SCOTTISH POWER PLC
Form 6-K
June 14, 2004

SECURITIES AND EXCHANGE COMMISSIONS

WASHINGTON, DC 20549

FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER

PURSUANT TO RULE 13a-16 OR 15a-16 OF

THE SECURITIES EXCHANGE ACT OF 1934

For the month of June 2004

SCOTTISH POWER PLC

(Translation of Registrant s Name Into English)

CORPORATE OFFICE, 1 ATLANTIC QUAY, GLASGOW, G2 8SP

(Address of Principal Executive Offices)

(Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.) Form 20-F x Form 40-F ¨

(Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.) Yes ¨ No x

(If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-____ .)

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1. Annual Report for the year ended March 31, 2004.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

/s/ Scottish Power plc

(Registrant)

Date June 10, 2004

By: /s/ Donald McPherson

Donald McPherson

Assistant Secretary

Annual Report

and Accounts

2003/04

Financial Highlights

	2004	2003	2004*	2003*
Turnover	**£ 5,797m**	£ 5,274m	**$ 10,666m**	$ 8,333m
Operating profit	**£ 1,023m**	£ 946m	**$ 1,882m**	$ 1,494m
Operating profit excluding goodwill	**£ 1,151m**	£ 1,085m	**$ 2,118m**	$ 1,714m
Profit before tax	**£ 792m**	£ 697m	**$ 1,457m**	$ 1,101m
Profit before tax excluding goodwill	**£ 920m**	£ 836m	**$ 1,693m**	$ 1,321m
Earnings per ordinary share/per ADS	**29.40p**	26.17p	**$ 2.17**	$ 1.66
Earnings per ordinary share/per ADS excluding goodwill	**36.40p**	33.71p	**$ 2.69**	$ 2.13
Dividends per ordinary share/per ADS	**20.50p**	28.71p	**$ 1.42**	$ 1.83

* Amounts for the financial years ended 31 March 2004 and 31 March 2003 have been translated, solely for the convenience of the reader, at the closing exchange rates on 31 March of $1.84 to £1.00 and $1.58 to £1.00 respectively. Dividends per American Depositary Share (ADS) are shown based on the actual amounts in US dollars. One ADS represents four ordinary shares.

ScottishPower is an international energy company listed on both the London and New York Stock Exchanges.

Through its operating subsidiaries the company provides in excess of 5.8 million electricity or gas services to homes and businesses in the western US and across the UK.

This Annual Report and Accounts examines our performance in 2003/04 and assesses the issues and opportunities ahead.

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ScottishPower has benefited from its clear focus on energy and the more settled conditions that have returned to its markets.

Charles Miller Smith, Chairman

Chairman s Statement

Getting better

ScottishPower has benefited from its clear focus on energy and the more settled conditions that have returned to its markets. We have got better at supplying customers with power and have improved performance by sharpening up our processes for providing energy and investing in organic growth projects to build long-term value. Our businesses continued to make good progress and delivered their planned targets for 2003/04.

The group s earnings per share* for the year were 36.4 pence, an improvement of 8% for the 12 months. Profits, earnings and investment increased; debt and interest charges fell, and the statistics on customer service, network reliability, and energy and risk management are all positive. The fourth quarter dividend of 6.25 pence per share brings the total dividends for the year to 31 March 2004 to 20.5 pence compared to 28.7 pence last year. Our goal now is to increase dividends broadly in line with earnings.

Business Progress

Our US businesses made further strides in operating efficiency and customer service standards. PacifiCorp benefited from strong economic trends in its service territories, with increases in customer numbers and load growth, while simultaneously reducing costs. We invested in network expansion and generating plant capacity and in the year we have been awarded $100 million in additional annual revenue from US rate cases. PPM, our newest business, invested substantially in additional wind generation and gas storage capacity.

Our UK businesses also did well. The Infrastructure Division lifted operating profit by 7% thanks to continued emphasis on reducing costs and enhancing service. The investment in modernising our distribution networks and replacing equipment has placed our operations in a strong position ahead of next year s price review. The UK Division gained 600,000 new customers, wholesale energy prices recovered from last year s historic low and operating profit* rose 30%. Customer numbers passed four million for the first time and we have added to both our conventional and renewable power plant portfolio.

Safety Matters

We are deeply saddened to report the death of Alan Ronald, a transmission linesman who died doing his job on 16 December 2003. ScottishPower has an improving record on safety and it is given top priority by our Board and all our operations. We are committed to minimising the dangers of our installations and know we need to do more to remind staff, customers and the public that we all bear responsibility for safe practices. ScottishPower will publish a full report on its social and environmental impact later in the year.

Board Appointments

There have been several changes to the Board this year. Simon Lowth joined the Board as Director, Corporate Strategy and Development, in September 2003. Judi Johansen, President and Chief Executive of PacifiCorp, was appointed in October 2003.

Mair Barnes and Sir Peter Gregson will retire at the AGM after completing two terms of office each. We thank them for their support and wise counsel and wish them well.

In their places we welcome Vicky Bailey, formerly an Assistant Secretary for Policy and International Affairs at the US Department of Energy, an ex-member of the Federal Energy Regulatory Commission who has also served as an Indiana state regulator, and Nancy Wilgenbusch, a distinguished community administrator and President of the Marylhurst University in Portland, Oregon. Their experiences of US business, government, academic and community management strengthen the close regulatory and community relations we are forging.

Staff

On behalf of shareholders and the Board, I want to acknowledge the dedication of our staff whose hard work has achieved this performance and thank them for their efforts.

Outlook

ScottishPower believes that the next 12 months offers promising opportunities. We expect that our strategy of investing for organic growth and improving operational performance will deliver value for our shareholders.

/s/ Charles Miller Smith

Charles Miller Smith, Chairman

25 May 2004

* *Excluding goodwill amortisation*

Dear Shareholder,

This has been another good year for ScottishPower. Our skills in serving customers, balancing demand and supply, and managing our assets, together with our increased investment programme, have resulted in higher growth, more efficient performance and better returns.

Ian Russell, Chief Executive

Chief Executive s Review

1 Delivering the Strategy

This has been another good year for ScottishPower. Our skills in serving customers, balancing demand and supply, and managing our assets, together with our increased investment programme, have resulted in higher growth, more efficient performance and better returns. All of our businesses delivered improved performance, principally due to increased revenues with higher volumes and prices, and the returns from investing in generation, networks and gas storage. As a result, pre-tax profit* increased by £84 million to £920 million, and earnings per share* increased by 8% to 36.4 pence.

The full year dividend of 20.50 pence per share is covered 1.78 times by earnings per share* in line with our stated policy effective from 1 April 2003. The dividend for each of the first three quarters of 2004/05 will be 4.95 pence per share, with the balance of the total dividend to be set in the fourth quarter. We remain committed to our stated policy of growing dividends broadly in line with earnings.

We remain focused on delivering our established strategy of improving operational performance and achieving organic growth by investing in projects with a range of attractive returns.

In improving our operational performance, we aim to increase revenue through regulatory rate cases and customer growth which, together with driving down costs across the group, bring improvements to the bottom line. In the year we have been awarded $100 million in additional annual revenue from US rate cases; grown our UK customer base by 600,000 to 4.25 million (16% growth); and reduced costs across the group by £49 million. We have also increased network reliability, with PacifiCorp reducing the average outage time for customers by 16% and Infrastructure Division reducing network faults by 8.5%.

We spent approximately £900 million in the year on net capital investment, some 40% of which was in projects which will deliver organic growth. We have exercised strict capital discipline and all our capital projects meet rigorous criteria for value creation. We have also developed a high quality pipeline of projects that offer a range of attractive returns. We believe current allowed regulatory returns justify investment in our regulated assets and, through incentives, we believe that we can better these returns. In our competitive businesses we seek returns of at least 2% above our weighted average cost of capital. All new investments, assessed on a risk adjusted returns basis, are expected to be earnings enhancing and support our aim of retaining our A credit rating for our principal operating subsidiaries. In the year, we invested in windfarm projects in the US and UK totalling more than 534 MW; commenced initial work on the new 525 MW Currant Creek gas-fired power plant in Utah; undertook substantial network investment in the US of 564 MVA; and added to our gas storage capacity. We currently forecast investing approximately £1.2 billion in the year to March 2005 in networks, generation and gas storage, all of which will deliver a range of attractive returns, some 50% of which is expected to deliver organic growth.

2 Investing for Organic Growth

Net investment in assets totalled £901 million in the year, with £247 million invested in the final quarter. Our organic growth expenditure totalled £364 million for the year, with 58% of that figure invested in our regulated businesses and 42% in our competitive businesses. Geographically, £268 million (74%) of growth spend was invested in the US and £96 million (26%) in the UK.

PacifiCorp s net investment in assets totalled £419 million, with £151 million (36%) of this invested for organic growth. Of this, £126 million was invested in new transmission and system networks, including new connections and system reinforcement spend and in our major network expansion project along the Wasatch Front in Utah. New generation growth investment of £25 million included spend on Currant Creek, the 525 MW plant, in Utah. In May 2004, PacifiCorp announced it had selected Summit Vineyard LLC to construct a 534 MW gas-fired plant for approximately $330 million. The proposed new plant, named Lake Side, would be located near Salt Lake City, Utah, and would provide base load power starting in 2007.

In our Infrastructure Division, net investment in assets was £260 million, with £60 million (23%) in organic growth areas such as new customer connections and network upgrading, including ongoing reinforcement projects in Dumfries & Galloway and Wrexham. Compared to 2002/03, we have increased investment in the replacement of network assets. The total number of distribution network faults has reduced by

* *Excluding goodwill amortisation*

Chief Executive s Review

8.5% in the year and we have achieved reductions in the unit cost of faults on our 33kV cable network and 11kV overhead line network.

In our UK Division, net investment in assets was £93 million, with £36 million (39%) of this invested in organic growth projects. This included investment in new wind generation of £26 million, with Cruach Mhor (30 MW) windfarm now fully commissioned and Black Law (96 MW) under construction, following receipt of planning consent in February 2004. The project to upgrade and increase the capacity of the Cruachan pumped storage hydro station from 400 MW to 440 MW is near completion. Offshore windfarm activity is also progressing with the allocation of a second site from the Crown Estates Office auction. In the next financial year, the division aims to continue to invest in renewable generation capabilities with the objective of meeting the stated target of achieving 10% of electricity supply from renewable sources by 2010. The Government granted planning permission in May 2004 for the construction of a highly flexible £100 million gas store near Byley, Cheshire.

PPM s net investment in assets for the year was £129 million, with £117 million (91%) invested in organic growth projects. Of this, more than £100 million was invested in new wind generation, with the construction of Flying Cloud (44 MW), Moraine (51 MW), Mountain View III (22 MW) and Colorado Green (81 MW). All of these windfarms qualified for US Production Tax Credits (PTCs) and accelerated tax depreciation benefits, and were commercially operational in the third quarter and contributing to profits. Other growth investments during the year included the purchase of an additional 17% ownership interest in the Alberta gas storage hub, bringing PPM s total ownership to 57%, and the commencement of a further gas storage development of 7 BCF at the Waha site in west Texas. The project is being developed in phases over six years, with the first phase operational by 2006.

3 Improving Operational Performance

PacifiCorp

Operating profit, excluding goodwill amortisation, increased by $65 million to $943 million, including the delivery of cost efficiencies of $49 million and deferred power costs recovered, which were $23 million lower at $91 million. The first quarter of 2004/05 has started less strongly than our expectations due to a combination of milder weather impacting on residential demand, lower hydro resource and lower thermal plant availability. However, PacifiCorp remains committed to achieving its target of $1 billion EBIT (earnings before interest and tax, excluding goodwill amortisation) in 2004/05.

PacifiCorp is currently pursuing a regulatory programme in all states with the objective of keeping rates closely aligned to ongoing costs. In March 2004, the Wyoming Public Service Commission granted PacifiCorp approximately $23 million of additional annual revenue, reflecting the Commission s recognition of the investments made by PacifiCorp in support of customer growth in the state. Along with awards earlier in the year of $65 million in Utah, $8.5 million in Oregon, and $3 million in California, this took the total of rate case awards in the year to approximately $100 million of additional annual revenue. These rate cases included full recovery for all new system investments and other new costs. The $27 million Washington general rate case is progressing on schedule with an outcome expected at the end of November 2004. PacifiCorp seeks to maximise its return on equity (ROE) within the limits permitted by US state regulators. The outcome of general rate cases conducted by the state regulatory commissions sets the authorised ROE, with each commission establishing its own ROE for PacifiCorp. During the year, the authorised ROE specified by PacifiCorp s state regulators ranged from 10.5% to 10.9%. Regulatory returns for PacifiCorp at September 2003, the end of the last regulatory reportable period, were approximately 8%.

As a regulated business, PacifiCorp serves some of the fastest growing regions in the western US, which provides an opportunity for further network investment and generation sourcing to ensure reliable service, and extensive expansion plans are underway. Regulatory and other final approvals to build the 525 MW Currant Creek gas-fired station in Utah, were given in March and April 2004, and we have already begun the first phase of construction of this $350 million plant. For the proposed Lake Side plant we are seeking regulatory approval by December 2004. Further opportunities include a potential 1,100 MW in proposed renewable projects and $212 million currently being invested for growth in infrastructure across our six states, including Utah, which has seen strong residential load growth of approximately 4% per annum in recent years. Network investments, such as the increase of 564 MVA of capacity added this year improved underlying system reliability. These systemwide investments have assisted in the delivery of a 16% improvement in reliability over the prior year, excluding major events such as the impact of the extremely challenging winter storms that hit PacifiCorp s service area. During the same period PacifiCorp has improved its level of safety, reducing lost time accidents by 25%.

In the year, PacifiCorp delivered $49 million of operating efficiencies, including benefits from generation plant performance, managing power costs, and negotiation of fuel contracts. Cumulative operating efficiencies now stand at $266 million and we remain on track to achieve our $300 million savings target in 2004/05.

PacifiCorp today has a proven management strategy to balance power demand and supply with a portfolio of generation and transmission assets, forward physical purchases and financial hedges, delivering a forecast net balanced position for the summer periods of 2004 and 2005. PacifiCorp s natural gas supply is also fully hedged through 2006 and the company is implementing longer- term supply arrangements to minimise natural gas supply risks for the Currant Creek plant.

Infrastructure Division

The success of Infrastructure Division, our UK wires business, in growing its regulated revenues and controlling its cost base, which reduced by £6 million in the year, helped drive operating profit up £26 million to £394 million. Our Infrastructure Division was rated amongst the top performers in the key area of asset management in an earlier independent study from Ofgem, an accolade that highlights the advances made as the company develops investment programmes around a clear understanding of asset risk and network performance. At the same time, we sought to minimise customer disruption through all weathers, largely successfully, as the Department of Trade and Industry acknowledged in a post-storm investigation.

As the UK s third largest electricity distribution business, we are set to play a key role in rewiring Britain. The Government agrees more money must be spent on preparing the UK for an increase in electricity supply from renewables as well as strengthening the existing network to meet the needs of the 21st century. We hope to invest at least £1.2 billion in our network in the next five years. In addition, we envisage some £100 million will be invested to accommodate Distributed Generation (DG), mainly to link new windfarms to the grid. We remain supportive of Ofgem s objectives in this area and believe that progress has been made towards the development of acceptable proposals for DG. A related scheme for expanding transmission is underway and preparatory work on stage one, an investment of over £200 million, is well advanced. Further stages still to be approved could see a total investment of £400 million over 10 years, which will be the biggest growth in the UK high voltage network since the 1960s. These investments will increase our regulated asset base and, consequently, returns.

We remain constructively engaged with Ofgem on the 2005 Distribution Price Control Review. Ofgem s March 2004 consultation document set out the issues, with key areas outstanding, including cost of capital. We will continue to press Ofgem for higher rates of return to reflect correctly the nature of our business and look forward to Ofgem s initial proposals due at the end of June this year.

UK Division

UK Division, our integrated generation and customer supply business, gained 600,000 customers in the year, bringing the total number of customers to 4.25 million, an increase of 16%. In the first quarter of 2004/05 we continue to make good progress in attracting more new customers. We continue to enjoy the benefit from using a single domestic billing system and this, along with other process improvements, has contributed to us gaining a top two ranking in quality of service ratings in minimising complaints for direct selling and customer transfers. The customer gains were not won lightly and stem from a tough, two-year streamlining of operations to improve customer service, facilitating our strong customer growth and also improving efficiency. Consequently, operating profit, excluding goodwill amortisation, rose by £23 million to £101 million.

UK Division has laid the foundations for increased returns by focusing on reliability and efficiency. Supply activities are being transformed by the 6 Sigma programme which aims to improve all customer handling processes and which delivered revenue and cost benefits of £13 million in the year. We have now extended this programme to our generation activities and expect to see both operational and cost improvements.

Pivotal to the running of our vertically integrated operations is the Energy Management hub whose performance has again underlined our ability to balance customer numbers and the generation capacity required to supply them while delivering competitive prices. The renegotiation or removal of restructuring contracts, inherited at privatisation, is now complete. Last year, an annual cost burden of approximately £25 million (based on 2002/03 market prices) was removed, following the renegotiation of the Nuclear Energy Agreement (with British Energy). The early termination of the Peterhead and Hydro Agreements (with Scottish and Southern Energy) will deliver a future annual saving of approximately £20 million from April 2005. As our customer base grows we continue to explore opportunities to add further gas-fired generation to our generation portfolio.

In addition, renewables are now central to the UK s future power needs and, as the UK s leading windfarm developer, ScottishPower is ideally placed to benefit. The planning approval for Black Law in Scotland s Central Belt in February 2004 was the largest consent given for an onshore windfarm in the UK and our experience in building windfarms gives the division a vital skills advantage in siting, environmental impact assessment and design. We were pleased to commission the 30 MW Cruach Mhor windfarm in March 2004. Our offshore wind activity is also progressing with the allocation of a second site from the Crown Estates Office auction.

The £100 million, 6 BCF gas storage facility near Byley, Cheshire will help provide greater security of supply, as gas imports to the UK are expected to rise. Byley s short cycle time will also enable it to respond to the expected increase in overall demand and price volatility.

Our focus on efficiency has also driven improvements in our fuel and logistics processes. Coal deliveries, under the new Clydeport contract started at Hunterston and Rosyth in April 2004, are expected to deliver savings of £8 million in the financial year 2004/05 and up to £10 million per annum thereafter. Additionally, on completion of successful trialing of co-burning, full biomass operations at Longannet and Cockenzie are planned to commence this year with expectations to deliver approximately £5 million of annual benefit through Renewables Obligation Certificates (ROCs).

The latest proposals for the National Allocation Plan under the EU Emissions Trading Scheme published on 6 May 2004 remain in line with our expectations and continue to show the burden of carbon reduction being placed on the power sector. Whilst supporting the overall Government objective of achieving a lower carbon economy, ScottishPower continues to argue that

the scheme must encourage sufficient investment in new generation to ensure the ongoing security of supply in the UK.

PPM

PPM, our competitive US energy company, continues to build on its impressive record. Operating profit, excluding goodwill amortisation, rose by $18 million (41%) to $63 million, with increased contributions from gas storage, optimisation of assets and its steadily growing share of the US wind power market.

PPM accounted for almost a third of new wind developments in the US in calendar year 2003, adding control of 528 MW (504 MW in the financial year 2003/04) to its portfolio, which now totals around 830 MW of renewable energy currently under its control. PPM is now pursuing its immediate goal of developing another 500 MW of wind projects. Their completion depends partly on the extension of the PTCs, expected to be introduced this year, which would keep PPM on track for its goal of 2,000 MW by 2010. In the longer-term, PPM is well placed to take full advantage of the 8,000 MW of potential projects and sites already ear-marked for development. In line with the group s prudent energy management strategy, PPM has already sold forward approximately 80% of its wind power in contracts of between 10 and 25 years, locking in a regular annuity value.

During the year, an increasing component of PPM s revenues came from its gas storage and hub services business, serving North America from bases in Texas and Canada, which include operating or contracting activities for gas storage and selling capacity forward. Our view is that gas prices will remain volatile, with tight supply and demand, enhancing the value of PPM s owned and contracted gas storage facilities which now total 67 BCF. In addition, as part of PPM s increased origination activities, the number of large wholesale gas customers has increased by approximately 50% over the past year and includes major refineries and municipalities.

4 Health and Safety

Health and safety continues to be our top priority and during the year we reviewed our health and safety policy and standards. ScottishPower has a good health and safety record, but it is my ambition to achieve world-class health and safety performance throughout the company.

Our new policy and standards reflect our determination to achieve our goal of creating a positive and productive environment that is free from injury or illness and causes no harm to our employees, customers or the general public.

We have stepped up employee involvement and training, launched behavioural safety auditing and we have been working with our contractors to ensure they share our commitment to health and safety. We have also improved the sharing of best operational practices across our businesses.

Looking ahead our policy will be to foster a sense of common purpose to create a culture that will drive excellent and sustainable health and safety performance.

5 Corporate Social Responsibility

During the year we have continued our commitment to building a strong business which creates benefits for customers, employees, shareholders, communities and the environment.

We were pleased to be ranked 12th out of 140 companies in Business in the Community s 2004 Corporate Responsibility Index and to win the Edison Electric Institute s International Award 2004, under the theme of Progress Through Responsibility .

In recognition of ScottishPower s support for communities, I was asked to lead a Commission for the UK Government to investigate the development of a Youth Volunteering Strategy. I look forward to this role and believe there is huge potential for a national volunteering programme that enables young people to fulfil their potential and help to build strong and cohesive communities throughout the UK.

6 Employees

At ScottishPower we recognise that our people are our greatest asset and employee feedback has been incorporated into the company s performance management system through our employee survey tools.

This group-wide employee survey measures how our employees feel about their working environment. The results are monitored by the Executive Team and are used as a basis for action to remove barriers to productivity and increase employee satisfaction.

We remain committed to developing talent at all levels within the organisation, supporting employee study by providing workplace and home-based learning opportunities and tailored management development programmes. Throughout the company we strive to recognise and celebrate the achievements of our people as we continue to build our business for the future.

7 Conclusion

Looking ahead, we are well placed to exploit fully the good opportunities we see for profitable growth on both sides of the Atlantic. Increasing demand and the need for more reliable and sustainable energy present attractive opportunities for organic growth and higher returns. We remain confident that our strategy will create further value for shareholders.

/s/ Ian Russell
Ian Russell, Chief Executive

25 May 2004

8 ScottishPower Annual Report and Accounts 2003/04

Business Review

1 Description of Business

Scottish Power plc (ScottishPower), a public limited company registered in Scotland, is an international energy company listed on both the London and New York Stock Exchanges. Through its operating subsidiaries, the company provides in excess of 5.8 million electricity or gas services to homes and businesses in the western US and across the UK. It provides electricity generation, transmission, distribution and supply services in both countries. The company s US activities extend to coal mining and gas storage, including gas facilities in western Canada and in Texas. In Great Britain, ScottishPower also stores and supplies gas. In the year to 31 March 2004, the sales revenues of the group were £5.8 billion ($10.7 billion).

Following its creation upon privatisation in 1991, ScottishPower developed by both organic growth and strategic acquisitions in the British electricity, gas and telephony markets - and through its November 1999 merger with PacifiCorp in the US. During 2001/02, the group was redefined as an international energy business, exiting non-strategic activities in the US and UK, demerging the UK telecommunications and internet business, Thus, to the company s shareholders and, in April 2002, selling the UK water and wastewater company, Southern Water. From 2002/03, ScottishPower has focused on its strategic aim of becoming a leading international energy company.

Strategic Context

ScottishPower s strategy is to become a leading international energy company; managing both regulated and competitive businesses in the US and the UK to serve electricity and gas customers. The regulated businesses provide a base for steady growth through consistent investment and proven skills in operational and regulatory management. In its competitive businesses where the group has local market knowledge and skill advantages, it seeks to grow its market share and to enhance margins through the integration of generation, energy management and customer services, again underpinned by best-in-class operational performance. The aim is to support the growth and development of both regulated and competitive businesses through a balanced programme of capital investment which will deliver organic growth. Growth will arise from investment in new generation, networks and gas storage assets. It will also be sought through competitive market share gains and selective acquisitions of smaller operations that complement the group s business and will accelerate its organic growth. Shareholder value will be created through an investment programme assessed on a risk-adjusted returns basis. Individual investments are expected to be earnings enhancing and supportive of the aim of retaining an A credit rating for the group s principal operating subsidiaries.

The strategy is delivered through four businesses, each clearly focused on its strategic priorities:

- PacifiCorp
- Infrastructure Division
- UK Division
- PPM

In each of the US and the UK, there is one business operating under regulation and one in competitive market conditions.

Business Review Description of Business

In the US, PacifiCorp operates as a regulated electricity business and the competitive energy business is PPM Energy, Inc. (PPM). Both are subsidiaries of PacifiCorp Holdings, Inc. (PHI) a non-operating, US holding company, itself an indirect wholly-owned subsidiary of ScottishPower. PHI is also the parent company of PacifiCorp Group Holdings which owns the shares of subsidiaries not regulated as domestic electricity providers, including PacifiCorp Financial Services, Inc.

In the UK, the regulated Infrastructure Division operates electricity transmission and distribution subsidiaries of the wholly-owned UK holding company Scottish Power UK plc (SPUK). Other subsidiaries comprise the group s competitive energy business, the UK Division, covering its British Isles generation assets, commercial and energy management activities and energy supply business units.

2 PacifiCorp

In November 1999, PacifiCorp and ScottishPower completed a merger under which PacifiCorp became an indirect subsidiary of ScottishPower. As a result of the merger, PacifiCorp developed and implemented significant organisational and operational changes arising from the strategic decision to focus on its electricity businesses in the western US and embarked upon a continuing programme of efficiency improvements.

Principal Business Activities

PacifiCorp is a regulated electricity company operating in portions of the states of Utah, Oregon, Wyoming, Washington, Idaho and California. As a vertically-integrated electricity business, PacifiCorp owns or controls fuel sources, such as coal and natural gas, and uses these fuel sources, as well as wind, geothermal and hydroelectric resources, to generate electricity at its power plants. This electricity, together with electricity purchased on the wholesale market, is transmitted over a grid of transmission lines throughout PacifiCorp s six-state region and is then transformed to lower voltages and delivered to end-use customers through PacifiCorp s distribution system. PacifiCorp conducts its retail electricity utility business as Pacific Power and Utah Power, and engages in electricity sales and purchases on a wholesale basis under the name PacifiCorp. The subsidiaries of PacifiCorp support its electricity utility operations by providing coal mining facilities and services and environmental remediation.

The western US energy market is experiencing growth in demand due to both increased customer numbers and underlying load growth. PacifiCorp continued its energy hedging strategy, maintaining a balanced loads and resources position through 2003. PacifiCorp has hedged its forecast load and resource balance and price exposure for 2004/05 and for summer 2005, when demand is expected to be supported by the commissioning of the first phase of the 525 MW Currant Creek plant in Utah. PacifiCorp also continued to invest in support of network safety, reliability and high-level performance, including targeted investments in areas of high demand growth. However, severe storms in late December 2003 and early January 2004 impacted the PacifiCorp network in northern Utah and parts of Oregon and California, increasing costs and leading to voluntary goodwill payments to those Utah customers who were without power for extended periods.

Retail Electricity Sales

PacifiCorp serves approximately 1.6 million retail customers in service territories aggregating about 135,000 square miles in portions of six western states. The geographical distribution of PacifiCorp s retail electricity operating revenues for the year ended 31 March 2004 was Utah, 39%; Oregon, 32%; Wyoming, 13%; Washington, 8%; Idaho, 6%; and California, 2%. In August 2003, PacifiCorp announced that it was discontinuing efforts to sell its California service area to the Nor-Cal Electric Authority and committed itself to continue to serve its more than 44,000 customers in Yreka, Crescent City, Alturas, Mt. Shasta and the surrounding communities.

The PacifiCorp service area s diverse regional economy mitigates exposure to economic swings. In the eastern portion of the service area, mainly Utah, Wyoming and south eastern Idaho, customer demand peaks in the summer when cooling systems and irrigation are heavily used. The principal industries are manufacturing, health services, recreation and mining or extraction of metals, coal, oil, natural gas, phosphates and elemental phosphorus. In the western part of the service territory, mainly consisting of Oregon, south eastern Washington and northern California, customer demand peaks in the winter months due to heating requirements and the economy generally revolves around agriculture and manufacturing, with pulp and paper, lumber and wood products, food processing, high technology and primary metals being the principal industries. During 2003/04, no single retail customer accounted for more than 2% of PacifiCorp s retail electricity revenues and the 20 largest retail customers accounted for 13% of retail electricity revenues. Trends in energy sales by class of customer are set out in Tables 3, 5 and 6 (page 31).

PacifiCorp serves some areas of rapidly changing population size and economic activity. In particular, a substantial part of the eastern service territory is in Utah and Idaho, states expected to be among the top ten states in the US for growth during the next few years. Additionally, recent warm summer temperatures are causing residential customers to install central air conditioning systems and are contributing to a faster summer peak growth. Commercial sales are positioned for growth in the eastern portion of the service territory, particularly Utah, because of strong population and economic viability and through Utah s central role in the manufacture, distribution and delivery of goods to surrounding western states. Wyoming is experiencing increasing industrial activity in its energy-related sectors, with increasing exploration and rig counts suggesting a positive trend in PacifiCorp s future sales to the industrial sector in the state.

Oregon, which has been experiencing recessionary conditions, nonetheless contains a number of communities showing high levels of growth suggesting the likelihood of an increasing pace of economic development and recovery across PacifiCorp service territories.

For the five years to 31 March 2009, the underlying annual growth in retail MWh sales in PacifiCorp s franchise service territories is estimated to be in the range of 1.5% to 2.6%, dependent upon factors such as economic growth, changes in customer numbers, weather, the potential effects on demand resulting from conservation efforts and changes in price. If prices increase in the region, demand growth over the region may slow.

Power Production and Fuel Supply

PacifiCorp owns or has interests in generating plants with an aggregate nameplate rating of 8,420 MW and plant net capability of 7,987 MW, see Table 1 (page 30). During 2003/04, approximately 73% and 5% of PacifiCorp s energy requirements were supplied by its thermal and hydroelectric generation plants respectively. The remaining 22% was obtained primarily through purchased power. The share of PacifiCorp s energy requirements generated by its own plants will vary from year-to-year and is determined by factors such as planned and unplanned outages, availability and price of coal and natural gas, precipitation and snowpack levels, environmental considerations and the market price of electricity. PacifiCorp will make use of existing long-term purchase contracts, and expects to choose appropriate cost-effective resources to meet the balance of its customer demand through new long- and short-term purchase arrangements, including those covering some 91 MW of wind power.

At 31 March 2004, PacifiCorp had 220 million tons of recoverable coal reserves that are mined by PacifiCorp s mining affiliates and are dedicated to nearby PacifiCorp-operated generation plants, see Table 2 (page 30). During 2003/04, these mines supplied some 30% of PacifiCorp s total coal requirements. Coal is also acquired through long-term and short-term contracts. Thirteen long-term coal contracts accounted for 68% of the overall 2003/04 requirements. The contract terms range from one to 19 years. PacifiCorp has also entered into long-term, fixed-price natural gas contracts to meet the forecasted needs of its existing natural gas-fired electricity generation plants to the end of calendar year 2006. Natural gas transportation capacity was purchased to meet the needs of the Currant Creek project, which is expected to start up in June 2005, and PacifiCorp has purchased most of its calendar year 2006 forecasted gas supply needs for the Currant Creek project.

To manage future generation needs and meet environmental objectives, PacifiCorp developed an Integrated Resource Plan (IRP), filed in January 2003 and updated in October 2003. The IRP is reviewed and updated every two years and provides a framework which will allow PacifiCorp to continue to select optimal solutions from a mix of renewable, thermal, market purchase and demand side management choices and will guide specific build or buy decisions made dependent on permitting, siting, emissions, cost recovery and economic conditions. Regulators in many of the states in which PacifiCorp operates have acknowledged the 2003 IRP. Costs incurred by PacifiCorp to provide a service to its customers are expected to be included as allowable costs for ratemaking purposes. However, under the US regulatory compact , PacifiCorp must demonstrate to regulators that the incurred costs are both reasonable and necessary to the provision of safe, adequate, reliable and efficient electricity utility services to its retail customers and that the decisions were made in a prudent manner.

Action items from PacifiCorp s 2003 IRP have been pursued in the Requests for Proposals (RFP) process which seeks to identify PacifiCorp s future resource mix though a programme coordinated with stakeholders in the six states it serves. From the first of the RFPs, PacifiCorp determined that the construction of a new 525 MW gas-fired plant in Utah, would be the lowest risk and most economical 2004/05 resource category choice to meet future generation needs. The plant will be named Currant Creek. The Utah Public Service Commission (UPSC) has given its approval for construction of the plant and the Utah Division of Air Quality issued its final approval order in May 2004. The plant is expected to come on-line in two phases over 2005 and 2006. On 10 May 2004, PacifiCorp announced that, following a thorough review of proposals submitted, it had identified the Summit Vineyard LLC proposal for the construction of a 534 MW Lake Side Power Plant near Salt Lake City, Utah as the best option to meet the long-term resource requirements of its customers. PacifiCorp s filing for a Certificate of Convenience and Necessity for the development could take up to six months to complete and is intended to facilitate a summer 2007 introduction of the plant. In February 2004, PacifiCorp issued a further RFP seeking up to 1,100 MW of new renewable resources across its service territories over the next seven years.

Wholesale Sales and Purchased Electricity

In addition to its base of thermal, renewable and hydroelectric generation assets, PacifiCorp uses a mix of long-term, short-term and spot-market purchases to balance its load and wholesale obligations. PacifiCorp enters into wholesale purchase and sale transactions to provide hedges against periods of variable generation or variable retail load. Generation varies with the level of outages or transmission constraints and retail load varies with the weather, distribution system outages and the level of economic activity. During the year ended 31 March 2004, 22% of PacifiCorp s energy requirements were supplied by electricity purchased under short- and long-term arrangements. For the year ended 31 March 2003, 23% of PacifiCorp s energy requirements were supplied by purchased electricity under short-and long-term purchase arrangements. During 2003/04, there was a slight decline in short-term wholesale sales and a broadly parallel reduction in short-term purchases with an overall increase in the use of owned generation and longer-term

purchases. PacifiCorp s wholesale transactions are integral to its retail business, providing for a balanced and economically hedged position and enhancing the efficient use of its generating capacity over the long term. PacifiCorp s transmission system is available for common use consistent with open access regulatory requirements and connects with market hubs in the Pacific Northwest to provide access to what is normally low-cost hydroelectric generation and also to the south western US, which provides access to normally higher-cost fossil-fuel generation.

Under the requirements of the Public Utility Regulatory Policies Act of 1978, PacifiCorp purchases the output of qualifying facilities constructed and operated by entities that are not public utilities. During 2003/04, PacifiCorp purchased an average of 108 MW from qualifying facilities, compared to an average of 101 MW in 2002/03.

3 Infrastructure Division

Three wholly-owned subsidiaries of SPUK SP Transmission Limited, SP Distribution Limited and SP Manweb plc are the asset-owner companies holding the group s UK regulated assets and transmission and distribution licences. A further wholly-owned subsidiary of SPUK SP Power Systems Limited (PowerSystems) provides asset management expertise and conducts the day-to-day operation of the networks.

Principal Business Activities

The asset-owner companies act as an integrated business unit to concentrate divisional expertise on regulatory issues and investment strategy. PowerSystems implements work programmes commissioned by and agreed with the asset-owner business. Strict commercial disciplines are applied at the asset owner-service provider interface, with PowerSystems operating as a contractor to the transmission and distribution business unit. An integrated senior management team within the Infrastructure Division applies the benefits of growing expertise in asset ownership, financing and operational service provision to the management of the group s regulated networks businesses in both the UK and the US.

Transmission and Distribution

ScottishPower owns and manages a substantial UK electricity transmission and distribution network which extends to over 115,000 km, with 67,100 km of underground cables and 48,400 km of overhead lines, comprising both the distribution system to customers in its two authorised areas and, in Scotland, its high-voltage transmission system (132 kilovolt (kV) and above, including those parts of the England-Scotland interconnector which are in its Scottish authorised area). Table 9 (page 32) shows key information with respect to the division s transmission and distribution services in 2003/04. These networks are operated under licences issued by the Gas and Electricity Markets Authority (the Authority) and held by the transmission and distribution businesses, which are entitled to charge for the use of the systems on terms approved by the Authority under various price control formulae.

The management focus of the transmission and distribution business is to outperform allowed regulatory returns from the provision of efficient, coordinated and economical networks which are open to licensed users on a non-discriminatory basis (in order to facilitate competition in

generation and supply) and operated to approved standards of safety and reliability. The business is also engaged in continuing work with the Office of Gas and Electricity Markets (Ofgem) and the rest of the industry to develop the price control framework to allow increased investment to secure the long-term safety, reliability and sustainability of the electricity infrastructure in Great Britain and to invest in network development to support the UK Government s planned expansion of renewable generation.

The income derived from the distribution business is dependent on the demand for electricity by customers in the authorised areas. Demand for electricity is affected by such factors as growth and movements in population, social trends, economic and business growth or decline, changes in the mix of energy sources used by customers, weather conditions and energy efficiency measures. Tables 10 and 11 (page 32) set out the demand in gigawatthours (GWh) by customer type within the broadly stable levels of electricity transported over the distribution systems in the ScottishPower and Manweb home areas during the five most recent financial years.

Asset Management

Within the PowerSystems business unit, the focus continues to be on cost-effectiveness and service quality improvement. Its principal business activities involve the construction and refurbishment of the UK transmission and distribution systems, their maintenance and related fault repair. PowerSystems acts as the major service provider to the ScottishPower transmission and distribution business and as the primary customer contact agent for network-related matters. PowerSystems continues to focus strongly on the efficient delivery of these services under contract. The regulatory framework provides financial incentives to improve network performance and customer satisfaction. PowerSystems is focused on maximising the financial benefit to be obtained from these incentives over the course of the current price control period.

Some 23% of the division s investment programme is devoted to organic growth areas such as new customer connections and network reinforcement. PowerSystems has continued to maintain a joint venture with Alfred McAlpine Utility Services Limited, called Core Utility Solutions Limited, to take advantage of the opportunities presented by the requirement for competitive provision of connections to distribution networks.

4 UK Division

The UK Division operates in gas and electricity markets which became fully competitive with the ending of residual price controls on 31 March 2002; although Ofgem continues to enforce licence conditions and regulate quality of service. The division comprises five wholly-owned subsidiaries: ScottishPower Generation Limited owns and operates the power stations and other generation assets in the British Isles and holds the group s generation licence; ScottishPower Energy Management Limited and ScottishPower Energy Management (Agency) Limited deal in gas and electricity at the wholesale level and in the commercial instruments and agreements which constitute the market balancing mechanisms for the competitive energy market in the UK; ScottishPower Energy Retail Limited is the gas and electricity supply company and holder of the group s supply licences, managing pricing, selling, billing and receipting for gas and electricity supply to both business and domestic customers and dealing with enquiries arising in the course of this business; and SP Dataserve Limited is the data management and metering company, managing the data processes which underpin customer registration through to billing and settlement.

The divisional management team oversees activities across the energy value chain, maximising value from a diverse generation portfolio through to a national customer base of 4.25 million, via an integrated commercial and energy management activity that acts to balance and hedge energy needs. In 2003/04, wholesale energy prices recovered from the historic lows of 2002/03 although, in light of the emphasis on a market-based framework for energy policy set out by the UK Government in February 2003, wholesale energy markets face the prospect of continuing structural and contractual changes. As an active market participant, the division engages fully in regulatory and contractual debate and in the consultation processes following the Government s review of energy policy. In the meantime, the division aims to leverage the benefits of its flexible generation asset base and commercial operations to deliver sustained earnings through improved business processes and customer service and to develop its position in renewable generation.

Principal Business Activities

The UK Division operates ScottishPower s generation assets in the British Isles, manages the company s exposure to the wholesale electricity and gas markets and is responsible for energy supply: the sales and marketing of electricity and gas to customers throughout Great Britain, together with the associated customer registration, billing and receipting processes and handling enquiries in respect of these services.

Power Plant Portfolio, Fuel Strategy and Generation Sales

The UK Division operates some 5,400 MW of generating capacity, see Table 8 (page 32) comprising coal, gas, hydroelectric and wind power generation assets, giving the division a particularly flexible portfolio. Acquisition of additional thermal generation capacity is kept under continuing review but purchases will only be made at value-enhancing prices and the current market is characterised by over-capacity. The restated public policy emphasis on renewable generation and the extension to 2015 of the Renewables Obligation Certificates scheme targets provide the context for continued expansion of the windfarm business which, at 31 March 2004, had operational windfarms totalling 158 MW, planning applications for a further 920 MW and environmental assessments begun on around 560 MW of further potential sites to ensure that the company target of 10% of supply from renewables by 2010 is met.

ScottishPower s fuel purchasing strategy is based upon the objective of achieving competitive fuel prices while balancing the need for security and flexibility of supply. The major components of the fuel portfolio are coal and gas, both fuels being sourced through a combination of long-term contracts and shorter-term trading. The division has three long-term contracts with terms of greater than five years for supply from major gas fields.

Generation output is managed in order to hedge risk and optimise the position in the balancing market. In 2003/04, some 19 terawatt hours (TWh) were despatched, both to contribute towards the approximately 33 TWh of retail and wholesale demand provided by the division and to maintain export volumes through the interconnectors to England & Wales and to Northern Ireland.

Energy Management and Commercial Arrangements

In addition to its own generation capacity and long-term bulk gas contracts the UK Division has access to additional generation under contract. Through its commercial and energy management operations, the division uses medium and short-term contractual arrangements to complete its energy purchase requirements and to sell its generation output into the electricity market in Scotland and, through the interconnectors, to England & Wales and to Northern Ireland. The Energy Bill intended to facilitate a Great Britain-wide market through the British Electricity Trading and Transmission Arrangements (BETTA) was introduced into Parliament in November 2003, although the new arrangements are now not expected to become effective until April 2005 at the earliest. BETTA is expected to have only a modest impact on end-user prices and the focus of consultation is now on transmission charging in a Great Britain-wide market, particularly in the light of the policy emphasis on renewables.

Through its activities in the electricity, gas and coal markets, ScottishPower s energy management business secures competitive advantage for the UK Division through hedging and optimising its position across the energy value chain, continuously evaluating and managing risk exposure. ScottishPower s Hatfield Moors gas storage site enhances the flexibility of the division s energy management position, both in meeting peak demands of supply customers and responding to the volatility of gas prices between midweek and weekends. In

addition, the bulk gas contracts allow the gas to be sold out or used in the division s power stations, giving yet more flexibility. A planning application for a 6 billion cubic feet (BCF) gas storage facility at Byley, Cheshire was approved in May 2004, following a public inquiry in late 2002.

The New Electricity Trading Arrangements, introduced into England & Wales in March 2001, provided for a direct contracting, pay-as-bid process between generators and suppliers, with imbalances between actual and contracted positions settled through a balancing mechanism intended to lead to more cost-reflective prices and more effective management of risk. In this context of a fully competitive energy market, the division has renegotiated or ended a number of long-term contracts put in place before privatisation in 1991 under which it was obliged to pay non-market-based rates for electricity from the nuclear plants of British Energy (BE) and the Peterhead power station and hydro plants of Scottish and Southern Energy (SSE). Necessary regulatory approvals have been received and the revised arrangements with BE took effect in November 2002, providing a benefit of some £25 million a year. Removal of the relevant contracts with SSE will take effect from April 2005, providing a further anticipated saving of around £20 million a year from 2005 onwards.

Energy Supply

Since September 1998 when, under the provisions of the Electricity Act, competition was extended to residential electricity customers, the strategic focus of the ScottishPower energy supply business has been the defence of its core markets, residential and small business customers in the ScottishPower and Manweb home areas, whilst seeking profitable additional business outside these historical regional boundaries. Retention of home area residential customers stands at 60% whilst targeted sales efforts, strategic marketing alliances, such as NESTMakers, the partnership with Sainsbury s and the use of e-commerce channels have helped develop a Britain-wide customer base which now stands at 4.25 million energy accounts. The business improvement programme introduced in 2001 continues to drive improvements across the retail supply business and has helped to deliver increased direct debit penetration and reduced customer churn rates in addition to cost benefits in areas such as billing, debt and customer registration business processes.

Metering and Data Management

In the competitive energy market SP Dataserve Limited (Dataserve) operates end-to-end process and data management in order to maximise efficiencies in the provision and control of registration and metering data for ScottishPower and other agency arrangements. Data management covers the establishment of new customers, maintenance of existing customers and accuracy of energy settlement. To effectively manage gas and electricity customers, Dataserve has continued to contribute to improvements in billing performance through the management of the agents, who provide much of the data.

5 PPM

PPM, the group s competitive US energy business, is a fast-growing energy provider, with operating assets in eight US states and in Canada. Its diverse portfolio, focus on wind power and moderate risk approach position PPM for continued earnings growth in 2004/05. PPM commenced substantive operations in 2001 (operating until January 2003 as PacifiCorp Power Marketing, Inc.) and is growing through a strategic focus on clean energy; concentrating on renewable power, natural gas storage and hub services and gas-fired generation.

Principal Business Activities

PPM s principal assets are thermal and renewable generation resources and natural gas storage facilities, including gas storage assets in western Canada and Texas. PPM creates value by securing quality assets at strategic locations and by locking in value with long-term contracts with creditworthy customers. Integration of plant operations, contract dispatch and energy management add additional value. The optimisation benefits come from displacing plant operations with low-priced electricity purchases, selling the displaced gas or placing it in storage, as well as using transmission and contract delivery flexibility to manage locational price differences in both gas and electricity. PPM aims to leverage the benefits of its flexible asset base and contracts to extract value across gas and electricity.

Power Production and Wholesale Sales

PPM has more than 1,600 MW of operating assets currently under its ownership or control and, of that, PPM has full economic interest in 1,368 MW, see Table 7 (page 31). PPM balances its supply and sales, selling a substantial amount of its supply forward under long-term contracts. In its electricity business, PPM serves a wide variety of wholesale energy customers including municipal agencies, public utility districts and investor-owned utilities. During 2003/04, the number of long-term customers served by PPM s wholesale electricity business grew from 6 to 18. These customers are primarily located in wholesale energy markets served by the 1.8 million square mile Western Electricity Coordinating Council service territories in the western US and the Mid-Continent Area Power Pool service territories in the upper midwest US.

Wind Power

PPM is the second largest provider of wind energy in the US. Six projects were completed in December 2003 bringing the total added during the calendar year to 528 MW and the total wind power under PPM s control to more than 830 MW. PPM continues to place much of its renewable energy output under long-term contracts. For example, all output from the new 162 MW Colorado Green windfarm has been sold under a 15-year agreement to supply the Public Service Company of Colorado. PPM has also developed the 51 MW Moraine Wind Power

Project in southwest Minnesota in conjunction with a long-term power sales agreement signed with the regional regulated utility, Northern States Power Company, and completed the development of the 44 MW Flying Cloud Wind Project in Iowa, which includes a 15-year agreement to sell power to Interstate Power & Light, a subsidiary of Alliant Energy. Approximately 80% of the wind power under PPM s control has been sold under long-term contract with the balance hedged under multi-year forward power sales.

Gas Storage and Hub Services

PPM s two major gas storage facilities are in Alberta, Canada and in Katy, Texas. Each is connected into substantial pipeline networks serving well-diversified customer bases under firm, long-term and short-term contract arrangements. In addition to the 44 BCF of gas storage capacity under its ownership during calendar year 2003, PPM has increased its available gas storage capacity by 23 BCF for calendar year 2004 through contracting for capacity in third-party storage facilities in western Canada, Texas and California. This capacity will be used, along with existing facilities, to extend PPM s energy management and hub services and represents one of a number of development opportunities identified to grow PPM s gas storage business at selective locations over the next several years. PPM also has begun development of a 7.2 BCF high-deliverability salt cavern gas storage project in west Texas.

6 Group Employees

US Businesses PHI and its subsidiaries had 6,704 employees at 31 March 2004, of which PacifiCorp and its subsidiaries had 6,507 and PPM and its subsidiaries 194. Approximately 58% of the employees of PacifiCorp and its mining subsidiaries are covered by union contracts, principally with the International Brotherhood of Electrical Workers, the Utility Workers Union of America and the United Mine Workers of America. In the company s judgement, employee relations in the US businesses are satisfactory.

UK Businesses ScottishPower and its UK subsidiaries had 8,117 employees, at 31 March 2004. Of these, 3,324 were employed in the Infrastructure Division and 4,793 in the UK Division. Approximately 56% of employees in the UK are union members, and 79% are covered by collective bargaining arrangements. In the company s judgement, employee relations in the UK businesses are satisfactory.

Human Resources Strategy

In 2003/04, plans were developed and implemented to give effect to the human resources strategy approved by the Board in July 2002, which aims to ensure that the business achieves superior results through the high performance of its employees. This is being achieved by strategic efforts to ensure that, wherever they work across the group, employees share a consistent, positive experience of working for ScottishPower which encourages and supports high personal performance. The key strategic initiatives to support the strategy include a strong commitment to leadership development, talent management to build organisational competencies and succession, a strong emphasis on continuously improving performance in health and safety, and efforts to improve employee engagement through a positive working climate.

A new group health and safety governance process was approved by the Executive Team in November 2002 and was implemented in 2003/04, with the Group Health & Safety Executive Committee composed of US and UK members meeting on a quarterly basis. Following extensive consultation and internal communication, a new group health and safety strategy was implemented in 2003/04. As part of the strategy, a new Group Health & Safety Framework composed of a new Group Policy and Health & Safety Standards was also approved for application group-wide. During November and December 2003, baseline assessments were undertaken using the new assessment protocol to measure the

performance of business units against standards set on a world-class health and safety scoring scale.

Employee Consultation

An annual survey is conducted across all businesses to provide a measure of employees perception of the company s direction and their sense of empowerment, value, training and development and of manager communication. Survey results are shared with all employees, reviewed by the Executive Team and used in each business to set targets and action plans for the following year. In addition, individual businesses use surveys and other tools to understand the issues that fall within their specific areas of responsibility and regular consultation takes place using a variety of means including monthly team meetings, team managers conferences, business unit road shows, safety committees, presentations, focus groups and employee magazines. Senior managers across the business meet with a cross-section of employees on a regular basis and with trade union representatives in joint consultations on issues of mutual interest.

Further details of group workplace policy and performance can be found in the ScottishPower Environmental and Social Impact Report and the ScottishPower Workplace Performance Report. Both are available on the ScottishPower website. The company also operates a number of all-employee share plans (see page 75).

7 Group Environmental Policy

ScottishPower recognises the need for a responsible business to embrace a wider role in society and to engage fully with shareholders, staff, communities, customers and other opinion formers. It aims to do this transparently, through an international framework, to ensure that key

principles are translated into action. This framework comprises overall international visionary goals; and specific goals for the US and UK. Performance towards meeting these goals is tracked through carefully chosen Key Performance Indicators, closely related to business unit objectives. ScottishPower s strategy is to become a leading international energy company. Hence, it must strive to achieve a balance between various needs including securing energy supply now and into the future, keeping energy affordable and minimising its impact on the environment.

Policy frameworks in the US and UK have common elements, particularly in using market instruments for air quality regulation and supporting renewables and energy efficiency measures. In the US, numerous Congressional proposals on multi-pollutant regulation feature tradable credits intended to provide cost-efficiency and flexibility in meeting emissions limits. Efforts continue in Congress to extend the renewable energy production tax credit, which helps to make new wind projects price-competitive in many US electricity markets. Also, efforts continue to create viable markets for renewable generation at the state level, most notably in California. The UK Government and the European Commission (EC) are developing firm proposals for the implementation of the European Union (EU) Emissions Trading Scheme which is scheduled to bring a mandatory emission trading regime into force in 2005. The UK Energy White Paper, published in February 2003, doubled the UK renewables target of 10% by 2010 to 20%, to be achieved by 2020. Energy saving and energy services received a boost, while resources were identified to support new clean coal. In Scotland, the Scottish Executive has announced the target of achieving 40% of electricity generation from renewable sources by 2020. This is being carried out at a time when network operators and the UK regulator, Ofgem, are engaging in discussions which recognise the need to set network upgrades in the context of future network development for renewables and embedded generation.

The group continues to develop specific policies to respond to these regulatory challenges, aiming to grow its business sustainably in new energy markets, to invest in renewables and clean-coal technology and to ensure that customers benefit from innovations in energy efficiency. It also aims to manage existing coal-fired assets responsibly, applying appropriate abatement technologies to reduce its environmental footprint whilst supporting security of supply and affordability of power for its customers. The lines of accountability for environmental policy are focused through the policy making Energy and Environment Committee, chaired by the Chief Executive and with direct reporting lines to ScottishPower s Executive Team.

Further details of group environmental policy and performance can be found in the ScottishPower Environmental and Social Impact Report and the Environmental Performance Report. Both are available on the ScottishPower website.

8 Charitable Contributions

In order to encourage comparability, the group uses the London Benchmarking Group (LBG) model to evaluate its community support activity groupwide. The LBG model is a standard for community reporting adopted by over 80 leading UK companies and ScottishPower s use of the model is reviewed each year by the LBG to help ensure the evaluation principles are correctly and consistently applied. During 2003/04, ScottishPower companies contributed £6.2 million in community support activity. This incorporated £600,000 categorised by the LBG model as charitable gifts, £4.8 million of community support activity categorised as community investment and £760,000 categorised as commercial initiatives in the community given in cash, through staff time and in-kind donations by the company s US and UK operations. An additional £1.2 million of charitable support was made through the PacifiCorp Foundation for Learning, which is fully endowed by ScottishPower companies.

Further details of group community engagement policy and performance can be found in the ScottishPower Environmental and Social Impact Report and the Marketplace & Community Performance Report. Both are available on the ScottishPower website.

9 Description of the Company s Property

US Businesses The US properties consist primarily of generating facilities, electricity transmission and distribution facilities, coal mines and a number of office facilities. Substantially all of PacifiCorp s electricity plants are subject to the lien of PacifiCorp s Mortgage and Deed of Trust.

PacifiCorp owns or has an interest in 54 hydroelectric generating plants. These have an aggregate nameplate rating of 1,077 MW and plant net capability of 1,164 MW. It also owns or has interests in 16 thermal-electricity generating plants with an aggregate nameplate rating of 7,310 MW and plant net capability of 6,790 MW. PacifiCorp also jointly owns one wind power generating plant with an aggregate nameplate rating of 33 MW and plant net capability of 33 MW. Table 1 (page 30) sets out key aspects of PacifiCorp s existing generating facilities. These generating facilities are interconnected through PacifiCorp s own transmission lines or by contract through the lines of others. Substantially all of PacifiCorp s generating facilities and reservoirs are managed on a coordinated basis to obtain maximum load carrying capability and efficiency. Portions of PacifiCorp s 73,000 miles of transmission and distribution networks are located, by franchise or permit, upon public lands, roads and streets and, by easement or licence, upon the lands of other third parties. Table 4 (page 31) sets out further information regarding the PacifiCorp networks.

PacifiCorp s coal reserves are described in Table 2 (page 30). Most are held pursuant to leases from the federal government through the Bureau of Land Management and from certain states and private parties. The leases generally have

multi-year terms that may be renewed or extended and require payment of rentals and royalties. In addition, federal and state regulations require that comprehensive environmental protection and reclamation standards be met during the course of mining operations and upon completion of mining activities.

PPM has more than 1,600 MW of operating assets currently under its ownership or control and, of that, PPM has full economic interest in 1,368 MW, see Table 7 (page 31). The majority of PPM s capacity, 606 MW of wind power contracted for a period of 25 years and 237 MW of thermal power contracted for a period of 30 years, comes from long-term agreements while 525 MW comes from outright ownership of six wind plants and two thermal plants. PPM s windfarms are on land owned or leased for 25 years or more. PPM also owns major gas storage facilities in Alberta, Canada and in Katy, Texas representing a total of 44 BCF of gas storage capacity.

UK Businesses The UK properties consist of generating stations, transmission and distribution facilities and certain non-operational properties in which the company holds freehold or leasehold interests.

ScottishPower owns seven power stations in Scotland, five of which are operational and two in England. It also owns three windfarms in Northern Ireland, six in Scotland, and one in the Republic of Ireland. In addition, the company has joint venture interests in one power station in England and three windfarms, two of which are in England and one in Wales. All generation plant is owned by the group, with the exception of the non-operational Methil power station, which is held on a ground lease that expires in 2012, and the windfarms which are generally held on ground leases of at least 25 years duration. See Table 8 (page 32) for further details of operational generation assets.

At 31 March 2004, the UK transmission facilities included approximately 4,000 circuit km of overhead lines and underground cable operated at 400 kV, 275 kV and 132 kV. In addition, the distribution facilities included over 110,000 circuit km of overhead lines and underground cable at voltages operating from 33 kV to 0.23 kV. The group holds either permanent rights or way leaves which entitle it to run these lines and cables through private land. See Table 9 (page 32) for further details.

10 Description of Legislative and Regulatory Background

As a public limited company (plc), Scottish Power plc is subject to the UK Companies Acts and is also registered as a holding company under the US federal Public Utility Holding Company Act of 1935, which is administered by the US federal Securities and Exchange Commission (SEC). Hence, Scottish Power plc, PacifiCorp and other subsidiaries are subject to regulation unless specific subsidiaries or transactions are otherwise exempt by SEC rules or orders. SPUK and its subsidiaries are exempt because SPUK is an exempt foreign utility as defined in the 1935 Act. Whereas US federal and state regulatory commissions generally have jurisdiction over mergers, acquisitions and the sale of utility assets, the UK Government, as a way to maintain control over ScottishPower and certain of its subsidiaries, required at privatisation the issuance of a ScottishPower Special Share . The Special Share only affected corporate control transactions at the overall group holding company level and had no effect on PacifiCorp. On 5 May 2004, the UK Government announced the redemption of the Special Share, following a review which concluded that public policy objectives are now adequately protected by the legal and regulatory framework currently in place.

ScottishPower s UK operations are subject to such EU Directives as the UK Government brings into effect, specifically, the EU energy liberalisation directives and EU prohibitions on anti-competitive agreements and the abuse of a dominant position (implemented through the Competition Act 1998, which came into effect from 1 March 2000) and also to the provisions of the Utilities Act 2000 (Utilities Act). The Utilities Act introduced a legal framework for energy company licences based on standard, UK-wide conditions and, taken together with requirements of the Department of Trade and Industry (DTI) and licence changes introduced by the Regulators, defines the regulatory framework within which SPUK and its subsidiaries must operate.

A summary of the more specific legislative and regulatory background to the operations of the group s businesses is set out below.

11 US Business Regulation

PacifiCorp is subject to the jurisdiction of the public utility regulatory authorities in each of the states in which it conducts retail electricity operations. These authorities regulate various matters including prices, services, accounting, issuance of securities and other matters. PacifiCorp is a licensee and a public utility as those terms are used in the Federal Power Act (FPA) and is, therefore, subject to regulation by the Federal Energy Regulatory Commission (FERC) as to accounting policies and practices, certain prices and other matters.

Because PPM does not conduct retail electricity operations, it is not subject to the same state public utility commission regulation as PacifiCorp. However, certain of its wholesale activities are regulated by the FERC and the state commissions impose certain limitations on affiliate transactions. In addition, PPM s gas storage activities in Texas are subject to regulation by the FERC and the Texas Railroad Commission and those in Canada by the Alberta Energy and Utilities Board.

FERC Issues

California refund case PacifiCorp is one of a number of parties to a FERC investigation of potential refunds for energy transactions in California during past periods of high-energy prices and, in 2001/02, established a provision of $17.7 million for these potential refunds. PacifiCorp s ultimate exposure to refunds is dependent upon any final order issued by the FERC in this proceeding.

Business Review Description of Legislative and Regulatory Background

FERC show-cause orders In August 2003, PacifiCorp and the FERC staff reached a resolution on the FERC order to show why various parties behaviour during the California energy crisis did not constitute manipulation of the wholesale electricity market. Under the terms of the settlement agreement, PacifiCorp denied liability and agreed to pay a nominal amount of $67,745 in exchange for complete and total resolution of the issues raised relating to it in the FERC s show-cause order. The FERC issued its final order approving the settlement in March 2004. Several market participants have requested a rehearing of the FERC s approval and a decision on a rehearing is expected from the FERC during the summer of 2004. In January 2004, the FERC dismissed PPM from the show-cause proceedings, finding that PPM did not engage in prohibited practices during the relevant period and indicating in the motion to dismiss several reasons why PPM s behaviour did not constitute manipulation of the wholesale electricity market.

Northwest refund case In June 2003, the FERC terminated its proceeding in this case, concluding that ordering refunds would not be an appropriate resolution of the issues relating to wholesale spot-market bilateral sales in the Pacific Northwest between 25 December 2000 and 20 June 2001. In November 2003, the FERC issued its final order denying a requested rehearing. Several market participants have filed petitions in the court of appeals for review of the FERC s final order.

Federal Power Act Section 206 case In November 2003, the FERC also issued its final order denying a rehearing of PacifiCorp s request for recovery of excessive prices charged under certain wholesale electricity purchases scheduled for delivery during summer 2002. Appeals for review of the FERC s final order by PacifiCorp and Morgan Stanley Capital Group, Inc. were transferred to the D.C. Circuit Court of Appeals for consolidation in December 2003. PacifiCorp obtained dismissal of the Morgan Stanley appeal, and requested transfer of the case back to the US Court of Appeals for the Ninth Circuit.

FERC market-based rates In February 2004, PPM s Katy Storage and Transportation business unit was granted market-based rate-making authority subject to re-examination if there is a significant change to Katy s market power status.

12 Regulation of PacifiCorp

Multi-State Process (MSP)

PacifiCorp is involved in a collaborative process with stakeholders in the six states it serves to develop mutually acceptable solutions to the issues faced by PacifiCorp and the states as a result of the operations of a multi-state utility. MSP seeks to clarify roles and responsibilities, including cost allocations for future generation resources, to provide states with the ability independently to implement state energy policy objectives and to achieve a permanent consensus on each state s responsibility for the costs and entitlement to the benefits of PacifiCorp s existing assets. Between April 2002 and July 2003, PacifiCorp and key parties from the states it serves (or, in the case of California, a key monitoring contact) analysed over 50 options which were narrowed to two possibilities. Following the July 2003 meeting, PacifiCorp undertook extensive analytical work to develop a single proposal that would best balance its needs and the requirements of the states in addressing the positions, issues and concerns raised and discussed during the course of the collaborative and individual state meetings. This work culminated in a regulatory filing in September 2003 in the states of Utah, Oregon, Wyoming and Idaho. A similar filing was made in Washington in December 2003 as part of the general rate case filing. A filing in California will follow, coordinated with rate case activity. Utah, Oregon and Wyoming continued formal and informal meetings among the states and commissions over the months to May 2004. Direct and rebuttal testimony is expected to be filed over May and June 2004, with hearings scheduled for July 2004. In Washington, hearings are scheduled for August/September 2004 with a probable order date of mid-November 2004.

Regional Transmission Organization (RTO)

PacifiCorp, in conjunction with nine other utilities, is seeking to form a Regional Transmission Organization (RTO), now to be known as Grid West, in response to the FERC s Order 2000. Creation of the RTO is subject to regulatory approvals from the FERC and state regulatory commissions. In September 2002, the FERC found that, with some modification and further development of certain details, the RTO proposal satisfies the 12 characteristics and functions in the FERC s Order 2000. Concerns raised by regional stakeholders about the RTO proposal have resulted in a renewed regional process to develop a staged approach to RTO formation that provides for enhanced regional input and accountability. The RTO, if and when fully implemented, would serve as an independent transmission provider for the RTO region and have the operational authority needed to direct bulk wholesale electricity transfers over a majority of the 60,000 miles of transmission lines owned by its members. Under the current proposal the RTO would have operational control but PacifiCorp would continue to own its transmission assets.

In July 2002, the FERC issued a Notice of Proposed Rulemaking, proposing a new Standard Market Design for wholesale electricity markets. The FERC subsequently issued a Wholesale Power Market Platform white paper in April 2003, which signalled a greater willingness to defer to regional solutions and not adopt overly prescriptive rules. After the Standard Market Design white paper was released, the Grid West filing utilities, operating through the Regional Representatives Group, a formal regional stakeholder body, developed a consensus of regional issues and opportunities and

unanimously approved a proposal for future progress. The Regional Representatives Group is currently developing an implementation plan for this regional proposal, which includes timing for seating an independent Board of Trustees, obtaining the necessary regulatory approvals and the first phase of operation by an independent regional operator. PacifiCorp expects that, in its final rule, the FERC will allow implementation schedules to vary depending on local needs and will allow for local differences. The FERC is closely monitoring any pending legislation in the US Congress and has not yet set a date for issuing the final rule.

Relicensing of Hydroelectric Projects

PacifiCorp s hydroelectric portfolio consists of 54 plants with a net plant capability of 1,164 MW, about 15% of PacifiCorp s total generating capacity. The majority of the hydroelectric generating portfolio is operated under licences from the FERC, granted for periods of 30 to 50 years. There is a complex regulatory process to apply for licence renewal which begins five and a half years before the expiration of an existing licence and involves a number of federal and state agencies, Native American tribes, as well as other stakeholders. Some state and federal agencies have mandatory authority to require certain terms and conditions to be included in the FERC licence. Often existing licences expire prior to the FERC s issuing of a new licence. In these cases, the FERC has historically issued annual operating licences so that the project can continue to operate while alternatives are evaluated; the FERC is continuing this practice.

In order to facilitate the licensing process, PacifiCorp may agree to early implementation of expected licence conditions, or settlement terms, if a settlement has been reached with licensing stakeholders. The cost of these measures, together with the costs for hydroelectric relicensing, are expected to be included in rates and, as such, not to have a material adverse impact on the group s consolidated results of operations. During calendar year 2003, PacifiCorp filed general rate cases in Utah, Oregon, Wyoming and Washington, which included each state s portion of the relicensing process costs associated with the projects where new licenses have become effective or are close to being issued by the FERC. In Oregon and Utah, the general rate cases ended in a commission approved settlement, and the commissions did not contest the hydroelectric relicensing costs. In Wyoming, the commission s general rate case order did not challenge the hydroelectric relicensing costs included in the test year, whilst, in Washington, the recovery of relicensing costs is among the issues being considered in the current rate case, which is expected to conclude by November 2004.

Regulatory Established Returns

The regulatory commissions in the various states where PacifiCorp operates approve an appropriate level of cost recovery for debt, preferred equity and common equity which results in an allowed return on rate base costs (ROR), including an allowed return on equity (ROE) representing the return on shareholder investment. Determination of these returns, and the composition of the investment costs included in the rate base, is made by the commissions in hearings on general rate cases. Rates are then set to allow PacifiCorp the opportunity, with no guarantees, to meet its expenses, recover its investments and earn the allowed ROE for its shareholders. PacifiCorp is currently pursuing a regulatory programme in all states, with the objective of keeping rates closely aligned to ongoing costs. In recently completed general rate cases, regulators in Utah, Oregon and Wyoming allowed full cost recovery on new investments for growth. This includes recovery of the investment costs themselves through inclusion in regulatory rate base, as well as recovery of operation and maintenance expenses. In addition, PacifiCorp is requesting similar cost recovery and rate base treatment of growth investments in a general rate case now in process in Washington and will include recent investments for growth in regulatory rate base calculations for future general rate cases in Idaho and California.

Commissions in all states served by PacifiCorp monitor PacifiCorp s achieved ROE for appropriateness in current market conditions. PacifiCorp continues to refine its internal procedures and to work with the commissions to ensure that all prudently incurred costs are reflected in its rates and that actual rates achieve allowable ROE levels. General rate adjustments reflecting changes in the regulated cost base granted in Utah, Oregon, Wyoming and California during 2003/04 have an annualised value of almost $100 million. In addition, PacifiCorp has a general rate case pending in Washington seeking approximately $27 million of proposed annual price increases to recover system investments and rising costs, including insurance, pension, healthcare, power, infrastructure and security costs. The Washington case should be completed by November 2004. Further rounds of rate cases are under consideration or development in most of the states served by PacifiCorp. As with any general rate case, the outcome of these requests is uncertain.

Recovery of Excess Power Costs

PacifiCorp has made progress towards recovering the deferred power costs incurred during the period of extreme volatility and unprecedented high price levels beginning in the summer of 2000 and extending through the summer of 2001. The Utah portion of these costs has been recovered through rate orders amounting to $147 million and recovery continues of $131 million plus ongoing carrying charges in Oregon and $25 million in Idaho. The Oregon rate order is the subject of an appeal by intervening parties which, if successful following oral arguments in May 2004, could require some refunds. In Wyoming, PacifiCorp s request for deferred power cost recovery was denied, a decision which has now been appealed to the Wyoming Supreme Court. On 30 April 2004, PacifiCorp filed another challenge to the decision in the US District Court for Wyoming, requesting recovery of over $150 million for wholesale power and transmission costs previously denied by

the Wyoming Public Service Commission (WPSC). In Washington, PacifiCorp filed for deferral and recovery of excess net power costs estimated at the time to be $17.5 million, including carrying charges, or, alternatively, that it be allowed to file a general rate case, which would otherwise not have been allowed until December 2005. The decision of the Washington Utilities and Transportation Commission (WUTC) was not to allow for the deferral and recovery of excess power costs but to allow PacifiCorp to file a general rate case any time before July 2005 that addresses the level of prices needed to cover all ongoing costs to serve Washington customers. This decision was challenged in August 2003 by the Public Counsel section of the state attorney general s office. A status conference was held in November and PacifiCorp and the WUTC staff submitted a joint reply brief in April 2004. In May 2004, the court confirmed the WUTC decision. Notwithstanding the pending challenge, PacifiCorp filed its Washington general rate case in December 2003 and expects that a final order will be made in November 2004.

Under UK Generally Accepted Accounting Principles (GAAP), all PacifiCorp s net power costs are charged to the profit and loss account when incurred. There is, therefore, a time lag between the recognition of allowable excess power costs under UK GAAP compared to US GAAP, which continues to benefit future UK GAAP reported earnings.

Demand Side Management (DSM)

PacifiCorp continues to offer its Energy Exchange programme in Utah, Oregon, Wyoming, Washington and Idaho. This programme is an optional, supplemental service, which allows participating customers an opportunity voluntarily to reduce electricity usage in exchange for a payment at times and prices determined by PacifiCorp. The programme is designed to enable all customers of one MW and greater to help address periods of high wholesale prices and peaks in demand when they occur.

During the summer of 2003, PacifiCorp filed and received regulatory approval in Utah for three new residential DSM programmes: a refrigerator recycling programme, an air-conditioning load control programme and an incentive programme to encourage the installation of evaporative coolers or energy-efficient air-conditioners. PacifiCorp filed for a tariff rider to allow it to recover costs incurred through the implementation of all DSM programmes approved by the Utah Public Service Commission (UPSC). Following the filing of testimony, tariff proposals and a series of technical conferences, interested parties have approved a stipulation detailing the introduction of a tariff rider mechanism and a self-direction programme for large customers. This stipulation was heard and approved by the UPSC in September 2003 and, following discussions with regulatory parties, PacifiCorp proposed setting an initial collection rate of 3% for the DSM tariff rider. The 3% collection rate, approximately $28 million annually, was approved by the UPSC in March 2004 and became effective, as planned, on customer bills from 1 April 2004.

PacifiCorp also completed DSM services in Oregon under a transition agreement with the Energy Trust of Oregon (ETO) helping to ensure that customers efficiency needs were adequately served throughout the ETO s initial start-up period and development of utility replacement programmes. The ETO was established as the deliverer of DSM services to Oregon as part of the State s industry restructuring legislation that was implemented in March 2002. Under a recovery method similar to Utah s tariff rider mechanism, PacifiCorp continues to invest in DSM in Washington State at around 3% of retail revenues.

In addition to its supply side Requests for Proposal, under the IRP, PacifiCorp issued a separate RFP for the demand side resources called for in the IRP in June 2003. Analysis of initial responses has been completed and PacifiCorp has selected certain proposals for further evaluation.

Renewable Energy

The 2003 IRP found that 1,400 MW of renewable energy was cost-effective over the following 10 years. PacifiCorp executed a power-purchase agreement with a new, 41 MW windfarm in Milton-Freewater, Oregon, in conjunction with the ETO. The ETO uses funds collected under Oregon s public benefits charge to cover the above-market cost of the wind project while PacifiCorp purchases the power at market price. This was the first joint effort on renewable energy development between PacifiCorp and the ETO, which is to exist through to 2012. PacifiCorp also released an RFP for 1,100 MW of renewable generation over a seven-year period and will evaluate bids during 2004/05.

During 2003/04 there were several policy developments affecting renewable generation. California continued to clarify implementation rules on its renewable portfolio requirement, which calls for investor-owned utilities in the state to supply 20% of their California-based load from renewables in 2017 and encourages publicly-owned utilities to do the same. Utilities such as San Diego Gas and Electric and Sacramento Municipal Utility District have begun to invest in new renewable projects. PacifiCorp is waiting for the disposition of clarifying legislation pending in the California General Assembly before implementing a compliance strategy. The Washington legislature contemplated a renewable portfolio standard in the 2004 legislative session but the measure failed to pass out of the House. The Utah legislature passed a sales and use tax exemption for renewable energy equipment in 2004 to create an incentive for renewable development within the state.

In 2003/04, PacifiCorp s Blue Sky programme, which offers customers the opportunity to support renewable energy development above its system investments, was approved by the California Public Utilities Commission (CPUC) and the Idaho Public Utility Commission (IPUC). The programme is now available to all customers in PacifiCorp s service territory. Based on data compiled by the US Department of Energy, PacifiCorp ranks fifth nationwide in customer participation and fourth in MWh sales in voluntary renewable energy programmes.

Competition and Deregulation

During 2003/04, PacifiCorp continued to operate its electricity distribution and retail business under state regulation. Certain industrial customers in Oregon can choose alternative electricity suppliers and the California General Assembly is debating legislation to restore direct access options for large customers. However, deregulation of the retail market has not developed widely and, whilst customer demand for choice in each state may eventually lead to retail competition in some form, no significant proposals for customer choice were brought forward in any of the legislatures outside California during 2003/04. PacifiCorp currently owns and operates transmission facilities as part of its vertically integrated operations. Transmission costs are bundled with generation and distribution costs in approved retail rates. Rules issued by the FERC in 1996 designed to facilitate competition in the wholesale market on a nationwide basis give greater flexibility and more choices to wholesale electricity customers. The moves to introduce RTOs also impact on PacifiCorp s transmission responsibilities and, possibly, the resultant revenues.

A summary of the outcomes and significant further regulatory and legislative developments in the states concerned is set out below.

Utah

PacifiCorp commenced a general rate case in May 2003. In January 2004, the UPSC approved a stipulation allowing an annual increase of $65 million, representing a 7% average price increase. The increase in customer rates was effective on 1 April 2004. A stipulation on rate spread and rate design was filed with, and approved by, the UPSC in January 2004. This order establishes rates giving PacifiCorp the opportunity to collect the previously ordered 7% average price increase and earn an authorised ROE of 10.7%.

Oregon

In August 2003, the Oregon Public Utility Commission (OPUC) approved a settlement of PacifiCorp s general rate case filed in March 2003. Under the settlement, base rates increased by $8.5 million annually on 1 September 2003, resulting in a 1.1% average price increase and an effective authorised ROE of 10.7% based on the filed capital structure. Also, a $12 million merger credit for the period from January 2004 to December 2004 was eliminated and a further merger credit will be reduced from $6 million to $4 million and amortised to return the full amount to customers by December 2004.

Wyoming

In May 2003, PacifiCorp filed a general rate case with the WPSC to recover rising costs (including insurance premiums, pension funding and healthcare costs) and request an increase in the authorised ROE to 11.5%. Hearings in the case were completed in January 2004 and an order granting a $22.9 million annual increase (and authorising a 10.75% ROE) was issued in March 2004. The new rates took effect in early March 2004. In September 2003, PacifiCorp filed a request to establish a power cost adjustment mechanism (the PCAM). This mechanism was intended to protect PacifiCorp from net power cost volatility and reduce the regulatory lag associated with recovery of net power costs, which are defined as fuel and wheeling expenses and wholesale sales and purchases. Hearings in the PCAM case were held in March 2004. The request to establish the PCAM was denied in April 2004.

Washington

In October 2003, PacifiCorp filed petitions with the WUTC for accounting orders to allow deferral and amortisation of the Trail Mountain coal mine closure costs and environmental remediation costs and requesting WUTC authorisation of accounting treatment relating to pension liability as well as confirmation by the WUTC that certain actuarially determined pension costs are recoverable in rates. These filings were made in response to the stipulation approved in the last general rate proceeding in Washington requiring that items treated as regulatory assets under authorisations from other states, which are proposed for inclusion in Washington at the end of the rate plan period, be supported by accounting authorisations in Washington. In December 2003, PacifiCorp filed with the WUTC for a general rate increase of $26.7 million annually, or 13.5% to recover higher power costs; increases in insurance, pension, healthcare, infrastructure and security costs; increase authorised ROE to 11.25% and receive approval for the proposed inter-jurisdictional cost allocation protocol. In addition, PacifiCorp is requesting that the WUTC adopt the findings of a prudence review of generating resources acquired since the 1986 Washington general rate case. The WUTC has adopted a procedural schedule requiring testimony from the staff and other parties in June 2004 and PacifiCorp s rebuttal testimony in July 2004. Hearings are scheduled to begin on 30 August 2004 with a final order expected in November 2004.

Idaho

In August 2003, the IPUC approved as filed PacifiCorp s July 2003 application for approval of a renewable-energy tariff. Under the proposed tariff, residential and non-residential customers can purchase newly developed wind, geothermal and solar powered energy in fixed increments. In December 2003 PacifiCorp filed with the IPUC to recover $4.2 million related to Idaho s portion of income tax payments resulting from audits of prior years. A stipulated agreement between the parties was filed in mid-May 2004. The filing requests recovery over 16 months, beginning in June 2004, when a power cost recovery surcharge, which began in June 2002, expires.

California

The CPUC issued a final order in November 2003 approving two stipulations in the general rate case and finalising permanent rates. The order grants an additional annual increase of $2.8

million effective from 1 December 2003. Combining this order with the interim increase in June 2002 results in an overall annual price increase of $7.6 million. This represents a 13.6% average price increase, with an authorised ROE of 10.9%.

13 Regulation of the Electricity and Gas Industries in the UK

The UK electricity and gas industries are regulated under the provisions of the Electricity Act, the Gas Acts and the Utilities Act. The Electricity and Gas Acts provided for the privatisation and restructuring of the industries in the late 1980s and the 1990s, including the introduction of price regulation for electricity transmission and distribution and gas transportation; and of competition in electricity generation, gas storage and the supply of both gas and electricity. The Acts established the licensing of industry participants and created regulatory bodies for each of the electricity and gas industries. In 2000, the Utilities Act enabled the electricity and gas regulators to be merged as the Authority, established new independent consumer councils and provided powers for Government Ministers to give statutory guidance on social and environmental issues and to set energy efficiency targets and renewables obligations.

The Utilities Act transferred the functions of the previous electricity and gas industry regulators to the Authority and provided for the appointment of a Chairman and other members of the Authority by the Secretary of State for Trade and Industry (Secretary of State). The Chairman of the Authority holds office for renewable periods of five years and is the Managing Director of Ofgem which provides administrative support to the Authority. Under the Utilities Act, the principal objective of the Secretary of State and the Authority is to protect the interest of customers, wherever appropriate by promoting effective competition. In carrying out those functions, they are required to have regard to the need to secure that all reasonable demands for electricity and gas are met; the need to ensure that licence holders are able to finance their functions; the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes or residing in rural areas. The Authority exercises, concurrently with the Director General of Fair Trading, certain functions relating to monopoly situations under the Fair Trading Act 1973 and the Enterprise Act 2002 and to anti-competitive conduct under the Competition Act 1980 and the Competition Act 1998. The Authority also manages UK compliance with the European Community Liberalisation Directive, which is concerned to introduce competition in generation and supply and non-discriminatory access to gas transportation and electricity transmission and distribution across the EU.

The Licensing Regime

The Authority is responsible for granting new licences or licence extensions for each of the following separate activities:

Electricity generation the production of electricity at power stations, hydroelectric plants, windfarms and some industrial plants. Through its wholly-owned subsidiary, ScottishPower Generation Limited, the group is licensed to operate some 5,400 MW of generating capacity and, by contracting in the wholesale market, has access to capacity operated by other licensed generators.

Electricity transmission the bulk transfer of electricity across a high-voltage network of overhead lines, underground cables and associated equipment typically operating at or above 132 kV. Through its wholly-owned subsidiary, SP Transmission Limited, the group owns and is licensed to operate the transmission system in central and southern Scotland. ScottishPower s transmission system is connected to that of SSE in the north of Scotland and is linked to the National Grid in England & Wales and to the Northern Ireland transmission system by interconnectors

which enable the export and import of electricity within the UK. Following a review by the Authority, a parliamentary bill has been published to facilitate revised arrangements in respect of the interconnector between Scotland and England; these are now expected to be in place by 2005.

Electricity distribution the transfer of electricity from the high voltage transmission system and its delivery to customers, across a network of overhead lines and underground cables operating at voltages ranging from 33 kV to 0.23 kV. The Utilities Act required separate licensing of the 14 regional distribution businesses introduced under electricity privatisation. Each Public Electricity Distributor (PED) licensee is required, among other duties, to develop and maintain an efficient, coordinated and economical system of electricity distribution and to offer terms for connection to, and use of, its distribution system on a non-discriminatory basis, in order to ensure competition in the supply and generation of electricity. Through its wholly-owned subsidiaries, SP Distribution Limited and SP Manweb plc, the group is licensed to distribute electricity within its two distribution services areas for all suppliers whose customers are within the areas. Charges for distribution are made to the various suppliers as appropriate. The Authority has granted a derogation, which will lapse only in certain limited circumstances, allowing the distribution businesses in the ScottishPower and Manweb PED licence areas to be managed and operated jointly.

Gas transportation and storage the onshore transportation system, most of which is owned and operated by Transco, the transportation arm of National Grid Transco plc, and the rest by other gas transporters, conveys gas from the beach terminals to consumers and is interconnected with the gas transportation systems of continental Europe, Northern Ireland and the Republic of Ireland. Storage capacities are largely used to balance supply and demand over time. Major facilities are used to balance seasonal variations in demand while diurnal storage

capacities provide flexibility in meeting changing gas demand on a daily basis. Competition in storage has been introduced progressively since 1998 through the auction of major storage capacity owned by Transco and the provision of new capacity by independent operators, including ScottishPower. Through its wholly-owned subsidiary, SP Gas Limited, the group is licensed as a gas transporter.

Gas shipping gas shippers contract with gas transporters to have gas transported between the beach terminal and the point of supply. Gas shippers can also access storage facilities. The group is licensed as a gas shipper.

Supply of gas and electricity the bulk purchase of gas and electricity by suppliers and its sale to customers, with the associated customer service activities, including customer registration, meter reading, sales and marketing, billing and revenue collection. Large industrial and commercial customers have been able to choose their energy suppliers for a number of years and the residential market was opened to competition progressively, commencing in April 1996, with residual controls on residential electricity prices ending in March 2002. Any electricity supplier wishing to supply electricity to domestic customers must obtain authorisation from the Authority and be subject to additional domestic supply obligations in its licence, including having its codes of practice (statements of intent about how the supplier will interact with customers) approved by the Authority. Broadly comparable arrangements allow British Gas Trading to supply mains gas to any connected customer in competition with licensed gas suppliers. Customers may continue to take supplies from the pre-privatisation monopoly supplier for the area or may choose an alternative licensed supplier. Once customers have changed a gas or electricity supplier, they are able to change supplier again subject to the contractual terms offered by licensed suppliers and approved by the Authority. Through its wholly owned subsidiary, ScottishPower Energy Retail Limited, the group is licensed as a gas supplier and an electricity supplier.

Modification of licences The Authority is responsible for monitoring compliance with the conditions of licences and, where necessary, enforcing them through procedures laid down in the Electricity and Gas Acts. Under these Acts, as amended by the Utilities Act, licences consist of standard licence conditions, which apply to all classes of licences, and special conditions particular to that licence. The Authority may modify standard licence conditions collectively through making proposals to all relevant licence holders. If some licence holders object, the modification may be carried out only if the number of objectors is below a specified minority. The Authority may modify a special licence condition with the agreement of the licence holder after due notice, public consultation and consideration of any representations or objections. In the absence of agreement for a special licence condition or if objections are above the specified minority threshold for a standard licence condition, the only means by which the Authority can secure a modification is following a modification reference to the Competition Commission and in the circumstances set out below. A modification reference requires the Competition Commission to investigate (having regard to the matters in relation to which duties are imposed on the Secretary of State and the Authority) and report on whether matters specified in the reference in pursuance of a licence operate, or may be expected to operate, against the public interest; and, if so, whether the adverse public interest effect of these factors could be remedied or prevented by modification of the conditions of the licence. If the Competition Commission so concludes, the Authority must then make such modifications to the licence as appear to it requisite for the purpose of remedying or preventing the adverse effects specified in the report, after giving due notice and consideration to any representations and objections. The Secretary of State has the power to veto any modification.

Modifications to licence conditions may also be made in consequence of a reference under the Fair Trading Act 1973, the Enterprise Act 2002 or the Competition Act. ScottishPower s acquisition of Manweb in 1995 and its merger with PacifiCorp in 1999 both involved ScottishPower s giving of undertakings to the Secretary of State to agree to modifications to the licences under which the group operates in the UK. Broadly, these modifications were designed to ring-fence various UK regulated businesses, to require that the group had sufficient management and financial resources to fulfil its UK obligations and to ensure that UK regulators would continue to have access to the information needed to carry out their duties.

Term and revocation of licences Licences under the Electricity Act, as modified by the Utilities Act, may be terminated by not less than 25 years notice given by the Secretary of State and may be revoked in certain circumstances specified in the licence. These include the insolvency of the licensee, the licensee s failure to comply with an enforcement order made by the Authority and the licensee s failure to carry on the activities authorised by the licence.

Price Controls

It is recognised that the development of competitive markets is not appropriate in some areas: particularly in the core activities of transmission and distribution of electricity and the operation of the gas transportation system. In these areas, regulatory controls are deemed necessary to protect customers in monopoly markets (by determining inflation-limited price caps) and to encourage efficiency. The group s UK transmission and distribution businesses are subject to price controls (or revenue controls in the case of the transmission business) which restrict the average amount, or total amount, charged for a bundle of services. The price caps are expressed in terms of an RPI X constraint on charges, where RPI represents the annual percentage change in the UK s retail price index, and X is a

percentage determined by the Authority. The X factor is used to reflect expected efficiency gains and investment requirements. For example, where RPI is running at 3% and X is 2%, a company would be able to increase the average charge for a bundle of services by 1% per annum. The Authority from time to time reviews the price cap formulae. Through participation in, and the submission of evidence to, these price control reviews and, where necessary, through the Competition Commission modification process described above, companies have the opportunity to comment on and seek to influence the final outcome of any price control review.

Transmission price control The revised transmission price control for ScottishPower took effect for the five years from 1 April 2000. The BETTA review proposes a Great Britain-wide wholesale market for electricity and revised arrangements. BETTA is dependent upon primary legislation and is expected to be implemented in 2005. Ofgem has proposed a two-year roll-forward of the current price control for SP Transmission from April 2005.

Distribution price control The maximum distribution revenue is calculated from a formula that is based on customer numbers as well as units distributed. Distribution price controls for the ScottishPower and Manweb areas, which took effect for the five years from 1 April 2000, are currently subject to a review by the Authority aimed at ensuring that customers interests are protected and that companies have the appropriate incentives to invest and operate efficiently. Key challenges for this review include modifying the regulatory framework to provide incentives for distribution companies to connect distributed generation and developing the quality of supply incentives established at the previous review.

14 Environmental Regulation

Throughout its operations, ScottishPower will meet, or better, relevant legislative and regulatory environmental requirements and codes of practice. ScottishPower will publish its 2003/04 Environmental and Social Impact Report and Environmental Performance Report in October 2004. Copies will be available on request from the Company Secretary and the reports will be available on the ScottishPower website.

US Environmental Regulation

Federal, state and local authorities regulate many of PacifiCorp s activities pursuant to laws designed to restore, protect and enhance the quality of the environment. These laws have increased the cost of providing electricity service and give rise to identifiable contingencies, principally in respect of Clean Air Act matters, which are subjects of discussions with the US Environmental Protection Agency (EPA) and state regulatory authorities. PacifiCorp expects that future costs relating to these matters may be significant and consist primarily of capital expenditure. PacifiCorp expects to manage its decision making and implementation of these matters effectively so that these and future costs will be found to be prudent and recoverable in rates and, as such, not to have a material adverse impact on the group s consolidated results of operations.

Air Quality

PacifiCorp s fossil fuel-fired electricity generation plants are subject to regulation under federal, state and local requirements. PacifiCorp uses emission controls, low-sulphur coal, plant operating practices sensitive to environmental impacts and continuous emissions monitoring to enable its plants to comply with emission and opacity limits, visibility and other air quality requirements. The EPA has initiated a regional haze programme intended to improve visibility at specific federally protected areas, some of which are located near PacifiCorp plants. PacifiCorp is anticipating climate change challenges with additions of renewable generation, conservation and thermal resources as outlined in the IRP. Carbon dioxide (CO_2) emissions risk has been recognised in PacifiCorp s IRP through the use of a projected additional cost based on the fuel s carbon content when evaluating the cost of new resources. PacifiCorp also supports development of trading and other market mechanisms, as well as offset strategies, where feasible, to reduce future compliance costs to customers.

The US Congress is currently considering several proposed bills that would create enforceable limits on electricity plant emission of sulphur dioxide (SO_2), oxides of nitrogen (NOx), mercury and in some cases, CO_2. The EPA also has proposed new regulations that could impact emissions and is pursuing enforcement actions against selected coal-fired power plants in the eastern and mid-western US with the aim of causing nationwide emission reductions. All of these efforts may lead to additional control equipment being installed over the next 10-15 years. PacifiCorp expects that future costs relating to these matters may be significant and would consist primarily of capital expenditure but will be spread over a number of years. PacifiCorp also expects that the impact will be mitigated by recovery through regulatory ratemaking.

Endangered Species

Protection of threatened and endangered species and their habitat makes it difficult and more costly to perform some of the core activities of PacifiCorp, including the siting, construction, maintenance and operation of new and existing transmission and distribution facilities, as well as hydroelectric, thermal and wind generation plants. In addition, endangered species issues impact the relicensing of existing hydroelectric generating projects, generally raising the price PacifiCorp pays to purchase wholesale electricity from hydroelectric facilities owned by others and increasing the costs of operation of PacifiCorp s own hydroelectric resources. Nonetheless, PacifiCorp creates and implements management systems to ensure that environmental considerations are successfully incorporated into major business decisions relating to its generation, transmission and distribution assets.

Environmental Clean-ups

Under the federal Comprehensive Environmental Response, Compensation and Liability Act and similar state statutes, entities that accidentally or intentionally disposed of, or arranged for the disposal of, hazardous materials may be liable for clean-up of the contaminated property. In addition, the current or former owners or operators of affected sites also may be liable. PacifiCorp has been identified as a potentially responsible party in connection with a number of clean-up sites because of current or past ownership or operation of the property or because PacifiCorp sent materials deemed to be hazardous to the property in the past. PacifiCorp has completed several clean-up actions and is actively participating in investigations and remedial actions at other sites. The costs associated with those actions are not expected to be material to the group s consolidated results of operations or financial position.

Mining

The federal Surface Mining and Reclamation Act of 1977 and similar state statutes establish operational, reclamation and closure standards that must be met during the operation and upon completion of mining activities. These obligations stipulate that mine property be restored consistent with specific standards and the approved reclamation plan. Significant expenditures are expected to be required as individual PacifiCorp mining operations are closed and reclamation occurs. The costs associated with reclamation are subject to the regulatory process. PacifiCorp expects to be allowed to recover these costs.

Water Quality

The federal Clean Water Act and individual state clean water regulations require a permit for the discharge of wastewater, including storm water runoff from the electricity plants and coal storage areas, into surface waters and groundwater. PacifiCorp believes that it has management systems in place to monitor performance, identify problems and take action to assure compliance with permit requirements.

UK Environmental Regulation

The group s UK businesses are subject to numerous regulatory requirements with respect to the protection of the environment, including environmental laws which regulate the construction, operation and decommissioning of power stations, pursuant to legislation implementing environmental directives adopted by the EU and protocols agreed under the auspices of international bodies such as the United Nations Economic Commission for Europe (UNECE). The group believes that it has taken and continues to take measures to comply with applicable laws and regulations for the protection of the environment. Applicable regulations and requirements pertaining to the environment change frequently, however, with the result that continued compliance may require material investments, or that the group s costs and results of operation are less favourable than anticipated.

Electricity Generation, Transmission, Distribution and Supply

The Electricity Act obligates the Secretary of State to take into account the effect of electricity generation, transmission, distribution and supply activities upon the physical environment in approving applications for the construction of generating facilities and the location of overhead power lines. The Electricity Act requires the group to take into account the conservation of natural features of beauty and other items of particular interest and, in terms of the Environmental Impact Assessment Regulations, to carry out an environmental assessment when it intends

to construct significant overhead transmission systems or power stations of greater capacity than 50 MW. The group also prepares formal statements on the Preservation of Amenity and Fisheries in line with the requirements of the Electricity Act.

The Utilities Act provided for environmental guidance to be given by the Secretary of State to the energy regulator, Ofgem, and for regulations to be drawn up which require licensed electricity suppliers to secure a certain percentage of their supplies from renewable energy sources, compliance being demonstrated by tradable Renewables Obligation Certificates . The current objective is that 10% of UK energy should come from renewable sources by 2010 and an objective of 20% by 2020 was included in the UK Government White Paper on energy. ScottishPower continues to develop its windfarm business and expects to meet the company target of 10% generation from renewables by 2010. In December 2003, the UK Government announced its desire to increase the firm Renewables Obligation target to 15% by 2015. The Utilities Act also provided for energy efficiency targets to be set for licensed suppliers to be implemented by an Energy Efficiency Commitment . The emphasis on energy saving has remained in the recent UK publication: Energy Efficiency the Government s Plan for Action. This was announced in April 2004 and indicated an increase in current Energy Efficiency Commitment targets for the period between 2005 and 2011.

The Environmental Protection Act of 1990 (EPA 1990) requires that potentially polluting activities such as the operation of combustion processes (which includes power plant) requires prior authorisation. The Act also provides for the licensing of waste management and imposes certain obligations and duties on companies which produce, handle, and dispose of waste. Waste generated as a result of the group s electricity activities is managed to ensure compliance with legislation and waste minimisation is undertaken where possible.

Generation Activities

The principal emissions from fossil-fuelled electricity generation are SO_2, NOx, CO_2 and particulate matter, such as dust, with the main waste being ash, namely pulverised fuel ash and furnace bottom ash. The primary focus of current environmental legislation to date has been to reduce emissions of SO2, NOx and particulates, the first two of which contribute to acid rain. More recently, the UK Government has consulted on the EU

Business Review Description of Legislative and Regulatory Background

Emissions Trading Scheme which will regulate the release of CO_2 from fossil-fuelled power stations. The proposed arrangements in the UK will be subject to approval by the EC during 2004, with scheme implementation scheduled for January 2005. A number of other power station emissions and discharges are subject to environmental regulation.

EPA 1990 is the primary UK statute governing the environmental regulation of power stations. In April 1991, it introduced a system of Integrated Pollution Control (IPC) for large scale industrial processes, including power stations, now enforced with respect to emissions to atmosphere in England & Wales by the Environment Agency (EA) and in Scotland by the Scottish Environment Protection Agency (SEPA). Each of ScottishPower s power stations is required to have its own IPC authorisation, issued by the EA or SEPA, regulating emissions of certain pollutants, seeking to minimise pollution of the environment and containing an improvement programme. Each IPC authorisation requires that a power station uses the Best Available Techniques Not Entailing Excessive Cost (BATNEEC) to prevent the emissions described above or, to the extent this is not practicable, to minimise and render harmless any such emissions. ScottishPower s IPC authorisations do not have an expiry date, but the EA or SEPA is required to review the conditions contained within them at least once every four years and may impose new conditions to prevent or reduce emissions of pollutants, subject to the application of BATNEEC.

The EU has agreed a Directive on Integrated Pollution Prevention and Control, which introduces a system of licensing for industrial processes such as power stations. This Directive is being implemented via the Pollution Prevention and Control Regulations (PPC Regulations) which will bring modifications to the IPC regime into effect, on a staged basis. The EU Directive will eventually require that all emission and pollution control measures are placed onto a Best Available Techniques basis to control the impact on the environment.

The EU has adopted a framework directive on ambient air quality assessment and management and, under the auspices of UNECE, protocols regarding reductions in the emissions of SO_2 and NOx have been agreed. These protocols are currently implemented in the EU by means of the Large Combustion Plants Directive (LCPD). The EU has finalised a Ceilings Directive which will implement the SO2 and NOx targets agreed in the UNECE Gothenburg Protocol. In the UK, the Government has submitted details to the EC of how it proposes to implement the LCPD. Continued uncertainty remains on final arrangements surrounding implementation of bulk emissions and emission limit values. Compliance with local air quality issues will continue to be implemented in the UK by means of the National Air Quality Strategy (NAQS) published in 1997, and reviewed in 2000. The provisions of the LCPD and of NAQS are to be introduced through the PPC permitting process on a plant-by-plant basis.

The group has identified options that, given the appropriate commercial conditions, would enable it to continue the environmental improvements required by potential future limits arising from this review, without materially constraining operational and commercial flexibility. In particular, gas-reburn technology, as used at Longannet, offers greater potential to reduce emissions than other technology in use elsewhere in the UK.

The Waste Incineration Directive (WID) imposes emission limits on the incineration or co-incineration of materials deemed to be waste in terms of relevant EU legislation. These will also be implemented via the PPC permitting process. During 2003/04, SEPA indicated that it considers that the WID provisions will apply to the burning of sewage sludge pellets used at Longannet Power Station. ScottishPower Generation Limited has petitioned for a Judicial Review of this decision by SEPA.

Contaminated Sites

While the nature of developments in environmental regulation and control cannot be predicted, the group anticipates that the direction of future changes will be towards tightening controls. In view of the age and history of many sites owned by the group, the group may incur liability in

respect of sites which are found to be contaminated, together with increased costs of managing or cleaning up such sites. Site values could be affected and potential liability and clean-up costs may make disposal of potentially contaminated sites more difficult. The Contaminated Land Regulations, which implement provisions of the Environment Act 1995 (EA1995), require local authorities to identify sites where significant harm is being caused and to take appropriate steps. In order for harm to be demonstrated it must be shown that a source of pollution, a receptor and a pathway are present. Harm may be eliminated by clean-up or by breaking the source to receptor pathway. Clean-up is only required to fit for subsequent use standards, so that environmental compliance is consistent with the intended use of the site.

Other proposals which may, under certain conditions impose strict liability for environmental damage, such as the Environmental Liability Directive, are presently being adopted by the EC. ScottishPower is not currently aware of any liability which it may have under EA1995 or proposed EU directives which will have a materially adverse impact on its operations.

15 Employment Regulation

Numerous laws and related codes of practice international, EU, UK and US ensure that companies offer equal opportunities to all individuals, regardless of gender, race, disability and age. Similarly, both the US and the UK have extensive legislation covering health and safety at work. ScottishPower has well-defined policies in place throughout its businesses to ensure that there are equal opportunities in employment and to comply with applicable employment laws. These policies cover a range of specific issues, such as disciplinary and grievance procedures, equal pay, harassment, race, sex and other forms of discrimination, stress and non-retaliation for the reporting of compliance issues.

A more extensive description of how the businesses discharge their wider responsibilities to protect the welfare, health and safety of the public and their employees, can be found in the ScottishPower Environmental and Social Impact Report and the ScottishPower Workplace Performance Report, available on the ScottishPower website. A brief overview of the two most extensively regulated aspects of employee relations follows.

Equal Opportunity

US businesses In the US, equal employment opportunities are provided without regard to race, colour, sex, religion, creed, age, sexual orientation, national origin, veteran s status, physical or mental disability or any other status protected under applicable local, state or federal law. The group provides equal opportunity for qualified applicants and employees and maintains a programme of affirmative action, pursuant to legal requirements, in order effectively to employ minorities and women and to encourage workforce diversity. The programme also covers disabled persons and veterans. The US affirmative action programmes establish specific, results-oriented procedures; determine whether effective utilisation of minorities and women is achieved; incorporate equal employment principles in supervisory training; and promote effective community outreach efforts for women and minority applicants.

UK Businesses The UK businesses work with both outside organisations and an internal equality forum to consider policies for racial equality, family issues, disabled people and other key areas. ScottishPower is affiliated with a number of organisations including the Equal Opportunities Commission, Employer s Forum on Age, Employer s Forum on Disability, Commission for Racial Equality and Parents at Work. Internal human resources staffs work with these organisations to find ways to incorporate their expertise into group and business unit policies.

The introduction of The Employment Equality Regulations 2003 extended existing equality legislation to protect workers from discrimination on the basis of their sexual orientation, religion or similar belief. The UK businesses have reviewed and updated their existing equality policies to ensure that they meet the new requirements. They have also worked in conjunction with their recognised trade unions to jointly develop and implement a new UK-wide Company Agreement. The agreement harmonises a number of significant terms and conditions, including maternity and paternity leave provisions and also contains harmonised employment procedures dealing with discipline, sickness absence, performance and grievance.

Health and Safety

Assessments against the Group Health & Safety Standards were carried out during November/December 2003, establishing a baseline for business unit performance against the Standards and the creation of a ScottishPower Best Practice Model. Targets have been set for business units to improve performance against the Standards and to improve in key areas. These are included in the business unit scorecards. Progress against the Standards will be measured in the fourth quarter of 2004/05.

US Businesses The lost time accident (LTA) rate for the US businesses reduced from 0.90 to 0.63, a reduction in LTAs of 55 to 42 during 2003/04. The PacifiCorp Employee Climate Survey scores also showed a good safety culture in place across PacifiCorp. At PPM, Pacific Klamath Energy received its Oregon Sharp Certification from the Oregon Occupational Safety and Health Administration, distinguishing its safety programme with other state leaders. In public safety, the amount of electricity public safety education performed increased about 20% above prior years, and the programme was ranked in the top tier in the industry. A team from Energy West Mining also won the National Mine Rescue Competition.

The group s US Health & Safety Committee continues to meet on a regular basis, providing senior executive oversight and leadership in PacifiCorp and PPM in these areas. Major initiatives are underway in PacifiCorp s power delivery, generation and mining business units and in

PPM to reduce and prevent accidents.

The US businesses participate with other industry stakeholders in the regulatory process on significant safety and health regulatory proposals affecting the utility and mining industries. PacifiCorp is also well represented amongst these stakeholders, with safety professionals occupying leadership positions in both mining and electricity trade associations safety groups.

UK Businesses The LTA rate for the UK businesses reduced from 0.83 to 0.62, a reduction in LTAs of 60 to 48. The highlight of the year was in the generation business which had a period of seven months without any LTAs.

To recognise the importance of employee involvement ScottishPower, in partnership with its trade unions, launched the new Safety Representatives Charter (the Charter) during August 2003. ScottishPower and the trade unions are committed to achieving a long-term goal of operating without harm to employees, customers and the public. Collaboration, over many years, in the company s health and safety activities has resulted in improved performance, particularly over recent years when the incidence of accidents and ill-health in the workplace has seen a consistent decline. Safety representatives have contributed greatly to improved performance and the introduction of the Charter will allow them to make a greater contribution in the future.

In the UK, the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations set out the requirements for reporting of all work-related accidents. As UK regulators and enforcement authorities increasingly seek to raise the priority and importance that companies give to health and safety issues, they are likely to take action for any non-compliance. The

company continues to support industry organisations, such as the Association of Electricity Producers, Engineering Employers Federation and Energy Networks Association, and engages in representation to the UK Health and Safety Executive, the DTI and other relevant organisations through these industry groups.

16 Business Risks

The risk management process established by the group is designed to identify, assess, monitor and manage each of the various types of risk involved in the group s business and activities; measure quantitative market risk exposure; and identify qualitative market risk exposure in its business. Increases or reductions in future retail demand for electricity as a result of economic growth or downturns, among other factors, including abnormal weather, may impact retail revenues, cash flows and investment levels. In particular, the pace of economic recovery in PacifiCorp s service territories, for example, Oregon which has been experiencing recessionary conditions, could impact PacifiCorp s results and timing of investments. The principal discussion of the group s management of market risks is set out on pages 49 to 54. An outline of the approach taken to the management of other business risks is set out in the following paragraphs.

Operating Risk

Operating risk is the risk that assets and mechanical systems, as well as business processes and procedures, might not perform as expected, with the result that the group may be unable to meet a portion of its obligations without resorting to an unanticipated market transaction. Operating risk is primarily mitigated through a combination of sound maintenance practices, prudent and safe operational processes and insurance products, such as business interruption insurance.

Security Risk

The emergence of terrorist threats, both domestic and foreign, is a continued risk to the entire utility industry, including ScottishPower. Potential destruction of assets and disruptions to operations are not readily determinable. The group has identified critical assets and developed several levels of security and emergency response to meet the increased threat level. The US businesses are well advanced in the implementation of a physical security plan to enhance the security surrounding critical assets under the overall auspices of the North American Electric Reliability Council 1200 Urgent Action standard.

The impact of cyber attacks has been relatively small, as compared to most businesses, based on preventive measures taken and rapid response to events. Planning and prioritisation for additional security enhancements is underway for 2004/05. In the UK, there is an established liaison with the security services and police, to ensure that critical assets are protected against potential threat of terrorism.

Pension Risk

As a result of the relative decline in the equity markets and low interest rates, the group anticipates that pension expense and cash contributions into the pension schemes will increase in the near future. The investment risk has been addressed as part of the pensions review undertaken by both the group and its pension scheme trustees, focusing on the asset allocation of the schemes.

Regulatory Risk

In the US the group is subject to the jurisdiction of federal and state regulatory authorities. The FERC establishes tariffs under which PacifiCorp provides wheeling services to the wholesale market and the retail market for states allowing retail competition, establishes both cost-based and market-based tariffs under which PacifiCorp sells electricity at wholesale and has licensing authority over most of PacifiCorp s hydroelectric generation facilities. The utility regulatory commissions in each state independently determine the rates PacifiCorp may charge its retail customers in that state.

Each state s rate setting process is based upon that commission s acceptance of an allocated share of total PacifiCorp costs as its responsibility . When different states adopt different methods to address this inter-jurisdictional cost allocation issue, some costs may not be incorporated into any rates in any state. Rate making is done on the basis of normalised costs, so if in a specific year, realised costs are higher than normal, rates will not be high enough to cover those costs. Likewise, if in a given year costs are lower than normal or revenues are higher, PacifiCorp retains the resulting higher-than-normal profit. Each commission sets rates based on a test year of its choosing. In states that use a historical test year, rate adjustments can follow cost increases, or decreases, by up to two years. Regulatory lag results in a delay in recovery of costs currently incurred but not in rates, and also imposes a time-value-of-money burden on PacifiCorp. Further, each commission decides what levels of expense and investment are necessary, reasonable and prudent in providing service. In the event that a commission decides that part of PacifiCorp s costs do not meet this standard, such costs will be disallowed and not recovered in rates. For these reasons, the rates authorised by the regulators may be less than the costs to PacifiCorp to provide electricity service to its customers in a given period.

Several of PacifiCorp s hydroelectric projects are in some stage of the FERC relicensing under the FPA. The relicensing process is a political and public regulatory process that involves sensitive resource issues. PacifiCorp is unable to predict the requirements that may be imposed during the relicensing process, the economic impact of those requirements, whether new licences will ultimately be issued or whether PacifiCorp will be willing to meet the relicensing requirements to continue operating its hydroelectric projects.

Federal, state and local authorities regulate many of PacifiCorp s activities pursuant to laws designed to restore,