

Schneider Electric S.A.

2007 Schneider Electric Employee Share Plan

Risks Related to Our Business

The Group operates worldwide, in competitive and cyclical markets

The worldwide markets for the products of the Schneider Electric Group (the “Group”) are highly competitive in terms of pricing, product and service quality, development and introduction time and customer service. The Group faces strong competitors, some of whom are larger or developing in certain lower cost countries. The Group is exposed to cyclical fluctuations in the rate of economic growth of, and level of capital expenditures in, the various countries in which it operates, though the impact of downturns in a particular market may be limited by its broad geographic reach and the diversified nature of its end user markets.

As the Group also operates in emerging or developing countries for 31% of its business, it is exposed to the risks associated with those markets.

The Group’s wide international presence exposes it to many economic, legal and political risks in its host countries. These include risks arising from social unrest (particularly, strikes and walk-outs), political instability, unforeseen regulatory changes, restrictions on capital transfers and other obstacles to free trade, and local tax laws, all of which may have an adverse effect on its business, results of operations or financial position.

The Group has implemented procedures designed to protect it from the effects of these risks, which are generally beyond its control, and to manage them as effectively as possible. The protection provided by these measures may nevertheless prove to be inadequate.

The development and success of the Group’s products depend on its ability to develop new products and services and to adapt to the market and to customer needs

The markets in which the Group operates experience rapid and significant changes due to the introduction of innovative technologies. Introducing new technology products and innovative services, which the Group must do on an ongoing basis to meet its customers’ needs, requires a significant commitment to research and development, which may not result in success. The Group’s sales and margins may suffer if it invests in technologies that do not function as expected or are not accepted in the marketplace or if its products, systems or service offers are not brought to market in a timely manner, become obsolete or are not responsive to customers’ requirements.

In order to meet these challenges, the Group has an R&D budget which, at approximately 5% of revenue, is among the highest in the industry. R&D involves 6,500 employees around the world, a number of them in development centers located in 25 countries. This ongoing commitment has allowed the Group to accelerate time to market and leverage the technology of strategic partners with whom it has also forged alliances to expand its lineup or geographic coverage. The Group has brought together all of its electrotechnical, electronic, electromechanical, software and other technical competencies by creating technology parks in China, the US, France and Japan.

Global support centers have also been established in Mexico, India and China to provide the technology parks with additional skills and development capacity at a very competitive cost.

The Group's business growth depends on its ability to develop, deepen and enhance customer relationships. The Group must constantly offer customers innovative solutions built around high quality products and services incorporating leading edge technologies that are closely tailored to customer needs and expectations. However, the Group does not have any exposure with a particular customer. Its ten largest customers represent less than 25% of its revenue.

Increasingly high customer satisfaction rates represent an important source of competitive advantage for the Group. It closely tracks the results of the quarterly surveys conducted in 55 countries among customers representing some 96% of annual sales. Improvement targets are set for each country, backed by specific action plans and progress monitoring procedures.

The Group's strategy involves growth through acquisitions, joint ventures and mergers, which may be difficult to identify and/or execute

The Group's strategy involves strengthening its capabilities through acquisitions, strategic alliances, joint ventures and mergers.

External growth projects are examined in detail by the business units, country organizations and corporate functions (Strategy, Finance, Legal Affairs and Human Resources) concerned under a rigorous internal process developed and led at Group level. A launch committee is responsible for initiating the review process to identify the risks and opportunities associated with each external growth project, while a validation committee reviews the results. Projects that successfully come through the review process are submitted for approval to the Group acquisitions committee made up of the main members of senior management. The largest projects require the prior approval of the Management Board and, in some cases, the Supervisory Board.

External growth transactions are inherently risky because of the difficulties that

may arise in integrating people, operations, technologies and products, and the related acquisition, administrative and other costs. The Group has therefore developed a process for integrating newly acquired businesses that extends over a period of 6 to 24 months depending on the type and size of the newly acquired entity. The integration scenario for each acquisition varies depending on whether the business was acquired to strengthen the Group's existing lineup, extend the lineup or penetrate a new segment. All told, there are five scenarios ranging from total integration to separate organization. Depending on the strategic objective, a matrix is drawn up showing the required level of integration for each of the newly acquired business's core functions, i.e. front office (sales force and brand), back office, R&D, corporate functions and management reporting. An integration plan is drawn up for each acquisition and submitted to the acquisitions committee for approval. The plan is implemented by an integration manager who reports to a Steering Committee that initially meets at monthly intervals and then on a quarterly basis.

The unit that presents the external growth project is accountable to Group senior management for meeting clearly defined business plan targets covering the performance of the new business and expected synergies with existing businesses. Actual performance is measured against business plan targets during quarterly business reviews and, for the largest acquisitions, by the Management Board and Supervisory Board.

The follow-up of the value of the acquisitions implemented is done through annual impairment tests.

Value in use is determined by discounting estimated future cash flows that will be generated by the tested assets. Estimated future cash flows are based on management's economic assumptions and operating forecasts, as well as long-term growth prospects generally equivalent to forecast inflation. The discount rate corresponds to Schneider Electric's weighted average cost of capital (7.5% at December 31, 2006 and 2005 and 8.5% at December 31, 2004), plus a risk premium depending on the region in question.

The Group's goodwill is mainly allocated to cash-generating units (CGU) located in Europe and in the United States. Tests performed on goodwill allocated to European and American CGUs are implemented with a discount rate equal to Schneider Electric's weighted average cost of capital, free of a risk premium. Moreover, the infinite growth rate of these CGUs is equal to 2% and has not changed for the last financial year.

The Group may be the subject of product liability claims and other adverse effects due to defective products, design faults or harm caused to persons and property

Despite its testing and quality procedures, the Group's products might not

operate properly or might contain design faults or defects. These design faults and defects could result in product liability claims, loss of revenue, warranty claims, litigation, a fall-off in demand or harm to the Group's reputation for safety and quality. To prevent or limit these risks, the Group recalls products if there are any doubts about a component, even if the defect is random and does not pose a safety risk.

Schneider Electric is covered by a global liability insurance program. Insured values under these programs adequately cover the Group's exposure to liability claims in connection with its businesses.

Information systems risks

The Group operates, either directly or through service providers, a wide range of highly complex information systems (servers, networks, applications, databases, etc.) that are essential to the efficiency of its sales and manufacturing processes. Failure of any of these hardware or software systems, a fulfillment failure by a service provider, human error or computer viruses could adversely affect the quality of service offered by the Group.

The Group regularly examines alternative solutions to protect against this type of risk and has developed contingency plans to mitigate the effects of any information system failure. Dedicated governance structures have been set up to manage relations with service providers responsible for outsourced IT systems operations.

Problems may also be encountered during the deployment of new applications or software. In particular, a project was launched in 2005 to design, develop and build a Group-wide SAP-based ERP system. The initial vision and detailed design phases were completed in July 2005 and the core system is now being built, for deployment on several pilot sites over the period 2007-2009. Once the trial phase has been completed at the end of 2009, the system will be rolled out to the entire Group over a period of around four years.

In view of the project's complexity, extensive functionalities and its worldwide deployment, a dedicated governance and cost control structure has been set up to track attainment of project milestones and limit the related risks.

However, despite the Group's policy of establishing governance structures and contingency plans, there can be no assurance that information systems projects will not be subject to technical problems or execution delays. While it is difficult to accurately quantify the impact of any such problems or delays, they could have an adverse effect on inventory levels, service quality and – consequently – the Group's financial results.

The Group is dependent upon hiring and retaining highly qualified management and technical personnel

Competition for highly qualified management and technical personnel is intense in the Group's industry. Its future success depends in part on the Group's ability to hire, assimilate and retain engineers and other qualified personnel.

The Group's human resources strategy is designed to create a motivating working environment. Specific policies have been developed covering international mobility, career development, training and compensation. The Group's expatriates help it to prepare the future of its business, build local teams and assemble the necessary skill-sets in targeted regions. The Group places considerable emphasis on training to deepen its skills base and retain employees.

The development and success of the Group's products depend on its ability to protect its intellectual property against competitors

The Group's future success depends to a significant extent on the development and maintenance of its intellectual property rights. Third parties may infringe the Group's intellectual property rights, and the Group may expend significant resources monitoring, protecting and enforcing its rights. If the Group fails to protect or enforce its intellectual property rights, its competitive position could suffer, which could have an adverse effect on its business.

In order to mitigate this risk, the patents developed or purchased by the Group are tracked by the industrial property team within the Finance & Control - Legal Affairs department. All industrial property information for the main Group subsidiaries is transmitted to this team, which is responsible for managing and protecting these intangible assets throughout the world. The same procedure is followed for trademarks.

Since 2005, the Group has decided to combat violations of industrial property rights more vigorously, taking legal action against patent counterfeiters in Germany, Italy, France and other jurisdictions.

The Group's plants and products are subject to environmental regulations

The Group's plants and products are subject to extensive and increasingly stringent environmental laws and regulations in all of its host countries.

In order to limit risks related to the environment generally, the Group is involved in a process to continuously improve the environmental performance of its plants and products. In 1992, the Group published a formal environmental policy, which was recently redefined to take account of changes both inside and outside Schneider Electric.

The policy is designed to improve manufacturing processes, promote eco-design and integrate customer concerns in the area of environmental protection. It also aims to identify, assess and prevent environmental risks, in order to guarantee full compliance with all environmental laws and regulations applicable to the Group's businesses. Environmental provisions are booked when the risks can be reliably measured or it is probable that clean-up work will be performed and the related cost can reasonably be estimated. No estimate is made of the potential cost of unidentified environmental risks. The Group expects spending on environmental compliance programs to increase as a result of changes to existing environmental regulations and the introduction of new regulations.

There can be no guarantee that the Group will not be required to pay significant fines or compensation as a result of past, current or future breaches of environmental laws and regulations by companies that are currently or were previously members of the Group. This exposure exists even if the Group is not responsible for the breaches, in cases where they were committed in the past by companies or businesses that were not part of the Group at the time.

The Group may be exposed to the risk of claims for breaches of environmental laws and regulations. Such claims could adversely affect the Group's financial position and reputation, despite the efforts and investments made to comply at all times with all applicable environmental laws and regulations.

If the Group fails to conduct its businesses in full compliance with the applicable environmental laws and regulations, the judicial or regulatory authorities could require the Group to conduct investigations and/or implement costly clean-up measures to deal with the current or past contamination of current or former facilities or off-site waste disposal facilities, and to scale-back or temporarily or permanently close facilities in accordance with the applicable environmental laws and regulations.

The Group's international operations expose it to the risk of fluctuations in foreign exchange rates

Because a significant proportion of transactions are denominated in currencies other than the euro, the Group is exposed to risk arising from changes in exchange rates. If the Group is not able to hedge them, fluctuations in exchange rates between the euro and these currencies can have a significant impact on its results of operations and distort year-on-year performance comparisons.

The Group actively manages its exposure to currency risk to reduce the sensitivity of earnings to changes in exchange rates. Hedging programs mainly concern foreign currency receivables, payables and operating cash flows, which are generally hedged by means of forward sales. Depending on market conditions, risks in the main currencies may be hedged based on recurring

forecast flows using contracts that expire in 12 months or less.

The Group's currency hedging policy is to protect subsidiaries against risks on all transactions denominated in a currency other than their functional currency. More than twenty currencies are involved, with the US dollar, Hong Kong dollar and British pound representing the most significant sources of risk.

The financial instruments to hedge the exposure of the Group to fluctuations in exchange rates are described in Notes 20.4 and 20.6 to the consolidated financial statements for fiscal year 2006 (found in the Schneider Electric 2006 Annual Report).

In 2006, the revenue produced in foreign currencies came to €8,879 million. Foreign currency assets and liabilities represented respectively €1,973 million and €5,156 million. The main exposure of the Group in terms of currency exchange risks is related to the US dollar and to currencies influenced by the US dollar. The Group estimates that in the actual structure of its operations, a 10% increase of the euro compared to the US dollar would have an impact of 0.3 points on operating margin.

Interest rate risk

The Group is exposed to risks associated with the effect of changing interest rates. Interest rate risk on borrowings is managed at Group level, based on consolidated debt and according to market conditions. The main goal of interest rate management policies is to optimize Group financing costs. Most bond debt is fixed rate.

Less than one year and/or with a variable rate, the Group has a net cash available of about €1.7 billion.

	Up to 1 year	1 to 5 years	More than 5 years
Financial liabilities	884.6	2,312.7	1,144.4
Financial assets	2,544.1	315.7	
Net position before management	1,659.5	1,997	1,144.4

A 1% change in interest rates would have an impact of around 15% on the Group's financial expense.

The financial instruments to hedge the exposure of the Group to fluctuations in interest rates are described in Notes 20.4 and 20.7 to the consolidated financial statements for fiscal year 2006 (found in the Schneider Electric 2006 Annual Report).

Counterparty risk

Transactions involving foreign currency and long and short-term interest rate hedging instruments are entered into with selected counterparties. Banking counterparties are chosen according to the customary criteria, including the credit rating issued by an independent rating agency.

Group policy consists of diversifying counterparty risks and periodic controls are performed to check compliance with the related rules.

Liquidity risk

Liquidity is provided by the Group's cash and cash equivalents and commercial paper programs. These programs are backed by undrawn confirmed lines of credit.

The Group's credit rating enables it to raise significant long-term financing and attract a diverse investor base. The Group's current credit rating is A, watch negative. The Group's liabilities and their terms and conditions are described in Note 17 to the consolidated financial statements for fiscal year 2006 (found in the Schneider Electric 2006 Annual Report).

Currency and interest rate risks are generally managed at Group level, with the aim of limiting the impact on results of changes in exchange and interest rates without entering into any trading transactions. Hedging decisions are made by the Finance & Control - Legal Affairs department and are reviewed at regular intervals based on changes in financial market conditions.

In line with the Group's overall policy of conservatively managing liquidity risk and protecting its financial position, when negotiating new liquidity facilities the Group resists the inclusion of clauses that would have the effect of restricting the availability of credit lines, such as covenants requiring compliance with certain financial ratios and material adverse change clauses.

The loan agreements for some of its liquidity facilities nevertheless include cross-default clauses whereby if the Group were to default on any of its liquidity facilities, it would immediately be considered as having defaulted on all such facilities. Moreover, anticipated reimbursement provisions exist for certain financing and lines of credit in case of change of control.

An increase in raw materials price could have negative consequences

The Group is exposed to fluctuations in energy and raw material prices (in particular steel, copper, aluminum, silver, nickel, zinc and plastic). If the Group is not able to hedge, compensate or pass on its increased costs to customers, this could have an adverse impact on its financial results.

The Group has, however, implemented certain procedures to limit its exposure to rising non-ferrous raw material prices. The purchasing departments of the operating units report their purchasing forecasts to the Corporate Treasury Center. Purchase commitments are hedged using forward contracts, swaps and, to a lesser extent, options.

The financial instruments to hedge the exposure of the Group to increase in raw materials price are described in Note 20.4 to the consolidated financial statements for fiscal year 2006 (found in the Schneider Electric 2006 Annual Report).

In 2006, purchases of raw materials totaled around €1 billion, including €400 million for non-ferrous metals, of which more than 70% were for copper. The Group enters into swap and options agreements in order to hedge all or part of its raw material purchases. Decisions to hedge such purchases, mostly of non-ferrous metals, depend on Group forecasts of changes of raw material market prices. As of December 31, 2006, Group hedges for non-ferrous metal purchases amounted to €115 million.

Equity risk

Exposure to equity risk primarily relates to treasury stock and shares in AXA. These positions are not hedged.

The Group's products are subject to varying national and international standards and regulations

The Group's products, which are sold in national markets worldwide, are subject to regulations in each of those markets, as well as to various supranational regulations. Those regulations include trade restrictions, tariffs, tax regimes and product safety standards. Changes to any of these regulations or standards or their applicability to the Group's business could lead to lower sales or increased operating costs, which would result in lower profitability and earnings.

The products of the Group are also subject to multiple quality and safety controls and regulations, and are governed by both national and supranational standards, though the majority of the lineup complies with world-recognized International Electrotechnical Commission (IEC) standards. Costs of compliance with new or more stringent standards and regulations could affect its business if the Group is required to make capital expenditures or implement other measures.

Since the Group's products comply with the dominant standards in its host markets, the Group is able to meet most all of its customers' needs.

Claims, litigation and other risks

In 2001, Schneider Electric made a public offer to purchase Legrand as part of a proposed merger project. When the offer closed in July 2001, the Company held 98.1% of Legrand. In an initial decision dated October 10, 2001, the European Commission vetoed the merger, and in a second decision dated January 30, 2002, it ordered the two companies to separate as quickly as possible. As a result, Schneider Electric sold its interest in Legrand to the KKR-Wendel Investissement consortium even though the Court of First Instance of the European Communities overruled the Commission's decisions on October 22, 2002. Schneider Electric launched proceedings against the European Commission to obtain damages for the prejudice caused, estimated at €1.6 billion. Hearings are scheduled for 2007.

Following public offers launched in 1993 by SPEP (the Group holding company at the time) for its Belgian subsidiaries Cofibel and Cofimines, Belgium initiated proceedings against former Schneider Electric executives in connection with the former Empain-Schneider Group's management of its Belgian subsidiaries. At the end of March 2006, the Brussels criminal court (*tribunal correctionnel*) ruled that some of the defendants were responsible for certain of the alleged offenses. The court also appointed an expert to assess the loss suffered by those plaintiffs whose claims were ruled admissible. The Group and its Belgian subsidiaries Cofibel and Cofimines were held civilly liable for the actions of their senior executives who were found liable. The Group is paying the legal expenses not covered by insurance of the former executives involved.

In connection with the divestment of Spie Batignolles, the Group booked provisions to cover the risks associated with certain major contracts and projects. Most of the risks were extinguished during 1997. Provisions were booked for the remaining risks, based on management's best estimate of the expected financial impact.

The issuer is not aware of any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the issuer is aware) during a period covering at least the previous 12 months, which may have, or have had in the recent past significant effects on the issuer and/or the Group's financial position or profitability.

Insurance

The Group's strategy for managing insurable risks is designed to defend the interests of employees and customers and to protect the environment, the Company's assets and its shareholders' investment. This strategy entails:

- Identifying and quantifying risk using different reporting systems.

- Preventing risks. The Group has a realistic prevention policy to ensure safety at its sites. The Triple A approach, conducted with insurance company experts, aims to enhance processes to control and manage risks by identifying vulnerable areas and implementing appropriate solutions to preserve the long-term sustainability of the Group's manufacturing resources and business. This approach builds on preventive measures already in place such as regular inspections, danger and vulnerability studies, safety management for people and equipment and security plans. As concerns risks of average frequency and intensity, the Group also has ongoing programs to prevent traffic accidents and work accidents and reduce transportation risk.

- Organizing and deploying crisis management resources, notably for technical and political risks and natural disasters.

- Maintaining the necessary insurance cover for the main risks facing Group companies (civil liability, property damage and business interruption, environmental accidents and transportation risk), under global programs. The Group continues to carefully screen insurance and reinsurance companies and evaluate their solvability. To maintain essential levels of cover while also optimizing insurance costs in light of constraints in the insurance and reinsurance markets, the Group has adopted a policy of self-insuring a certain number of recurring risks, whose frequency and financial impact can be reliably estimated (primarily automobile risks). Through its reinsurance subsidiary, the Group covers moderate property damage, business interruption and civil liability risks. The amounts involved are not material at the consolidated level.

In addition, the Group has taken out specific cover in response to certain local conditions, regulations or the requirements of certain risks, projects and businesses.

This cover has been renewed in 2007.

Liability insurance

The Group is covered by a global liability insurance program. Insured values under this program total €230 million, representing adequate coverage of the Group's exposure to liability claims in connection with its businesses.

Property and casualty/business interruption insurance

A global property and casualty/business interruption insurance program has been set up for the Group in all countries except for the United States, Canada and Mexico where a separate program has been established to take account of the specific requirements and characteristics of the North American market. Aggregate settlements under the global program are capped at €250 million and specific limits apply to certain risks, such as earthquake damage and machine

damage. In 2007, a combined program will be set up, covering all sites worldwide. In 2006, external auditors prepared a report on the impact of a major event causing an interruption of one of the Group's businesses. The external auditors' findings were used to develop an analysis model that the Group is planning to roll out to other businesses.

Transport insurance

A global transport insurance program has been set up for the Group in all countries except for the United States, Canada and Mexico where a separate program has been established to take account of the specific requirements and characteristics of the North American market. The program covers all goods shipments, including between Group facilities, by all means of transport, with a maximum insured value of €15.2 million per convoy.