New remuneration for electricity transmission

9 January 2014

New reference framework for the electricity sector

- The new Electricity Sector Law was passed on 26th December (Law 24/2013)
- The Royal Decree of Transmission was passed on 27th December (RD 1047/2013)
- Mechanisms have been established to minimise differences between income and expenses by means of the automatic review of tolls and charges
- The principles and criteria establishing remuneration for regulated activities have been strengthened and clarified to bring them into line with European peers
- The transmission activity is part of a more stable and predictable backdrop

Guaranteeing supply, quality and the economic and financial sustainability of the electricity system

New regulation to guarantee the stability of the electricity transmission activity

Transparent, stable and predictable

Sustainable

Incentives for efficiency

Key principles

Transparent, stable and predictable

- A single methodology applicable to all electricity transmission facilities.
- 6-year regulatory periods. First regulatory period ends 31 December 2019.
- Remuneration of investment shall be made for all assets in service according to their net value. All assets currently in operation are assigned a useful life and a return on investment.
- Facilities will be remunerated according to when they were brought into service (eliminating the penalty arising from the n+2 effect and compensation up to “n” for facilities commissioned after 1998).
- Based on reference unit capex costs and operation and maintenance costs.
- The financial return is benchmarked to the Spanish 10-year bond yield. This will increase by a spread to be revised in each regulatory period.
- The useful life of facilities may be extended and remuneration set for when this occurs.
- Incentives for efficiency and availability of the transmission network will be established.

General remuneration model for transmission facilitie

Transparent, stable and predictable

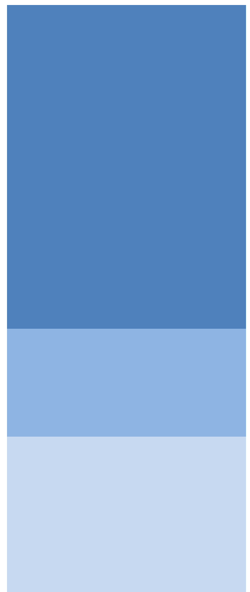
Investment Return

Financial Return

Depreciation

+

O&M Remuneration



- Net value of the investment to be remunerated = audited investment value, adjusted by 50% of the difference with the benchmark unit cost of the year asset is comissioned
- Financial rate of return = 10-year bond yield (1) + spread
- According to useful life
- Based on benchmark operation and maintenance unit costs updated annually throughout the asset's useful life

(1) 10-year Government bond yield in secondary market over 24 months before May of the year prior to the start of the regulatory period.

- Financial expense recognized arising from delays between the commissioning of the facility and the remuneration collection on investment and O&M.
- In the 1st regulatory period, the differential will be 200 bp while the rate of return is set at 6.5% before tax.
- Once the useful life ends, the extension of useful life will be remunerated in addition to O&M retribution

Transparent, stable and predictable

Remuneration for assets in operation

INVESTMEN T RETURN

Assets prior to 98

- Implicit valuation based on retribution on investment associated with these facilities.
- The average residual life set by the Ministry of Industry, Energy and Tourism will be used.
- The residual life may increase depending on renovation and improvements made.

Assets after 98

- Assets are valued at replacement cost based on benchmark unit investment costs(*).
- The useful life will be calculated based on the year each facility was brought into operation.

- The applicable financial rate of return for the first regulatory period is 6.5%

OPERATION AND MAINTENANCE REMUNERATION

- Based on benchmark operation and maintenance unit costs (*)

** Benchmark unit investment and O&M costs will be defined by the Ministry of Industry, according to proposals from the CNMC.*

Pending regulatory issues

Transparent, stable and predictable

- Investment and O&M benchmark unit costs must be established.
- Set average residual life of facilities prior to 1998 by verifying renovation and improvements carried out at assets prior to 98.
- New plan defining investment requirements for new electricity transmission facilities.

2014

April
- The CNMC proposes investment and O&M benchmark unit costs

June
- Renovation and improvements made at facilities prior to 1998 verified

July
- Ministry of Industry establishes parameters used to calculate remuneration for transmission activity

Sustainability

Sustainable

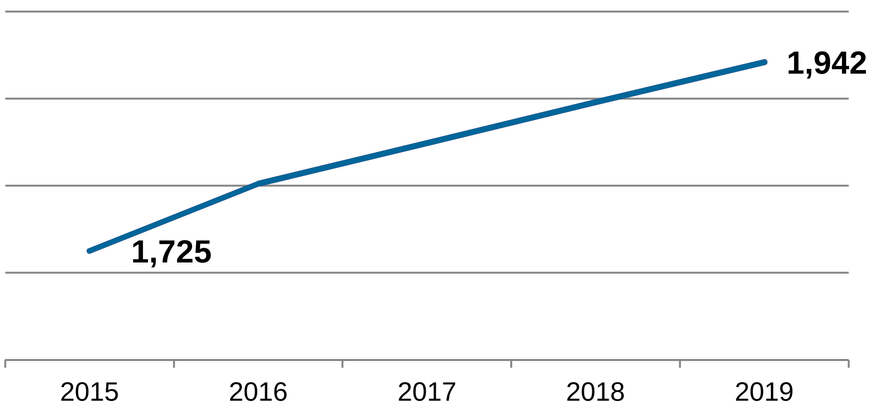
- Tools have been introduced to align investment in the transmission network with the system's financial sustainability.
- Annual volume may not exceed 0.065% of estimated GDP for a certain year, unless economic or technical reasons make it necessary. Maximum investment established is assumed by the electricity system as an annual cost.
- The Ministry of Industry must submit estimates for transmission revenue over a period of six years.

Sustainable

Sustainable, stable and predictable revenue

Estimated transmission tariff according to RD (*)

Transmission remuneration
(€mn)



Δ 3%TACC

- Forecasts have been calculated using temporary methodology as per RD-l 9/2013, of 12 July.
- Hypothetical annual investment scenario of €600 mn.
- Revenue performance includes availability incentive and remuneration for Gas Natural-Fenosa assets (approx €37 mn in 2013).
- 2015 is the start year of the first regulatory period.
- The 2014 tariff for REE is estimated at over €1,600 million and approx 1,685€mn in 2015.

(*) Figures taken from analysis report of the regulatory impact of Royal Decree 1047/2013 sent to the State Council establishing the methodology used to calculate electricity transmission remuneration and the regime of payments for access and connection studies for transmission networks.

Return on new investment

Efficiency incentives

6% -6.5% — **Post-tax IRR of project with efficiencies**

1.4% -1.9% — **Operating efficiencies and availability + Complementary businesses**

4.6% — **Post-tax IRR of project**

6.5% — **Pre-tax IRR of project**

Additional measures to create value: financial and process management

Next steps

- Achieve a reasonable outcome for various pending remuneration and regulatory aspects.
- Analyse treatment of maintenance capex.
- Review main operating processes according to efficiency and adequate quality criteria.
- Develop a suitable remuneration model for system operations.
- Define Strategic Plan for forthcoming years.

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