accident at Eggborough power station in July of this year, where one of our contractors lost his life. We are taking this matter extremely seriously and are undertaking an inquiry into the accident, as are the Health and Safety Executive ( HSE ). Safety standdowns are being carried out across the fleet to ensure that the issues related to the incident are fully addressed.

We continue to pursue life extensions for our stations. The first of these decisions is with respect to Dungeness B. The technical and commercial work required is progressing well and a decision is expected to be made this fall.

We announced our UK preliminary results for the year ended March 31, 2005 on July 27, 2005. A copy of the announcement is available on our website *www.british-energy.com*.

After full and careful consideration of the benefits and disadvantages of reporting under UK IFRS, our registration with the SEC and the publishing of US GAAP results (including the demand for this information and the substantial costs and commitment of management time of doing so) the Board has concluded that we should seek the agreement of the bondholders to dispense with future US GAAP reporting and that if this is agreed de-registration from the SEC is in our best interests. We will be seeking the necessary approvals although there can be no assurance that we will be able to obtain these.

In addition, we will be seeking at our Annual General Meeting certain amendments to the Long Term Deferred Bonus Plan which we believe are necessary to make it consistent with our current business plans. The changes include a modification to the output targets for the financial year ending March 31, 2006. Theses changes do not affect our expected average annual nuclear output over the next two years which remains at 63 TWh. For further details of the Long Term Deferred Bonus Plan, see Item 6 Directors, Senior Managers and Employees.

**OUR BUSINESS**

**Our nuclear power stations**

We own and operate two types of nuclear reactor namely, the AGR and the PWR. They differ in many respects including, amongst other things, in the types of fuels used and in the design of the reactor. Each of our seven AGR nuclear power stations, Dungeness B, Hartlepool, Heysham 1, Heysham 2, Hinkley Point B, Hunterston B and Torness, is powered by two AGRs. Sizewell B is powered by a single PWR. Whereas the AGR design is unique to the UK, the PWR design is the most common reactor type in the world.

As well as being unique to the UK, our AGR stations were constructed to varying specifications by different engineering consortia which we consider makes demonstrating safety cases for different

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reactors less straightforward and can mean that implementation of remedial action to make good a defect at one station cannot always be replicated with ease at other differently designed stations. For further information on safety cases see the paragraph below headed Station lifetimes .

An AGR has a graphite moderator (which helps to control the reaction) which is comprised of large graphite bricks with channels for the fuel rods, control rods and pressurized carbon dioxide coolant. The reactor is encased in a steel-lined pre-stressed concrete pressure vessel several meters thick which also acts as a biological shield. The boilers in which the water is heated are situated inside the pressure vessel. The AGR uses enriched uranium for its fuel.

A PWR is contained inside a steel pressure vessel filled with pressurized water which acts as the coolant and moderator. Pressurized water is pumped around the reactor and through the boilers. The pressure vessel, boilers and connecting pipework are contained within a steel-lined pre-stressed concrete containment building, which acts as one of the multiple designed-in barriers to the release of radioactivity in the event of an accident. The fuel used is enriched uranium dioxide and is contained in zirconium alloy tubes.

**SEASONALITY**

Electricity demand in the UK is seasonal, in that demands and prices have been generally lower in summer than in winter. As a result, we (and other generators) schedule a significant proportion of planned outages for summer months. This seasonality in both prices and output has a direct effect on financial performance and cash flows. See also Item 3 Risk Factors We continue to face liquidity risks associated with the seasonality of our business and the provision of collateral to our counterparties .

**Operating regime**

***Capacity and output***

The electrical output of a station depends on a combination of its overall generating capacity, the output level at which the station actually operates and its availability. The capacity of each station is reviewed and amended from time to time to reflect the long-term capability of the plant. The table below sets out the capacity values for each of our nuclear stations, the output of each of our nuclear stations for each of the last five fiscal years and the percentage of the fleet s load capacity that was achieved in each year ( Annual Load Factor ).

| Station | Capacity (MW)[1] | Output[3] (TWh)/Year ended March 31, | | | | |
|---|---|---|---|---|---|---|
| | | 2005 | 2004 | 2003 | 2002 | 2001 |
| Dungeness B | 1,110 | 6.47 | 6.66 | 5.18 | 5.25 | 3.66 |
| Hartlepool | 1,210 | 5.04 | 8.28 | 9.34 | 8.83 | 9.09 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Heysham 1 | 1,150 | 5.11 | 6.28 | 7.85 | 8.11 | 8.92 |
| Heysham 2 | 1,250 | 8.21 | 9.81 | 9.30 | 9.03 | 10.05 |
| Hinkley Point B | 1,220 | 9.27 | 8.11 | 8.26 | 8.98 | 8.23 |
| Hunterston B | 1,190 | 8.26 | 8.77 | 8.93 | 9.85 | 6.43 |
| Sizewell B | 1,188 | 9.12 | 8.90 | 9.20 | 9.22 | 8.43 |
| Torness | 1,250 | 8.30 | 8.15 | 5.70 | 8.30 | 7.71 |
| Total | 9,568 | 59.78 | 64.96 | 63.76 | 67.57 | 62.53 |
| Annual Load Factor[2] | | 71% | 77% | 76% | 81% | 75% |

(1) Capacities are stated net of all power consumed for the stations own use, including power imported from the National Grid.
(2) Annual load factors are obtained by dividing the actual output by the output that would have been achieved had each station operated at its stated full load capacity in that year for the entire period.
(3) Output in each year reflects any statutory, refueling and unplanned outages as discussed below.

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The output levels which stations can achieve relative to their stated capacities are affected by a number of factors, including plant operating conditions and operating strategies, which can result in a station being operated at below its maximum capacity level. Station availability is principally affected by the number and duration of planned and unplanned outages and load reductions, such as those required to carry out refueling (as described below). Taking into consideration the impact of statutory outages and refueling (but excluding planned repair outages), the maximum annual load factor which could be achieved across our portfolio of stations is approximately 90 per cent. This is less than the annual load factor which could be achieved at a PWR power station.

During the year we identified issues related to potential corrosion of steel tendons used to maintain the integrity of the pre-stressed concrete pressure vessels and boiler closure units at Heysham 1 and Hartlepool during planned outages. We completed a limited inspection of boiler closure unit tendon wires and demonstrated that the tendon wires were intact and free from corrosion. Techniques have been developed and deployed successfully to continue inspections at both plants. During the statutory outage inspections at Heysham 1 in May this year a further issue was identified relating to the potential for stress corrosion cracking of primary holding down bolts. There are forty-eight bolts per boiler closure unit and the risk of stress corrosion cracking is associated with the presence of water and $CO_2$. Work programs are ongoing to develop our understanding of, and to address, this risk. These will include non-invasive inspections. We expect these programmes to be completed by the end of July. As a consequence the return to service date of the relevant unit at Heysham 1 is expected to be delayed for about a month. One unit at Hartlepool (which is of similar design) is currently shut down for repair work to the generator transformer and the return to service of this unit is expected to be delayed for a month for similar work to be carried out. We intend to inspect the integrity of the studs at the other two units at Heysham 1 and Hartlepool later this year.

Additional graphite brick inspections at Hartlepool during 2004 revealed a small number of bricks had cracked in a manner not predicted by our analytical models. We have increased the frequency of our inspections of the graphite cores affected and are required to develop further safety cases in conjunction with the NII. For further information on these issues, see Item 3 Key Information Risk Factors Problems of potentially damaged boiler closure unit pre-stressing tendons and subsequent inspection requirements at our Hartlepool and Heysham 1 nuclear power stations could negatively affect our profitability or revenues .

***Statutory outages***

Periodically, our reactors need to be shut down to allow for regulatory inspection and routine maintenance. We refer to these as statutory outages. The interval between the statutory outages is determined by the plant safety case which includes the requirements for inspection, maintenance and testing, and the arrangements in place to control this interval are approved by the NII . Currently, each of our AGRs must initiate a statutory outage once every three years and our PWR once every 18 months.

After a statutory outage, the NII s consent is required for a reactor s return to service and this consent is dependent upon us demonstrating the continuance of an adequate safety case in respect of that reactor. For more information on safety cases see the paragraph below headed Station lifetimes . We seek to reduce the impact of statutory outages on revenue by timing such outages to occur during periods of lower demand for electricity when prices are lower (generally between March and October). We also seek to reduce the duration of any statutory outages by improving the efficiency with which we conduct the required program of work. AGR statutory outages completed during the year ended March 31, 2005 had an average duration of 47 days, compared to 53 days in 2004 and 56 days in 2003. Statutory outages are limited to one reactor within each AGR station at any one time.

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During the year ended March 31, 2005 we carried out four statutory outages (with a further statutory outage commencing at Sizewell B in March 2005) resulting in a loss of output of 2.9 TWh. Sizewell B returned to service in mid May 2005.

***Refueling operations***

Reactor output is also affected by planned outages including load reductions required to carry out refueling. During the year ended March 31, 2005 output losses of 3.0 TWh were attributable to refueling, 0.5 TWh less than expected due to lower overall output. We conduct on-load refueling (i.e., refueling, while the reactor s power is reduced to between 20 per cent. and 40 per cent. of full power) at Hinkley Point B, Heysham 2, Hunterston B and Torness to help reduce the amount of output lost due to refueling. We refuel these reactors one at a time at each station. On-load refueling operations typically take a few days to complete and are repeated approximately every six weeks for each reactor.

At Heysham 1, Hartlepool and Dungeness B we refuel the reactors whilst they are off-load, which typically takes approximately one week. We also refuel these reactors one at a time at each station. This process typically occurs every five months for each reactor.

Improvements in fuel utilization have reduced the amount of refueling required at each reactor. In particular, we have developed more efficient fuel management techniques, such as increasing fuel enrichment and radial shuffling (the movement of partially burnt fuel assemblies from the edge of the reactor to the center so that more of the energy can be extracted from the fuel over a longer period) to increase the output extracted per tonne of fuel loaded. Radial shuffling is carried out routinely at Hinkley Point B and Hunterston B. It was also carried out routinely at Hartlepool and Heysham 1 but was suspended in 2002 because of fuel failures. Limited shuffling has recommenced this year at Hartlepool and the position regarding routine shuffling will be reviewed following further examination of discharged fuel. Some shuffling has been carried out at Dungeness B but it was suspended in 2002 as a precautionary measure and routine shuffling will not recommence until a revised safety case has been presented.

Radial shuffling is not carried out at Torness or Heysham 2 because we believe that to do so would disproportionately increase the time taken to complete refueling and therefore would be uneconomical.

We are presently in discussions with BNFL regarding possible further increases in fuel enrichment and changes to the fuel design that will further improve its utilization and also make it less susceptible to failure. For further details on fuel failures, see Item 3. Risk Factors The failure of our AGR fuel could result in decreases in our output and revenues .

PWRs are not designed to refuel on-load and must be shut down for refueling. Accordingly, we seek to time statutory outages at Sizewell B to coincide with refueling outages. Although Sizewell B has only one reactor, that reactor has a performance capacity comparable to the combined reactor capacity of both reactors at an AGR station and the impact of an outage for the same period is therefore substantially greater than that associated with a single AGR reactor. Sizewell B currently operates for a period of up to 18 months between statutory/refueling outages, the average length of which is 47 days. During refueling, approximately one third of the fuel is replaced.

***Unplanned losses***

Our level of unplanned losses in recent years has significantly affected the results of our operations. To date these unplanned losses have been caused by a variety of factors, amongst the

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most significant of which are problems with our refueling equipment and processes, turbine-generators, tendons, boilers, gas circulators (which are used to pump carbon dioxide coolant gas around the reactor core) and pipe work (which is used to carry sea water for cooling). We believe that these losses are indicative of a deterioration in the material condition of our plant over time caused by: (i) a shortfall in investment when compared with international benchmarks for spending at nuclear power stations; (ii) a failure to perform required maintenance on a timely basis; and (iii) human errors in the operation and maintenance of plant. The table below sets forth the total unplanned losses (expressed in terawatt hours) for the past five years.

| Total unplanned losses (TWh)/Year to March 31, | | | | |
|---|---|---|---|---|
| **2005** | **2004** | **2003** | **2002** | **2001** |
| 17.3TWh | 10.7TWh | 10.6TWh | 9.1TWh | 12.8TWh |

The substantial increase in total unplanned losses for the year ending March 31, 2005, was primarily due to the significant impact of prolonged outages at Heysham 1 and Hartlepool nuclear power stations.

A requirement for significant additional work was identified during the statutory outages on one reactor at each of Heysham 1 and Hartlepool. The subsequent planned shutdown of the second reactor at Hartlepool and the unplanned shutdown of Heysham 1 s second reactor resulted in extended outages at all four of these reactors. This was necessary to undertake not only planned cast iron pipework replacement works but also the inspection of boiler closure units, additional graphite core inspections and to address emergent fire and flood safety case requirements. The requirement to replace cast iron pipework resulted from the unplanned outage at Heysham 1 in the previous financial year following the failure of certain pipework. The issue relating to boiler closure units emerged during the statutory outage at Hartlepool and concerned the integrity of the pre-stressing tendons used to secure the concrete pressure vessel of the reactor units and the potential impact on the boiler closure units. The increased graphite core inspections arose from the findings made during the Hartlepool outage which were not within the expectations of the safety case. All four units returned to service at the end of December 2004, although a subsequent turbine blade failure at Heysham 1 at the end of January resulted in that unit being shutdown until early April while repairs were carried out. The resultant loss of output from these outages was 7.4 TWh.

In addition to these output losses and the losses resulting from statutory outages and refueling, there were further losses of potential generation from unplanned outages of 9.9 TWh. Of these, some 6.5 TWh were due to outages of 14 days or less.

***Performance Improvement Program***

During the year we continued to implement PiP with the aim of improving the reliability of our nuclear fleet and reducing the level of unplanned nuclear losses. The program has six main areas: foundation (organization, people, leadership and culture change), training, human performance, equipment reliability, management of work and operational focus. The focus for the past year has been on improvements relating to people and process in each of these areas.

To support the implementation of PiP we have sought advice from experienced consultants and called upon significant support from WANO in order to supplement our in-house teams with additional experienced nuclear professionals.

Over the year we have developed and implemented a new organizational structure for the Company. We have also created assessment and development centers for senior staff and introduced new station organization structures. Development of leaders has continued through the provision of

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on-site coaching support and the use of action learning groups. In addition we have recruited 415 staff (a net increase of 181) into the organization to enhance areas such as maintenance and training to increase the operational knowledge throughout the organization. Improvements in training are a key part of PiP and training has been strengthened as a result.

Human performance has been one of the main areas of focus at our nuclear power stations this year. We have educated leaders on how to encourage positive behavior, reinforce standards and expectations and promote the use of error reduction tools in order to ensure the best possible performance from our staff. To re-inforce this message, leaders are expected to spend time in the field every week observing and coaching staff. This has had a positive effect on many of our performance indicators including lost time accidents, nuclear reportable events and unplanned automatic reactor trips.

To address equipment reliability issues we have formed an Asset Planning and Investment Group ( APIG ). The APIG and associated processes will enable more effective investment in our plant. To further address this issue we are also creating a new System Health Department at each station.

We have also completed the roll out of a comprehensive corrective action program ( CAP ) across the nuclear fleet. This program enables identification and rectification of issues concerning people, plant and processes and is identified by many US nuclear plant operators as being a key factor in driving performance improvement.

We have had significant success in establishing and embedding a consistent set of processes relating to management of work in our nuclear power stations across the company. We have seen a significant reduction in our non-outage plant defect backlog, beyond our stretch target for the year.

We have now started an effectiveness review process across all areas of PiP, to ensure that the improvements introduced are effective and sustainable. The focus for the program over the coming year is to integrate the processes into the line organization. In recognition of the work carried out on change management, the Company was short-listed for a Manufacturing Excellence Award by the Institute of Mechanical Engineers.

**Station lifetimes**

The primary factor in determining the operating life of a nuclear power station is the technical and economic practicability of supporting an agreed safety case for that station in accordance with its nuclear site licenses. The safety case is the totality of documented information and arguments which substantiates the safety of the plant, providing a written demonstration that relevant standards have been met and risks reduced as low as reasonably practicable. It is a live document subject to review, change and amendment over time, reflecting changes in the plant, its mode of operation, understanding of safety-related issues, and accumulation of operating experience.

The adequacy of the safety case for each power station is justified at each statutory outage for the following period by undertaking appropriate inspection, maintenance and testing of the plant and reviews of its operating performance. The results are reported to the NII, which must give its formal consent under the nuclear site license before the reactor concerned may be restarted. The NII s consent to restart is a matter determined by the NII in its sole discretion. Its decisions are made by reference to its satisfaction with

the safety case at the reactor in question. From time to time such consent to restart is not received from the NII until further work has been undertaken. Under this regime a reactor may only be operated following restart for the period determined by the safety case. This period is currently three years for all our AGR power stations and two years for Sizewell B s PWR.

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In addition, every ten years we have to undertake a Periodic Safety Review ( PSR ) for each nuclear power station. This involves a systematic review and reassessment of its safety case against current standards and practices, in the light of operating experience and knowledge of aging mechanisms. It evaluates factors that could limit safe operation and reasonably practicable improvements in the period until the next PSR. PSRs, too, require NII acceptance in order for us to secure continued operation. Following the first PSRs at our AGR stations, the NII gave its acceptance for a further ten years of operation for each station based on an agreed program of plant modifications to ensure adequate safety cases. The first PSR for Sizewell B has been submitted to the NII and responses have been received and are currently being addressed. For further information on PSRs, see the heading below entitled Periodic Safety Reviews .

A key factor for operating life is the ability to demonstrate the continuing integrity of reactor components which are required to support the safety case, but may be uneconomic to replace. For the AGRs such components include the graphite moderator core and the boilers; for the PWR they include the reactor pressure vessel. In such cases the lifetime is dependent on the NII s perception of the key technical issues such as the onset of graphite core brick cracking and boiler tube failures (which are discussed in greater detail in Item 3. Risk Factors Problems of graphite core brick cracking and reduced boiler life could negatively affect our profitability and the lifetime of our AGR stations ).

The assessed potential lifetime of our stations used in our financial statements is termed the accounting life . This is derived from our judgement of our technical and economic ability to make a secure safety case at each statutory outage and at any relevant PSR, and to maintain the operability of the station as a whole up to the end of that life. These judgements are reviewed from time to time in the light of operating experience. For six power stations, this has led to an increase in accounting life of 5 or 10 years over the initial accounting life of 25 years. The current accounting lives and corresponding estimated closure dates are set out in the following table.

| Station | Accounting Lifetime | Estimated Closure Date | Date next PSR is submitted to NII | Date of expected response from NII |
|---|---|---|---|---|
| Dungeness B | 30 | 2013 | December 2006 | January 2008 |
| Hinkley Point B | 35 | 2011 | March 2006 | January 2007 |
| Hunterston B | 35 | 2011 | March 2006 | January 2007 |
| Heysham 1 | 30 | 2014 | December 2007 | January 2009 |
| Hartlepool | 30 | 2014 | December 2007 | January 2009 |
| Torness | 35 | 2023 | December 2008 | January 2010 |
| Heysham 2 | 35 | 2023 | December 2008 | January 2010 |
| Sizewell B | 40 | 2035 | December 2013 | January 2015 |

The exact closure date of each reactor at each of our AGR stations will depend on the timing of the reactors statutory outages. We will aim to close one of the pair of reactors at each station ahead of the other in order to allow defueling, which is the preliminary to decommissioning, to take place with optimal fuel utilization and generated output.

***Further extension of accounting lifetimes***

We recognize that extending the lifetimes of our stations has the potential to enhance the value of our asset base, and we plan to carry out the evaluations to see if further extension of station lives is technically and economically feasible. Following the completion of the Restructuring any extension to the declared closure dates of our stations is also subject to NDA consent. This work is currently underway for Dungeness B and we expect to make a decision in the fall. Such assessment takes account of the

likely performance of the power station, the value of the output it generates, and the cost incurred to secure this performance while maintaining the safety case and compliance with other

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regulatory requirements. We will undertake the technical and commercial evaluations for life extensions at the remainder of the nuclear fleet at the appropriate time having regard to improving shareholder value.

We carried out a fair value exercise as at the Restructuring Effective Date and concluded that the process of reviewing the station life extension at Dungeness B was sufficiently progressed at that time, that a willing buyer and willing seller would have increased the accounting life of Dungeness B from 25 years to 30 years. We are progressing with the technical and commercial work for Dungeness B life extension in line with our plans.

There can be no assurance that lifetime extensions will be attainable at any of our AGR power stations nor that the existing operating lifetimes used in our financial statements will be capable of being achieved. For further information see Item 3 Risk Factors Problems of graphite core brick cracking and reduced boiler life could negatively affect our profitability and the lifetime of our AGR power stations. If our AGR power stations are to operate until the end of the current operating life used in our financial statements, we will also need to continue to be able to source new AGR fuel from, and dispose of spent fuel to, BNFL, the sole supplier of AGR fuel. See Item 3 Risk Factors . Our business depends on equipment and service suppliers of a specialized nature.

**Nuclear fuel cycle**

There are several clearly identifiable stages in the life of nuclear fuel, known as the fuel cycle. The stages of fuel preparation before it enters the reactor, namely, uranium supply, conversion, enrichment and fabrication, are known as the front end fuel cycle. The handling, storage, reprocessing and ultimate disposal of spent fuel and associated waste products are known as the back end fuel cycle. The various stages of the fuel cycle and the relevant fuel cycle contracts are described in more detail below.

***The front end fuel cycle***

*Uranium supply, conversion and enrichment*

New uranium production is supplied from mines in the form of uranium ore concentrate, and is available on the competitive world market. It is first converted into uranium hexafluoride (natural $UF_6$). There are four major suppliers of conversion services and there is a competitive world market.

Once the uranium has been converted to natural $UF_6$, it is enriched by increasing the proportion of Uranium $U_{235}$ to make it suitable for use in certain types of commercial nuclear reactor (enriched $UF_6$). There are four major suppliers in a competitive world market for enrichment services. Uranium in the forms of ore concentrate, $UF_6$ and enriched $UF_6$ are collectively termed uranics. Over the last 15 years a substantial proportion of the world s uranics needs have been met from ex-military and civil stockpiles.

*Fabrication*

Up to the fabrication stage, fuel cycle processes are identical for both AGRs and PWRs. At the fabrication stage, enriched $UF_6$ is converted into either AGR or PWR ceramic fuel pellets and assembled to produce fuel elements/assemblies which are subsequently loaded into the reactors. See Item 3 Risk Factors the risk starting Our business depends on equipment and service suppliers of a specialized nature .

The sole supplier of AGR fuel fabrication services is BNFL. A competitive world market exists for PWR fuel fabrication services.

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***Front end fuel cycle contracts***

*Uranium procurement, conversion and enrichment*

Under arrangements agreed as part of the Restructuring, BNFL is now responsible for purchasing all the uranics we require to be manufactured into fuel for our AGR power stations. Previously BNFL purchased uranics on behalf of BEG (UK) stations only. BNFL is also responsible for purchasing enriched uranium for on-supply to our PWR fuel fabricator. These arrangements are set out in the AGR fuel fabrication and supply agreements between our companies and BNFL.

Existing contracts for the supply of uranics and BEG s existing stocks of uranics both transferred to BNFL as part of the revised purchasing arrangements and are sufficient to fully meet our requirements for our AGRs and PWR until at least the end of calendar year 2006.

*AGR fuel fabrication*

We are dependent on BNFL as the sole supplier of AGR fuel fabrication services for the operating life of our AGRs. The AGR Fuel Supply Agreements agreed as part of Restructuring will expire when no further AGR fuel is required to be loaded into our AGR stations.

We maintain stocks of fuel at our AGR power stations which, together with the capability of the AGRs to continue to generate power without the need for new fuel to be loaded, would be sufficient for approximately three to four months continuous generation in the event of supply disruption.

*PWR fuel fabrication*

Fuel fabrication services for Sizewell B are currently provided by Framatome ANP ( Framatome ) utilizing enriched uranium supplied to us by BNFL under the AGR Fuel Supply Agreements referred to above. The agreement with Framatome provides for a mix of fixed commitments for PWR fuel fabrication and options for us to call for additional PWR fuel fabrication, and is capable of meeting Sizewell B s requirements until around 2015.

As PWR fuel fabrication is readily available in a competitive world market, we believe that it would be possible to secure replacement supplies in the event of supply disruption from Framatome, subject to fuel compatibility and licensing requirements.

***The back end fuel cycle***

*Spent fuel*

Spent fuel is fuel which is removed from a reactor because it can no longer support the required level of power generation. Following a three to six month period of storage and cooling in water-filled ponds at the AGR station sites, the spent AGR fuel is loaded into specially designed flasks and transported to BNFL s plant at Sellafield, England for reprocessing or long-term storage. Our spent PWR fuel is stored on-site in cooling ponds pending construction of a longer term storage facility. Spent AGR and PWR fuel is stored for long periods prior to final disposal, or, after a period of at least three years for AGR spent fuel or five years for PWR spent fuel, it can be reprocessed.

*Spent Fuel Reprocessing*

Reprocessing of spent AGR fuel separates uranium and plutonium from highly radioactive nuclear waste products and is followed by storage of the resulting materials. We use BNFL s THORP reprocessing facilities at Sellafield. Reprocessed uranium can be recycled once it has been converted, enriched and fabricated into new AGR or PWR fuel. Reprocessed uranium is not currently used in the UK and a safety case has not been developed for its future use.

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*Nuclear waste*

Nuclear waste products are categorized by their radioactivity levels into low level radioactive waste ( LLW ), intermediate level radioactive waste ( ILW ) and high level radioactive waste ( HLW ).

LLW comprises potentially contaminated and slightly radioactive materials, such as used protective clothing and tools. In the UK, LLW represents approximately 86 per cent. by conditioned volume of radioactive waste. Most LLW can be handled by workers wearing simple protective clothing and gloves and without any requirement for radiation shielding.

ILW is more radioactive than LLW and includes the sludges and resins from the cleaning of cooling pond water and certain wastes arising from the reprocessing of spent fuel. In the UK, approximately 14 per cent. by conditioned volume of radioactive waste is classified as ILW.

HLW comprises spent fuel which is not reprocessed and certain nuclear waste products separated out from uranium and plutonium during the reprocessing of spent fuel. These categories of waste are characterized by the fact that their temperature may rise significantly as a result of their radioactivity and as such this factor has to be taken into account in the design of storage or disposal facilities. In the UK, HLW represents approximately 0.1 per cent. by conditioned volume of radioactive waste although this contains approximately 95 per cent. of the total radioactivity in all nuclear waste (excluding uranium and plutonium recovered from reprocessing).

The Government policy on HLW from reprocessing is that it should be stored for at least 50 years to allow the radioactivity to decay and heat generation to reduce. Once the waste has been allowed to cool the favored option is for underground disposal. Spent fuel which is not reprocessed should similarly be allowed to cool. Once the HLW has cooled, it will continue to be stored pending a decision on final disposal. There is currently no disposal route available in the UK for either ILW or HLW. However the Committee on Radioactive Waste Management is due to report to Government on this issue by July 2006.

*Management and disposal of nuclear waste*

We are responsible for the management and disposal of all operational nuclear waste arising from our operations in conformity with relevant law and regulations and having regard to Government policy.

Solid LLW is often incinerated on site and the resulting ash and other LLW that has not been incinerated is, if appropriate, compacted and sent to BNFL for disposal at their facility at Drigg, England. We have a contract with BNFL for the disposal of LLW which expires on March 31, 2006.

At present our ILW is stored on-site in purpose-built facilities and, in most cases, these facilities are designed to accommodate all of the ILW that we expect to be created during the current station lifetime. In anticipation of the fact that the capacity of our

untreated ILW Resin storage tanks at Sizewell B will be exhausted ahead of plan, we are presently engaged in modifying the station s on-site encapsulation plant to enable it to encapsulate ILW. Once the ILW has been cement encapsulated in metal drums, the waste can be stored in Sizewell B s conditioned waste storage building. We intend to complete the encapsulation plant modifications before ILW resin storage tank exhaustion.

**Pipe failure at THORP**

On April 21, 2005 BNG reported that a pipe had failed in one of the heavily shielded cells, known as the feed clarification cell, in THORP at Sellafield. This resulted in a quantity of dissolved nuclear fuel being released into a sealed, contained area. THORP reprocesses spent or used nuclear fuel from our AGRs and also from Light Water nuclear reactors. Reprocessing separates out the components of used fuel which comprises 96 per cent. Uranium, about 1 per cent. Plutonium and some 3 per cent. waste. Both the Uranium and Plutonium can be recycled into fresh fuel.

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Since this event was reported, BNG have completed recovery of the escaped liquid back into primary containment. A Board of Inquiry was established by BNG and has reported. BNG have stated that they are confident that they have the capability of returning THORP to service.

BNG have assured us that the necessary steps will be taken to maintain continuity of AGR receipts at Sellafield, both during the current period of uncertainty regarding Thorp and through to the end of life of our AGR stations. We understand that the Nuclear Decommissioning Authority share similar views to BNG. See also Item 3 Risk Factors, the risk starting Our business depends on equipment and service suppliers at a specialized nature .

***Back end fuel cycle contracts***

*Reprocessing and long-term management of spent fuel*

AGR fuel

Each individual AGR power station s storage capacity varies but overall capacity is approximately equivalent to nine months of spent fuel storage and with the storage facilities usually holding approximately six months spent fuel, this leaves approximately three months additional capacity in case of any short term interruptions in the movement of spent fuel to BNFL s Sellafield site. Typically storage facilities are around two-thirds full at any time, although currently stocks of spent fuel are higher than this. If a station s spent fuel storage facilities became full, the station could theoretically continue to generate, but the volume of electricity produced would gradually reduce as the fuel in the reactor was consumed. It would not be possible to load additional fuel into the reactor until the equivalent quantity of spent fuel within the station s storage facilities was dispatched to Sellafield.

We have contracts with BNFL (the only available supplier of reprocessing and long term storage services in respect of spent AGR fuel) for the long term management of spent fuel covering the fuel loaded into the AGR power stations prior to Restructuring (the BNFL Historic Contracts ) and for all the fuel loaded into the reactors after the Restructuring Effective Date through to the end of their operating lives (the New Spent Fuel Agreements ).

Under the BNFL Historic Contracts, BNFL provides spent fuel management services for defined periods for all spent fuel arising from fuel which was loaded into our AGR power stations prior to completion of the Restructuring ( historic spent fuel ). We retain ultimate responsibility for these materials after the date on which BNFL is no longer obliged to perform the services. The Government has agreed to meet our liabilities to BNFL (subject to certain exceptions) under the BNFL Historic Contracts (pursuant to the provisions of the HLFA ). Under the HLFA, the Government also have an option to acquire title to any of our historic spent fuel and materials deriving from spent fuel management at Sellafield.

Under the NLFA the Government (subject to certain exceptions) fund the management and disposal of uncontracted liabilities arising from the spent fuel management services (and for which BEG retains responsibility). Schedule 3 of the NLFA defines the uncontracted liabilities. The Government fund the uncontracted liabilities to the extent that these and other defined liabilities cannot be met from the NLF. Under the BNFL Historic Contracts, BNFL is responsible for the storage of the uranium, plutonium and, pending disposal, HLW and ILW arising from historic spent fuel reprocessing and for the storage of historic spent fuel which is not reprocessed until an agreed date.

BNFL is obliged to treat, package and store ILW resulting from fuel contracted for reprocessing under the Historic Fuel Agreements. If BEG requires it, BNFL will store our ILW waste until an agreed date. BNFL also take title to and all liabilities for certain pond equipment (LLW and/or ILW) which is used to store fuel on behalf of BEG. The contracts with BNFL also provide for the possibility of extending these periods of storage, subject to obtaining necessary regulatory and planning consents, and taking into account the need for storage beyond this date.

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Under the New Spent Fuel Agreements BNFL take title to, and all liability for, the management and ultimate disposal of all AGR spent fuel arising from fuel loaded into the reactors on or after Restructuring.

PWR fuel

We intend that spent PWR fuel from Sizewell B will be stored on the Sizewell B site pending final direct disposal of the fuel. PWR fuel is not currently expected to be reprocessed although this option has not been discounted.

The spent fuel storage pond at Sizewell B was designed to accommodate 18 years of spent fuel arisings and will be reconfigured to accommodate approximately 30 years spent fuel arisings, subject to obtaining appropriate consents including from the NDA. The reconfiguration work requires completion by 2009/10 to allow the continued operation of Sizewell B. At this time, it is our judgement that these works will be completed before or during 2009/10. We will consider and finalize, in due course, arrangements for the remainder of lifetime arisings for spent PWR fuel in the light of the prevailing commercial and regulatory environment. The current planning assumption is that a Spent Fuel Dry Storage facility to accommodate the remainder of Sizewell B s spent fuel for the remainder of its lifetime and to facilitate the station s decommissioning will be constructed on the Sizewell B site. The spent fuel will be stored until a suitable spent fuel and/or HLW disposal facility becomes available.

The qualifying costs of waste management and the disposal of spent Sizewell B fuel will be met by the NLF (described in greater detail in Item 4 Restructuring The Nuclear Liabilities Fund, and the paragraph below headed: Liability for decommissioning).

**Nuclear decommissioning**

***The decommissioning process***

Decommissioning of a nuclear power station is the process whereby it is shut down at the end of its economic life and eventually dismantled. Throughout the world, over 90 nuclear reactors have been shut down and a large number of decommissioning projects are in progress. Decommissioning usually takes place over several decades and the majority of these projects are at an early stage. However, there is a growing volume of experience of the early decommissioning activities and pre-closure planning and preparation requirements of large scale nuclear power station decommissioning.

Our objectives for decommissioning are to: ensure the continued safety of the public, the workforce and the environment; minimize the environmental impact of the decommissioning of our stations as far as reasonably practicable; release sites for other use as appropriate; and, consistent with all of the foregoing, minimize the expenditure of resources on decommissioning.

We have adopted the Early Safestore Decommissioning Strategy ( ESS ) for decommissioning our AGR power stations.

ESS was also previously the decommissioning technical planning basis for Sizewell B s PWR. However, the prudent provisioning planning assumption for Sizewell B was that a prompt dismantling/decommissioning strategy would be pursued. Hence, the technical planning basis for Sizewell B is now being revised to reflect the prudent provisioning planning basis. The works to revise the Sizewell B Decommissioning strategy will be completed by October 2005.

The principal stages of decommissioning as defined by IAEA are:

*Stage 1*: pre-closure preparatory work; defueling; decommissioning engineering preparatory work; and management of potentially mobile operational wastes;

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*Stage 2*: dismantling redundant ancillary buildings; safestore development; site surveillance, care and maintenance; and

*Stage 3*: preparation for reactor building dismantling and clearance; retrieval and management of stored radioactive waste; reactor dismantling and reactor building dismantling and clearance; and site clearance and release for re-use.

For the ESS strategy for our AGR stations BEG have adopted an eleven activity strategy which aligns with the three IAEA stages.

For our Sizewell B PWR prompt dismantling decommissioning strategy a similar approach is proposed (however, with no period of safestore/deferral prior to reactor dismantling).

We anticipate that after defueling the reactors, dismantling them will be deferred for at least 85 years (for AGRs) and up to 50 years (for PWRs) after closure of the relevant nuclear power stations. It should be noted that work is currently ongoing to refine and revise the technical and provisioning/costing basis for BEG power station decommissioning (both AGR and PWR). These works will be completed in October 2005.

**Liability for decommissioning**

We have an obligation under our nuclear site licenses to decommission our stations at the end of their useful life. The estimated undiscounted costs of decommissioning our AGR and PWR stations are £5.6 billion. For further details, see Note 8 of our audited consolidated financial statements. Prior to the Restructuring certain of the decommissioning liabilities were covered by arrangements with the NDF to which we made contributions pursuant to the terms of the Nuclear Decommissioning Agreement which was entered into on March 29, 1996.

Following the Restructuring the Nuclear Decommissioning Agreement has terminated, the Nuclear Liabilities Funding Agreement and Contribution Agreement have become fully effective and the NDF has been enlarged into and renamed the NLF.

**Nuclear Liabilities Fund**

Under the terms of the Restructuring, the NLF will, subject to certain exceptions, fund certain of our qualifying uncontracted nuclear liabilities (i.e. all those nuclear liabilities for which there is currently no contract in place) and the costs of decommissioning our nuclear power stations. The NLF is funded by contributions from us and the Government has agreed to fund the qualifying decommissioning costs and qualifying uncontracted liabilities to the extent that they exceed the assets of the NLF. To the extent that there are any surplus funds in the NLF, this amount will be paid to the Government. In addition to the issue of £275 million of New Bonds to the NLF, we make the following contributions to the NLF:

fixed decommissioning contributions of £20 million per annum (indexed to RPI but tapering off as our nuclear power stations are currently scheduled to close);

£150,000 (indexed to the RPI) for every tonne of uranium in the fuel loaded into Sizewell B from the Effective Date of the Restructuring; and

The NLF Cash Sweep.

The trustees of the NLF will have the right from time to time to convert all or part of the NLF Cash Sweep into our convertible ordinary shares. On a full conversion the NLF would hold up to 65 per cent. of the thereby enlarged share capital of the Company. These shares will be subject to certain voting restrictions, so that, for so long as the shares are held by NLF, they will be non voting to the extent

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they would otherwise carry more than 29.9 per cent. of our voting rights. The convertible ordinary shares will convert into New Shares automatically on transfer by the NLF to a third party but will not otherwise be convertible at the option of the NLF. There are certain restrictions on the manner in which the NLF may convert its NLF Cash Sweep Payment or dispose of any of its shares. For further information see Item 4 The Restructuring The Nuclear Liabilities Fund.

**COAL FIRED GENERATION**

**Eggborough Power Station s operating regime**

We acquired EPL, the owner of the Eggborough power station, from National Power (now RWEnpower) in March 2000. This purchase was re-financed by a project finance loan of £550 million entered into on July 13, 2000 pursuant to which the Eggborough Banks were granted security. As part of the Restructuring, the Eggborough Banks continue to have security over, among other things, the shares in EPL and the Eggborough power station and have an option to acquire Eggborough power station either through a share or asset purchase in 2010 (or earlier if there is an event of default).

Eggborough power stations continues to be operated by our subsidiary EPL. Output from Eggborough was 2.5 TWh for the period after the Restructuring Effective Date and 5.1 TWh for the period prior to it, a total of 7.6 TWh, for the year ending March 31, 2005 compared with 7.6 TWh and 5.7 TWh for the respective preceding years. The Eggborough power station s output level is influenced by a number of factors including the market price of coal, carbon, electricity and our contracted trading position, and by relevant environmental legislation (the influence of relevant environmental legislation will significantly increase over time).

Being coal-fired, Eggborough power station produces emissions containing $CO_2$, sulfur dioxide ( $SO_2$ ) and nitrogen oxides ( NOx ), and therefore its future output will be affected by the impact of two important environmental initiatives which seek to limit these emissions namely, the ETS and the LCPD, which are discussed in the paragraph below headed Legislation affecting the Eggborough Station s output .

Eggborough power station consists of four generating units with a nominal capacity of 500 MW per unit and is operated at various levels, rather than at constant levels in the manner of our nuclear stations. Decisions over when to operate the units at Eggborough depend primarily on the revenue that can be earned from electricity sales and the cost of operation. The main variable cost is the market price of coal.

In recent outages evidence of turbine blade cracking was found in inspections of two units. With minor repairs to one unit, and modification of the second during the current outages, these units should be returned to service shortly at slightly reduced output. The inspection of a remaining similar turbine on a third unit should also be completed shortly.

Coal for the Eggborough Station is procured from a variety of suppliers. The aim is to secure the majority of anticipated requirements up to a year ahead. Exposure to movements in coal market prices is hedged through using a mixture of fixed and floating price contracts and other financial instruments related to coal price. A mixture of both UK and imported coal is used and the coal is generally delivered by rail freight directly to Eggborough.

The capability has been developed at Eggborough for co-firing coal with various forms of organic material ( biomass ) which qualify for co-fired Renewable Obligation Certificates ( ROCs ).

We own an ash disposal site at Gale Common, close to Eggborough power station, which is used for the disposal of ash produced by the Eggborough Station and the nearby Ferrybridge power station, which is owned by a subsidiary of Scottish and Southern Energy plc. For further information relating to

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Gale Common, see Item 3 Risk Factors, the risk beginning Our right to title to certain ash and water pipelines which benefit Gale Common ash disposal site near Eggborough power station is not registered with the Land Registry .

**Investment in the Eggborough Station**

In response to recent developments in relation to the regulation of emissions, details of which are set out in the paragraph below headed Legislation affecting Eggborough Power Station s output , we have fitted two of the four generating units with flue gas desulfurisation ( FGD ) equipment. Remedial works have now been completed to address a performance problem which emerged during commissioning tests in 2004, and further testing of the plant is in progress. This equipment is designed to reduce emissions of $SO_2$ to the atmosphere from the units which have been fitted with FGD by approximately 90 per cent.

As part of the Restructuring, there are limits on the funding of Eggborough power station. Any investment outside these limits requires the approval of the holders of the New Bonds. We are also contractually committed to certain capital investments to improve the Eggborough power station s performance and reliability.

**Applications for Restrictions on Mining**

Eggborough power station does not enjoy a protected right of support. As a result, there is presently no restriction on coal mining taking place in circumstances whereby the stability of Eggborough power station could be affected. We have tried, unsuccessfully, to negotiate an acceptable pillar of support agreement with UKC who hold a license from the Coal Authority to mine coal and undertake mining operations in the vicinity of the station.

If UKC were to mine under or in proximity to Eggborough power station in circumstances affecting its stability, then extensive liabilities would fall on UKC pursuant to the Coal Mining Subsidence Act 1991. Under this Act, the coal operator is required to carry out remedial works and/or make payments for the consequences of the mining damage.

An application submitted by us to the Secretary of State pursuant to the Mines (Working Facilities and Support) Act 1966 for restrictions to be imposed on the working of minerals under part of land affecting Eggborough power station, and land adjacent to it was unsuccessful.

As a consequence, the stability of Eggborough power station may be adversely affected if UKC were to mine under or in proximity to it. If this were to occur, it may not be possible to continue the operation of Eggborough, or substantial repairs could be required. For additional information, see Item 3 Risk Factors we do not currently own the rights of support for the land under the Eggborough Power Station .

**Legislation affecting Eggborough Power Station s output**

The ETS and the revised LCPD are major environmental initiatives which will have an important impact on the Eggborough Station as they seek to reduce $CO_2$, and $SO_2$, NOx and particulates. The ETS commenced on January 1, 2005. The main provisions of the revised LCPD which limit emissions are due to become effective on January 1, 2008 and will restrict further the limits of permitted emissions.

**ETS**

Combustion installations with a rated thermal output in excess of 20 megawatts (excluding hazardous or municipal waste installations) require a Greenhouse Gas Emissions Permit (an

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Emissions Permit ). Under an Emissions Permit, a combustion installation is allocated $CO_2$ emissions allowances ( ETS Allowances ). From January 1, 2005 onwards, each combustion installation must begin monitoring $CO_2$ emissions and must submit ETS Allowances equal in amount to its actual annual reportable emissions of $CO_2$ by the date falling four months from the end of the year in which such emissions arose. In any year, a combustion installation s emissions of $CO_2$ may not exceed its ETS Allowances for such year unless it has purchased additional ETS Allowances to cover such excess emissions (in principle, ETS Allowances should be tradable across all EU member states, enabling those operators with a surplus of allowances to sell to those with a shortfall).

Eggborough power station has an Emissions Permit and was allocated ETS Allowances equating to 4.54 million tonnes of $CO_2$ emissions in each of the calendar years 2005, 2006 and 2007 according to the final National Allocation Plan ( NAP ) published by the Government and approved by the European Commission. This is equivalent to the level of emissions associated with electrical output of approximately 5.4 TWh in each such year. Additional allowances will need to be acquired if the Eggborough power station is to continue to generate electricity at 2004/05 levels.

The basis for the allocation of ETS Allowances in the second phase of the ETS (this relates to the period from 2008 to 2012) has yet to be determined by the Government.

***LCPD***

The LCPD seeks to reduce the emissions of certain pollutants (namely NOx, $SO_2$ and particulates) into the air from large combustion plants. By January 1, 2008, EU member states must achieve significant emissions reductions in one of two ways:

ensuring that all permits for the operation of existing plants contain conditions securing compliance with the Emission Limit Values ( ELVs ) established for new plants; or

ensuring that existing plants are subject to a National Emission Reduction Plan ( NERP ).

The ELV approach involves setting emission rate limits for individual plants, for $SO_2$, oxides of nitrogen and particulates for a given period which cannot be exceeded without breaching their permit. In comparison NERP involves the reduction of total emissions of $SO_2$, oxides of nitrogen and particulates for the EU member state concerned, referenced to the levels that would have been achieved by applying the same rate limits as under ELVs to existing plants in operation in the year 2000, on the basis of each plant s actual annual operating time, fuel used and thermal output averaged over the last five years of operation up to and including 2000. Provided that the total amount allocated to an EU member state is not breached, an EU member state has some flexibility in how it introduces NERP. For example, while each plant may be subject to limits under NERP, it may allow its plants to trade their allocation amongst other plants in that same EU member state. However, a member state s flexibility under NERP will always be limited by the limits set under the pollution, prevention and control regime, the fact that the LCPD provides that the closure of plants included in the NERP shall not result in an increase in the total annual emissions from the remaining plants covered by the plan, and the fact that the requirements of the LCPD under a national plan approach need to be met on a calendar basis (this therefore, removes the possibility of banking or trading allowances across the years).

The Government has sought clarification from the European Commission on a number of matters and has delayed its decision on how the LCPD will be implemented. These matters are firstly, whether a plant will be treated as being a whole station, or an

individual generating unit, in which case Eggborough power station s four units would be treated as separate plants. Secondly, the Government has proposed implementing a hybrid NERP/ELV solution where large power stations, such as Eggborough, would be subject to rate limits for future emissions. As at the date of execution of this report, the Government has not provided any further guidance on application of the LCPD in the UK.

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Plant owners have the option to opt-out of the LCPD in which case they will be permitted to run plants for a total of 20,000 hours between January 1, 2008 and January 31, 2015, subject to additional regulations imposed by the EA. Given the uncertainty on the key issues, the Government has provided further instruction that plant that is opted out by June 30, 2004 can be opted back in prior to December 31, 2005. British Energy has therefore chosen to conditionally opt-out its two non-FGD units, the conditionality relating to i) the choice to opt back in prior to the December 31, 2005 deadline and ii) whether a plant is treated as being a whole station, or an individual generating unit (if the former is the case the two-unit opt-out would be deemed invalid and those two units would be opted back-in again (subject to the consent of the Eggborough Banks holding 66 2/3 per cent. of the debt under the Amended Credit Agreement (such consent not to be unreasonably withheld or delayed)).

The final details of the implementation of the LCPD may affect the level of generation from the Eggborough power station and other fossil fuel plants in the future.

***Other legislation***

Limits on the emissions of pollutants may also be imposed in permits issued by the EA and it is possible that stricter limits could be imposed than under the LCPD and ETS. This is because the EA are required to implement the LCPD and ensure that in doing so the National Emissions Ceiling Directive is not compromised. In addition, the EA has to take into account the requirements of the Integrated Pollution, Prevention Control Directive in 2006 and also the National Emissions Ceiling Directive, the Habitats Directive and the Water Framework Directive requirements in setting permit conditions going forward.

**ELECTRICITY SALES**

***Role of trading***

We have continued to follow a prudent trading strategy, in line with commitments made in November 2004, to reduce the Group s exposure to potential falls in the market price of electricity. Our routes to market include direct sales to industrial and commercial customers, contracting in the wholesale market, together with sales of balancing and ancillary services to National Grid Transco (the operator of the electricity transmission network) ( National Grid Company ). We also sell forward in order to manage the risks of short to medium price volatility in wholesale market prices and because there is insufficient liquidity in the short term markets alone for us to be sure that we would be able to sell our generation at an acceptable price. This approach does however reduce in the medium term the benefit we receive from wholesale electricity prices rising.

As at March 31, 2005, fixed price contracts were in place for approximately two-thirds of planned output for the fiscal year 2005/06 at an average contracted price of £26.4/MWh. As at June 30, 2005, fixed price contracts were in place for approximately three-quarters of planned output for the fiscal year 2005/06, at an average contracted price of £29.8/MWh. We intend to progressively close our exposure to market prices for 2005/06 and to build our hedge position for 2006/07 subject to the limits on trading collateral.

***Market Conditions***

Electricity prices in the UK wholesale market reached all time highs during 2004/05, driven up by high oil and gas prices and concerns in the market over the ability of gas supplies to meet demand at peak times. Both spot and forward electricity prices have also been very volatile throughout the year.

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Gas prices continue to be a key influence on the electricity market, and electricity prices have mirrored movements in gas prices through the year. In fall 2004, the National Grid Company highlighted a risk that there might be insufficient gas to meet power station demand in the event of a cold winter. This contributed to a sharp rise in gas and power prices for winter 2004/05 and winter 2005/06. Although temperatures in winter 2004/05 were above the long term averages, and it was the warmest January since 1990, relatively cold weather at the end of February, coupled with reduced gas supply, triggered exceptionally high spot prices for both gas and power. Worldwide demand for coal has remained strong, keeping coal prices in the range $60-80/tonne for delivery to European ports.

The forward price for annual baseload electricity for 2005/06 delivery rose from around £24.5/MWh in March 2004 to over £35.0/MWh by the end of March 2005, an increase of over 40 per cent. As mentioned above, concerns over a potential shortfall in winter peak gas supply contributed to a rise in the price for delivery for the year from October 2005 to over £37.0/MWh in early October 2004. As of June 30, 2005, the annual prices for delivery from October 2005 had subsequently risen to over £49.0/MWh.

On January 1, 2005, the ETS came into effect. From that date, all installations covered by the scheme must have a permit to emit greenhouse gases and will be required to submit allowances on an annual basis to cover their emissions of carbon dioxide. The initial allowances have been allocated by the Government according to a National Allocation Plan which has been approved by the European Commission. The market price of allowances has risen since the beginning of 2005, and reached over 15/tonne of carbon dioxide at April 30, 2005 and 25/tonne at June 30, 2005, increasing the cost of marginal coal and gas generation.

***The wholesale market***

We are active in the over-the-counter market as well as negotiating structured contracts on fixed or indexed price terms. Over-the-counter transactions include both futures and options on electricity as a hedge against adverse market price movements in the short to medium term. Trading in products which may be regarded as regulated investments is carried out by our trading subsidiary, British Energy Trading Services Limited ( BETS ) as agent and arranger for BEPET. BETS is regulated by the Financial Services Authority in respect of these activities.

Short term trading is carried out via the Amsterdam Power Exchange (UK) Limited ( APX ) which provides an anonymous electronic trading platform and clearing and notification service for electricity futures and spot trades for individual half-hour periods. We primarily use APX as a means of balancing our within-day physical position by either buying or selling to compensate for differences between our notified contractual position and planned generation and forecast supply.

Our ability to utilize the wholesale market as a route to market is affected by the strength and depth of the market, see risk Item 3 Risk Factors: Lack of liquidity in the wholesale market may adversely affect or require us to alter our trading strategy .

***Trading Development Program***

Following a comprehensive review of our trading capabilities, we have now completed our Trading Development Plan. As a result of the program we have strengthened key skills by the recruitment of experienced staff, in particular in the areas of trading finance and risk management. We have developed sophisticated plant performance and reliability models to assist in decisions over the

optimum running of our plant and improved risk monitoring policies and procedures. We have also made major changes to develop communications and interface arrangements between our generation, trading and direct supply activities to enhance business performance.

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***Direct supply business***

Volume equivalent to almost half of our generation was sold directly to industrial and commercial customers in 2004/05. Total direct sales were 31.4 TWh, up 7 per cent. from 29.1 TWh in 2003/04. We now have over 2,000 customers and are supplying over 15,000 sites across Great Britain. We have continued to hold number one ranking in the quarterly customer satisfaction survey of industrial and commercial customers carried out by the Energy Information Center, a position we have now held for over five years. We have also regained top ranking for customer satisfaction in Datamonitor s six-monthly survey, reported in March 2005, against strong competition from other suppliers. The direct sales business was transferred to a new subsidiary company, BEDL, on April 1, 2005. BEDL is licensed to supply non-domestic customers throughout Great Britain.

***Arrangements in Scotland***

Until April 1, 2005 there was no wholesale market in Scotland. Prior to that date we sold all the output from our Scottish nuclear power stations to Scottish Power and Scottish and Southern Energy under the terms of the Nuclear Energy Agreement ( NEA ), which was originally entered into in 1990 and subsequently amended, most recently, on July 15, 2002. Under the revised terms of the NEA, Scottish Power and Scottish and Southern Energy purchased the electricity generated by our Scottish power stations from us at a price linked to market prices and terms for the supply of base load energy in England and Wales.

On April 1, 2005, the British Electricity Trading and Transmission Arrangements (or BETTA ) were brought in to extend the existing market arrangements for England and Wales to include Scotland. Under BETTA, the National Grid Company has responsibility for operating and balancing the transmission system across Great Britain. Revised charging arrangements for access to the transmission network were also introduced at the same time. The NEA came to an end when BETTA was implemented.

***Collateral***

Our electricity contracts give rise to the need for us to provide credit support in the form of cash collateral. In respect of trades in the wholesale market, this is requested by counter-parties to ensure that, should the contracts terminate early for whatever reason, there are sufficient funds available to reimburse the costs they may incur in replacing the terminated transactions in the open market. Credit support is also required to ensure that there are sufficient funds available to cover balancing, transmission, distribution and other similar costs and charges.

Our industrial and commercial customers do not require us to provide collateral. However, collateral is required by transmission and distribution network operators in order to cover liability for their charges.

**REGULATION**

**Introduction**

Our participation in the electricity industry in Great Britain (being England, Scotland and Wales, but excluding Northern Ireland), through a variety of routes, and the nature of the bulk of our electricity generation being by nuclear power reactors means that we are a highly regulated business. In addition to the safety, competition, health and environment legislation which typically applies to a conventional power generation business, we are also subject to extensive safety, health and environmental constraints which apply solely to the operators of nuclear power plant, for example, the Nuclear Installations Act 1965 and the Radioactive Substances Act 1993. These regulatory regimes are described below in the paragraph below headed Regulation of the UK nuclear generation industry .

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**Regulation of the electricity industry**

***Key legislation***

The framework for the economic regulation of the electricity industry in Great Britain is set out in the Electricity Act 1989 ( Electricity Act ) which was amended by the Utilities Act 2000 ( Utilities Act ) and the Energy Act 2004 ( Energy Act ).

GEMA was established by the Utilities Act. GEMA s functions under the Electricity Act which are largely carried out by OFGEM include granting licenses to generate, transmit, distribute or supply electricity; enforcing compliance with license conditions; administering funds generated by the English and Scottish Renewables Obligation Certificates (described in the paragraph below headed Renewables Obligations ); and setting standards of performance for electricity licensees. The Electricity Act requires GEMA and the Government to exercise their functions under the Act in the manner which they consider is best calculated to protect the interests of consumers present and future, wherever appropriate by promoting effective competition.

***Regulatory developments***

On July 22, 2004, the Energy Act received Royal Assent. It provides the framework for the establishment of the NDA launched on April 1, 2005 to manage the decommissioning of the United Kingdom s nuclear legacy as well as the development of offshore wind and other marine renewable energy sources outside territorial waters. The Energy Act further provides for the implementation of BETTA which was brought into effect on April 1, 2005 and had the effect of extending the market arrangements already applicable in England and Wales to Scotland and creating a single wholesale electricity market for Great Britain. These new arrangements have created a much larger market for our Scottish generation due to the ending of the NEA, under which all of our Scottish generation was sold to Scottish Power and Scottish and Southern Energy. However, the termination of the NEA also means a loss of the guaranteed market for the output of our Scottish stations and other routes to market for this output are now being used.

**Licenses**

***Electricity generation licenses***

Unless covered by exemption, all electricity generators operating a power station in the UK are required by the Electricity Act to have a generation license. Generation licenses in Great Britain are granted by GEMA and impose certain conditions on licensees. The majority of these are set out in standard license conditions and apply to all generation license holders. The conditions attached to a generation license require the license holder, amongst other things, to comply with the Balancing and Settlement Code ( BSC ), the Grid Code and the Connection and Use of System Code ( CUSC ). BEG was granted a generation license by the Director General of Electricity Supply (GEMA s predecessor) which came into effect on April 1, 1996. This license was then amended and restated by a licensing scheme made by the Secretary of State on September 28, 2001. Subject to provisions within the Electricity Act, GEMA may modify the standard conditions of any license type. Failure to comply with any of the generation license conditions may subject the licensee to a variety of sanctions, including enforcement orders by GEMA, the imposition of monetary penalties or license revocation if an enforcement order or payment of a monetary penalty is not complied with.

***Electricity supply licenses***

Subject to minor exceptions, all electricity consumers in the UK must be supplied by a licensed supplier as provided for by the Electricity Act. Licensed suppliers purchase electricity and make use of

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the transmission and distribution networks to achieve delivery to customers premises. Licenses impose certain obligations on licensees. The majority of these obligations are set out in Standard Licence Conditions ( SLCs ).

SLCs are split into four distinct parts not all of which are applicable to all supply license holders. The license deals with general obligations and requires the holder, amongst other things, to comply with the BSC, CUSC, Grid Code and Master Registration Agreement (the agreement to which all licensed suppliers and distribution businesses are parties and which is concerned with retail customers changing their suppliers).

We currently hold one supply license through which we supply our large industrial and commercial customers in connection with our direct supply business. We are not licensed to supply to domestic customers.

**Approval of State Aid**

On September 22, 2004, the European Commission advised the Government that insofar as the restructuring plan notified by the Government on March 7, 2003 under Article 87(3) of the EU Treaty involved the grant of State Aid, such State Aid was compatible with the common market. The European Commission s decision was subject to certain conditions. These conditions included, amongst others, a requirement that we separate our direct supply business from other generation and trading businesses by April 1, 2005. This has been completed, and the transfer of our direct supply business from BEG to BEDL, was effected by April 1, 2005. A further requirement of the conditions to the grant of State Aid was to consolidate our nuclear generation activities into a single subsidiary. This was effected by July 1, 2005. For additional information see Item 4 Recent Developments.

**Renewables Obligation**

One of the ways in which the Government is seeking to increase the proportion of electricity generated from renewable sources is by the introduction of the Renewables Obligation (the Renewables Obligation ). The Renewables Obligation on licensed electricity suppliers to source a proportion of their total electricity requirements from eligible renewable sources or to contribute through a buy-out payment came into force in April 2002. The amount of the Renewables Obligation increases from 3 per cent. in March 2003 to 10.4 per cent. in March 2011. As we are a licensed electricity supplier, we are subject to the Renewables Obligation in respect of sales through our direct supply business.

Each MWh of electricity produced by an accredited renewable generator earns a ROC or, in Scotland, a Scottish Renewables Obligation Certificate ( SROC ). These certificates can be sold or purchased independently from the electricity to which they relate and a supplier can meet its renewables obligations by submitting equivalent ROCs/SROCs for the prescribed percentage of electricity supply or by making a buy-out payment to GEMA (for 2004/05 set at £31.39/MWh and adjusted annually to reflect changes in the RPI) or a combination of both.

The Renewables Obligation is designed to incentivize electricity suppliers to acquire a sufficient number of certificates to meet their total requirements, rather than making buy-out payments which are then distributed by GEMA (with interest accrued) to suppliers who have submitted ROC/SROCs in compliance with the Renewables Obligation.

In 2003/2004, the Renewables Obligation in respect of our direct supply sales business was 1,078,225 MWh (at the time of publication, OFGEM have not published a comparable figure for 2004/05). This was met through a combination of ROCs, SROCs, and contributing to the buy-out fund.

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The cost of meeting the Renewables Obligation is recovered from customers through their bills. For 2004/5 the amount of the obligation was 4.9 per cent. and the buy-out payment was £31.39/MWh.

**Climate change levy**

The Climate Change Levy ( CCL ), introduced in April 2001, aims to encourage the efficient use of energy and to reduce $CO_2$ by around 5 million tonnes a year from 2001 levels by 2010. The CCL benefits qualifying renewables generators because energy acquired from renewable sources is exempted from the levy.

Our nuclear stations and the Eggborough power station do not qualify as renewable or Combined Heat and Power generators for the purposes of CCL. All suppliers are required to collect the CCL from their business customers and to pass this to HM Revenue and Customs every quarter.

**Regulation of the Eggborough Power Station and Gale Common**

***Key legislation***

We are subject to numerous environmental regulations with respect to our ownership and operation of the Eggborough power station and the Gale Common ash disposal facility (the Gale Common Facility ) located not far from Eggborough power station.

A system of Integrated Pollution Control ( IPC ) for power stations was introduced under the Environmental Protection Act 1990 for which the EA has responsibility for enforcement. The EA s IPC authorizations require power stations to use Best Available Techniques Not Entailing Excessive Cost to prevent or, where that is not possible, to minimize their emission of certain pollutants.

The Pollution Prevention and Control Directive was implemented in the UK on May 1, 2004 by the Pollution Prevention and Control Regulations and will modify the IPC regime, in relation to noise, waste minimization and energy efficiency, amongst other areas. Applications for authorization under the new Pollution Prevention and Control Regulations must be submitted to the EA by March 31, 2006 for the Eggborough power station and by March 31, 2007, for the Gale Common Facility.

Disposal of ash to the Gale Common Facility is governed by the Landfill (England and Wales) Regulations 2002, the Pollution Prevention and Control Regulations and hold two waste management licenses which are regulated by the EA.

More generally, we are also subject to the Water Resources Act 1991 which governs water pollution and requires persons who have knowingly permitted water pollution to carry out remediable works and the EU Environmental Liability Directive which is aimed at the prevention and remedy of environmental damage to water, land and bio-diversity, and is based on the principle that the

polluter should bear the cost of damages caused to the environment or of measures to prevent imminent threat of damage.

***Environmental management***

We have a comprehensive environmental management system in place for Eggborough power station which is accredited by Lloyds Register Quality Assurance to international standard ISO 14001, a standard which demonstrates our continued commitment to the prevention of pollution and recognizes our environmental performance.

EPL is also a member of the Joint Environmental Program, a research initiative funded by eight of the major fossil fuel power station operators in the UK, whose objective is to increase our knowledge of the impact that the production of electricity from fossil fuels has on the environment.

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In 1994, we carried out a comprehensive Environmental Effects Evaluation covering emissions to air, land and water from our nuclear stations. Since this time, we have periodically updated the evaluation as part of our efforts to develop an effective environmental management system.

**Regulation of the UK nuclear generation industry**

***Key legislation***

The principal areas of nuclear safety and security regulation in the UK (except for Northern Ireland) cover the construction, operation and decommissioning of nuclear installations and the protection of workers and the public against ionizing radiations. The principal regulating provisions are the NIA, the Ionizing Radiations Regulations 1999 ( IRRs ) and the Anti-Terrorism Crime and Security Act 2001 ( ATCSA ).

Environmental regulation of the nuclear industry covers the disposal of radioactive waste including discharges to the environment under the Radioactive Substances Act 1993 ( RSA ). Regulation of the transport of radioactive material is the subject of the Radioactive Material (Road Transport) Act 1991, ( RMRTA ).

The nuclear generation industry is also subject to the same regulations as other generators as regards non-nuclear aspects of health and safety and environmental protection, in particular under the Health and Safety at Work Act 1974 ( HSWA ), the Environmental Protection Act 1990 ( EPA ), the Water Resources Act 1991, the Pollution Prevention and Control Act 1999 and in Scotland, the Control of Pollution Act 1974.

***Nuclear site licenses***

Under UK law, and in particular the HSWA, employers are responsible for ensuring the safety of their workers and the public. This responsibility is reinforced for nuclear installations by the NIA which establishes a nuclear licensing regime controlled by the HSE. The licensing function is administered on HSE s behalf by the NII. Operation of a nuclear plant is governed by the nuclear site license and the license conditions which are attached to it and apply to the whole plant through its life cycle, up to and including decommissioning.

Before a nuclear site license is granted, the NII must be satisfied as to the safety of the operation and eventual decommissioning of an installation, and the ability of the applicant to understand and meet its obligations. Prospective licensees will be assessed under three broad areas: organization of applicant and measures to discharge license obligations; location and security of site; safety of the site s design, its manufacture, installation, commercial operation and maintenance. The safety of the installation is demonstrated through a written safety case and the applicant also documents the arrangements for the management of safety which the NII assesses prior to granting a license. Modifications to the original safety case are managed through arrangements which ensure that significant changes cannot be made if the NII objects. All of our nuclear power stations hold nuclear site licenses. The conditions to the licences are contained within the schedules to the license and are standard to all licenses.

The NII s regulatory approach to safety involves defining levels of tolerable risk. Activities above the level of tolerability are not normally permitted. Tolerable risks must be reduced to a level which is as low as reasonably practicable ( ALARP ). The ALARP principle has been embodied in a set of safety assessment principles which the NII uses as a basis for assessing safety cases.

The NII scrutinizes the activities of the licensee directly on site, and of the licensee s central support organization, through the assessment of the licensee s written submissions. An NII inspector is

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allocated to each nuclear power station and is typically present on site one week per month to hold meetings with the station staff and to check for compliance with the license conditions and safety case requirements. An inspection team may also visit the station to assess a particular part of the plant, or aspect of the safety case, and may also visit the licensee s central support organization to assess its part in ensuring safety on the licensed sites. As discussed in greater detail in the paragraph below headed Safety management , each license also requires the establishment of a Nuclear Safety Committee ( NSC ) for each licensed site, to provide independent advice to the licensee on significant nuclear safety issues.

There are nuclear site license conditions requiring the licensee periodically to shut down the reactor to carry out inspections and maintenance (statutory outages), particularly in respect of the reactor core and other plant that cannot be accessed whilst operating, and to review and reassess the safety case for the plant. Statutory outages take place at intervals of up to three years for an AGR and up to eighteen months for a PWR. Before consenting to the reactor restarting, the NII has to be satisfied that, based on the previous operating experience and the condition of the plant, there is an adequate safety case for the operation of the plant for the next period. This may require enhancement of the safety case to justify continued operation.

Nuclear site licenses require adequate arrangements to be made for the decommissioning of any plant. To ensure that a licensee s decommissioning strategies remain sound as circumstances change, they are reviewed every five years by the NII, which also consults the relevant environmental regulatory bodies. Applicants justify their chosen decommissioning strategy to the NII and demonstrate that there will be adequate funds to carry out the work.

The NII on behalf of the HSE regulates conventional and nuclear safety. Its enforcement powers include the service of improvement notices, prohibition notices and prosecutions. The NII regulates under the nuclear site licenses through the use of directions, specifications, notifications, consents, approvals and agreements. In addition to the ability to prevent a reactor restarting following a planned outage, the NII may also direct a licensee to shut down a nuclear reactor.

Under our nuclear site licenses, we are also required to carry out a PSR to review the safety case for each of our stations once every ten years to demonstrate that it is safe to operate the relevant reactors for the next ten years, taking into account current safety standards, the operational history and the effects of plant aging. Further details of the PSR are set out below in the paragraph below headed Periodic Safety Reviews . Nuclear site licenses for each of our nuclear power stations are held by BEG.

***Safety management***

In accordance with its site license, each nuclear power station has established a NSC to provide independent advice to the licensee on significant nuclear safety issues. The NSC consists of senior company personnel with knowledge of, and responsibility for, nuclear safety and the relevant station director and external appointees who have significant experience in the nuclear industry. The NII approves the terms of reference of each NSC, which determines the matters to be referred to it, and has a power of veto on any appointment to a NSC.

***License condition on organizational change***

In March 2000, the NII added a new condition to the standard nuclear site license, thereby bringing changes to organizational structure and resource directly within the licensing regime so far as they affect nuclear safety. We have site license compliance arrangements in place to address the new license condition and to manage organizational changes which may affect nuclear safety, such as the creation of new station posts, reductions in manpower or outsourcing of functions.

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***Nuclear liability under the Nuclear Installations Act***

The NIA provides that the licensee of a nuclear site has a duty to ensure that no occurrence involving either nuclear material or ionizing radiations causes personal injury or damage to property other than property of the licensee, or other property which is on the site and is used in connection with the operation of the nuclear installation. The licensee is liable for a breach of this duty irrespective of fault and we currently maintain insurance in relation to this risk.

Under the NIA, our liability to pay compensation for a breach of this duty is currently limited to £140 million per occurrence (excluding interest or costs). The NIA requires the licensee to make provision, by insurance or such other means as the Government may approve, for sufficient funds to be available at all times to ensure that duly established claims are satisfied up to £140 million per site in respect of each of the periods of the licensee s responsibility specified in the NIA. The NIA also requires that the Government will make available such sums (in addition to insurance or other funds which may be available from the licensee) as may be required to ensure that all duly established claims (excluding interest or costs) in respect of any occurrence are satisfied, up to 300 million special drawing rights (equivalent to approximately £240 million). A claim for compensation which is not satisfied out of this sum may, under the NIA, be satisfied by the Government to such extent as it may determine. The Secretary of State may direct the licensee to begin a new period of responsibility in the light of previous occurrences or claims thereby requiring the licensee to re-instate any provision that may have been reduced as a result of claims following an occurrence.

It is likely that these thresholds will increase in the near future. On February 12, 2004, the Government signed a Protocol to amend the Paris Convention on Third Party Liability in the Field of Nuclear Energy, 1960 and the Supplementary Brussels Convention, 1963 which together increase the limit of liability of nuclear operators to a minimum of 700 million; the liability of the Government to 500 million ; and the liability of the pool of funds contributed to by contracting parties to the Brussels Convention to 300 million. The Government has indicated its intention to ratify the relevant amendments by the end of 2006. Total compensation available under the revised regime will be a minimum of 1.5 billion, a four-fold increase. In addition, the definition of nuclear damage will be expanded to allow a broader range of damage to be compensated, including economic loss and the costs of preventive measures. Following ratification of the Protocol, the NIA will be amended. The Directors believe that the insurance market will have sufficient capacity to offer cover for these liabilities (and are aware that the costs of insurance will increase in line with the increases in liability resulting from the intended amendments to the NIA described above) arising to a nuclear operator and intend to maintain such insurance following implementation of the Restructuring. See Item 3 Risk Factors, the risk beginning The amount of insurance cover we are mandatorily required to maintain .

***Health and safety***

Operators of nuclear power stations must comply with the strict limits set out in the IRRs which lay down basic safety standards for the protection of the health of workers and the general public against the dangers arising from ionizing radiations.

**Periodic Safety Reviews**

The adequacy of the safety case for each power station is confirmed at each statutory outage, at which point the NII reviews the operating performance of the station and the examination, maintenance, inspection and testing that we have carried out on the plant. Prior to consenting to the nuclear reactor restarting, the NII must be satisfied that there is an adequate safety case for the operation of the plant.

In addition to the ongoing monitoring, pursuant to a condition of our nuclear site licenses, a PSR is required at each nuclear power station, at intervals of not more than ten years, to review the safety

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case for continued operation for the next ten years taking into account operational history, plant aging and current safety standards. The nuclear power station s commercial viability may be significantly eroded if we fail to convince the NII of the adequacy of the safety case. The scope and timing of the PSR is agreed between the NII and the licensee.

Once the timing of the PSR is agreed the licensee carries out the review and submits its findings to the NII. The NII s expectation from a PSR is that it will receive confirmation that safety structures, systems and components remain fit for purpose insofar as they are able to perform according to original design intent and that modern standards are achieved as far as reasonably practicable. The NII may require additional work to be carried out to demonstrate the adequacy of the safety case for continued operation and the progress of any such work will usually be monitored by the NII on an ongoing basis.

The first PSR has been completed for each of our AGRs. Sizewell B, the last station to complete a PSR, provided its submission to the NII in December 2003. The NII is expected to complete its assessment of that submission in September 2005 (although generally the NII takes approximately thirteen months to assess our PSRs). For details of the PSR dates for all our stations see the paragraph above headed Station lifetimes .

The next PSR of Hunterston B and Hinkley Point B is planned to be submitted to the NII in March 2006 at which time we will be required to confirm that all the recommendations arising from the previous PSRs of Hunterston B and Hinkley Point B have been implemented. The NII s decision whether to agree continued operation of each nuclear power station is expected a year or so after these submission dates.

**Public safety**

***Transport***

The transport of all radioactive material, both waste and fuel, off-site must comply with the Department of Transport requirements under RMRTA and the HSE s requirements under HSWA and ATCSA. The RMRTA regulates the transport by road of radioactive material. Under these Acts, the Government may regulate the packaging, labeling, consignment, handling, transport, storage and delivery of radioactive packages. The current regulations require certain consignments to be specifically approved by the Secretary of State for Transport.

***Security***

We operate in a world where we must be vigilant to security threats of all sorts in particular as a result of increased levels of terrorist activity internationally. Our operations are regulated and subject to audit by the OCNS which, in 2002, published its initial report after the terrorist attacks on the World Trade Center in New York on September 11, 2001, and must comply with the Nuclear Industries Security Regulations 2003 (the NIS Regulations ) which are made under ATCSA and all directions made under that legislation. The NIS Regulations make provision for the protection of nuclear material, both on sites and in transit, against the risks of theft or sabotage, and for the protection of sensitive nuclear information, such as site security arrangements. The OCNS published its latest annual report ( The State of Security in the Civil Nuclear Industry and Effectiveness of Security Regulation April 2004-March 2005 ) on July 25, 2005. The 2005 report contained recommendations and changes, some of which we will be

developing with the OCNS over the coming months, along with other nuclear operating companies to consider the impact of the revised strategy on our security arrangements but it is likely to result in increased security costs.

In August 2004 the Uranium Enrichment Technology (Prohibition on Disclosure) Regulations 2004 came into force. These Regulations make it an offence to make an unauthorized disclosure of uranium

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enrichment technology. This technology is used in the civil nuclear industry and can also be used in to develop nuclear weapons. An Explanatory Memorandum, Regulatory Impact Assessment and Guidance for the regulations have been prepared by OCNS.

Through the Standing Committee on Police Establishments, OCNS reviews police numbers and deployment at licensed nuclear sites policed by the Civil Nuclear Constabulary ( CNC ) such as British Energy s nuclear power stations.

The OCNS announced in summer 2004 that all the UK s nuclear generating stations will benefit from an enhanced layer of security when armed response units are deployed during 2005/6. Powers to deploy these officers had been included in ATCSA. Until permanent deployment at each station armed tactical response units are on hand to familiarize staff and where required to respond to operational requirements. We believe that these new measures will add a prudent enhancement to the security measures already in place.

Our security arrangements are independently reviewed, and we remain confident that our security regime and processes are of a high standard. We are further enhancing our security arrangements to meet the increasing UK regulatory requirements and conform with Government guidelines. The reviews cover protective security-related compliance issues as well as compliance with legal requirements. Our security policy and our security risk management audit process are documented and subject to regular internal review and we consider we have effective systems in place to address security issues across a range of areas including personnel recruitment, information technology, physical security and health and safety. We make every effort to ensure that robust security management is achieved.

The needs of security have to take account of the need for information to be available for use, so in June 2004 OCNS published Guidance entitled Finding a Balance . Issue No.2 of this guidance was published in April 2005. It made no substantive changes to the previous Guidance, but it updated on the creation of the CNC (previously the United Kingdom Atomic Energy Authority Constabulary).

***Emergency arrangements***

Emergency arrangements have been established and demonstrated to the satisfaction of the relevant regulators. Each power station has an emergency plan which is approved by the NII and lodged with local emergency services, public libraries and others. Information on emergency arrangements is discussed at local consultative meetings and information is provided to local residents. Each power station has an emergency control center on-site, as well as off-site arrangements for co-ordination with the police, the local authorities, other emergency services and other government agencies. No nuclear emergencies have occurred at any of our sites which have resulted in a release of radioactivity above the authorized level.

***Safety performance***

Under the terms of our nuclear site licenses, all incidents are required to be recorded and investigated and those of significance must be notified to the NII within defined time scales.

To aid public understanding of the safety significance of events at nuclear installations and their consequences, the International Atomic Energy Agency and the Nuclear Energy Agency of the Organization for Economic Co-operation and Development have developed the International Nuclear Event Scale which sets out various levels of incident increasing in seriousness from 1 (i.e. an anomaly beyond the authorized operating regime) to 7 (i.e. major accident with widespread health and environmental effects) and the criteria relating to each level.

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Only events at level 4 and above involve a significant release of radioactivity off-site. There has never been an event at any of our power stations resulting in an exposure to radiation of a person on or off the site above the statutory exposure limits, or the need to consider countermeasures to protect the public off-site. No event has been rated higher than level 2 at any of our power stations (i.e. an incident with a significant failure in safety provisions but with sufficient defense in depth remaining to cope with additional failures or an event resulting in a radiation dose to a worker in excess of the statutory annual dose limit and/or an event which leads to the presence of significant quantities of radioactivity in the installation in areas not expected by design and which require corrective action).

There has been a reduction in the collective radiation exposure to our workers from 0.09 man Sv/reactor in 2003/2004 to 0.03 man Sv/reactor in 2004/2005. This figure represents approximately one twenty-fifth of the worldwide median of the operators contributing to information collated by the WANO and places the Company within the top 10 per cent. of performers in this respect.

We maintain an open culture that promotes the reporting of all accidents, including those where no injury actually resulted. In the year to March 31, 2005, our accident frequency rate was 0.22 lost-time accidents per 200,000 man-hours of operation, a decrease from 0.53 in the prior year.

The Royal Society for the Prevention of Accidents ( ROSPA ) has recognized our safety performance by awarding all of our eight nuclear stations (together with Eggborough power stations s FGD project) with Gold Awards for achieving very high standards of safety in 2004/05. Gold Medal Awards were presented to two of our power stations for achieving continued safety performance over the last five years and six of our power stations were awarded the President s Award for achieving Gold Awards for the last ten consecutive years.

***NII safety management audit***

In 1998, the Board announced its decision to reorganize the Group and, in particular, our two licensed subsidiaries, BEG and BEG (UK), to bring all eight UK nuclear power stations under one licensee, namely BEG. Following this decision, in April and May 1999, the NII carried out a major audit of the safety management arrangements in the central functions that support safety at the licensed sites. The report from this audit was published by the NII in January 2000, and included 103 recommendations to be addressed by both licensees. The NII expressed concern about the ability of BEG and BEG (UK) to maintain adequate levels of technical support in the future, the extended working time of technical staff, the levels of contractor support being used and the adequacy of the management of change arrangements. The NII confirmed that it was not concerned about the immediate safety of the power stations, but wished to ensure that BEG and BEG (UK) remained adequate nuclear licensees in the future. On July 1, 2005 our nuclear generation facilities were consolidated into BEG. See Item 4 Information on the Company. The Restructuring State Aid Restrictions on our ability to operate .

As well as dealing with recommendations on an individual basis, four main processes were developed to deal with the NII s main areas of concern. The processes covered; Management of Skills and Resources, Management of Work, Management of Contractors and Management of Change.

Since publication of the NII audit report in January 2000, we have worked to develop processes to address the NII s concerns. Of the 103 recommendations, 84 have been fully cleared and require no further action, and the remainder, most of which are related to the main processes outlined above, are being monitored to confirm that the agreed resolution has been fully carried out. The

majority of the remaining recommendations have now been passed to the NII for full post-monitoring closure. The NII has been using the BEG and BEG UK management of the relocation of technical staff from Scotland to Barnwood as a test of whether the processes put in place to address the audit findings are working.

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***WANO***

We are a member of WANO which is an international non-governmental organization comprising operators from more than 420 nuclear power plants in over 30 countries. WANO aims to maximize the safety and reliability of its members nuclear power plants. WANO undertakes a program of site evaluations with the intent of reviewing operations at each of our nuclear power stations every two years.

WANO also carries out corporate evaluations where corporate means any part of the power plant organization which does not report directly to the station director. These evaluations provide an opportunity for members to be informed of how other members of WANO perform in relation to the question of corporate organization and how the member in question is performing against benchmarks called Performance Objectives and Criteria ( POs & Cs ) for operational nuclear power plant which WANO has developed over the years, which set the expectations of how the best performing utilities should perform. A subset of the POs & Cs has been developed as the basis for corporate reviews. At our request, WANO carried out a corporate review of BEG and BEG (UK) in July 2001, which was the first such review outside of North America.

Sizewell B hosted a WANO follow-up review in June 2005 when the WANO team leader indicated the long-standing trend in declining performance levels at the plant had been stopped and noted signs of visible improvement in most areas of previous concern.

***Compliance with nuclear regulations***

We place great emphasis on the importance of maintaining and continuing to develop a safety first culture in addition to complying with regulatory requirements. Our overall organizational structures and policies and our safety management arrangements are designed to ensure that legislative requirements and developments are recognized, implemented and monitored through appropriate procedures and practices and that continuous improvements in safety culture and performance are promoted.

**Environmental regulation**

Our operations are subject to numerous international, environmental and health and safety laws and regulations governing, amongst other things, the construction, operation and decommissioning of nuclear and coal-fired power stations; discharges to the air, water and land; the use, handling, transport and disposal of radioactive and hazardous substances and wastes; soil and groundwater contamination, and public and employee health and safety.

All investigations of the British Energy nuclear power station sites to date suggest that with the historical exception of one site where a diesel spill has been the subject of extensive remediation, now complete, there are no significant bodies of contaminated land present as defined under UK law. In some instances limited amounts of radiological or non-radiological contamination have been found in underlying groundwater: in these instances expert assessments have suggested no need for remediation but have identified the need for long term surveillance. Networks of groundwater monitoring wells are currently being established at each of the nuclear power station sites in order to provide comfort on current conditions and against the possibility of future losses or migration from adjacent sites. These networks, now in place at five out of the eight sites, are expected to be complete by the end of

2006. Routine sampling will be maintained on such groundwater monitoring networks with data arising being reviewed against appropriate risk-based criteria prompting further expert review, investigation or intervention where appropriate.

***Waste, emissions and discharges***

The Radioactive Substances Act 1993 ( RSA ) governs the disposal of radioactive waste including radioactive discharges. Radioactive gaseous, liquid or solid waste may only be disposed of or moved

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off the site in accordance with authorizations granted under the RSA. To enable the re-licensing to BEG of the two nuclear stations in Scotland (previously licensed to BEG (UK) under the NIA), it was also necessary for the RSA authorizations in respect of the two Scottish stations to be transferred to BEG. This took place with effect from July 1, 2005.

In England and Wales, the EA regulates nuclear power stations and grants discharge authorizations under the RSA. In Scotland, SEPA regulates under the RSA. We have obtained all necessary consents and authorizations from the EA and SEPA for the disposal of radioactive waste and for discharges from our stations.

The EA is undertaking a review of BEG s authorizations to discharge radioactive substances to the environment, regulated under the RSA. The revised authorizations, expected at the end of 2006, will lead to a reduction of many of the existing discharge limits and a range of new requirements including operational, maintenance and procedural refinements. The new limits and arrangements are not expected to affect the operational requirements of any of the power stations. We are in the process of preparing submissions to the EA to assist in the review process and have begun to prepare for the implementation of the new requirements. SEPA have already received submissions regarding the two Scottish power stations and are expected to complete their review on a similar timescale to the EA. The outcomes of the SEPA review are expected to be very similar to those of the EA.

The EPA provides for a waste management licensing regime and imposes certain obligations and duties on companies that produce, handle and dispose of non-radioactive waste. Separately, the IPC environmental authorization regime introduced in 1991 under the EPA provides an authorization regime for emissions which requires that a power station use the best available techniques (not entailing excessive cost) to minimize the emission of certain pollutants. The IPC is under a staggered process of repeal, to be replaced by a new Integrated Pollution Prevention and Control ( IPPC ) regime. The IPPC regime will combine the waste management and emission regimes and will impose progressively stricter requirements on power stations. It is expected to be fully implemented by 2007. The regulatory bodies under the new IPPC regime will remain the EA and SEPA.

***Consumer information***

In order to comply with one of the requirements of EU Directive 2003/54/EC, all electricity suppliers are required to provide information on the types of fuel that have been used to produce the electricity, to assist consumers in making informed choices about the environmental impact of the electricity they buy. This requirement is imposed by way of a new license condition which entered into force on March 18, 2005 although we have been disclosing fuel mix and other environmental information to customers since 2003.

**Environmental performance**

***Our AGR and PWR Stations***

The Center for Environment, Fisheries and Agriculture Science produces a Radioactivity in Food and the Environment report on behalf of the EA, SEPA and the Food Standards Agency which contains radiological monitoring data. The report shows that in 2002 radiation doses to the public resulting from our radioactive discharges to the environment were well below the national and international limits in all parts of the UK.

Both in England and Wales and in Scotland, compliance with radioactive discharge authorizations is assessed through returns made to the relevant regulator and a regular program of site inspections by the regulator.

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None of our stations has ever been prosecuted for exceeding any of its authorized discharge limits for the disposal of radioactive waste. However, in 2003 BEG (UK) was prosecuted relating to the discharge of an Active Effluent Discharge Tank in October 2001 at Torness and was fined £15,000. On September 23, 2002 the EA issued an enforcement notice against BEG and Sizewell B for failing to maintain and keep in good repair the systems for managing relevant radioactive waste. This relates to alleged discharges of solid waste from two liquid radioactive waste systems. We cannot rule out further action being taken by the EA over this matter.

We have been served with a number of Enforcement Notices from the environmental regulatory authorities requiring improvements to plant and/or processes associated with environmental performance. In October 2003, the EA wrote to us highlighting a number of events that, in its view, indicated a serious shortfall in our compliance with, and understanding of, our environmental permits and environmental legislation. In December 2003, we responded to the EA setting out the actions that we intended to take to resolve the issues raised in their October 2003 letter. These included enhancing the level of station resource dedicated to environmental compliance. We continue to meet with the EA to review our environmental performance.

**Eggborough Power Station and Gale Common**

Every year we set environmental objectives and targets for Eggborough power station and the Gale Common facility. For 2003/04, we set twenty targets related to the key environmental policies as an integral part of the station s business plan process and to ensure compliance with the requirements of ISO14001.

Along with other power station operators in the Aire Valley (the area in which the Eggborough power station is located), we monitor ambient air quality as part of a process agreed with the EA in order to meet the requirements of our IPC authorization. Results from this monitoring have all compared very favorably with the National Air Quality Standards which came into effect in April 2005 and UK Objective for the protection of human health.

We continue to play our part in creating and maintaining bio-diversity at the Eggborough power station and Gale Common through integrated Land Management Plans which we have developed with ADAS (a consultancy and research organization to land-based industries in the UK and abroad and formerly part of the Ministry of Agriculture, Fisheries and Food). The purpose of these plans is to protect and enhance the wildlife in, and conserve the local landscape and historical heritage of, the area in which we conduct our business.

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**PROPERTY, PLANT AND EQUIPMENT**

Our properties consist of power stations and associated land and administrative offices, and various other properties (a small number of which are held pending disposal). We own the freehold (in England and Wales)/feuhold (in Scotland) to each of our eight UK nuclear power stations and one coal-fired power station as well as our corporate offices at Barnwood near Gloucester in England. We also lease our corporate headquarters at Livingston, together with offices at East Kilbride and Renfrew (all in Scotland) and London, England. During the year we sold our former headquarters building at Peel Park, East Kilbride (later renamed Orbital House) although we retained office space there under a lease back arrangement to accommodate certain administrative functions (see below for further details). Details of our power stations and offices are set out below:

| Type | Type | Capacity (MW) | Location | Size (square feet) (approximate) (Principal Offices only) |
|---|---|---|---|---|
| **Nuclear Power Stations:** | | | | |
| Dungeness B | AGR | 1,110 | England | |
| Hartlepool | AGR | 1,210 | England | |
| Heysham 1 | AGR | 1,150 | England | |
| Heysham 2 | AGR | 1,250 | England | |
| Hinkley Point B | AGR | 1,220 | England | |
| Hunterston B | AGR | 1,190 | Scotland | |
| Sizewell B | PWR | 1,188 | England | |
| Torness | AGR | 1,250 | Scotland | |
| **Coal-fired Power Station:** | | | | |
| Eggborough | | 1,960 | England | |
| **Principal Offices:** | | | | |
| Systems House, Livingston | | | Scotland | 24,150 |
| Barnwood, Gloucester | | | England | 307,341 |
| Sheldon Square, London | | | England | 6,043 |
| Orbital House, East Kilbride | | | Scotland | 11,489 |
| Innovation House, Renfrew | | | Scotland | 24,976 |

During the year we completed the sale of our Head Office at Peel Park in East Kilbride and our Head Office was transferred to its new location at Livingston, Scotland. A small number of staff remained at Peel Park under a ten year leaseback arrangement of part of the building and some self contained engineering support teams moved to an office in Renfrew. Power stations central support functions are being consolidated at our Barnwood office in Gloucestershire in order to improve their efficiency and focus on these support functions.

Following the sale of Peel Park, we have taken a 15 year lease of two floors of the office in Livingston with a ten year break option. We have also agreed to take a 12-24 month lease of one wing of the office in Renfrew and a long lease of a second wing until 2013 with a break option in 2009.

In connection with its privatization in July 1996, BE Ltd entered into a Property Clawback Deed with the Secretary of State. BE Ltd s obligations under the Property Clawback Deed were assumed by us upon the Restructuring Effective Date. The Property Clawback Deed provides that in the event of the disposal (or a deemed disposal) of any property in which we had an interest as at March 31, 1996 (other than our power stations), the Government is entitled to 50 per cent. of any capital gain realized on the disposal in

excess of £400,000 increased in accordance with RPI since April 1, 1996. Although the assessment has not been completed, we believe that no gain susceptible to the Property Clawback Deed was realized upon our sale of our office building at Peel Park. The Property Clawback Deed will cease to have effect from March 31, 2006.

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Certain of our subsidiaries have granted security over their assets in order to secure the decommissioning default payments and related costs and expenses under the Contribution Agreement. For a discussion of the environmental aspects of our operations, see Item 4 Regulation.

**Competition**

Our generation competes in the wholesale market for electricity with other power stations, including other nuclear power stations, and a number of coal-, oil- and gas-fired power stations. Our major competitors in generation are E.ON UK, RWEnpower, EDF Energy, Drax Power, Scottish Power, Scottish and Southern Energy and BNFL. In addition, there are a large number of companies that own single power plants. Compared to nuclear power stations, coal-, oil- and gas-fired power stations are able to more easily adjust their output to take advantage of changes in market price, which in some situations may put us at a competitive disadvantage.

There has been some consolidation of supply businesses in recent years. Excluding British Energy, there are only six major suppliers in Great Britain: E.ON UK, RWEnpower, EDF Energy, Scottish Power, Scottish and Southern Energy and Centrica (British Gas). While we operate exclusively in the industrial and commercial sector, the other major suppliers also compete in the domestic retail sector. Gaz de France also competes in the industrial and commercial sectors.

On June 13, 2005 the European Commission announced an inquiry into competition in gas and electricity markets in response to concerns raised by consumers. The inquiry will focus on the functioning of wholesale markets and how prices are set. On June 14, 2005 the European Commission issued a request for information to electricity generators, traders and suppliers. British Energy has been asked to respond to this request. The European Commission intends to issue an interim report on the inquiry by the end of 2005, and the main results will be published in 2006.

**Legal Proceedings**

On February 12, 2004 we received a notice of warranty claims from the consortium which purchased our 82.4 per cent. interest in Bruce Power alleging breach of certain warranties and representations relating to tax and to the condition of certain plant at the Bruce power station.

The claim relating to the condition of the plant is based upon alleged erosion of some of the steam generator support plates, through which boiler tubes pass, which it is alleged resulted in an extended outage of one unit at the plant to carry out repair works and loss of net revenues and costs of approximately C$64.5million. The consortium also claims that the alleged erosion may reduce the operating life of the unit and/or result in further repairs involving further losses. We have rejected the claim and if pursued, we expect to defend it.

The principal tax claim relates to the treatment of expenditures at the Bruce plant during the period of our ownership that is currently being considered by the Canadian tax authorities. The treatment proposed by us could result in a material tax rebate that has not been recognized in our financial statements. The consortium claims that allowance of the expenditure for that period would cause it to lose future deductions. We have rejected the tax claim and expect to defend it if it is pursued further. We do not believe

that the amount of the tax claim should materially exceed the amount of the rebate, and therefore the tax claim should not have a material impact on our cash flow. See Item 3. Risk Factors We are involved in a dispute that if resolved or determined against our interests could adversely affect our available cash.

Under the Bruce Power sale agreement with the consortium, C$20 million was retained in trust to meet any representation and warranty claims. This amount may be retained pending resolution of the claims.

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In addition to the consideration payable by the consortium under the master purchase agreement, up to a further C$100 million was payable to us contingent upon the restart of two of the Bruce A units under a trust agreement (the Trust Agreement ) entered into on the same date. Had the first unit restarted by June 15, 2003, C$50 million would have been released to British Energy and an additional C$50 million would have been released to British Energy had the second unit restarted by August 1, 2003. An amount of C$5 million was deducted from the C$50 million payable in respect of each unit for its failure to restart by the scheduled restart date or by the first day of each successive calendar month following the scheduled restart date. The Group received C$20 million on March 22, 2004 and C$10 million on May 25, 2004 in partial consideration under the Trust Agreement. British Energy commenced arbitration proceedings in Ontario against the Ontario Provincial Government ( the Province ) in December 2004 in accordance with the procedures set out in the Safety and Power Pool Performance Trust Agreement between British Energy and the Province seeking the payment of additional consideration under the Trust Agreement on the basis that Bruce A Units 3 and 4 restarted earlier than the Province claims. No additional amounts appear on its balance sheet at March 31, 2005 because of uncertainties regarding their realization. The amounts recoverable in respect of the restarts will be substantially lower than the maximum C$100m but the amounts and timing of the payments have still to be confirmed.

We have agreed settlement of working capital adjustments primarily relating to the value of nuclear fuel and taxation matters, to the purchase price for the sale of AmerGen, and have agreed to pay to Exelon an adjustment of $9.5 million, of which half was paid in February 2005 and the remaining half is due at the end of September 2005.

We are in discussions with FLS Miljø a/s, the main contractor for the FGD plant at Eggborough power station about completion of the work. Although certain matters are disputed by both parties, we are endeavoring to resolve these, and to complete the project, without referring the matter to formal dispute resolution under the contract.

## ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

*You should read the following discussion in conjunction with Selected Consolidated Financial and Other Data , Risk Factors and our consolidated financial statements and the related notes included herein beginning on page F-1. Some of the statements in the following discussion are forward-looking statements. See Special Note Regarding Forward-Looking Statements . Some of the following discussion involves reference to non-GAAP financial measures see Non-GAAP Financial Measures .*

### Overview of the Company

Our principal activity is the generation, sale and trading of electricity all of which we consider as one reporting segment. We are the UK s largest generator of electricity, producing around one fifth of the UK s electricity and employing approximately 5,400 staff. We own and operate eight nuclear power stations and one coal-fired power station in the UK. Of our nuclear power stations, seven are AGR power stations (Dungeness B, Hartlepool, Heysham 1, Heysham 2, Hunterston B, Hinkley Point B and Torness) and the eighth (Sizewell B) is our sole PWR power station. Our nuclear power stations have a combined capacity of approximately 9,600 MW. Eggborough, our coal-fired power station in Yorkshire, has a capacity of approximately 2,000 MW. During the year ended March 31, 2005 (a year covering both the pre and post-Restructuring periods), our power stations produced total output of 67.4 TWh, which was comprised of output of 59.8 TWh from our nuclear power stations and 7.6 TWh from Eggborough power station. BEPET, one of our subsidiaries, arranges the balancing of our electricity generation and supply. Our direct supply business is one of the largest suppliers of electricity to the UK s industrial and commercial sector.

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**The Restructuring**

We completed our Restructuring on January 14, 2005. The commercial and structural factors which contributed to our financial difficulties can be primarily attributed to:

- high fixed production cost, and, as a merchant generator, significant exposure to fluctuations in the wholesale electricity prices which declined approximately 35 per cent. over the two years to September 2002;
- contractual agreements which exacerbated our exposure to electricity prices;
- significant nuclear fuel and site decommissioning liabilities without certainty that these liabilities would be sufficiently covered by our contributions to the NDF; and
- increasing indebtedness and constraints on the ability to repay these obligations, exacerbated by the downgrade in our investment rating in September 2002.

We reviewed our business and assessed the Company s longer term prospects which resulted in us initiating discussions with the Government to seek immediate financial support and to implement a longer term financial restructuring.

In October 2003, we announced that we had agreed to the terms of the Restructuring which was subsequently completed on January 14, 2005. The completion of the Restructuring resulted in our Creditors compromising debt and other obligations in exchange for £425 million of New Bonds and Project Finance Loan, plus the receipt of New Shares. In addition, an option to acquire the Eggborough power station in 2010 for a one time payment of £104 million and cancellation of the Project Finance loan outstanding at that time was granted to certain Creditors.

We also entered into the Government Restructuring Agreement in connection with the Restructuring to satisfy our nuclear liabilities and decommissioning obligations. The new arrangements with the Secretary of State required the existing NDF to be further funded, enlarged and renamed the NLF. Upon Restructuring, the NLF was issued with £275 million of New Bonds and will receive various annual payments from the Company to fund qualifying uncontracted nuclear liabilities and the qualifying costs of decommissioning of our nuclear power stations. In exchange, the Secretary of State will fund certain historic nuclear liabilities and qualifying uncontracted nuclear liabilities and qualifying decommissioning costs to the extent that they exceed the assets of the NLF.

As a result of the Restructuring we have put into place measures to address many of the factors which led to the requirements to restructure, including:

- new BNFL contracts which link the cost of our nuclear fuel to the market price of electricity, thus hedging our exposure to fluctuations in electricity prices;

implementing mitigating factors to the uncertainty of the nuclear fuel and decommissioning liabilities; and

agreeing a plan with our creditors which resulted in the extinguishment of certain indebtedness and created a new capital structure.

Our past performance is not indicative of our future prospects. Whilst there are various factors affecting our business which are outside our control, we believe that through these changes we will be better able to adapt to future fluctuations in wholesale electricity prices.

The Restructuring resulted in the issuance of 561.0 million New Shares with warrants to purchase an additional 29.5 million New Shares at £0.98 per share to creditors and shareholders. In addition, the NLF may, at its option, convert the certain required payments from the Company into Convertible Shares of the Company ( Convertible Shares ). The terms of the Convertible Shares will

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limit the general voting rights attaching to such shares, while held by the NLF, to the maximum amount which can be held by the NLF (and its concert parties) without triggering a mandatory offer under the UKLA Takeover Code, being currently 29.9 per cent.

For further information about the Restructuring, the NLF and the related agreements see Item 4. Information on the Company Restructuring.

**Disposals**

We made two significant divestitures during the periods under review. In February 2003 we disposed of our 82.4 per cent. interest in Bruce and in December 2003 we sold our 50 per cent. interest in AmerGen. The sale of Bruce resulted in total proceeds of C$728 million and a total loss on disposal of £2 million. The sale of our joint venture investment in AmerGen resulted in proceeds of US$277 million and a loss on disposal of £110 million. See Note 15 of the consolidated financial statements for further discussion of disposals.

The Bruce disposal is reported as discontinued operations and the consolidated financial statements for all prior periods have been adjusted to reflect this presentation, while the disposal of AmerGen was treated as a sale of an investment.

**Factors Affecting our Business**

The primary factors affecting our business include plant output, achieved electricity prices, operating costs and capital investment expenditures. The Restructuring did not impact the general operations of our business, except where specifically identified. The operational performance measures for the year ended March 31, 2005 have been illustrated as pre-Restructuring and post-Restructuring and in total. These key factors are discussed below.

*Nuclear and coal output*

The electrical output that our eight nuclear stations and one coal fired station can achieve is affected by a number of factors, including plant operating conditions and strategy and the frequency and duration of outages. The table set forth below shows our nuclear and coal output from continuing operations for the periods under review:

| Year ended March 31, 2005 | The period from January 15 to March 31, 2005 | The period from April 1, 2004 to January 14, 2005 | Year ended March 31, | | Variance | |
|---|---|---|---|---|---|---|
| | | | 2004 | 2003 | 2005-2004 | 2004-2003 |

| | TWh | TWh | TWh | TWh | TWh | % | % |
|---|---|---|---|---|---|---|---|
| Nuclear output | 59.8 | 14.3 | 45.5 | 65.0 | 63.8 | (8) | 2 |
| Coal output | 7.6 | 2.5 | 5.1 | 7.6 | 5.7 | 0 | 33 |
| Total Output | 67.4 | 16.8 | 50.6 | 72.6 | 69.5 | (7) | 4 |

*Nuclear output.* The principal factor affecting our nuclear output for any given period is the number and duration of outages. The nuclear regulatory regime in the UK requires each nuclear power station to be shut down periodically for maintenance and inspection as a condition of that power station s nuclear site license. We refer to such a shut down as a statutory outage . Certain of our nuclear power stations must also be reduced in load or shut down to allow for refueling. Nuclear power stations must also be reduced in load or shut down for maintenance and testing or to address an unplanned technical malfunction or engineering failure, which we refer to as unplanned outages .

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The table set forth below shows the aggregate loss of output, in terawatt-hours, associated with our statutory, refueling, unplanned and other outages.

| | Year ended March 31, 2005 | | | Year ended March 31 | | Variance[1] | |
|---|---|---|---|---|---|---|---|
| | Total | The period from January 15 to March 31, | The period from April 1, 2004 to January 14, | 2004 | 2003 | 2005-2004 | 2004-2003 |
| | *TWh* | *TWh* | *TWh* | *TWh* | *TWh* | *%* | *%* |
| Statutory outages | 2.9 | 0.1 | 2.8 | 4.9 | 5.9 | (41) | (17) |
| Refueling | 3.0 | 0.6 | 2.4 | 2.9 | 3.0 | 3 | (3) |
| Unplanned losses | 17.3 | 2.4 | 14.9 | 10.7 | 10.6 | 62 | 1 |
| Total | 23.2 | 3.1 | 20.1 | 18.5 | 19.5 | 25 | (5) |

(1) Variances that indicate a decrease from one year to the next and designated by ( ) are a positive indicator for the Company. Similarly, variances that indicate an increase from one year to the next are a negative indicator.

Our level of unplanned outages in recent years has significantly affected our operating and financial performance. Since 2003, unplanned losses arising from incidents other than major plant failures has gradually increased during the periods under review. To date these unplanned outages have been caused by a variety of technical issues. We believe that the loss of output arising from these outages is indicative of a materiel deterioration in the condition of our plants over time.

We have taken steps to improve the performance of our plants. We continue to implement PiP which is expected to improve the reliability of our nuclear plants, thereby reducing unplanned outages. And the completion of the Trading Development Program will assist us in decisions over the optimal running of our plant and improving risk monitoring activities. With the necessary measures in place, we expect our nuclear output to average 63.0 TWh over the next two financial years.

We have sought to reduce the impact of refueling outages through the introduction of low power on-load refueling (that is, refueling while the reactor is still on) at four of our seven AGR stations as well as scheduling refueling outages to coincide with statutory outages. PWRs are not designed to refuel on-load and must be shut down for refueling. We have reached an agreement with the NII which has allowed us to extend the period between statutory outages at all of our AGR stations to three years. The period between statutory outages is 18 months in the case of our PWR power station. We seek to reduce the impact of statutory outages on revenue by timing such outages to occur during periods of lower demand for electricity when prices are lower (generally between March and October). We also seek to reduce the duration of any statutory outages by improving the efficiency with which we conduct the required program of work. We carried out four statutory outages during the year and have six planned outages for the year ending March 31, 2006.

*Coal output*. The Eggborough power station is operated at various output levels rather than at constant levels in the manner of our nuclear stations. Eggborough is operated primarily as a flexible mid-merit plant and its output level is influenced by a number of factors including the market prices of coal, carbon and electricity. As such, prevailing market prices of electricity and coal, carbon dioxide emissions, our contracted trading position and unplanned outages at our nuclear plants are the primary factors driving our total output for each of the periods under review. Output levels at Eggborough for the year ended March 31, 2005 were 7.6TWh, the same level as for the year ended March 31, 2004.

*Electricity Prices*

Our realized price for electricity, which is calculated by dividing total electricity revenue (net of energy supply costs and miscellaneous income) by total output during the period, is critical to our profitability. We consider the average forward price for baseload power to represent a market price for wholesale electricity sales.

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The table set forth below illustrates our realized price as compared to market price:

| | Year ended March 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Realized Price[1] | £ 20.2/MWh | £ 16.9/MWh | £ 18.3/MWh |
| Market Price[2] | £ 20.4/MWh | £ 16.7/MWh | £ 18.6/MWh |

(1) Our realized price for the year ended March 31, 2003 reflects the effect of several changes to the manner in which we account for revenue and certain operating costs as a result of the introduction of new trading arrangements brought about by the commencement of NETA. This puts 2003 realized price on a comparable basis with 2005 and 2004.

(2) The Market Price quoted is the average of the mid-point of the closing prices for annual baseload contracts during the year prior to delivery as reported on European Daily Electricity Markets, published by Heren Energy.

As at June 30, 2005 fixed price contracts were in place for approximately three quarters of planned output for the year ending March 31, 2006 at an average contracted price of £29.8/MWh. This price excludes the impact of higher prices that might have been achieved as a result of running Eggborough to take advantage of the differential between plan and baseload prices. This price also excludes Balancing Services Use of System and other electricity market participation charges of around £0.7/MWh and market costs incurred through output variation and unreliability expected to be around £1.0/MWh and the impact of capped price arrangements of approximately 5 TWh at around £30/MWh. We intend to progressively close out our exposure to market prices for 2005/06 and to build our contract position for 2006/07 subject to limits on trading collateral.

Electricity prices in the UK wholesale market reached an all time high during the year, driven up by high oil and gas prices and concerns in the market over the ability of gas supplies to meet demand at peak times. Both spot and forward power prices have also been very volatile throughout the year.

Gas prices continue to be a key influence on the electricity market. In fall 2004, National Grid Transco highlighted a risk that there might be insufficient gas to meet power station demand in the event of a cold winter. This contributed to a sharp rise in gas and power prices for winter 2005 and 2006. Although temperatures in winter 2004 were above long term averages, relatively cold weather at the end of February, coupled with reduced gas supply, triggered exceptionally high spot prices for both gas and power. Worldwide demand for coal has remained strong, keeping coal prices in the range $60-$80/tonne for delivery to European ports.

The forward price for annual baseload electricity for 2005/06 delivery rose from around £24.5/MWh in March 2004 to over £35.0/MWh by the end of March 2005, an increase of over 40 per cent. Concerns over a potential shortfall in winter peak gas supply contributed to a rise in the price for delivery for the year from October 2005 to over £37.0/MWh in early October 2004. As at June 30, 2005, the price for delivery from October 2005 had subsequently risen to over £49.0/MWh.

*Operating costs*

In general, the operation of nuclear power stations is characterized by high fixed costs, such as maintenance and the cost of decommissioning our power stations. Fuel costs represent our most significant operating cost and reflect not only the amount of fuel burnt during the period (based on total output) and the efficiency of our fuel utilization (the percentage of nuclear fuel used

before it is removed from the reactor) but also include the cost of reprocessing and storage of spent fuel and storage and disposal of nuclear waste, collectively referred to as back-end fuel costs.

The cost of coal has remained high, in the range of $60-80/tonne for delivery to European ports. Fossil fuel costs are expected to increase with the introduction of ETS from January 1, 2005. The Company will be required to purchase additional allowances from the market to cover the shortfall in

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allocated allowances to cover emissions of carbon dioxide. The market price of allowances has risen since the beginning of 2005 and was in excess of 15/tonne of carbon dioxide on March 31, 2005 and 25/tonne at June 30, 2005.

On March 31, 2003 and May 16, 2003, we exchanged contracts with BNFL covering front end and back end AGR fuel services respectively, which became fully effective on completion of the Restructuring.

The new arrangements provide an important partial hedge against electricity market price movements on approximately 50 per cent. of the Group s total nuclear output. The pricing provisions in the contracts are intended to enable us to reduce a proportion of our fuel costs which are fixed by providing for a discount when the market baseload price of electricity is below a specified amount and a surcharge when above this amount. As electricity prices have risen substantially since October 2003, we are now making additional payments to BNFL under the new arrangements for spent fuel management in the form of the surcharge referred to above. This will continue as long as electricity prices remain above £16.00 per MWh but capped at £21.0 per MWh (in 2002/2003 monetary values and indexed to the RPI).

Whilst we do not operate in, or have exposure to, hyperinflationary economies, our cost base is subject to normal inflationary factors with certain costs specifically impacted by movements in the RPI.

*Investment expenditures*

Significant investment expenditures are required to properly maintain the condition of the power stations and to minimize unplanned plant outages. We expect that our investment in plant projects, strategic spares, including costs associated with PiP will be in the range of £230 million to £250 million for the year ending March 31, 2006.

**Results of Operations**

***The period from January 15 to March 31, 2005, the period from April 1, 2004 to January 14, 2005 and the year ended March 31, 2004.***

On January 14, 2005 our Restructuring was formally approved by the Scottish Courts and was effective immediately. As a result of the Restructuring, our results of operations after that date are not comparable to results reported in prior periods because of differences in the bases of accounting and the capital structure. The periods presented prior to and including January 14, 2005 have been designated Predecessor and the periods subsequent to January 14, 2005 have been designated Successor . Refer to Note 2 to the consolidated financial statements for additional information on the completion of Restructuring.

*Revenue*

Revenues for the periods from January 15 to March 31, 2005 and April 1, 2004 to January 14, 2005 were primarily affected by levels of output experienced in the twelve months to March 31, 2005, together with movements in electricity prices and levels of energy supply costs being recharged to customers.

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Revenue is analyzed as follows:

| | Successor | Predecessor | |
|---|---|---|---|
| | The period from January 15 to March 31, 2005 | The period from April 1, 2004 to January 14, 2005 | Year ended March 31, 2004 |
| | | (In £ millions) | |
| Wholesale generation sales | 233 | 458 | 703 |
| Direct supply sales | 170 | 512 | 522 |
| | 403 | 970 | 1,225 |
| Energy supply costs recharged to customers | 73 | 229 | 260 |
| Miscellaneous income | 6 | 23 | 31 |
| Revenue | 482 | 1,222 | 1,516 |
| **Per cent. Split** | | | |
| Wholesale generation | 58% | 47% | 57% |
| Direct supply | 42% | 53% | 43% |

Revenue was £482 million for the period from January 15 to March 31, 2005, and was £1,222 million for the period from April 1, 2004 to January 14, 2005. For the year ended March 31, 2004 revenues amounted to £1,516 million.

For the period from January 15 to March 31, 2005 and the period from April 1, 2004 to January 14, 2005, realized electricity prices were £23.5 per MWh and £19.1 per MWh, respectively, as compared to £16.9 per MWh for the year ended March 31, 2004. Additionally, nuclear output for the same periods was 14.3 TWh, 45.5 TWh and 65.0 TWh, respectively. Output was impacted by unplanned outages including significant outages at Heysham 1 and Hartlepool. These two outages resulted in lost output of approximately 7.4 TWh for the period from April 1, 2004 to January 14, 2005. In the twelve months to March 31, 2005, there were further unplanned outages resulting in a loss of 9.9 TWh of which 6.5 TWh was due to outages of 14 days or less. Total output for the twelve months ended ended March 31, 2005 was 67.4 TWh compared with 72.6 TWh for the year ended March 31, 2004. As noted previously, coal output included in these totals was constant at 7.6 TWh.

Growth in direct supply sales has continued in the year. This is in line with the Company s strategy to target industrial and commercial customers. As at March 31, 2005, we had contracts in place to supply over 2,000 customers and were supplying over 15,000 sites across Great Britain. As at March 31, 2004, we had contracts in place to supply 1,350 direct supply customers at 7,500 sites. Volume to our direct supply customers was 6.8 TWh for the period January 15 to March 31, 2005 and 24.6 TWh for the period April 1, 2004 to January 14, 2005 and 29.0 TWh for the year ended March 31, 2004.

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*Operating expenses*

Total operating expenses were £642 million for the period from January 15 to March 31, 2005 and £1,409 million for the period from April 1, 2004 to January 14, 2005, compared with £1,706 million for the year ended March 31, 2004. Operating expenses are further analyzed as follows:

| | Successor | Predecessor | |
|---|---|---|---|
| | The period from January 15 to March 31, 2005 | The period from April 1, 2004 to January 14, 2005 | Year ended March 31, 2004 |
| | | (In £ millions) | |
| Fuel costs | 127 | 507 | 532 |
| Staff costs | 81 | 233 | 272 |
| Operating and maintenance expense | 101 | 390 | 451 |
| Depreciation and amortization | 73 | 87 | 101 |
| Energy supply costs | 73 | 229 | 260 |
| (Gain)/loss from movements in derivative contracts | 171 | (37) | 90 |
| Other operating expense | 16 | | |
| Total operating expenses | 642 | 1,409 | 1,706 |

*Fuel Costs*. Total fuel costs amounted to £127 million for the period from January 15 to March 31, 2005, of which £71 million was nuclear fuel costs and £56 million was coal costs. Coal costs include costs of £10 million attributable to carbon costs as well as other fuel costs for Eggborough. For the period from April 1, 2004 to January 14, 2005, total fuel costs were £507 million, comprising £416 million in respect of nuclear fuel costs and £91 million for coal costs. Total fuel costs were £532 million for the year ended March 31, 2004, of which nuclear fuel costs were £437 million and coal costs were £95 million.

The financial results for the Predecessor have been prepared on the basis of the historic BNFL contracts in respect of back end fuel costs. The Successor results have been prepared on the basis of the revised BNFL contracts in respect of back end fuel costs which become effective on completion of the Restructuring.

Coal prices have continued to increase on their 2004 levels. ETS costs have been a component of the cost of operating Eggborough since the ETS scheme came into effect on January 1, 2005. To the extent that carbon dioxide emissions exceed the amount of allowances that have been granted to us, we recognize costs based on the market price of ETS allowances at that point in time.

*Staff costs*. Staff costs were £81 million for the period from January 15 to March 31, 2005, including a charge of £19 million for severance. For the period from April 1, 2004 to January 14, 2005, staff costs amounted to £233 million, which included £12 million with respect to severance charges. Excluding the effect of severance costs, staff costs have increased due to a combination of salary inflation, increased headcount and increased overtime payments incurred as part of the unplanned outages. In the year ended March 31, 2004 staff costs amounted to £272 million.

*Operating and maintenance expense*. Operating and maintenance expense comprises the operating expenses of our power stations and support functions, excluding those costs which are discussed separately in this section. Operating and maintenance expense during the period from January 15 to March 31, 2005 was £101 million, including £3 million of expenditure on research and development. For the period from April 1, 2004 to January 14, 2005, operating and maintenance expense was £390 million, including £56 million relating to the Restructuring and £11 million of expenditure on research and development. Total operating and maintenance expense for the year ended March 31, 2004 amounted to £451 million, including £43 million relating to the Restructuring and £14 million of expenditure on research and development.

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*Depreciation and amortization*. As part of the purchase accounting exercise at Restructuring, the carrying value of property, plant and equipment was increased significantly, resulting in a proportionately higher depreciation charge for the period from January 15, to March 31, 2005 and is expected to result in higher ongoing depreciation charges in the future. Depreciation and amortization was £73 million for the period from January 15 to March 31, 2005, compared with depreciation and amortization of £87 million for the period from April 1, 2004 to January 14, 2005. For the year ended March 31, 2004 depreciation and amortization charges amounted to £101 million.

*Energy supply costs*. Energy supply costs mainly comprise the costs incurred for the use of distribution and transmission systems and are fully recovered through revenue. Energy supply costs also include costs related to meeting costs of compliance with the Renewables Obligation as part of the regulations governing climate change. Renewables Obligation costs are also fully recovered through revenue. Total energy supply costs were £73 million for period from January 15 to March 31, 2005, and were £229 million for the period from April 1, 2004 to January 14, 2005. For the year ended March 31, 2004 energy supply costs were £260 million. The increase in energy supply costs reflects the inclusion of Renewable Obligation Certificates compliance costs, and growth in our direct supply business as noted previously.

*(Gain)/loss from movements in derivative contracts*. With our trading strategy of selling forward our output, we have a number of contracts for delivery in the future with prices that are different to current market prices, which require to be marked to market at each reporting date. As a result of the increases in electricity market prices, movements in the fair values of commodity contracts and derivatives have resulted in charges of £171 million and gain of £37 million for period from January 15 to March 31, 2005 and for the period from April 1, 2004 to January 14, 2005, respectively. For the year ended March 31, 2004 a charge of £90 million was recognized in connection with the commodity contracts and derivatives.

*Other operating expense*. For the period from January 15 to March 31, 2004 we had other operating expense primarily in connection with the recognition of certain commodity contracts at Restructuring.

*Interest income and expense*

Interest expense has been affected by the extinguishment of indebtedness pursuant to the Restructuring. Interest expense for the period from January 15 to March 31, 2005 was £10 million as a result of the issuance of the New Bonds due 2005 through 2022. Interest expense for the period from April 1, 2004 to January 14, 2005 consisted of £79 million of interest on Predecessor debt. For the year ended March 31, 2004, interest expense consisted of £60 million related to Predecessor debt.

We had interest income of £5 million, £15 million and £11 million for the periods from January 15 to March 31, 2005, from April 1, 2004 to January 14, 2005 and the year ended March 31, 2004. Interest income was further affected by an increase in interest rates and increase in balances of cash and cash equivalents.

*Income Taxes*

A tax benefit was recognized in connection with tax loss carry forwards for the period from January 15 to March 31, 2005 and the period from April 1, 2004 to January 14, 2005 respectively.

*Net income/(loss)*

As a result of the factors discussed above, net loss for the period from January 15 to March 31, 2005 was £122 million and £226 million for the period from April 1, 2004 to January 14, 2005. Net income for the year ended March 31, 2004 was £7,562 million, after taking account of the cumulative effect of a change in accounting principle of £7,640 million (net of taxes of £273 million) upon adoption of FASB Statement No. 143, *Accounting for Asset Retirement Obligations* ( SFAS 143 ).

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***Year Ended March 31, 2004 compared to the Year Ended March 31, 2003***

*Revenue*

The table below sets forth the revenue generated by each of our wholesale and direct supply routes to market.

| | Year ended March 31, | | Variance | |
|---|---|---|---|---|
| | 2004 | 2003 | £ | % |
| | (In £ millions) | | | |
| Wholesale generation | 703 | 852 | (149) | (17.5) |
| Direct supply | 522 | 419 | 103 | 24.6 |
| | 1,225 | 1,271 | (46) | (3.6) |
| Energy supply costs recharged to customers | 260 | 184 | 76 | 41.3 |
| Miscellaneous income | 31 | 73 | (42) | (57.5) |
| Revenue | 1,516 | 1,528 | (12) | (0.8) |
| **Per cent. split** | | | | |
| Wholesale generation | 57% | 67% | | |
| Direct supply | 43% | 33% | | |

The decrease in revenue was primarily due to lower realized prices for our electricity. Our realized price for the year ended March 31, 2004 was £16.9 MWh compared with £18.3 MWh for the year ended March 31, 2003, a 7.7 per cent. decrease.

The decrease in realized prices for electricity was partially offset by the growth in our direct supply business and increases in output. Our direct supply business become an important route to market for us, and one which demonstrates growth potential. Our target customer base is predominantly among the energy intensive industrial and commercial users, with electricity demands of over 1,000 MWh per annum. In the year ended March 31, 2004 we had contracts in place to supply some 1,350 direct supply customers at 7,500 sites. Our direct supply business increased by almost 30 per cent. in volume terms in the year ended March 31, 2004, to 29.0 TWh. The volume of power sold directly to customers through the direct supply business was equivalent to 40 per cent. of total output for the year ended March 31, 2004. This follows an increase of 20 per cent. in volume terms compared to the year ended March 31, 2003.

Total output for the year ended March 31, 2004 was 72.6 TWh, representing an increase of 3.1 TWh as compared with total output of 69.5 TWh for the year ended March 31, 2003. This increase was the result of output increases of 1.2 TWh from our nuclear plants and 1.9 TWh from the Eggborough power station. Our nuclear output was nevertheless affected by a number of unplanned outages. In particular, the major outage in both reactors at Heysham 1 resulted in the loss of 3.2 TWh due to cast iron pipe-work failure. The outages at Heysham 1 were equivalent to some £71 million of lost profit contribution inclusive of imbalance costs and associated fuel savings. Output at the Eggborough power station increased in 2004 compared with prior years in order to take advantage of higher electricity prices and to provide cover for the unplanned outages at our nuclear plants during the year.

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*Operating expenses*

The following table sets forth the various components of our operating costs for the years ended March 31, 2004 and 2003.

| | Year ended March 31, | | Variance | |
|---|---|---|---|---|
| | 2004 | 2003 | £ | % |
| | (In £ millions) | | | |
| Fuel costs | 532 | 1,050 | (518) | (49.3) |
| Staff costs | 272 | 228 | 44 | 19.2 |
| Operating and maintenance expense | 451 | 598 | (147) | (24.6) |
| Depreciation and amortization | 101 | 300 | (199) | (66.3) |
| Energy supply costs | 260 | 184 | 76 | (41.3) |
| Loss from movements in derivative contracts | 90 | 112 | (22) | (19.6) |
| Impairment of property, plant and equipment | | 6,680 | (6,680) | (100.0) |
| Total operating costs | 1,706 | 9,152 | (7,465) | (81.6) |

*Fuel cost.* Total fuel costs for the year ended March 31, 2004 amounted to £532 million, a decrease of £518 million compared with £1,050 million for the year ended March 31, 2003. Nuclear fuel costs were £437 million for the year ended March 31, 2004, representing a decrease of £540 million as compared with £977 million for the year ended March 31, 2003. Coal costs were £95 million for the year ended March 31, 2004, representing an increase of £22 million as compared with £73 million for the year ended March 31, 2003.

The £540 million decrease in the nuclear fuel cost, was attributable to the adoption of SFAS 143 on April 1, 2003. Upon adoption, back end fuel costs became recorded on a discounted basis as set out in SFAS 143. Previously, elements of back end fuel costs, uncontracted back end fuel in particular, were recorded on an undiscounted basis. The £22 million increase in coal costs relates primarily to the increase in output from the Eggborough power station over the year ended March 31, 2004.

*Staff costs.* Staff costs increased by £44 million from £228 million for the year ended March 31, 2003 to £272 million for the year ended March 31, 2004 mainly due to increased pension costs, salary inflation and an increased head count.

*Operating and maintenance expense.* Operating and maintenance expense comprise the operating expenses of the power stations and certain support functions. Operating and maintenance expense decreased £147 million from £598 million for the year ended March 31, 2003 to £451 million for the year ended March 31, 2004. The decrease was the result of the write down of slow moving inventory and the costs related to higher outages in 2003 as compared to 2004.

*Depreciation and amortization.* Depreciation charges were £101 million for the year ended March 31, 2004 compared to £300 million for the year ended March 31, 2003. The charges for depreciation for the year ended March 31, 2004 were significantly

affected by the property, plant and equipment impairment charge of £6,680 million at March 31, 2003.

*Energy supply costs.* Energy supply costs mainly comprise the costs incurred by our direct supply business for the use of the distribution and transmission systems. These costs, however, are passed onto our customers and are fully recovered through revenue. For the year ended March 31, 2004 energy supply costs also included costs of £36 million related to meeting the cost of compliance with the Renewables Obligation. We are required to comply with the Renewables Obligation as part of the regulations introduced by the UK Government which are intended to address climate change. The

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costs for the year ended March 31, 2004 were £260 million compared with £184 million for the year ended March 31, 2003, an increase of £76 million. This increase reflects the inclusion of costs associated with the Renewables Obligation and growth in the direct supply business since March 31, 2003 as discussed above.

*Loss from movements in derivative contracts.* The fair value of derivative contracts decreased £90 million for the year ended March 31, 2004 as compared to £112 million for the year ended March 31, 2003. The decrease in fair values for derivative instruments was due to the continued strengthening of energy prices in the market as compared to our fixed and capped contract prices.

*Impairment of property, plant and equipment.* During the year ended March 31, 2003, we recognized a significant impairment charge on our property, plant and equipment. No similar charge was required in the year ended March 31, 2004.

*Interest income and expense*

The interest expense of £60 million for the year ended March 31, 2004 was £208 million lower than the charge for the year ended March 31, 2003. The principal reason for this decrease was due to lower charges in relation to the interest rate swaps. In the year ended March 31, 2003 there were interest charges of £56 million resulting from out of the money element of interest rate swaps which were no longer considered to be effective as hedges together with the write-off of borrowing costs. The borrowing costs had been previously capitalized and were being amortized over the expected duration of loan financing in respect of the acquisition of the Eggborough Station. These decreases were offset by an increase in standstill interest due to a full year charge in the year ended March 31, 2004. For the year ended March 31, 2004 there were interest credits of £5 million reflecting a partial reversal of the provision for interest rate swaps.

Interest income for the year ended March 31, 2004 increased over the year ended March 31, 2003 primarily due to an increase in cash balances.

*Income Taxes*

A tax benefit was recognized for the year end March 31, 2004 primarily due to tax loss carry forwards.

*Disposals*

On December 22, 2003, British Energy plc completed the sale of its 50 per cent interest in AmerGen to Exelon for US$277 million in cash subject to certain post closing adjustments. The final adjustment to the AmerGen sale price was agreed on February 11, 2005, and resulted in a US$9.5 million reduction to the sale price. Taking account of the gain on disposal recorded in the year ended March 31, 2004 additional expense of £3 million was recognized in the period from April 1, 2004 to January 14, 2005.

*Cumulative effect of adoption of new accounting policy*

On April 1, 2003 we adopted SFAS 143 in connection with our nuclear fuel liabilities and decommissioning obligations. We recorded a cumulative adjustment of £7,640 million (net of tax charge of £273 million) primarily related to discounting the obligation to its present value.

*Net income/(Loss)*

As a result of the factors discussed above, the net profit was £7,562 million compared with a net loss of £7,800 million in the year ended March 31, 2003. The primary reason for the movement is attributable to the cumulative effect of adopting SFAS 143 in the year ended March 31, 2004 combined with the significant write-down in assets for the year ended March 31, 2003.

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**Liquidity and capital resources**

As a result of the Restructuring our results of operations after January 14, 2005 are not comparable to results reported in prior periods because of differences in the bases of accounting and the capital structure for the Predecessor Company and the Successor Company.

*Cash flows*

Despite the loss for the period, cash provided by operating activities was £111 million for the period from January 15 to March 31, 2005 which reflects the non-cash nature of some of our charges in the statement of operations, together with cash settlements made in respect of liabilities and adverse working capital movements. Cash used in operations of £98 million for the period from April 1, 2004 to January 14, 2005 was related to working capital improvements were more than offset by non-cash charges and cash settlements on liabilities in addition to the loss for the period. Cash provided by operating activities was £158 million for the year ended March 31, 2004.

Cash provided by investing activities was £31 million for the period from January 15 to March 31, 2005 compared with £65 million used in investing activities for the period from April 1, 2004 to January 14, 2005. Cash used in investing activities was £6 million for the year ended March 31, 2004. In the post-Restructuring period, the amounts held on restricted use term deposits reduced, although this was offset partly by capital investment in the period.

Cash used in financing activities was £25 million for the period from January 15 to March 31, 2005 and £0 million for the period from April 1, 2004 to January 14, 2005. Cash used in financing activities was £7 million for the year ended March 31, 2004. In the post-Restructuring period, a total of £28 million of debt has been repaid.

*Capital resources*

On January 14, 2005 we issued £550 million of New Bonds due from 2005 to 2022 and a Project Finance Loan of £150 million in connection with the Restructuring. Interest is due quarterly beginning March 31, 2005. The New Bonds and the Project Finance Loan will be redeemed in 18 unequal installments on March 31 of each year from March 31, 2005 to March 31, 2022. The Project Finance Loan is secured on the assets of EPL. The New Bonds are guaranteed by the Company and substantially all existing and future material subsidiaries, and the Project Finance Loan is collateralized by a mortgage of shares in EPL, an assignment of the EPL Share Purchase Agreement and Tax Deed of Covenant and a debenture comprising fixed and floating charges over EPL assets.

As at March 31, 2005, total debt of £676 million comprised of an aggregate principal amount of £531 million of New Bonds and £145 million of Project Finance Loan.

The credit ratings as of March 31, 2005 for the New Bonds issued at Restructuring are as follows:

| | Rating |
|---|---|
| Moody s Investor Services | Ba3 |
| Standard and Poor s | BB |
| Fitch Ratings | BB- |

Our £150 million Project Finance Loan is not rated. We maintain a close dialogue with the Rating Agencies, including twice yearly meetings and attendance at investor presentations.

Sub-investment grade credit rating has meant that we continue to provide significant levels of collateral to counterparties in order to cover their trading exposures or, to maintain trading arrangements, thereby substantially reducing the levels of cash resources available to us.

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We are required to comply with certain covenants under the terms of the New Bonds that restricts our ability to incur additional indebtedness, make certain payments and engage in certain transactions, among other covenants. These are summarized as follows:

The activities of the Company are limited to nuclear and renewable generation, together with generation from Eggborough, and the sale and trading of electricity. Furthermore, the nature of transactions with some other parties are restricted.

The Company may not incur any further indebtedness other than as permitted under the terms of the New Bonds unless the Consolidated Fixed Charge Coverage Ratio of the Company, over a specified period, is greater than 2:1 based on UK GAAP (an equivalent ratio is in process of being determined for US GAAP). Further indebtedness is permitted if it arises from activities which are necessary for the operation of the business (e.g., the sale and trading of output; guarantees and indemnities in respect of environmental licenses and other permits, and operational and maintenance contracts etc). In addition, a maximum principal of £75 million may be drawn in order to meet costs resulting from outages and seasonal working capital, and credit support obligations in respect of trading arrangements.

Certain types of payments are also restricted. These include dividends, redemption of capital stock, repayment of any subordinated indebtedness and investments in other companies unless permitted under the terms of the New Bonds. Restrictions apply if the Company is, or would be, in default of its obligations under the terms of the New Bonds, or the aggregate amount of these payments (excepting dividends) would exceed certain limits based on adjusted aggregate net income.

The Company may not sell any capital stock of a subsidiary, or substantially all of a subsidiary s properties or assets, or any other property or assets other than in the ordinary course of business unless 80 per cent. of the consideration is in cash (or equivalent), it is at a fair market value, and a resolution of the board of directors is delivered to the trustee. The proceeds of any such sale must either be reinvested in the Company, or retained to the extent that the target reserves (as required under the Contribution Agreement) exceed the cash reserves, or the amounts not so invested or retained shall be used to redeem the New Bonds, in accelerated decommissioning payments, and the payment of indebtedness ranking pari passu with the New Bonds.

The Company is also restricted with regard to the guarantees that it can make for indebtedness, sale and leaseback transactions, the sale or transfer of capital stock of a subsidiary, and encumbrances or restrictions on the ability of a subsidiary to pay dividends or any indebtedness owed to the Company.

As at March 31, 2005 we were in compliance with our debt covenants.

Also in connection with the Restructuring, we issued 561.0 million New Shares and 29.5 million Warrants at a conversion price of £0.98 per share. The Warrants allow the holder to subscribe for New Shares within five years of issue.

On August 25, 2004 our subsidiary BEG entered into a receivables financing facility agreement with Barclays Bank plc. This contains detailed covenants for the benefit of the facility provider, which mirror those under the New Bonds. In addition to these, the agreement also contains a financial interest coverage covenant (assessed on a consolidated group-wide basis) and covenants relating to the conduct of the electricity supply business customary for a receivables facility. On April 1, 2005 this facility was transferred to BEDL at the same time as the Direct Supply Business was transferred from BEG to BEDL and BEG became a guarantor. At March 31, 2005 the facility was undrawn.

*Future liquidity and commitments*

Our main source of liquidity is our operating businesses. Cash generated by our operating businesses is dependent upon the reliability of our power stations in producing electricity, the realized

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price for electricity, operational risk and capital investment expenditure and maintenance requirements. We believe that, with the completion of the Restructuring, our current available working capital is sufficient to meet our present requirements.

*Cash and cash equivalents (including restricted cash).* As at March 31, 2005 we had £230 million in cash and cash equivalents. In addition, we had a further £226 million, classified as restricted cash, deposited as collateral in support of trading activities. In the event that outages, collateral requirements or other events impact our ability to generate sufficient cash or liquidity for our operations, we have access to the facilities described above.

*Nuclear Liabilities Fund.* Under the new arrangements with the Secretary of State, the former NDF was enlarged into and renamed the NLF, which will fund, subject to certain exceptions, the Group s qualifying uncontracted nuclear liabilities and qualifying decommissioning costs. To the extent there is any surplus in the NLF, this amount will be paid to the Secretary of State. We are responsible for funding certain excluded or disqualified liabilities and will, in certain circumstances, be required to compensate or indemnify the NLF and the Secretary of State in relation to such liabilities. Our obligations under these arrangements with the Secretary of State are guaranteed by certain companies in the Group.

In consideration for the assumption of these liabilities by the Secretary of State and the NLF, Holdings issued £275 million in New Bonds to the NLF. We will also now make the following payments to the NLF (i) an annual contribution initially equal to 65 per cent. of the British Energy Group s adjusted net cash flow, adjusted for certain corporate actions but never to exceed 65 per cent. (the NLF Cash Sweep Payment ) ii) fixed decommissioning contributions equal to £20 million per annum (indexed to RPI but tapering off as the nuclear power stations are currently scheduled to close); and (iii) £150,000 (indexed to RPI) for every tonne of uranium in PWR fuel loaded into the Sizewell B reactor after the Restructuring Effective Date.

The NLF has the right from time to time to convert all or part of the NLF Cash Sweep Payment into Convertible Shares (the NLF Conversion Right). On a full conversion, the NLF would hold up to 65 per cent. of the thereby enlarged equity share capital of the Company. However, the terms of the Convertible Shares include a limit on the voting rights attaching to such shares equal to a maximum of 29.9 per cent. The Secretary of State has confirmed that he has no current intention to direct the NLF to exercise the NLF Conversion Right but reserves the right to do so. As at March 31, 2005, the NLF had not converted all or part of the NLF Cash Sweep into convertible shares and the NLF Cash Sweep Payment contribution percentage was 64.99 per cent.

*New BNFL Contracts*. At the Restructuring Effective Date, new contracts with BNFL covering front end (i.e. fuel preparation before it enters the reactor) and back end (i.e. handling, storage and ultimate disposal of spent fuel) AGR fuel services became effective. These contracts require variable payments based on the market price of electricity and amounts of fuel loaded. Under the new agreements, BNFL will assume title to new spent fuel on delivery to BNFL from our AGR power stations. As a result, we do not retain the obligation and future cost of disposing of the spent fuel.

*Investment expenditure*. In relation to the financial year ending March 31, 2006, we expect that the investment in plant projects, major repairs and strategic spares across the whole company, including incremental costs associated with PiP will be in the range of £230 million to £250 million, compared with £162 million in the twelve months ended March 31, 2005.

*Pension obligation*. We operate two pension arrangements within the Electricity Supply Pension Scheme ( ESPS ): the British Energy Generation Group ( BEGG ) for the majority of employees and the British Energy Combined Group ( BECG ) for employees at Eggborough Power Station. In addition, eligible senior employees are provided additional retirement benefits. The pension plans

are defined

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benefit plans, which are externally funded and subject to triennial actuarial valuation. The Restructuring did not have an impact on the number of participants or to the Company s obligation to fund the ESPS. However, in applying purchase accounting in connection with the Restructuring, we recognized the full liability of the projected benefit obligation in excess of plan assets. We expect to make a contribution of £60 million to the pension scheme in the year ended March 31, 2006. Our expected future obligations for the years 2006 to 2015 are £943 million and based on actuarial calculations.

*European Union s Emission Trading Scheme.* On January 1, 2005 the ETS took effect. The scheme requires all producers of carbon dioxide to have a permit to emit greenhouse gases. Under the Scheme, certain companies were allocated a number of allowances to be submitted on annual basis to cover their emissions of carbon dioxide. To the extent that our emissions exceed the allowances granted to us, we will be required to purchase additional allowances from the market. The market price of allowances has risen since the beginning of 2005 and was in excess of 15/tonne of carbon dioxide on March 31, 2005 and 25/tonne at June 30, 2005. The Government has granted us, in connection with our Eggborough station, an allocation of 4.54 million tonnes of carbon dioxide allowances under the ETS scheme for each of the calendar years 2005, 2006 and 2007, which is equivalent to approximately 5 TWh of generation per annum.

*Contingent liabilities*. Amounts owing by EPL to the Eggborough Banks are not guaranteed by the Company. However, the Company guarantees the payment of amounts by BEPET to EPL, calculated to cover EPL s borrowing and operating costs.

On February 12, 2004 BE Ltd received a notice of warranty claims from the consortium which purchased the Group s 82.4 per cent. interest in Bruce Power alleging breach of certain warranties and representations relating to tax and to the condition of certain plant at the Bruce Power Station.

The claim relating to the condition of the plant is based upon alleged erosion of some of the steam generator support plates through which boiler tubes pass, which it is alleged resulted in an extended outage of one unit at the plant to carry out repair works and loss of revenues and costs of approximately C$64.5 million. The consortium also claims that the alleged erosion may reduce the operating life of the unit and/or result in further repairs involving further losses. We have rejected the claim and expect to defend it if it is pursued further.

The principal tax claim relates to the treatment of expenditure at the Bruce Power Station during the period of our ownership which is currently being considered by the Canadian Tax Authorities. The treatment proposed by British Energy could result in a rebate of a material amount of tax to us which has not been recognized in the financial statements of the period. The consortium claims that allowance of the expenditure for that period would cause it to lose future deductions. We have rejected the claim and expect to defend it if it is pursued further. We believe that the amount of the claim should not, in any event, materially exceed the amount of the rebate, and that the claim should have no material cash flow impact on the us.

Under the agreement with the consortium C$20 million is retained in trust to meet any representation and warranty claims, and this may be retained pending agreement or determination of the claims.

We have given certain indemnities and guarantees in respect of the disposal of our investment in AmerGen.

We have given certain indemnities and guarantees in respect of our subsidiary undertakings. No losses are anticipated to arise under these indemnities and guarantees, provided relevant subsidiary undertakings continue on a going concern basis.

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We are involved in a number of other claims and disputes arising in the normal course of business which are not expected to have a material effect on our operations, cash flows or financial position.

**Disclosure of Contractual Obligations**

We have made various financial commitments in the ordinary course of our business. Such commitments include entering into contracts for the supply of fuel for our power stations and capital expenditure commitments. In addition, we have made certain contingent financial commitments which may become payable under certain circumstances, for example in the event that a guarantee becomes payable.

The following table provides a summary of our general financial obligations:

| | March 31, 2005 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Payment due by period | | | | | | |
| | Total | 2006 | 2007 | 2008 | 2009 | 2010 | Thereafter |
| | (in £ millions) | | | | | | |
| New Bonds[1] | 531 | 39 | 42 | 45 | 48 | 51 | 306 |
| Project Finance Loan[1] | 145 | 11 | 12 | 12 | 13 | 14 | 83 |
| Debt interest payments | 349 | 47 | 44 | 40 | 36 | 32 | 150 |
| Nuclear fuel purchases | 1,317 | 198 | 95 | 70 | 63 | 73 | 818 |
| Coal purchases | 162 | 95 | 40 | 27 | | | |
| Capital commitments | 16 | 15 | 1 | | | | |
| Operating leases | 13 | 3 | 3 | 3 | 4 | | |
| Pension and other post retirement obligations | 943 | 83 | 84 | 85 | 87 | 92 | 512 |

(1) Final maturity in 2022.

As at March 31, 2005 the estimated minimum commitment for the supply of coal was 4 million tonnes which, at contract prices on March 31, 2005, amounts to approximately £162 million.

In addition to the liabilities and provisions described in the consolidated financial statements, we have provided certain guarantees and commitments in respect of the extent of capital expenditure by EPL. We also entered into commitments to purchase and sell electricity in the normal course of business.

The above table does not include any obligations in respect of the NLF Cash Sweep Payment which may fall due as the amounts will vary according to the cash flow in any year and the target reserves established by the Company. The NLF Cash Sweep Payment is the annual payment to be made to the NLF pursuant to the terms of Restructuring, initially, 65 per cent. (subject to adjustment) of the Company s adjusted net cash flow.

In addition to the above, there are also amounts payable relating to our back end fuel costs and decommissioning liabilities. These amounts are based on our expected future output and costs. For more information as to how we calculate the amounts set forth below, see Critical Accounting Policies Nuclear Liabilities and Decommissioning .

| | Payment due by period | | | | | | |
|---|---|---|---|---|---|---|---|
| | Total | 2006 | 2007 | 2008 | 2009 | 2010 | Thereafter |
| | (in £ millions) | | | | | | |
| Nuclear and decommissioning liabilities | 12,222 | 187 | 187 | 187 | 236 | 191 | 11,234 |

**Off-Balance Sheet Arrangements**

On January 31, 2005 we entered into a sale and partial leaseback transaction with respect to property we owned. We sold our property in East Kilbride at its carrying value of £7 million, recognizing

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no gain or loss on sale. As part of the transaction, we entered into an operating lease to lease approximately 16 per cent. of the office space. We do not retain any other interest in the disposed of property and do not retain any ongoing obligations with respect to the property.

**Critical Accounting Policies**

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States ( US GAAP ) requires us to make estimates and judgements that affect our reported amounts of assets and liabilities, revenues and expenses. We have identified the following critical accounting policies that affect the more significant estimates and judgements used in the preparation of our consolidated financial statements. On an ongoing basis, we evaluate our estimates, including those related to the matters described below. These estimates are based on the information that is currently available to us and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could vary from those estimates under different assumptions or conditions.

*Restructuring accounting*

Completion of the Restructuring resulted in a new reporting entity. Under our Restructuring accounting as of January 14, 2005, when British Energy Group plc acquired BE Ltd, we have applied purchase accounting under FASB Statement No. 141 *Business Combinations* ( SFAS 141 ). The entity allocated the consideration paid to the entity s assets acquired and liabilities assumed, based on fair values. Pursuant to SFAS 141, in determining fair values, the market values of specific assets and liabilities were used. Where readily determinable market values were not available, we were required to estimate fair value using other methodologies requiring significant judgement and our best estimate of future prices, output, costs and discount rates. For certain assets and liabilities, where we believed additional valuation experience would be warranted, we engaged a firm of valuation specialists to assist us in the valuation of certain assets and liabilities.

The effective date of the Restructuring is considered to be the close of business on January 14, 2005 for financial reporting purposes. As a result of the implementation of the Restructuring accounting, the financial statements of the Company after the effective date are not comparable to the Company s financial statements for prior periods.

*Nuclear liabilities and decommissioning*

We record liabilities for spent nuclear fuel and decommissioning costs. On April 1, 2003 we adopted SFAS 143 to account for legal obligations associated with the retirement of long-lived assets that result from the construction, development or normal operation of a long-lived asset.

A liability for an asset retirement obligation is recognized when a legal obligation arises and should be initially measured at fair value. The liability should also be capitalized as part of the carrying amount of the related long-lived asset. Changes in the liability due to the passage of time, accretion expense, are recorded as an operating expense in the statement of operations. The determination of the fair value of our asset retirement obligations requires management to make certain judgements about the estimated useful lives of our long-lived assets, changes in technology, economic and market conditions, and actions or

assessments by our regulators. A change in these judgements can affect the amount of asset retirement obligations recognized in our financial statements.

The estimated costs of decommissioning are discounted at our credit adjusted risk free rate, to reflect the timescale before and during which the work will take place (following closure of the power station). We anticipate that after defueling the reactors, dismantling them will be deferred for at least 85 years (for AGRs), and up to 50 years (for PWRs). These liabilities have been discounted using a long term real rate of 3 per cent., which is consistent with the UK Government s long term bond rate. This

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long term bond rate was deemed to be appropriate given that the Secretary of State, under the NLFA, will assume payment for any nuclear and decommissioning liabilities should the NLF not be able to make such payment. This guarantee by the Secretary of State results in adjusting our credit adjusted risk free rate to the British Government s long term borrowing rate for these specific asset retirement obligations.

Prior to the Restructuring, and any related guarantee by the Secretary of State, we used a credit adjusted risk free rate of 12.2 per cent., which was consistent with our credit status before the Restructuring.

*Property, plant and equipment*

Property, plant and equipment (other than assets in the course of construction) are stated in the balance sheet at cost less accumulated depreciation. Accumulated depreciation includes additional charges made where necessary to reflect impairment in value. Assets in the course of construction are stated at cost and are not depreciated until brought into commission.

Subsequent to the Restructuring, we have included strategic spares within property plant equipment and capitalized certain costs in connection with statutory outages, both of which we believe better represents the nature and usage of our assets.

The charge for depreciation of property, plant and equipment is based on the straight line method so as to write off the costs of assets, after taking into account provisions for diminution in value, over their estimated useful lives. The charges for depreciation are dependent on our estimates of the useful life for property, plant and equipment.

Accounting lifetimes of our nuclear power stations and other long-lived assets reflect our current assessment of potential life limiting technical factors and independent engineering assessments. The operating lifetime of a nuclear power station is limited principally by the lifetime of items which are uneconomical to replace such as the graphite core, the boiler (in AGRs) and other components inside the reactor pressure vessel. The methodologies and technology used to evaluate the expected lifetimes of nuclear stations are dynamic, resulting in progressively improved measurement capabilities that allow us to determine whether the safety case for an extended accounting life of a nuclear power station can be supported. The estimates of station accounting lives are therefore subjective. The extension of a station s life may improve our results, in light of the incremental income and the largely fixed cost base. We carried out a fair value exercise as at the Restructuring Effective Date and concluded that the process of reviewing the station life extension at Dungeness B was sufficiently progressed at that time, that a willing buyer and willing seller would have increased the accounting life of Dungeness B from 25 years to 30 years. We are progressing with the technical and commercial work for Dungeness B life extension in line with our plans and we expect to make a decision in the fall.

*Impairment of long-lived assets*

Long-lived assets, such as property and equipment, are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. An impairment loss is recognized when estimated undiscounted future cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. When impairment is identified, the carrying amount of the asset is reduced to its estimated fair value. The calculation of estimated un-discounted future cash flows is based on our best estimates of future prices, output and

costs and is therefore subjective.

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*Pensions*

The Company accounts for its defined benefit pension plan following the accounting principles of FASB Statement No. 87, *Employers Accounting for Pensions* ( SFAS 87 ) and the disclosure rules under FASB Statement No. 132R, *Employers Disclosures about Pensions and Other Postretirement Benefits, an Amendment of FASB 87, 88 and 106* ( SFAS 132R ). We use an actuarial method for determining the pension costs and net pension liability or asset. Periodic pension costs are comprised of service and interest costs together with amortization of deferred actuarial gains and losses and offset by the expected return on plan assets. In computing our pension expense and obligation, significant assumptions and estimates are applied including:

expected rate of returns on plan assets

discount rates used in the valuation of benefit obligations

timing of employee retirements.

Changes in these assumptions may result in a different pension expense and obligation than that presented in our financial statements.

As a result of the Restructuring and applying purchase accounting, a liability was recognized for the projected benefit obligation in excess of plan assets. As at March 31, 2005 the recorded pension liability was £456 million.

**New and Recently Issued Accounting Pronouncements**

*The following new accounting standards were adopted by the Company during the year ended March 31, 2005 and the impact of such adoption, if applicable, has been presented in the accompanying Consolidated Financial Statements:*

FASB Interpretation No. 46*, Consolidation of Variable Interest Entities* ( FIN 46 ) In January 2003, the FASB issued FIN 46 which requires the primary beneficiary of a variable interest entity s activities to consolidate the variable interest entity. FIN 46 defines a variable interest entity as an entity in which the equity investors do not have substantive voting rights and there is not sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. The primary beneficiary absorbs a majority of the expected losses and/or receives a majority of the expected residual returns of the variable interest entity s activities. In December 2003, the FASB issued FIN 46 (Revised December 2003), *Consolidation of Variable Interest Entities An Interpretation of ARB No. 51* ( FIN 46R ), which supersedes and amends the provisions of FIN 46. The Company has not identified any material variable interest entities created, or interests in variable entities obtained which require consolidation or disclosure under FIN 46R.

EITF Issue No. 03-1*, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* ( EITF 03-1 ) In March 2004, the EITF reached a consensus on Issue No. 03-1, which provides guidance on assessing whether impairments are

other-than-temporary for marketable debt and equity securities accounted for under SFAS No. 115, and non-marketable equity securities accounted for under the cost method. The consensus also requires certain disclosures about unrealized losses that have not been recognized in earnings as other-than-temporary impairments.

In September 2004, the FASB issued FSP No. EITF Issue 03-1-1, *Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*, which delays indefinitely the application of guidance provisions of EITF 03-1 until further application guidance can be considered by the FASB. The FSP did not delay the effective date for the disclosure provisions of EITF 03-1 which have been adopted by the Company. The Company does not expect the final guidance to have a material impact on its consolidated results of operations, financial position or cash flows.

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*The following new accounting standards were issued, but have not yet been adopted by the Company as of March 31, 2005:*

FASB Statement No. 151, *Inventory Costs an amendment of ARB No. 43* ( SFAS 151 ) In November 2004 the FASB issued SFAS151 which requires idle facility expenses, freight, handling costs, and wasted material (spoilage) costs to be recognized as current period charges. It also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS151 will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is evaluating the impact of this standard on its consolidated financial statements.

FASB Statement No. 123 (*Revised* 2004), *Share-Based Payment* ( SFAS 123R ) In December 2004, the FASB issued SFAS 123R, which replaces SFAS 123 and supersedes APB Opinion 25. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first annual period beginning after June 15, 2005. The pro forma disclosures previously permitted under SFAS 123 will no longer be an alternative to financial statement recognition. Under SFAS 123R, the Company must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at the date of adoption. The transition methods include prospective and retroactive adoption options. Under the retroactive option, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested awards at the beginning of the first quarter of adoption of SFAS 123R, while the retroactive methods would record compensation expense for all unvested awards beginning in the first period restated. The Company does not anticipate the adoption of SFAS 123R on April 1, 2006 to have any material impact on its consolidated financial position, results of operations or cash flows. However, SFAS 123R also requires the benefit of tax deductions in excess of recognized compensation costs to be reported as a financing cash flow rather than an operating cash flow as required under current accounting guidance. This may result in the reduction of net operating cash flow and an increase of net financing cash flows in periods after the effective date.

FASB Statement No. 153*, Exchanges of Non-monetary Assets an amendment of APB Opinion No. 29* In December 2004, the FASB issued SFAS 153 which amends APB Opinion No. 29 by eliminating the exception to the fair-value principle for exchanges of similar productive assets. SFAS 153 also eliminates APB Opinion No. 29 s concept of culmination of an earnings process. The amendment requires that an exchange of non-monetary assets be accounted for at fair value if the exchange has commercial substance and fair value is determinable within reasonable limits. SFAS 153 is effective for non-monetary transactions occurring in fiscal periods beginning after June 15, 2005. The impact of SFAS 153 will depend on the nature and extent of any exchanges of non-monetary assets after the effective date, but the Company does not currently expect SFAS 153 to have a material impact on its consolidated financial position, results of operations or cash flows.

FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* ( FIN 47 ) In March 2005, the FASB issued FIN 47 which clarifies that the term conditional asset retirement obligation as used in SFAS 143 refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. This Interpretation is effective no later than the end of the fiscal years ending after December 15, 2005. The Company does not expect the adoption of FIN 47 to have a material impact on its consolidated financial position, results of operations or cash flows.

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## ITEM 6. DIRECTORS, SENIOR MANAGERS AND EMPLOYEES

### Directors and Senior Management

We operate under the overall direction of our Board of Directors. Our Articles of Association provide that the number of Directors shall not, unless or until otherwise determined by an ordinary resolution, be less than four nor more than 15. The Articles of Association also provide that at every annual general meeting of shareholders any Director who has been appointed by the Board of Directors since the previous Annual General Meeting, together with such other Directors are required to ensure that one third (or the number nearest to but not less than one third) of the Directors shall retire from office. The Directors to retire by rotation in this manner in each year are the Directors who have been longest in office since their appointment or re-appointment. At our Annual General Meeting to be held on September 15, 2005, all our Directors will stand for election. Directors who retire by rotation in this manner are eligible to stand for re-election. The Directors may, at any time, appoint any person to be a director. Any person so appointed will hold office until the next Annual General Meeting of shareholders and shall then retire and be eligible for election. The Directors may appoint one or more of their number to the office of Chief Executive, Managing Director or to other executive office for such period and on such terms as the Directors think fit. All executive Directors have one-year rolling employment contracts with us, with the exception of William Coley, whose contract terms are yet to be agreed. The executive officers have contracts that are terminable by us on one year s notice. It is our policy that Non-Executive Directors are appointed for a three-year term, renewable for a further three-year term on the basis of satisfactory performance, except where they are required to stand for re-election under the Articles of Association.

The name, title, age and date appointed of each of our Non-Executive Directors, our Executive Directors and our executive officers as at March 31, 2005 were as follows:

| Name | Title | Age | Date appointed |
|---|---|---|---|
| Adrian Montague ¨ | Chairman | 57 | November 28, 2002 |
| William Coley ♣¨< | Chief Executive | 61 | June 1, 2003 |
| Stephen Billingham ♣¨<◊ | Finance Director | 46 | September 16, 2004 |
| Roy Anderson # ♣¨ | Chief Nuclear Officer | 56 | September 16, 2004 |
| Ian Harley +M¨< | Independent Director | 54 | June 1, 2002 |
| Pascal Colombani *M ¨ | Independent Director | 59 | June 1, 2003 |
| Sir Robert Walmsley +*M# ¨ | Independent Director | 64 | August 1, 2003 |
| John Delucca +M¨< | Independent Director | 61 | February 9, 2004 |
| Clare Spottiswoode +*M¨< | Deputy Chairman and Senior Independent Director | 52 | December 1, 2001 |
| David Pryde +*M¨< | Independent Director | 56 | September 1, 2004 |
| Robert Armour ♣<◊ | Company Secretary and General Counsel | 45 | December 13, 1995 |
| Sally Smedley ♣◊ | Director, Human Resources and Communications | 55 | February 8, 1999 |
| Neil O Hara ♣ | Director, Power and Energy Trading | 39 | May 3, 2004 |

\+ Denotes member of the Audit Committee.
* Denotes member of the Remuneration Committee.
M Denotes member of the Governance and Nominations Committee.
\# Denotes member of the Safety, Health and Environment Committee.
Denotes member of the Nuclear Performance Review Committee.
♣ Denotes member of the Executive Committee.
¨ Denotes member of the British Energy Group plc Board.
< Denotes member of the Trading Review Committee

◊ Denotes member of the Pensions Committee
William Coley was appointed as Chief Executive Officer on April 14, 2005 following the resignation of Mike Alexander on March 20, 2005. Prior to this William Coley served as an Independent Director from June 2003.

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Each of the current British Energy Group plc Directors was appointed to the Board of the Company on September 16, 2004. Prior to the January 14, 2005, each of the Directors was also a Director of BE Ltd. The dates in the table above refer to the Directors dates of appointment as directors of BE Ltd.

The written consent of the Special Shareholder is required for the appointment of the Chairman of the Board. There are no family relationships between any of our Directors or executive officers.

In accordance with the terms of the Creditor Restructuring Agreement, John Delucca and David Pryde were both nominated to serve as Directors by the Bondholders. Their appointments were subject to our Board agreeing their suitability and experience. The Board remains satisfied as to their independence.

**Directors**

*Adrian Montague* joined British Energy as Chairman in November 2002 and also held an executive role until the appointment of Mike Alexander as Chief Executive in March 2003. He is currently also Chairman of Michael Page International plc, Chairman of Infrastructure Investors LP, Chairman of Cross London Rail Links Limited, and Chairman (since May 26, 2005) of Friends Provident plc and a non-executive director of Cellmark AB. A law graduate of Cambridge University, he was a partner with Linklaters & Paines, before joining Kleinwort Benson as Head of the Project and Export Finance Department in 1993, and subsequently became Global Head of Project Finance of Dresdner Kleinwort Benson in 1997. Then he undertook a number of senior roles in the implementation of the Government s private finance policies, serving as the Chief Executive of the Treasury Taskforce from 1997-2000, and as Deputy Chairman of Partnerships UK plc, and a Private Finance Advisor to the Department of the Environment, Transport and The Regions between 2000 and 2001. He was awarded a CBE in 2001.

*William Coley* accepted the position of Chief Executive on March 20, 2005 following the resignation of Mike Alexander and took up the post on April 14, 2005. Prior to this he served as an independent Non-Executive Director from June 2003. He joined Duke Power, a major US utility company as an engineer in 1966, becoming Group President in 1997 and retiring from this position in 2003 after a 37 year career with the company. During his time at Duke Power he held a variety of management and executive roles including Vice-President, Central Division and Senior Vice-President, Power Delivery. He was elected to Duke Power s Board of Directors in 1990, becoming Senior Vice-President, Customer Group and was President of the Associated Enterprises Group between 1994 and 1997. A Non-Executive Director of CT Communications Inc. and Peabody Energy (both publicly traded companies), and a director of ER Jahna Enterprises (a privately owned company) he holds a BSc in Electrical Engineering from the Georgia Institute of Technology. He is a registered Professional Engineer in North and South Carolina. He is a member of the Trading Review and Nuclear Performance Committees.

*Stephen Billingham* was appointed to the Board as Finance Director on September 16, 2004, having joined British Energy on August 25, 2004. Prior to joining British Energy, he was the Group Finance Director of the engineering consultancy and support services group, WS Atkins plc, during its successful financial recovery. Previously he led the finance team which signed the large and complex Metronet-London Underground Public Private Partnership, which maintains two-thirds of the London Underground infrastructure. For seven years he was the Group Treasurer of the engineering group BICC plc (now Balfour Beatty plc). He has held finance positions in Severn Trent plc, Burmah Oil plc and British Telecommunications plc. He holds a BSc from Brunel University and a PhD from the University of Aston in Birmingham. He is a member of the Association of Corporate Treasurers. He is also a member of the Trading Review and Pensions Committees.

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*Roy Anderson* was appointed to the Board as Chief Nuclear Officer (designate) of British Energy on September 16, 2004 having joined British Energy on July 5, 2004. The introduction of the role of Chief Nuclear Officer was approved by the NII in April 2005. He was previously President of PSEG Nuclear in the US, and Chief Nuclear Officer of Nuclear Management Company and of Florida Power Corporation. His early career involved working for Carolina Power and Light Company, Boston Edison Company and General Electric Company, all in the US. He has a degree in marine and nuclear engineering and an MBA in operation research. He is a member of the Safety, Health and Environment and Nuclear Performance Review Committees.

*Ian Harley* was appointed as an independent Non-Executive Director in 2002 and is Chairman of the Audit Committee. He joined Abbey National in 1977 where he held a variety of posts in the Finance, Retail Banking and Wholesale Banking Divisions before joining its board in 1993. He spent nine years on the board as first Finance Director, then Chief Executive, before retiring in 2002. An Economics graduate of Edinburgh University, he is a Fellow of the Institute of Chartered Accountants and a Fellow and Past President of the Institute of Bankers. He is currently a Non-Executive Director of Rentokil Initial plc, JW Educational Limited and Remploy Limited, a Vice-President of the National Deaf Children s Society and a Governor of the Whitgift Foundation. Previously Chairman of the Association for Payment Clearing Services, a member of the Deposit Protection Board, appointed by the Bank of England, and a member of the Financial Services Authority s Practitioner Panel. He is also a member of the Governance and Nominations, and Trading Review Committees.

*Dr. Pascal Colombani* was appointed as an independent Non-Executive Director in 2003. He holds a doctorate in nuclear physics and is a former Chairman and CEO of the French Atomic Energy Commission. He is Associate Director at ATKearney, a director of Alstom SA, Rhodia SA and of the French Institute of Petroleum. He is Chairman of the French Association for the Advancement of Science and a member of the French Academy of Technology. He was also formerly the Chairman (non-executive) of Areva, the nuclear engineering conglomerate, and a board member of Electricité de France and France Télécom. He is Chairman of the Nuclear Performance Review Committee and a member of the Governance and Nominations, and Remuneration Committees.

*Sir Robert Walmsley* was appointed as an independent Non-Executive Director in 2003. Previously he served in the Royal Navy where his final appointment was as Controller of the Navy and member of the Navy Board as a Vice Admiral, starting in 1994. He was knighted in 1995. During his earlier naval career he held a number of nuclear related posts including service as the Chief Engineer of a nuclear submarine, Project Manager of a Nuclear Submarine Refit and Refuel, and Chairman of the Naval Nuclear Technical Safety Panel; he was Director General, Submarines between 1993 and 1994. He held roles in Procurement at the Ministry of Defense and was Executive Aide to the Chief of Defense Procurement between 1986 and 1987. After retiring from the Navy, he was appointed as Chief of Defense Procurement (a Permanent Secretary grade post in the Civil Service), occupying that position from 1996 until 2003. Holding an MA from Cambridge University and a postgraduate diploma in control engineering he also was awarded an MSc in Nuclear Science and Technology from the Royal Naval College. He is a Senior Adviser at bankers Morgan Stanley and an independent director of General Dynamics Corporation, Major Projects Association, EDO Corporation and Stratos Global Holding Limited. He is Chairman of the Governance and Nominations Committee and the Safety Health and Environment Committee, a member of the Audit, Remuneration, and Nuclear Performance Review Committees, and a Non-Executive Director of British Energy Generation Limited, the Group s licensed nuclear generator subsidiary.

*John Delucca* was appointed as an independent Non-Executive Director in February 2004. He holds an MBA in Finance from Fairleigh-Dickinson University School of graduate study and a BA from Bloomfield College and has held a variety of senior roles in US business. Most recently, from 2003 until March of this year he was Executive Vice-President and Chief Financial Officer of the REL

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Consultancy Group. Prior to that from 1998 to 2002 he was Executive Vice-President, Finance and Administration and Chief Financial Officer of Coty Inc and a member of their Executive Committee. Between 1993 and 1998 he was Senior Vice-President and Treasurer of RJR Nabisco Inc., having previously held executive positions with Hascoe Associates, a private investment group, the Lexington Group, providing financial consulting to distressed companies, the Trump Group and the International Controls Corporation, where he was Executive Vice-President and CFO as well as Chairman and CEO of a subsidiary, Transway Finance Company. He is a Non-Executive Director, and chairs the audit committees, of ITC Deltacom, Enzo Biochem and Elliott Company. He has been a lecturer at Fordham University s Graduate School of Business Administration and Adjunct Assistant Professor at Seton Hall University School of Business Administration. He is Deputy Chairman of the Audit Committee and a member of the Trading Review and Governance and Nominations Committees.

*Clare Spottiswoode* was appointed as an independent Non-Executive Director in 2001. Chair of the Remuneration Committee. Her career started as an economist with the Treasury before establishing her own software company. Between 1993 and 1998 she was Director General of Ofgas and has also served as a member of the Government s Deregulation Task Force (1993) and the Public Services Productivity Panel (1998). Mrs Spottiswoode currently chairs Economatters Limited and is also currently a Non-Executive Director of Advanced Technology (UK) plc, Tullow Oil plc, Anker plc, Biofuels Corporation and Petroleum Geo-Services ASA. Awarded a CBE for services to industry in 1999, she holds degrees from Cambridge and Yale Universities. She is the Deputy Chairman and the senior independent Non-Executive Director, Chairman of the Remuneration Committee and a member of the Trading Review, Audit and Governance and Nominations Committees.

*David Pryde* was appointed as an independent Non-Executive Director on September 1, 2004. He has extensive trading and risk management experience. Having formerly headed precious metals trading in Asia and NM Rothschild and Sons Ltd and Philipp Brothers Inc., he joined JP Morgan & Co Inc. in 1984 and has subsequently held various senior management positions in their trading businesses, including Global Head of Precious Metals Trading, Global Head of Commodity Derivatives Trading and Marketing and Global Head of Futures and Options Brokerage. He sat on the boards of the Commodity Exchange, the Chicago Mercantile Exchange and the Futures Industry Association. He is Chairman of the Trading Review Committee and a member of the Remuneration, Audit and Governance and Nominations Committees.

*Mike Alexander* (57) resigned as Chief Executive on March 20, 2005. Prior to his appointment as Chief Executive Officer at British Energy in March 2003 he was Chief Operating Officer and executive Board Member of Centrica plc, and before that Managing Director of British Gas Trading. He is a non-executive director of Associated British Foods plc and was previously Chairman of AG Solutions Limited, Hydrocarbons Offshore Limited and a Non-Executive Director of The Energy Saving Trust.

*David Gilchrist,* formerly Managing Director, Generation, resigned as a Director on August 5, 2004. Formerly Executive Vice President, Finance of Bruce Power LP (1999 2001), having previously been Financial & Commercial Director, British Energy North America, and he was Executive Director, Finance of Nuclear Electric Limited. A Chartered Engineer and member of the Institution of Mechanical Engineers, he was Business Development Director at GKN plc prior to joining Nuclear Electric in 1991.

*Martin Gatto* resigned as Interim Finance Director on September 16, 2004. He remained with the Company as Chief Financial Officer until December 31, 2004. Prior to joining British Energy he was interim Chief Financial Officer at Midlands Electricity plc and was Group Financial Director at Somerfield plc between 1993 and 2002.

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**Executive Officers**

*Robert Armour* was appointed Company Secretary in 1995 and General Counsel in 2003. A solicitor, he was a partner in Wright Johnston & Mackenzie, solicitors, between 1986 and 1990 before joining Scottish Nuclear Limited as Company Secretary in 1990. He was Director of Performance Development for Scottish Nuclear Limited between 1993 and 1995. From 1997 to 2003 he was Director of Corporate Affairs. He holds a law degree and MBA from Edinburgh University and has also attended INSEAD s Advanced Management Program. He is a member of the Executive and the Pensions and Trading Review Committees.

*Neil O Hara* was appointed as Director of Power and Energy Trading in May 4, 2004. He has over ten years trading and risk management experience in the energy sector including the power, coal and gas sectors. His trading experience was gained in the UK and US whilst working at Manufacturers Hanover Trust, British Gas, Natural Gas Clearinghouse (Dynergy), Accord/Centrica and RWE. He has also worked on generation optimization, co-firing and operations and engineering projects. He is a member of the Executive and Trading Review Committees.

*Sally Smedley* was appointed as Director, Human Resources and Communications on February 8, 1999, previously she was Human Resources and Corporate Relations Director at East Midlands Electricity plc, and Employee Relations Director, the BOC Group plc. She has a BSc (Tech) in Occupational Psychology. She is a member of the Executive and Pensions Committees.

*Peter Wakefield* was appointed as Safety and Technical Director on April 4, 2005. He joined British Energy from Eskom, the vertically integrated South African power utility. He has extensive experience in the nuclear industry and all aspects of nuclear power plants. He was the first operating manager at Koeberg, holding a Senior Reactor Generator License, before moving through station, corporate engineering and technology management posts. Earlier in his career he spent four years in the UK power industry and one and a half years with EdF in the French nuclear program. He has an electrical engineering degree and an executive management education from South Africa and Switzerland. He is a member of the Executive and the Safety Health and Environment and Nuclear Performance Review Committees.

Details of other directorships and outside interests of our directors and executive officers are as follows:

| | **Other Directorships/Outside Interests** |
|---|---|
| Adrian Montague | Michael Page International plc<br>Cross London Rail Links Limited, Friends Provident plc,<br>Cellmark AB; Infrastructure Investors LP |
| William Coley | CT Communications Inc; Peabody Energy |
| Pascal Colombani | AT Kearney; Alstom SA; French Institute of Petroleum, Rhodia, SNC-Lavali |
| Ian Harley | Rentokil Initial plc; Remploy Limited; National Deaf Children s Society; JW Educational Limited |
| Clare Spottiswoode | Advanced Technology (UK) plc; Economatters Ltd; Tullow Oil plc;<br>Anker plc; Biofuels Corporation; Petroleum Geo-Services ASA |
| John Delucca | ITC Deltacom; Enzo Biochem Inc.; The Elliott Company |
| Sir Robert Walmsley | EDO Corporation General Dynamics; Morgan Stanley;<br>Major Projects Association; Stratos Global Limited |
| Stephen Billingham | None |
| Roy Anderson | None |
| David Pryde | None |

| | |
|---|---|
| Robert Armour | Scottish Council Development and Industry; Nuclear Industries Association |
| Neil O Hara | None |
| Sally Smedley | Remploy Limited |
| Peter Wakefield | None |

None of the other Directors or executive officers had other business interests outside of British Energy.

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**Compensation of Directors and Officers**

During the year ended March 31, 2005, the aggregate amount of compensation we paid to all Executive and Non-Executive Directors and executive officers was £3,954,973 (excluding pension contributions, and any payment to Mike Alexander for loss of office). During the year ended March 31, 2005, the aggregate amounts set aside or accrued to provide pension, retirement or similar benefits for Executive and Non-Executive Directors and executive officers, pursuant to any existing plan, was £136,674.

In the year ending 31 March 2005, all our Executive Directors were entitled to bonus payments under the Interim Bonus Plan. This took the form of a deferred bonus granted to members of the Executive Committee either wholly in shares (in the case of Executive Directors) or mainly in shares and partly in cash in the case of other Executive Committee members. The maximum level of award was 150 per cent. of salary, except in the case of Roy Anderson who was hired from the US and is entitled to 1.67 times that figure.

On the basis of performance against a range of challenging targets underpinned by the safety and environmental priorities necessitated by the nature of our activities, Executive Committee members will each receive 38.2 per cent. of salary (63.6 per cent. in the case of Roy Anderson). So far as the award of shares is concerned one third of this amount is payable immediately with one third released in 2005/06 and the final third in 2006/07.

In recognition of the exceptional effort, commitment and determination required to meet both the engineering challenges and to complete the Restructuring the Remuneration Committee decided to make a one-off discretionary payment to members of the Executive Committee equal to 50 per cent. of base salary. This amount is shown under bonus in the Emoluments Table in the section below entitled Directors Emoluments .

William Coley became an Executive Director of British Energy Group plc on April 14, 2005 and the terms of his contract are yet to be finalised. His remuneration shall be a fixed salary of £531,915 per annum (or such higher rate as determined by the Remuneration Committee of the Board and approved by British Energy Group plc in General Meeting). This is in addition to Directors fees of £27,000 per annum and shares in the British Energy Group plc, having a value at the date of payment of £13,000, payable to him under his previous terms of appointment as a Non-Executive Director. He will be eligible for a bonus of £265,958 payable at the end of the financial year ending March 31, 2006 subject to the absolute discretion of the Remuneration Committee and approval by the Board. He will not be eligible for membership of any occupational pension scheme. He also receives an accommodation allowance of £105,770 per annum.

*Service Contracts*

We aim to set notice or contract periods for Executive Directors at one year or less. Where it is necessary to offer longer notice or contract periods to new Executive Directors recruited from outside the company, it is our policy to reduce the duration of these contracts as soon as possible after the initial period has expired. With the exception of William Coley, whose contract terms are yet to be agreed, all of our Executive Directors currently have 12-month rolling contracts.

*Termination Provision*

The Company s policy is that Directors service contracts should not have express termination provisions other than the contractual notice periods.

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David Gilchrist resigned from the Board on August 4, 2004 and his employment terminated on November 4, 2004. The payment to him disclosed under Compensation for Loss of Office in the table entitled Directors Emoluments represents the balance of his contractual notice plus a payment in respect of bonus entitlement for 2004/05 and for loss of bonus entitlement for a proportion of 2005/06.

Mike Alexander resigned from the Board on March 20, 2005. As at July 27, 2005 no compensation for loss of office had been agreed.

*Independent and Non-Executive Directors*

With the exception of Adrian Montague, who undertook an executive role with the Company from November 2002 to March 2003, we consider all our directors to be independent in accordance with the UK Combined Code on Corporate Governance.

The remuneration of Non-Executive Directors is determined by the Board. Appointed for three-year terms, our independent and Non-Executive Directors do not have service contracts, are not eligible for any of our share schemes and do not receive any pension provision from us.

The expiry dates of the current Non-Executive Directors appointments are:

| Name | Expiry Date |
|---|---|
| P Colombani | 05/31/2006 |
| J Delucca | 01/31/2007 |
| I Harley | 05/31/2008 |
| A Montague | 08/31/2005 |
| D Pryde | 05/30/2007 |
| C Spottiswoode | 11/30/2007 |
| R Walmsley | 07/31/2006 |

**Board Practices**

The Board meets sufficiently regularly to discharge its duties effectively. There is frequent contact amongst the Directors between Board Meetings to progress the Company s business.

All of the Non-Executive Directors serving on the Board have held senior positions in other major organizations either in the UK or internationally. Each of them is involved in decision making on key issues facing the Group and brings a wide range of experience to the Board. The Non-Executive Directors of the Company meet as a group from time to time without Executive Directors present and from time to time also meet without the Chairman present.

The Board has a number of matters reserved to it, including appropriate strategic, financial and organizational matters. These are considered at the Board s monthly meetings. The Board receives reports covering operational, financial, safety, risk management and regulatory performance to assist in identifying key issues for all of the business on a regular and timely basis. All Directors may obtain independent professional advice at the Company s expense and all Directors have access to the advice and services of Robert Armour, the Company Secretary who is accountable to the Board through the Chairman on all corporate governance matters. Where appropriate, matters have been delegated to Board Committees, all of which have written constitutions and terms of reference. Further information on our committee structure is provided below.

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We have maintained the Committee structure previously operated by BE Ltd. Our current committee structure is described below:

***Remuneration Committee***

The Remuneration Committee is concerned primarily with the pay, benefits and other employment conditions of Executive Directors and the members of the Executive Committee. The Committee is made up entirely of Independent Directors. In addition, it reviews the pay and benefits to other senior staff, to ensure reasonable consistency. The Terms of Reference for the Committee empower it to:

- establish the remuneration policies and practices for Executive Directors and certain other Directors and senior employees;
- design and implement long-term incentive schemes;
- determine and review the individual remuneration packages of the Executive Directors and other selected senior employees, including pension arrangements;
- authorize the annual performance incentive plan; and
- obtain professional advice and expertise necessary for the performance of its duties.

The Remuneration Committee is chaired by Clare Spottiswoode. Pascal Colombani, Sir Robert Walmsley and David Pryde are also members of the Committee.

*Remuneration Policy*

The Group s remuneration policy aims to attract and retain management with the appropriate professional, managerial and operational expertise necessary to achieve the Group s objectives.

It is the Committee s aim to ensure that the total package (including benefits) is competitive not just in UK terms but can also attract specialists skills in the international nuclear market.

The Committee s policy is that base salaries are positioned broadly around the market median with an incentive opportunity which will reflect the Company s business strategy and the challenges it faces.

In particular it is the Committee s policy that:

A significant proportion of the Executive Directors pay should be variable and linked to the performance of the Company.

Taking account of the external market the movements in base pay of Directors and Executive Committee Members should be broadly in line with the pay increases awarded to other staff.

In determining the link between base and variable pay the Company should be mindful of Safety and Environmental issues.

There should be a strong and clear link between reward and performance against agreed stretch targets.

The Committee has addressed the issue of suitable long-term incentives being in place for Executive Directors and senior staff. The Committee has decided that it is not appropriate to introduce a traditional long term plan at this stage of the Company s development. It proposes to put in place an annual plan which pays out over three years.

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***Audit Committee***

The Audit Committee is comprised entirely of independent Non-Executive Directors. Ian Harley is Chairman and John Delucca Deputy Chairman of the Committee. Ian Harley and John Delucca are considered to be audit committee financial experts. Sir Robert Walmsley, Clare Spottiswoode and David Pryde are also members of the Committee. The Audit Committee has the primary purpose of assisting the Board in overseeing the integrity of the Company s financial statements, and overseeing the Company s compliance with legal and regulatory requirements. The Committee is also responsible for considering and recommending appropriate accounting policies for the Group, and reviewing the adequacy and effectiveness of internal control and compliance procedures within British Energy and ensuring that the Group complies with all statutory requirements in relation to the principles, policies and practices adopted in the preparation of the financial statements including those arising as a result of the application of the US Sarbanes-Oxley Act 2002 ( the Sarbanes-Oxley Act ). The Committee reviewed risk management processes across the Group including actions to mitigate or control key risks facing British Energy. The Committee receives reports from both external and internal auditors in relation to matters arising from their work and is also responsible for encouraging and monitoring the adoption of best practice in corporate governance. The Committee receives reports twice per annum from the Group Risk Management Committee. The Committee reviews the scope and results of the external audit including the auditors cost effectiveness, independence and objectivity, and is responsible for making recommendations to the Board in relation to the appointment and independence of the external auditors and their remuneration. The Committee also reviews the nature and extent of the non-audit services provided by the external auditors to the Group to ensure that these are appropriate, and that a balance of objectivity and value for money is maintained.

***Governance and Nominations Committee***

The Governance and Nominations Committee is comprised entirely of Non-Executive Directors and is chaired by Sir Robert Walmsley. Ian Harley, Pascal Colombani, John Delucca, Clare Spottiswoode and David Pryde are also members. It replaced the BE Ltd Nominations Committee in November 2004. The Committee is responsible for encouraging and monitoring the adoption of good corporate governance practice drawing on the practices and codes prevailing in the UK, US and the EU. It reviews the Company s code of conduct and ethics and compliance with this code and our legal obligations generally. The Committee also advises on the corporate social responsibility performance of the Group. The Committee also advises the Board in relation to senior appointments throughout the Group. Board appointments recommended by the Committee will be made after an appropriate search and selection process has been undertaken, including, where appropriate, the use of external advisers to identify suitable candidates.

***Safety, Health and Environment Committee***

This Committee provides advice to the Board in relation to the health and safety of staff, contractors, visitors and the general public, plant safety and our environmental performance. It reviews key safety and environmental risks affecting our business and the actions taken to mitigate or control them. It is chaired by Sir Robert Walmsley. Roy Anderson is also a member and the Committee also includes three independent experts as well as certain other senior managers of the Group. The meetings, which consider both site specific and generic issues, are held in rotation at the nuclear power stations with the Station Manager and site safety representatives in attendance.

***Nuclear Performance Review Committee***

The Nuclear Performance Review Committee considers and advises the Board and the Executive Committee on issues relating to the performance of and improvements to the Group s nuclear fleet including operational performance, performance improvement, plant reliability, preventive maintenance

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and Materiel Condition. The Committee reviews and advises on the implementation and direction of the Company s ongoing Performance Improvement Program. The Committee is chaired by Pascal Colombani and its membership includes Sir Robert Walmsley, Roy Anderson, Peter Wakefield, and certain other senior managers with appropriate technical expertise. The Chief Executive and executives of the nuclear generation subsidiary board will continue to have responsibility for and will direct the operational and safety policy of the Group s nuclear operations.

***Trading Review Committee***

The Trading Review Committee, chaired by David Pryde, was established shortly after his appointment and meets every second month to review hedging and risk management strategy for trading and to ensure activities are conducted within overall risk limits. The Committee reviews and provides advice on the management and use of risk measurements and control, as well as monitoring performance against strategy. It also oversees the management and maintenance of the policies, procedures, authorization and overall risk control framework which will is carried out by a sub-committee, the Trading Risk Sub-Committee. William Coley, Stephen Billingham, Ian Harley, John Delucca, Clare Spottiswoode, Robert Armour and Neil O Hara are also members.

***Executive Committee***

Chaired by William Coley, the Executive Committee comprising the senior executives, directs the business of the Group in accordance with delegated authorities from the Board. The Executive Committee meets weekly to maintain close scrutiny and management of the Group s affairs, directing performance, taking corrective action and ensuring the Board is kept abreast of all material events. Stephen Billingham, Roy Anderson, Robert Armour, Sally Smedley, Neil O Hara and Peter Wakefield are also members.

**Management Committees and Subsidiary Boards**

Throughout the year a number of executive management committees and subsidiary boards were used to assist the Directors in controlling the business. These included the Generation Board which directed operational and safety policy in the Group s nuclear operations. The Chief Executive and executives on the Generation Board continue to direct the operational and safety policy of our nuclear operations.

**Group Risk Management Committee**

This is an executive committee chaired by the Finance Director. It meets every two months to review the group-wide risk management processes of the business, maintain an overview of the risks facing the business and reports to the Audit Committee on a regular basis.

**Pensions Committee**

This is an executive committee which monitors the management of the two Group Pension Schemes and is chaired by Sally Smedley, the Group s Human Resources and Communications Director. The Chairmen of the British Energy Generation Group Trustees and the British Energy Combined Group Trustees are members, as are certain other Directors and senior managers of the Group. The Committee reviews and advises on the policies being adopted by the Trustees of these Schemes and is responsible for advising the Board on all matters relating to these Schemes.

**Share Ownership**

Prior to the Restructuring BE Ltd operated several share option schemes (collectively, the Old Share Plans ). The No. 1 Scheme was designed for approval by the UK Inland Revenue under

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Schedule 9 of the UK Income and Corporation Taxes Act of 1988 and, consequently confers certain tax benefits on its participants. The No. 2 Scheme, also established by BE Ltd, is an unapproved share option scheme and does not, therefore, confer any particular tax benefits on its participants. Collectively, the No. 1 Scheme and No. 2 Scheme are referred to as the Executive Share Option Schemes . In order to be eligible to participate in the Executive Share Option Schemes an individual had to have been a full time director or employee of BE Ltd. The No. 3 Scheme (the All-Employee Share Option Scheme ) was approved by the UK Inland Revenue and was available to all of our employees other than those who may participate in the Executive Share Option Schemes. There is also a Sharesave (save-as-you earn SAYE ) Scheme that was open to all BE Ltd s UK employees and full time Directors who had been continuously employed for such period as the Board prescribed (which could not exceed five years before the date the options were to be granted).

As at March 31, 2005 there were 2,803,541 options outstanding under the Executive Share Option Schemes, 14,223,094 options outstanding under the All-Employee Share Option Scheme, and 7,375,672 options outstanding under the Sharesave Scheme.

As at March 31, 2005, our Directors and executive officers as a group, held options to purchase 193,150 ordinary shares, all of which options were issued pursuant to our Executive Share Option Schemes. Detailed below are the No. 1 and No. 2 Scheme options held by Directors and executive officers. These options became exercisable three years after the date of grant, subject to achievement of a performance condition. For further details see the section entitled Executive share options below.

Upon Restructuring, British Energy Group plc adopted six stock compensation plans a Sharesave Scheme, an Employee Share Option Plan, an Executive Share Option Plan, an Interim Deferred Bonus Plan, a Long Term Deferred Bonus Plan, and a Share Incentive Plan (collectively, the New Share Plans ). The terms of the Sharesave Scheme, Employee Share Option Plan and the Executive Share Option Plan are not materially different from the Old Share Plans.

No shares or options had been granted under any of the New Share Plans as of March 31, 2005. Total awards granted under the New Share Plans cannot exceed 10 per cent. of share capital over a rolling 10-year period. Of the total awards, grants under the Executive Plan cannot exceed 5 per cent. of share capital over a rolling 10-year period.

A description of the material New Share Plans appears below.

*Employee Share Option Plan ( Employee Plan ) and Executive Share Option Plan ( Executive Plan )*

The intention is that the Employee Plan will be used to facilitate grants to non-senior executives with grants to senior executives made under the Executive Plan. Under both plans, participants may be granted options over common stock but the proportion of those options which may be exercised is subject to the achievement of performance targets over a three-year performance period set by the Remuneration Committee. To the extent that an option or part of an option becomes capable of being exercised at the end of the three-year performance period, it will ordinarily remain exercisable between three and ten years from the date of grant.

*Interim Deferred Bonus Plan*

A deferred bonus in common stock and cash may be granted to executive directors and senior executives by the Remuneration Committee based on performance against targets in respect of the financial year ended March 31, 2005. It is intended that participants in the Interim Deferred Bonus Plan will not participate in the Executive Plan. It is intended that rewards for performance in subsequent financial years will be provided through the Long Term Deferred Bonus Plan.

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*Long Term Deferred Bonus Plan ( LT Plan )*

Certain executive directors and selected senior executives are eligible to receive conditionally awarded shares, or share options in the Company at no cost with the proportion of those shares which may vest subject to the achievement of performance targets over a three-year performance period. It is intended that participants in the LT Plan will not participate in the Executive Plan.

**Directors Emoluments**

During the year the Board reviewed the fees paid to non-executive Directors except the Chairman. With effect from September 1, 2004 the revised structure is:

| | |
|---|---|
| Independent/Non-Executive Director (Basic Fee) | £ 27,000 |
| Additional fee for Deputy Chairman/Senior Independent Director | £ 10,000 |
| Additional fee for Chairing Committees (per Committee) | £ 10,000 |
| Membership of Committee | £ 1,500 |
| Attendance at Board Meeting or Committee Meeting | £ 500 |
| Telephone attendance at Board Meeting or Committee Meeting | £ 250 |

In addition, with effect from April 1, 2004, those Non-Executive Directors who travel from the USA receive £1,000 per Board meeting subject to a maximum of £10,000 per annum. Those who reside elsewhere outside the UK are paid £500 per meeting to a maximum of £5,000 per annum.

Adrian Montague s base fee is £150,000 per annum which was, as a consequence of the additional time commitment as in previous years maintained at a level of £300,000 per annum until Restructuring was achieved. He immediately reverted to his base fee on January 17, 2005, the date of listing of shares in the Company. Under a voluntary arrangement Mr Montague s letter of appointment was amended such that 30 per cent. of his base fee is payable in shares. This arrangement became effective on March 1, 2005. His contract also provided for additional lump sum fees to be paid when certain milestones related to the Restructuring were achieved and £100,000 became eligible for payment in January 2005.

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The payments to Directors and Executive Officers in each of the last three fiscal years (in each case ended March 31) were as follows:

| | Basic Salary and Fees (£) | | | Bonus (£) | | | Contingent Fees (£) | | | Compensation for Loss of Office (£) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Name** | **2005** | **2004** | **2003** | **2005** | **2004** | **2003** | **2005** | **2004** | **2003** | **2005** | **2004** | **2003** |
| A Montague | 269,315 | 300,000 | 100,000 | | | | 100,000 | | 300,000 | | | |
| W Coley[1] | 76,250 | 25,000 | | | | | | | | | | |
| S Billingham[2][13] | 188,740 | | | 286,813 | | | | | | | | |
| R Anderson[2] | 300,939 | | | 361,333 | | | | | | | | |
| P Colombani[3] | 52,750 | 22,500 | | | | | | | | | | |
| J Delucca[4] | 70,083 | 4,500 | | | | | | | | | | |
| I Harley | 63,750 | 36,500 | 25,833 | | | | | | | | | |
| C Spottiswoode | 80,500 | 59,000 | 53,333 | | | | | | | | | |
| R Walmsley[5] | 75,083 | 24,667 | | | | | | | | | | |
| D Pryde[6] | 52,333 | | | | | | | | | | | |
| **Total Emoluments for serving Directors at March 31, 2005** | 1,229,743 | 472,167 | 179,166 | 648,146 | | | 100,000 | | 300,000 | | | |
| D Hawthorne[7] | | 25,228 | 152,978 | | | | | | | | | |
| M Alexander[8] | 407,949 | 400,000 | 33,333 | | 190,004 | | | | | | | |
| M Gatto[9] | 179,596 | 130,000 | | 25,868 | 36,013 | | | | | | | |
| D Gilchrist[10] | 69,581 | 199,013 | 183,563 | 18,482 | 106,105 | | | | | 136,092 | | |
| R Hill[11] | | 19,167 | 57,500 | | | | | | | | | |
| K Lough[12] | | 151,975 | 211,250 | | 73,679 | | | | | | 145,625 | |
| R Biggam[14] | | | 11,167 | | | | | | | | | |
| R Jeffrey[15] | | | 309,188 | | | | | | | | | 98,000 |
| M Kirwan[16] | | | 45,042 | | | | | | | | | |
| P Stevenson[17] | | | 25,893 | | | | | | | | | |
| J Walsh[18] | | | 7,325 | | | | | | | | | |
| **Total Emoluments (all Directors)** | 1,886,869 | 1,397,550 | 1,216,405 | 692,496 | 405,801 | | 100,000 | | 300,000 | 136,092 | 145,625 | 98,000 |
| S Smedley | 173,413 | 157,875 | 148,025 | 157,968 | 76,239 | | | | | | | |
| N O Hara | 193,750 | | | 160,946 | | | | | | | | |
| R Armour | 157,150 | 141,700 | 127,550 | 142,965 | 69,161 | | | | | | | |
| **Total Emoluments (all Directors & Executive Officers)** | 2,411,182 | 1,697,125 | 1,491,980 | 1,154,375 | 551,201 | | 100,000 | | 300,000 | 136,092 | 145,625 | 98,000 |

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| Name | Other Benefits (£) | | | Total Emoluments Excluding Pension (£) | | | Pension Contributions (£) | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| A Montague | | | 209 | 369,315 | 300,000 | 400,209 | | | |
| W Coley[1] | | | | 76,250 | 25,000 | | | | |
| S Billingham[2][13] | 8,046 | | | 483,599 | | | 8,925 | | |
| R Anderson[2] | 33,599 | | | 695,871 | | | 11,475 | | |
| P Colombani[3] | | | | 52,750 | 22,500 | | | | |
| J Delucca[4] | | | | 70,083 | 4,500 | | | | |
| I Harley | | | | 63,750 | 36,500 | 25,833 | | | |
| C Spottiswoode | | | | 80,500 | 59,000 | 53,333 | | | |
| R Walmsley[5] | | | | 75,083 | 24,667 | | | | |
| D Pryde[6] | | | | 52,333 | | | | | |
| **Total Emoluments for serving Directors at March 31, 2005** | **41,645** | | **209** | **2,019,534** | **472,167** | **479,375** | **20,400** | | |
| D Hawthorne[7] | | | 8,046 | | 25,228 | 161,024 | | | 21,749 |
| M Alexander[8] | 28,218 | 32,864 | 2,202 | 436,167 | 622,868 | 35,535 | 15,300 | 16,929 | 1,385 |
| M Gatto[9] | 11 | Nil | | 205,475 | 166,013 | | | | |
| D Gilchrist[10] | 9,034 | 15,247 | 20,067 | 233,189 | 320,365 | 203,630 | 9,257 | 16,929 | 12,020 |
| R Hill[11] | | | | | 19,167 | 57,500 | | | |
| K Lough[12] | | 11,309 | 12,886 | | 382,588 | 224,136 | | 11,657 | 12,020 |
| R Biggam[14] | | | | | | 11,167 | | | |
| R Jeffrey[15] | | | 17,349 | | | 424,537 | | | |
| M Kirwan[16] | | | 4,007 | | | 49,049 | | | 4,453 |
| P Stevenson[17] | | | | | | 25,893 | | | |
| J Walsh[18] | | | | | | 7,325 | | | |
| **Total Emoluments (all Directors)** | 78,908 | 59,420 | 64766 | 2,894,365 | 2,008,396 | 1,679,171 | 44,957 | 45,515 | 51,627 |
| S Smedley | 10,991 | 8,248 | 10,879 | 342,372 | 242,362 | 158,904 | 15,300 | 16,929 | 12,020 |
| N O Hara | 53,780 | | | 408,476 | | | 14,025 | | |
| R Armour | 9,645 | 10,287 | 8,784 | 309,760 | 221,148 | 136,334 | 15,300 | 16,929 | 12,020 |
| **Total Emoluments (all Directors & Executive Officers)** | 153,324 | 77,955 | 84429 | 3,954,973 | 2,471,906 | 1,974,409 | 89,582 | 79,373 | 75,667 |

Notes

(1) Appointed as a Non-Executive Director on June 1, 2003. Appointed as Chief Executive on April 14, 2005
(2) Appointed as Executive Director on September 16, 2004. Emoluments relate to the period from July 2, 2004. He joined the Company on August 25, 2004.
(3) Appointed as Non-Executive Director on June 1, 2003
(4) Appointed as Non-Executive Director on February 9, 2004
(5) Appointed as Non-Executive Director on August 1, 2003
(6) Appointed as Non-Executive Director on September 1, 2004
(7) Resigned as Executive Director on February 15, 2003. Appointed as Non-Executive Director on February 15, 2003 and resigned on March 12, 2004
(8) Resigned as Executive Director on March 20, 2005. As at July 22, no compensation for loss of office had been agreed.
(9) Appointed as Executive Director on December 8, 2003. Resigned on September 16, 2004
(10) Resigned as Executive Director on August 4, 2004
(11) Retired as Non-Executive Director on July 31, 2003
(12) Resigned as Executive Director on December 8, 2003
(13) Bonus relates to a full year of service in line with his service agreement.
(14) Resigned as Non-Executive Director on June 10, 2002.
(15) Resigned Director on February 10, 2003.
(16) Resigned as Director on May 31, 2002. The salary figure for 2003 includes accrued holiday pay of £13,458.
(17) Resigned as Director on February 28, 2003.
(18) Resigned as Non-Executive Director on July 16, 2003.

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**Directors and Executive s Shareholdings**

The table below lists the total number of shares held by our Directors and Executive Officers as at July 25, 2005

| Ordinary shares | July 25, 2005[2] | As a % of total Issued share Capital[2] | March 31, 2004[1] | As a % of total Issued share Capital[1] |
|---|---|---|---|---|
| A Montague | 3,258 | 0.0006 | 2,188 | 0.0004 |
| W Coley | 8,466 | 0.0015 | | |
| S Billingham | | | | |
| R Anderson | 3,547 | 0.0006 | | |
| P Colombani | 3,143 | 0.0006 | | |
| J Delucca | 3,161 | 0.0006 | | |
| I Harley | 3,183 | 0.0006 | 2,000 | 0.0003 |
| C Spottiswoode | 3,234 | 0.0006 | | |
| R Walmsley | 4,598 | 0.0008 | | |
| D Pryde | 8,197 | 0.0015 | | |
| N O Hara | | | | |
| S Smedley | 1 | 0.0000002 | 50 | 0.00001 |
| R Armour | 193 | 0.000034 | 12,282 | 0.002 |
| P Wakefield | | | | |
| Total | 40,981 | 0.0073 | 16,520 | 0.0027 |

Notes:

(1) Ordinary Shares in British Energy plc (total of 620,362,444)
(2) Ordinary Shares in British Energy Group plc (total of 561,315,459)

As at July 25, 2005, our Directors and executive officers as a group, held 40,981 shares, representing 0.0073 per cent. of our issued and outstanding ordinary shares. All British Energy Group plc ordinary shares are of the same class and therefore Directors and executive officers have the same voting rights as shareholders.

Any ordinary shares required to fulfill entitlements under current option schemes may be provided by the British Energy Employee Share Trust ( BEEST ). As beneficiaries under the BEEST, the Directors are deemed to be interested in the shares held by the Trust, which, at March 31, 2005, amounted to 434,701 ordinary shares and 912,872 warrants.

**Executive share options**

As at March 31, 2005 Directors interests in Executive and SAYE share options over ordinary shares were as follows:

***No. 1 Scheme Options****

| | Date of Grant | Date when option expires | Option price | Number of Ordinary Shares under Option |
|---|---|---|---|---|
| Robert Armour | August 12, 1997 | August 11, 2007 | £ 2.60 | 11,538 |
| Sally Smedley | February 8, 1999 | February 7, 2009 | £ 6.67 | 4,497 |

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***No. 2 Scheme Options****

| | Date of Grant | Date when option expires | Option price | Number of Ordinary Shares under Option |
|---|---|---|---|---|
| Robert Armour | June 29, 1998 | June 28, 2005 | £ 5.08 | 11,392 |
| | June 25, 1999 | June 24, 2006 | £ 5.29 | 25,436 |
| | July 14, 2000 | July 13, 2007 | £ 2.41 | 43,523 |
| Sally Smedley | February 8, 1999 | February 7, 2006 | £ 6.67 | 15,368 |
| | June 25, 1999 | June 24, 2006 | £ 5.29 | 25,023 |
| | July 14, 2000 | July 13, 2007 | £ 2.41 | 56,373 |

* Share options were granted in previous years by BE Ltd. Legal advice has been obtained to the effect that the changes in the corporate structure of British Energy as a result of the restructuring did not trigger the early exercise provisions under these options. The Remuneration Committee decided not to allow holders of options in BE Ltd to roll them over into options over shares in the Company. The options granted by BE Ltd are still capable of exercise, but immediately on exercise the shares will be converted into shares in the Company in the ratio of 50:1. Accordingly the effective exercise price of the options is significantly higher than the current share price and it is unlikely the options will be exercised.

*Retirement Benefits for Directors and Executive Officers*

***British Energy Generation Group Approved Pension Plan Table Standard Accrual 1/60th***

| | Years of Service | | | | |
|---|---|---|---|---|---|
| | 15 | 20 | 25 | 30 | 35 |
| Remuneration[1] | | | | | |
| >£102,000 | £ 25,500 | £ 34,000 | £ 42,500 | £ 51,000 | £ 59,500 |

(1) For the Directors and the executive officers covered the maximum remuneration that can be taken into account to calculate Approved Scheme benefits is subject to an earnings cap which at March 31, 2005 was £102,000.

In the case of Sally Smedley the British Energy Generation Group ( BEGG ) of the Electricity Supply Pension Scheme approved plan will provide as much pension promise as possible subject to Inland Revenue Limits. Any excess pension will be provided through the company s own finances via an UURBS (Unapproved Unfunded Retirement Benefits Scheme). All other Directors and executive officers with company pension arrangements will only receive the standard 1/60$^{th}$ of capped pay from BEGG and all benefits in excess of this will be provided under the UURBS.

The following Directors and Executive Officers receive benefits from the UURBS in addition to the Approved Pension Scheme. The current Unfunded Pensionable Pay in excess of the Earnings Cap and accrual rate on which their total benefit will be calculated is:

| Member Name | Current Pensionable Salary over earnings cap[1] | Accrual Rate | Estimated Credit Years of Service to Normal Retirement Age |
|---|---|---|---|
| S Billingham | 212,000 | Up to max 1/30 | 20 |
| R Anderson | 305,130 | Up to max 1/30 | 9 |
| M Alexander | 323,000 | £10k per annum for each year of service | 2 |
| D Gilchrist | 100,100 | Up to max 1/30 | 12 |
| S Smedley[2][3] | 77,000 | Up to max 1/30 | 14 |
| R Armour | 60,000 | Up to max 1/30 | 33 |
| N O Hara | 73,000 | Up to max 1/45 | 28 |

(1) Current Pensionable salary over earnings cap = Full Pensionable salary minus the earnings cap.
(2) Accrual Rate of 1/45$^{th}$ to 31/03/2000 then up to max 1/30th
(3) Subject to Inland Revenue limits the benefits may be provided entirely through BEGG Approved Scheme.

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Roy Anderson and Stephen Billingham are members of BEGG. Mike Alexander and David Gilchrist were also members of BEGG when they were directors. Martin Gatto was not a member of any company pension scheme nor was any payment made to him in lieu of any pension arrangement. No elements of remuneration other than base pay are pensionable.

The following Directors have accrued entitlements under defined benefits scheme as follows:

| Name | Age | Accrued Pension at March 31, 2005 (£) | Estimated Credit Years of Service to Normal Retirement Age |
|---|---|---|---|
| M Alexander | 56 | 20,531 | 2 |
| R Anderson | 56 | 7,422 | 9 |
| S Billingham | 47 | 3,766 | 20 |
| D Gilchrist | 51 | 62,642 | 12 |
| S Smedley | 55 | 10,442 | 14 |
| R Armour | 45 | 30,321 | 33 |
| N O Hara | 39 | 1,550 | 28 |

The accrued entitlements shown are those which would be paid annually on retirement based on service to the end of the year.

The accrual rate of Roy Anderson and Stephen Billingham is 1/30 subject to total pension from all sources not exceeding two-thirds of final salary.

Roy Anderson, Stephen Billingham, Robert Armour, Neil O Hara (and Mike Alexander when he was a director) are required to make contributions of 5 per cent. capped salary to BEGG and to salary sacrifice 5 per cent. of pensionable pay in excess of earnings cap. Sally Smedley is required to pay 5 per cent. of total pensionable earnings to BEGG subject to a maximum of 15 per cent. of earnings cap; any contribution in excess of the 15 per cent. maximum will be paid via salary sacrifice.

*Employees*

The table below sets out the average number of full-time equivalent permanent employees of the British Energy Group for each of the last three financial years

Full-time equivalent Permanent Employees (year to March, 31)

| 2003 | 2004 | 2005 |
|---|---|---|
| 5,082 | 5,139 | 5,446 |

A large proportion of our employees (approximately 80 per cent. of the total) are members of trade unions and are covered by collective bargaining agreements. There have been no significant disputes in the last 12 months.

The average number of Agency temporary employees for the most recent financial year was 656.

*Employee Share Schemes*

Details of Employee Share Scheme are provided above under the heading Share Ownership .

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## ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

### Major Shareholders

***Control of Registrant***

We are not directly or indirectly owned or controlled by another corporation or by any government (except to the extent permitted by the Special Share, discussed below). As at July 22, 2005 we had been notified of the following interests of 3 per cent. or more of the issued ordinary share capital of British Energy Group plc.

| Title of Class | Shareholder | Address | Number of Shares | Percentage |
|---|---|---|---|---|
| Ordinary | Deutsche Bank AG | Taunusanlage 12, 60262 Frankfurt am Main, Germany | 80,819,369 | 14.3 |
| Ordinary | Invesco Asset Management | Invesco Park, Henley on Thames, Oxfordshire, RG9 1HH | 34,583,450 | 6.1 |
| Ordinary | Schroder Investment Management | 31 Gresham Street, London EC2V 7QA | 30,791,787 | 5.4 |
| Ordinary | Brian J Stark | 3600 South Lake Drive, St Francis, Wisconsin 53253 | 30,651,582 | 5.4 |
| Ordinary | M&G Investment Management | Governor s House, 5 Laurence Pountney Hill, London, EC4R OHH | 27,552,415 | 4.9 |
| Ordinary | Fidelity Investments | FMR Corp., 82 Devonshire Street, Boston MA 02109 | 17,306,373 | 3.1 |
| Ordinary | Duquesne Capital Management LLC | 2579 Washington Road, Suite 322, Pittsburgh, PA 15241 | 17,140,150 | 3.0 |
| Ordinary | Legal & General Investment Management | Bucklersbury House, 3 Queen Victoria Street, London, EC4N 8NH | 16,950,363 | 3.0 |

The voting rights of holders of 3 per cent. or more of our ordinary shares do not differ from those of other shareholders.

On March 31, 2005, there were 72,240 registered holders of ordinary shares of whom 44 registered holders of a total of 16,265 ordinary shares had addresses in the US. The combined holdings of these US shareholders constituted less than 1 per cent. of the total number of ordinary shares outstanding. As certain of the ordinary shares are held by brokers and other nominees, these

numbers may not be representative of the actual number of beneficial owners in the US or the number of ordinary shares beneficially held by US persons.

The NLF may, at its option, convert certain cash amounts due under the NLF Cash Sweep Payment into ordinary shares of British Energy. Such option if effective and if exercised may result in a change of control. For additional information, see Note 2 to our consolidated financial statements starting on page F-1. We do not know of any other current arrangements the operation of which may result in our change of control.

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Our share capital includes one special rights redeemable preference share (the Special Share ), with a nominal value of £1.00. The Special Share may only be held by the Special Shareholder, which includes any of one or more of Her Majesty s Secretaries of State, another minister in the UK Government, the Treasury Solicitor or any person acting on behalf of the UK Government. The Special Shareholder may, after consulting with us and subject to the provisions of the Companies Act, require us to redeem the Special Share at any time after September 30, 2006 at its nominal value by giving us notice and delivering the relevant share certificate. The registered holder of the Special Share may attend and speak at any general or other meeting of holders of any class of our shares but has no right to vote at any such meeting.

Until such time as the Special Share is redeemed, our Articles of Association prohibit any person (other than certain permitted persons) from holding more than 15 per cent. of the voting rights of our issued share capital. We call this restriction the Limitation . As long as the Limitation is in effect, we are required by our articles to enforce the Limitation (including, without limitation, withdrawal of voting rights of such shares and the forced sale of such shares).

The written consent of the Special Shareholder is required for each of the following:

- The amendment, removal or alteration of the effect of (including the ratification of any breach of) certain provisions of our Articles of Association, including the provisions with respect to the Special Share and the Limitation.

- The creation or issue of any of our shares carrying voting rights other than (a) shares carrying voting rights in all circumstances at general meetings of our shareholders and (b) shares which do not constitute equity share capital (as defined in the Companies Act) and which, when aggregated with all other such shares, carry the right to cast less than 15 per cent. of the votes capable of being cast on a poll at any general meeting of our shareholders.

- Variation of any voting rights attached to any class of shares.

- The appointment of the Chairman of the Board.

- The passing of a resolution for our voluntary winding up.

- Any changes to the Articles of Association of our operating subsidiaries that would allow them to issue shares to any person other than to certain group companies in each case and the disposal by us of any such shares.

As a consequence of the Restructuring British Energy plc became a wholly-owned subsidiary of the Company. As a result, the interests of shareholders in British Energy plc were very substantially diluted. (See Item 4. Information On The Company Restructuring )

**Related Party Transactions**

***Interest of Management in Certain Transactions***

There have been no material transactions during our most recent three fiscal years, nor are there presently proposed to be any material transactions to which we or any of our subsidiaries are or were a party and in which any Executive or Non-Executive Director, or 10 per cent. shareholder, or any relative or spouse thereof or any relative of such spouse, who had the same home as such person or who is a Director or Executive Officer of any parent or subsidiary of British Energy had or is to have a direct or indirect material interest.

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Dr. Pascal Colombani, who is one of our independent Non-Executive Directors is also a director of Alstom SA (since July 2004). As part of our normal operations, we purchase goods and services from members of the Alstom group. Although none of these contracts for goods or services is adjudged to be material, over the three year period ending on March 31, 2005, we have purchased goods and services from Alstom with a total value of around £45 million.

**Officers and Directors**

A payroll systems error was identified and subsequently rectified during the year ended March 31, 2004. As a result of this error, personal retirement benefit contributions were not deducted in full from the salary of some higher paid employees. Following detailed investigation, the individuals concerned, including several Directors and senior officers of the company, were granted up until March 31, 2008 by our Remuneration Committee to repay salary overpayments. No interest was payable on the overpayments over the extended period. After further consideration, the Company recognized that this extended time period might constitute an unintentional breach of s402 of the Sarbanes-Oxley Act, and, consequently, the Directors involved were asked to repay all outstanding amounts. Up to March 31, 2005, Mike Alexander had repaid £10,200 (the maximum permissible under Inland Revenue limits). He subsequently repaid a further £3,400 up to the end of July 2005. The balance will be recovered from him as part of any payment of compensation for loss of office. David Gilchrist, Sally Smedley and Robert Armour have repaid the amounts in full. The Directors and officers who received the overpayment and the maximum amounts outstanding were as follows.

| | |
|---|---|
| Mike Alexander | £ 26,820 |
| David Gilchrist | £ 15,483 |
| Sally Smedley | £ 12,870 |
| Robert Armour | £ 7,302 |

The Company operates a car ownership scheme (the COS Scheme ) under which employees who satisfy certain criteria are entitled to be provided with a car for business and personal use.

Under the COS Scheme, eligible employees are entitled to be provided with, amongst other things, both interest bearing and interest free loans to fund the purchase of a car. Two of our executive officers, Robert Armour, and Sally Smedley currently participate in the COS Scheme.

Following a review of these arrangements, we consider that the loan element of the COS Scheme may constitute a personal loan to each of the relevant executive officers under s402 of the Sarbanes-Oxley Act. As a consequence, we are taking steps to terminate the participation of these executive officers in the COS Scheme.

**ITEM 8. FINANCIAL INFORMATION**

See Item 18. Financial Statements .

**ITEM 9. THE OFFER AND LISTING**

**Nature of Trading Market**

The principal trading market for our ordinary shares is the London Stock Exchange. There is no established public trading market for our ordinary shares in the United States. Following the completion of our Restructuring, our shares were admitted to trading on January 17, 2005. The ordinary shares of British Energy plc were delisted from the London Stock Exchange on October 21, 2004. For further information see Item 4 Restructuring Requisitioned EGM and Delisting of BE Ltd s ordinary shares, A shares and American Depository Receipts . In addition, prior to September 28, 2004 ADRs, (each of which represented 75 ordinary shares in British Energy plc) issued by Morgan Guaranty Trust Company of New York, as depositary for our ADRs, or the Depositary, were listed on the NYSE. On

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that date, following notification of our intention to delist the ordinary shares of British Energy plc from the official list of the London Stock Exchange, our ADRs were suspended from the New York Stock Exchange and have subsequently been permanently delisted. Since neither British Energy plc nor the Company were able to satisfy the relevant listing criteria for the NYSE on Admission, no new ADRs were issued on Admission. Holders of ADRs received the New Shares and/or Warrants to which they were entitled. The table below sets forth, for the calendar quarters of each year indicated, the highest and lowest middle-market quotations (the closing price quoted for a security on any given day on the London Stock Exchange as published in the Daily Official List of the London Stock Exchange) for the ordinary shares. For additional historic information on dividends see Item 3 Key Information.

| | Ordinary Shares[1][4][5] | | ADRs[2][4] | |
|---|---|---|---|---|
| | High | Low | High | Low |
| | (in pence) | | (in US dollars) | |
| **QUARTERLY** | | | | |
| **2000** | | | | |
| First | 399.75 | 175.25 | 25.88 | 11.06 |
| Second | 205.00 | 119.50 | 12.50 | 7.25 |
| Third | 262.00 | 165.00 | 16.19 | 10.38 |
| Fourth | 258.00 | 162.25 | 14.81 | 9.50 |
| **2001** | | | | |
| First | 295.50 | 193.00 | 17.35 | 11.75 |
| Second | 324.00 | 228.50 | 19.10 | 13.20 |
| Third | 337.00 | 256.75 | 19.40 | 14.45 |
| Fourth | 293.00 | 219.00 | 16.60 | 12.90 |
| **2002** | | | | |
| First | 259.75 | 175.00 | 14.96 | 10.20 |
| Second | 190.00 | 161.00 | 10.94 | 9.42 |
| Third | 171.50 | 5.00 | 9.15 | 0.50 |
| Fourth | 16.88 | 5.15 | 1.07 | 0.36 |
| **2003** | | | | |
| First | 7.50 | 3.20 | 4.93 | 0.22 |
| Second | 7.17 | 3.50 | 8.72 | 4.05 |
| Third | 6.75 | 3.50 | 7.96 | 4.25 |
| Fourth | 5.50 | 4.03 | 6.90 | |