32 NET DEBT

Analysis of changes in net debt

	1 January 2006 £m	Exchange differences £m	On acquisition of subsidiaries (excluding cash) £m	Other non-cash movements £m	Cash flow £m	31 December 2006 £m
Cash and cash equivalents	620	(26)	–	–	386	**980**
Assets held for trading	52	(3)	–	2	(9)	**42**
Total funds	672	(29)	–	2	377	**1,022**
Loans due within one year	(187)	5	(26)	(96)	73	**(231)**
Loans due after more than one year	(2,721)	224	(40)	84	(756)	**(3,209)**
Secured bonds	(445)	(2)	(234)	3	–	**(678)**
Preferred equity facility	(173)	21	–	–	–	**(152)**
Convertible bonds	(125)	16	–	24	(152)	**(237)**
Total debt	(3,651)	264	(300)	15	(835)	**(4,507)**
Net debt	(2,979)	235	(300)	17	(458)	**(3,485)**

	1 January 2005 £m	Exchange differences £m	On acquisition of subsidiaries (excluding cash) £m	Other non-cash movements £m	Cash flow £m	31 December 2005 £m
Cash and cash equivalents	565	18	–	–	37	620
Assets held for trading	47	2	–	3	–	52
Total funds	612	20	–	3	37	672
Loans due within one year	(71)	–	–	(73)	(43)	(187)
Loans due after more than one year	(2,503)	(145)	–	63	(136)	(2,721)
Secured bonds	(449)	–	–	4	–	(445)
Preferred equity facility	(154)	(18)	–	(1)	–	(173)
Convertible bonds	(136)	(17)	–	(3)	31	(125)
Total debt	(3,313)	(180)	–	(10)	(148)	(3,651)
Net debt	(2,701)	(160)	–	(7)	(111)	(2,979)

33 FINANCIAL INSTRUMENTS

a) Energy trading risk, energy market risk and hedge accounting

The Group hedges exposures that arise from the ownership and operation of power plants and related sales of electricity and purchases of fuel and utilises derivatives to optimise the return achieved from these assets. The Group enters into derivative commodity financial instruments to convert floating or indexed electricity and fuel prices to fixed prices in order to lessen its vulnerability to reductions in electricity prices for the electricity it generates and to increases in fuel prices for the fuel it consumes in its power plants. Commodity derivative financial instruments also provide a way to meet customers' pricing requirements while achieving a price structure consistent with the Group's overall pricing strategy.

The Group accounts for certain energy sales and fuel purchases as cash flow hedges where the forecast transaction is highly probable and the hedge is assessed as effective.

b) Treasury policy

Treasury policy seeks to ensure that adequate financial resources are available for the development of the Group's business whilst managing its currency, interest rate and counterparty credit risks. The Group's treasury policy is not to engage in speculative transactions. Group treasury acts within clearly defined guidelines that are approved by the Board.

c) Risk identification and management

There is a continuous process for identifying, evaluating and managing the key risks faced by the Group. Activities are co-ordinated by the Risk Committee, which is chaired by the CFO, and has responsibility, on behalf of the Board, for ensuring the adequacy of systems for identifying and assessing significant risks, that appropriate control systems and other mitigating actions are in place, and that residual exposures are consistent with the Group's strategy and objectives. Assessments are conducted for all material entities.

d) Interest rate risk and hedge accounting

The Group's policy is to fix interest rates for a significant portion of its debt. This equates to 71%, as at 31 December 2006, using forward rate or interest rate swap agreements. Significant interest rate management programmes and instruments require the specific approval of the Board. The weighted average interest rate of fixed rate debt was 7%. Where project finance is utilised, our policy is to align the maturity of the debt with the contractual terms of the customer offtake agreement. The Group accounts for certain interest rate swaps as cash flow hedges where the forecast transaction is highly probable and the hedge is assessed as effective.

Effective interest rates and maturity analysis

The following is a table illustrating the effective interest rates of interest earning financial assets and interest bearing financial liabilities and the periods in which they mature:

								31 December 2006
	Effective interest rate	Carrying amount £m	Maturity less than 12 months £m	Maturity 1-2 years £m	Maturity 2-3 years £m	Maturity 3-4 years £m	Maturity 4-5 years £m	Maturity more than 5 years £m
Financial assets								
Finance lease receivable:								
Euro	7.5%	798	26	27	28	29	30	658
US dollars	10.0%	288	7	7	8	8	7	251
Assets held for trading:								
Australian dollars	6.1%	42	42	–	–	–	–	–
Cash and cash equivalents:								
Australian dollars	6.1%	80	80	–	–	–	–	–
Czech koruna	2.4%	15	15	–	–	–	–	–
Euro	3.6%	149	149	–	–	–	–	–
Sterling	5.1%	549	549	–	–	–	–	–
US dollars	5.2%	179	179	–	–	–	–	–
Other currencies	4.5%	8	8	–	–	–	–	–
Total financial assets		**2,108**	**1,055**	**34**	**36**	**37**	**37**	**909**
Financial liabilities								
Secured bank loans:								
Australian dollars	7.5%	987	27	39	54	38	45	784
Effect of interest rate swap	*0.2%*	*(796)*	*(43)*	*(111)*	*(20)*	*(250)*	*(358)*	*(14)*
Czech koruna	3.3%	49	49	–	–	–	–	–
Effect of interest rate swap	*0.1%*	*(7)*	*(7)*	–	–	–	–	–
Euro	5.9%	456	64	32	27	45	36	252
Effect of interest rate swap	*0.1%*	*(35)*	*(5)*	*(20)*	*(10)*	–	–	–
Sterling	7.1%	511	54	43	36	37	33	308
Effect of interest rate swap	*(0.2)%*	*(300)*	*19*	*14*	*(125)*	*(141)*	*(67)*	–
US dollars	8.1%	1,404	35	29	33	490	40	777
Effect of interest rate swap	*(0.2)%*	*(869)*	*(20)*	*(21)*	*(175)*	*(271)*	*(195)*	*(187)*
Other currencies	7.3%	33	2	3	3	3	3	19
Sub-total of secured bank loans	7.4%	3,440	231	146	153	613	157	2,140
Sub-total of effect of interest rate swaps	*0.1%*	*(2,007)*	*(56)*	*(138)*	*(330)*	*(662)*	*(620)*	*(201)*
Secured bonds:								
Euro	5.4%	236	10	11	12	12	12	179
Sterling	8.1%	442	–	–	–	–	–	442
Preferred equity facility:								
US dollars	7.4%	152	–	152	–	–	–	–
Convertible bonds[(1)]:								
Euro	6.6%	124	–	–	–	–	–	124
US dollars	7.4%	113	–	–	–	113	–	–
Sub-total of loans and bonds included in net debt		4,507	241	309	165	738	169	2,885
Loans from minority interests:								
US dollars	8.0%	25	16	3	4	2	–	–
Sterling	5.7%	56	–	–	–	–	–	56
Total financial liabilities		**4,588**	**257**	**312**	**169**	**740**	**169**	**2,941**

	Effective interest rate	Carrying amount £m	Maturity less than 12 months £m	Maturity 1-2 years £m	Maturity 2-3 years £m	Maturity 3-4 years £m	Maturity 4-5 years £m	Maturity more than 5 years £m
								31 December 2005
Financial assets								
Finance lease receivable:								
Euro	7.9%	460	12	12	14	15	16	391
Assets held for trading:								
Australian dollars	5.5%	52	52	–	–	–	–	–
Cash and cash equivalents:								
Australian dollars	5.4%	109	109	–	–	–	–	–
Czech koruna	1.9%	4	4	–	–	–	–	–
Euro	2.4%	55	55	–	–	–	–	–
Sterling	4.5%	331	331	–	–	–	–	–
US dollars	4.3%	109	109	–	–	–	–	–
Other currencies	3.2%	12	12	–	–	–	–	–
Total financial assets		1,132	684	12	14	15	16	391
Financial liabilities								
Secured bank loans:								
Australian dollars	6.7%	1,108	40	41	80	71	46	830
Effect of interest rate swap	*0.7%*	*(701)*	*(17)*	*(160)*	*(169)*	*(71)*	*(266)*	*(18)*
Czech koruna	2.8%	55	8	47	–	–	–	–
Effect of interest rate swap	*0.8%*	*(40)*	*–*	*(40)*	*–*	*–*	*–*	*–*
Euro	4.8%	371	21	22	24	23	27	254
Effect of interest rate swap	*0.4%*	*(43)*	*(5)*	*(5)*	*(8)*	*(21)*	*(4)*	*–*
Sterling	6.8%	335	85	17	15	22	17	179
Effect of interest rate swap	*(0.3)%*	*(192)*	*(19)*	*(12)*	*(10)*	*(15)*	*(136)*	*–*
US dollars	7.2%	1,013	31	33	37	31	540	341
Effect of interest rate swap	*0.2%*	*(440)*	*56*	*(23)*	*(24)*	*(200)*	*(17)*	*(232)*
Other currencies	7.7%	26	2	2	2	3	3	14
Sub-total of secured bank loans	6.6%	2,908	187	162	158	150	633	1,618
Sub-total of effect of interest rate swaps	*0.4%*	*(1,416)*	*15*	*(240)*	*(211)*	*(307)*	*(423)*	*(250)*
Secured bonds:								
Sterling	8.3%	445	–	–	–	–	–	445
Preferred equity:								
US dollars	7.2%	173	–	–	173	–	–	–
Convertible bond(1):								
US dollars	7.4%	125	–	–	–	–	125	–
Sub-total of loans and bonds included in net debt		3,651	187	162	331	150	758	2,063
Loans from minority interests:								
US dollars	8.0%	81	–	21	–	–	60	–
Total financial liabilities		3,732	187	183	331	150	818	2,063

(1) The effective interest rates for the convertible bonds represent the coupon on the par value of the bond and the accretion of the liability element which excludes the equity or embedded derivative components (refer note 25).

The effect of interest rate swaps refers to the amortisation profile in the notional amount of the interest rate swap, and are included in the above table to identify to which financial liability they relate. They are not included within total financial liabilities shown above as they are recognised as derivative financial instruments in the balance sheet.

The effect of the Group interest rate swaps effectively replaced £796 million (2005: £701 million) of floating rate Australian dollar borrowings, £869 million (2005: £440 million) of floating rate US dollar borrowings, £300 million (2005: £192 million) of floating rate sterling borrowings, £7 million (2005: £40 million) of floating rate Czech koruna borrowings and £35 million (2005: £43 million) of floating rate euro borrowings with fixed rate borrowings.

Management estimates that a one percentage point increase in interest rates would have the effect of decreasing the Group's profit before tax by approximately £3 million (2005: £8 million).

The floating rate financial liabilities comprise bank borrowings bearing interest rates fixed in advance for various time periods up to 12 months by reference to LIBOR for that time period.

33 FINANCIAL INSTRUMENTS continued

e) Currency exposures

Currency translation exposure

The results of the Group's foreign operations are translated into sterling at the average exchange rates for the period concerned. The balance sheets of foreign operations are translated into sterling at the closing exchange rates. In order to hedge the net assets of foreign operations, borrowings are generally in the same currency as the underlying investment. The Group aims to hedge a reasonable proportion of its non-sterling assets in this way. It is our policy not to hedge currency translation through foreign exchange contracts or currency swaps.

Currency transaction exposure

This arises where a business unit makes sales and purchases in a currency other than its functional currency. Transaction exposure also arises on the remittance from overseas of dividends or surplus funds. The Group's policy is to match transaction exposure where possible, and hedge remaining transactions as soon as they are committed, by using foreign currency contracts and similar instruments.

Currency exposures comprise the monetary assets and liabilities of the Group that are not denominated in the functional currency of the operating unit involved, other than certain non-sterling borrowings treated as hedges of net investments in overseas operations.

Management estimates that a one percentage point strengthening of sterling against all currencies would reduce the Group's profit before tax by approximately £3 million.

f) Borrowing facilities

The Group has substantial borrowing facilities available to it. The undrawn committed facilities available at 31 December 2006 in respect of which all conditions precedent have been met at that date amount to £667 million (2005: £441 million).

	31 December 2006			31 December 2005		
	Facility £m	**Undrawn £m**	**Available £m**	Facility £m	Undrawn £m	Available £m
US dollar Corporate revolving credit facility (October 2009)(1)	**327**	**322**	**322**	373	142	142
US dollar ANP Funding 1 revolving credit facility (May 2010)(2)	**56**	**40**	**40**	64	34	34
US dollar Tihama term facility (December 2021)	**249**	**–**	**–**	284	72	72
Australian dollar Canunda facility (December 2014)	**37**	**–**	**–**	39	12	12
Sterling Rugeley FGD construction facility (July 2014)	**145**	**129**	**129**	–	–	–
Sterling Rugeley working capital and credit facility (July 2014)	**195**	**100**	**100**	–	–	–
Czech koruna IPO revolving credit facility (May 2007)	**24**	**24**	**24**	24	20	20
Sterling Corporate working capital facility (January 2006)(3)	**–**	**–**	**–**	60	60	60
Sterling Corporate letter of credit facilities(4)	**324**	**11**	**11**	94	1	1
Subsidiary facilities in various currencies	**110**	**41**	**41**	153	100	100
Total	**1,467**	**667**	**667**	1,091	441	441

(1) The drawn element of the US dollar Corporate revolving credit facility relates to letters of credit issued of £5 million.

(2) The ANP Funding 1 revolving credit facility includes a US$50 million supported and US$60 million unsupported working capital credit facility with capacity to issue letters of credit. At 31 December 2006, £4 million (2005: £8 million) and £12 million (2005: £22 million) of letters of credit had been drawn from each of these facilities respectively.

(3) The Corporate working capital facility could have been utilised to draw cash and issue letters of credit in relation to merchant trading support. It was not renewed when it expired in January 2006.

(4) The Corporate letter of credit facilities can be utilised to issue letters of credit. At 31 December 2006, £347 million of letters of credit had been drawn from these facilities (2005: £93 million) and £212 million of cash and cash equivalents was used as collateral in relation to these facilities (2005: £28 million).

Uncommitted facilities available at 31 December 2006 were:

	31 December 2006			31 December 2005		
	Total £m	**Drawn £m**	**Undrawn £m**	Total £m	Drawn £m	Undrawn £m
Facility						
Bank borrowing and overdraft facilities	**35**	**–**	**35**	36	18	18
Subsidiary facilities in various currencies	**4**	**2**	**2**	11	2	9
	39	**2**	**37**	47	20	27

Bank borrowing facilities are normally reaffirmed by the banks annually although they can theoretically be withdrawn at any time.

g) Fair values of financial assets and liabilities

Set out below is a comparison by category of the carrying amounts and fair values of all the Group's financial assets and liabilities as at 31 December 2006:

	31 December 2006		31 December 2005	
	Carrying amount £m	**Fair value £m**	Carrying amount £m	Fair value £m
Financial assets				
Other investments	**26**	**26**	4	4
Finance lease receivables	**1,086**	**1,114**	460	460
Other long-term receivables	**29**	**29**	–	–
Trade receivables (current)	**139**	**139**	163	163
Other receivables (current)	**157**	**157**	108	108
Derivative financial assets	**281**	**281**	268	268
Assets held for trading	**42**	**42**	52	52
Cash and cash equivalents	**980**	**980**	620	620
Total financial assets	**2,740**	**2,768**	1,675	1,675
Financial liabilities				
Trade payables (current)	**303**	**303**	358	358
Other payables (current)	**226**	**226**	153	153
Other payables (non-current)	**40**	**40**	14	14
Derivative financial liabilities	**430**	**430**	687	687
Secured bank loans	**3,440**	**3,439**	2,908	2,928
Preferred equity facility	**152**	**152**	173	173
Convertible bonds	**237**	**247**	125	125
Secured bonds	**678**	**727**	445	480
Loans from minority interests	**81**	**81**	81	81
Provisions	**43**	**43**	33	33
Total financial liabilities	**5,630**	**5,688**	4,977	5,032

The methods and assumptions used to estimate fair values of financial assets and liabilities are as follows:

(i) Other investments comprise equity held in privately owned, unquoted companies as well as debt instruments in which there is no active market available to value them. Therefore fair value cannot be reliably measured. The fair value has thus been based on the cost amount.

(ii) The fair value of finance lease receivables and other long-term receivables have been estimated by discounting estimated cash flows.

(iii) Trade and other receivables (current) and trade and other payables (current) are stated at fair value, set equal to book value, because of their short maturity.

(iv) The fair value of energy derivatives is measured by reference to forward price curves using discounted cash flows and other similar quantification techniques (refer note 41).

(v) The fair value of the Group's forward exchange contracts, foreign currency swaps and foreign currency options have been calculated using market rates in effect at the balance sheet dates.

(vi) Assets held for trading have been estimated using quoted market prices and discounted cash flows.

(vii) All loans and bonds have been calculated using market prices where available or the present value of future cash flows arising.

h) Hedges

As explained on pages 15 to 17 of the business and financial review, the Group's policy is to hedge the following exposures:

(i) Energy price fluctuations – using physical hedges through the operation of energy supply and trading activities together with financial products.

(ii) Interest rate risk – using interest rate swaps, options and forward rate agreements.

(iii) Structural and transactional currency exposures – using currency borrowings, forward foreign currency contracts, currency options and swaps.

(iv) Currency exposures on future expected sales – using currency swaps, forward foreign currency contracts, currency options and swaps.

The hedging of structural currency exposures associated with foreign currency net investments is recognised in the consolidated balance sheet.

33 FINANCIAL INSTRUMENTS continued

i) Cash flow hedging reserve movements

The cash flow hedging reserve balance at 31 December 2006 and the periods in which the cash flows are expected to occur are as follows:

	Year ended 31 December 2006			Year ended 31 December 2005		
	Energy derivatives £m	Interest rate swaps £m	Total £m	Energy derivatives £m	Interest rate swaps £m	Total £m
Unrecognised gains/(losses) at 31 December 2006	**3**	**3**	**6**	(103)	(15)	(118)
Cash flows expected in:						
Less than 12 months	**22**	**(1)**	**21**	(67)	(2)	(69)
1-2 years	**(12)**	**–**	**(12)**	(27)	(1)	(28)
2-3 years	**(4)**	**(1)**	**(5)**	(10)	(1)	(11)
3-4 years	**(3)**	**(1)**	**(4)**	1	(1)	–
4-5 years	**–**	**–**	**–**	–	(4)	(4)
More than 5 years	**–**	**6**	**6**	–	(6)	(6)
	3	**3**	**6**	(103)	(15)	(118)

Gains and losses recognised in the hedging reserve during the year were as follows:

	Year ended 31 December 2006			Year ended 31 December 2005		
	Energy derivatives £m	Interest rate swaps £m	Total £m	Energy derivatives £m	Interest rate swaps £m	Total £m
Gains and (losses) recognised in the hedging reserve during the year	**39**	**16**	**55**	(104)	7	(97)
Gains and (losses) arising in previous years that were recognised during the year	**67**	**2**	**69**	(7)	(2)	(9)
Amount removed from hedging reserve and included within the income statement during the year due to settlement of contracts	**(4)**	**–**	**(4)**	(33)	3	(30)
Cash settlement of derivatives during the year	**4**	**1**	**5**	33	(8)	25
Amount removed from hedging reserve and included within a non-financial item during the year	**–**	**(1)**	**(1)**	–	5	5
	106	**18**	**124**	(111)	5	(106)

j) Hedge of a net investment

An economic foreign currency exposure arises from net investments in Group entities whose functional currency differs from the parent's. An accounting exposure arises from differences between the functional currency of the net investments and the Group's presentation currency. Changes in exchange rates between the functional currency of the net investment and that of its parent will cause the amount of the net investment to vary.

In the absence of hedge accounting the foreign exchange gains and losses on retranslating the net assets of the foreign operation would be taken to reserves, whilst those on the loan would be recognised in the income statement. This creates a mismatch in foreign currency translation. When net investment hedging is applied, this mismatch is eliminated.

The Group, as part of its hedging strategy, has therefore chosen to borrow some debt denominated in foreign currencies in order to hedge the net investments in certain assets within its portfolio. As the hedging instrument is foreign currency borrowings rather than a derivative, no fair value for this instrument is included within the fair value of derivatives disclosed on the balance sheet.

k) Counterparty credit risk

The Group's policy is to manage its credit exposure to trading and financial counterparties within clearly defined limits. Energy trading activities are strictly monitored and controlled through delegated authorities and procedures, which include specific criteria for the management of counterparty credit exposures in each of our key regions. Counterparty exposure via customer offtake agreements is monitored and managed by the local asset team with assistance from Group treasury where appropriate. In addition, Group treasury manages the Group-wide counterparty credit exposure on a consolidated basis for financial counterparties, with the active and close involvement of the global risk manager. Financial counterparty credit exposure is limited to relationship banks and commercial paper with strong investment grade credit ratings.

We are exposed to credit-related losses in the event that counterparties to traded contracts and financial instruments do not perform according to the terms of the contract or instrument. This is mitigated by the fact that for the majority of the Group's commodity trading arrangements there is a legally enforceable right of set-off that reduces the credit exposure of the Group in the event of counterparty default.

Where possible the Group will also enter into master netting agreements that further serve to mitigate its credit exposure.

With regard to financial instruments subject to credit risk, we select counterparties with appropriate ratings for the size, type and duration of the instrument involved. A small proportion of counterparties trading energy are below investment grade. For those energy market transactions with counterparties below investment grade, and which are not supported by appropriate collateral, reserves are carried against the trading risk. Exposures within this band are restricted and closely monitored within narrow limits. We do not expect any significant credit loss to result from non-performance of instruments or traded contracts.

The immediate credit exposure of financial instruments is represented by those financial instruments that have a net positive fair value by counterparty at 31 December 2006. At 31 December 2006, the exposures for interest rate swaps, currency swaps and forward exchange contracts were not considered to be material. Contracts for differences also involve a degree of credit risk. This risk is controlled by appropriate authorisation and monitoring procedures.

34 COMMITMENTS

Lease and capital commitments

	31 December 2006 £m	31 December 2005 £m
Capital commitments: contracted but not provided	**174**	82
Future minimum lease payments under non-cancellable operating leases:		
Within one year	**7**	6
Between one and five years	**23**	21
After five years	**24**	27
	54	54
Offset by future minimum receipts under non-cancellable operating subleases	**(5)**	(8)

Operating lease payments substantially represent rentals payable by the Group for office properties and wind turbine equipment.

Fuel purchase and transportation commitments

At 31 December 2006, the Group's subsidiaries had contractual commitments to purchase and/or transport coal and fuel oil. Based on contract provisions, which consist of fixed prices, subject to adjustment clauses in some cases, these minimum commitments are currently estimated to aggregate to £385 million (2005: £301 million) expiring within one year, £1,373 million (2005: £978 million) expiring between one and five years and £880 million (2005: £915 million) expiring after more than five years.