



Stranded Costs (CTC)

9 March 2005

CTCs ARE A REGULATED CONCEPT, ESTABLISHED BY LAW, REQUIRED TO RECOVER STRANDED COSTS

Concept

- 6th Transitional Provision N^o. 1 of the Electricity Act (Law 54/1997)

*Recognises “the existence of costs associated with the transition to a competitive market regime on the part of the companies which own electrical energy generating assets” and as a result, “said companies are granted the **right to receive compensation** for these costs”*

*“The global amount of these costs, valued at 31 December 1997, may in no instance exceed 1,441,502 million pesetas (**Euro 8.664 billion**) in technical competition transition charges”*

Recovery procedure

- 6th Transitional Provision N^o. 3 of the Electricity Act (Law 54/1997)

*“If the average generation costs referred to in article 16.1 of the present Act of each of the companies which own generation facilities is annually in excess of 6 pesetas per kWh, this excess shall be deducted from the actual quoted value” (**recovery through the market, versus recovery from differentials** if there is a tariff gap)*

CTCs are an intrinsic part of Law 54/1997 and all agents and new entrants are aware of them

CTCs REPRESENT A PAYMENT COMMITMENT RECOGNISED BY THE EUROPEAN UNION AND USED IN OTHER COUNTRIES

Ruling by the European Commission 1999/797/CE and NN 49/99

- *The **existence of a CTC regime is justified** as “the transfer of a compensatory payment to certain electricity producers, financed via a tariff or tax to be borne by consumers”*
- *The ruling refers to the “**reasonableness**” of the CTC scheme and the **amount provided for**; in fact, it even states that “net losses to the companies benefiting from CTCs (...) are higher than the maximum CTC quantities fixed by the Spanish authorities”*
- *It is guaranteed that **no company will recover more than the amount provided for**: “The payment of the aid will take into account the trends in electricity market prices. If this price is higher than 6 pesetas per kWh (Euro 36/MWh), the sum of the aid to each beneficiary company will be reduced ex post by the earnings accruing from the differential between this price and the target price of 6 pesetas per kWh. This reduction could be as sufficient to **reduce the aid to zero**”*

International precedents

- Portugal and Italy, where similar schemes were also approved by the European Union
- The US.

THE METHODOLOGY FOR CALCULATING CTCs CONTEMPLATES ADJUSTMENTS WHICH SIGNIFICANTLY REDUCE THE ORIGINALLY ESTIMATED AMOUNTS

Calculation methodology (1997)

Turnover required to recover stranded costs (i.e. repayment of capital during the previous regulatory regime, the *Marco Legal Estable*)

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Estimated market turnover in a deregulated market

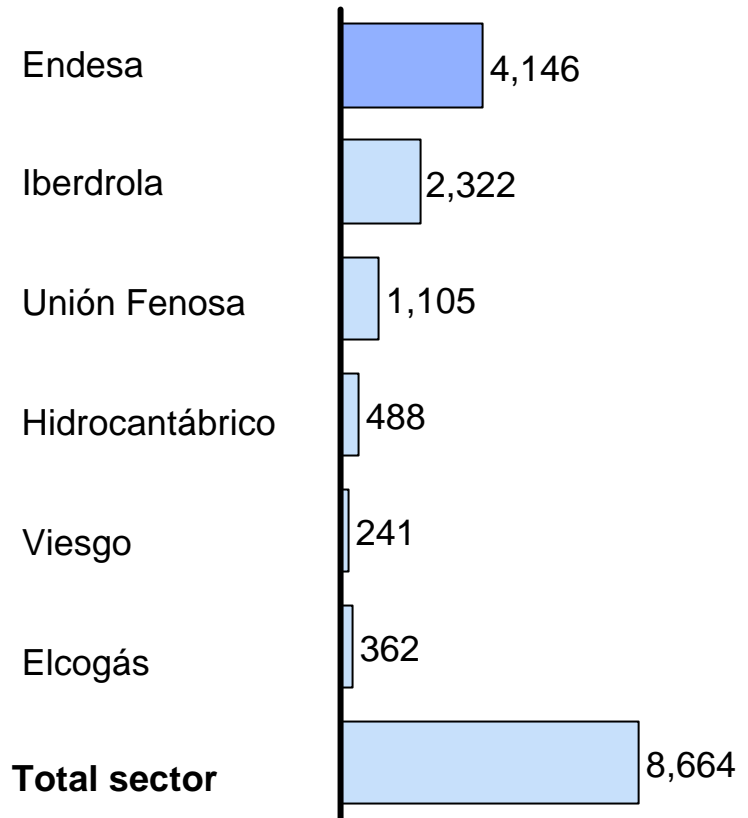
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Adjustments (i.e. a 32.5% efficiency factor discount to the CTCs; an additional 16% discount on the remainder as of 31-12-98; other)

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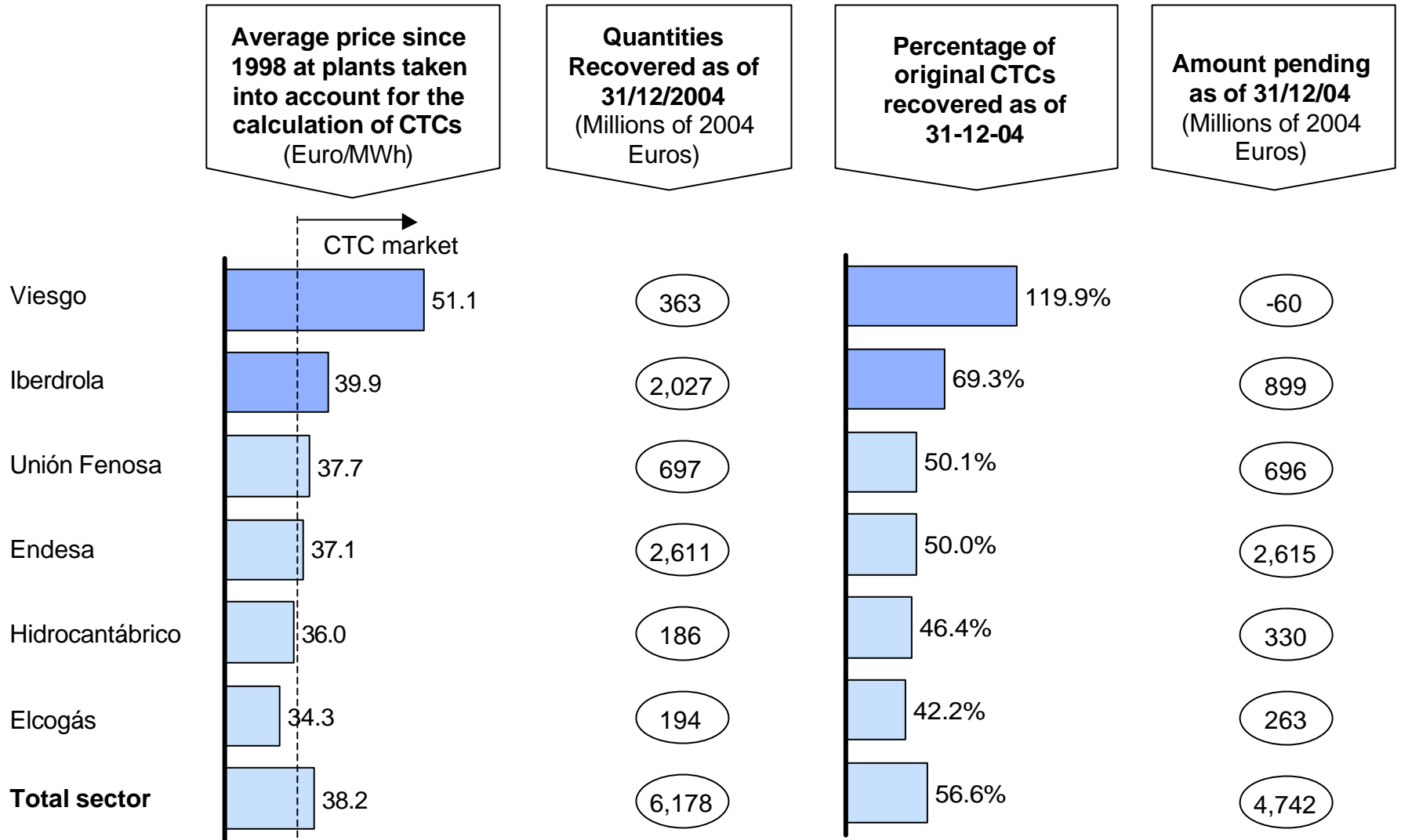
Competition Transfer Charges (CTCs)

Original amounts per agent Millions of 1997 Euros



THERE ARE SIGNIFICANT DIFFERENCES IN THE DEGREE TO WHICH AGENTS HAVE RECOVERED THEIR CTCs

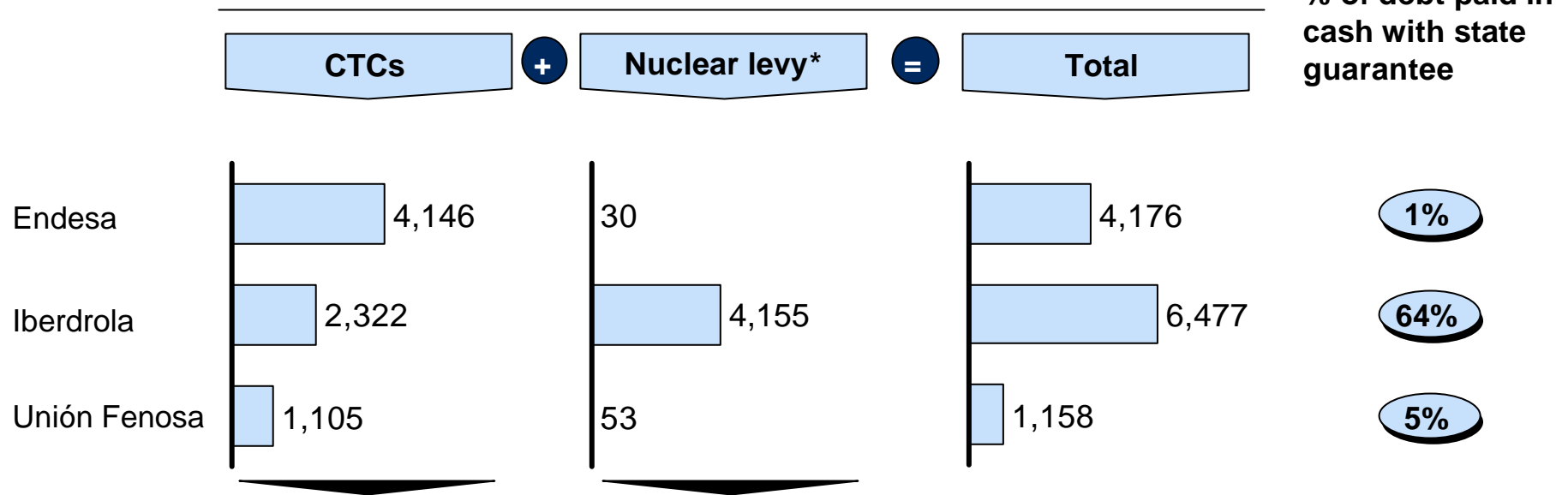
Provisional recovery data from the National Energy Commission, as of 12/04



Note: The amounts recovered as of 31-12-2004 are expressed in 2004 monetary values, updated from 1997 figures (i.e., a total to be recovered of Euro 8.664 billion)

CTCs ARE A SIMILAR CONCEPT TO THE NUCLEAR MORATORIUM LEVY, ALTHOUGH THE LATTER HAS BEEN FULLY PAID OUT: A STRANDED INVESTMENT WHICH MAY NOT BE RECOVERED BY THE MARKET

Amounts owed in CTCs and nuclear levy by agent
Millions of 1997 Euros



- Payment incomplete, to be made between 1998 and 2010
- Recovery of remaining amounts charged to 2005-2010 tariff

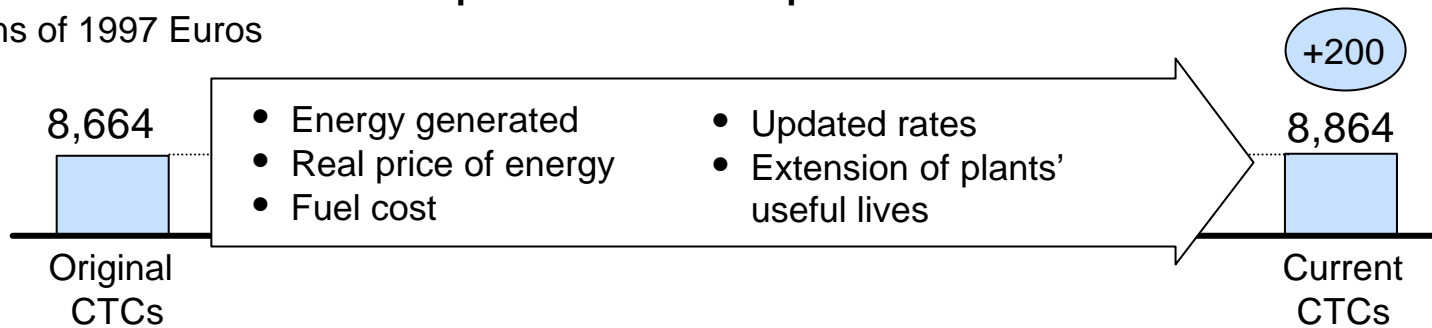
- Payment made to companies in cash, with a state guarantee
- Cessation of right to charge quantities paid to third parties, which annually recover the anticipated amount

* In addition to Iberdrola, Unión Fenosa and Endesa, there was a fourth beneficiary of the nuclear moratorium, Sevillana. Sevillana was acquired by Endesa after the moratorium levy was granted, such that the price paid by Endesa already reflected the amount owing to Sevillana. Accordingly, the beneficiaries of the moratorium were Sevillana's former shareholders, not Endesa

CTCs HAVE NOT BEEN FULLY PAID OUT

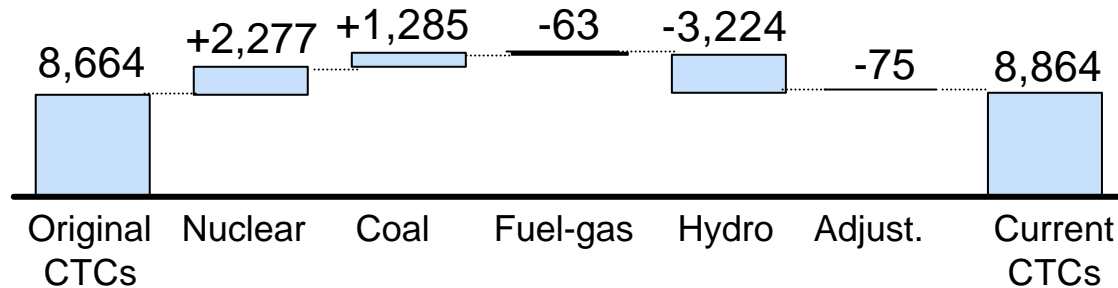
Valuation of sector CTCs with updated calculation parameters

Millions of 1997 Euros



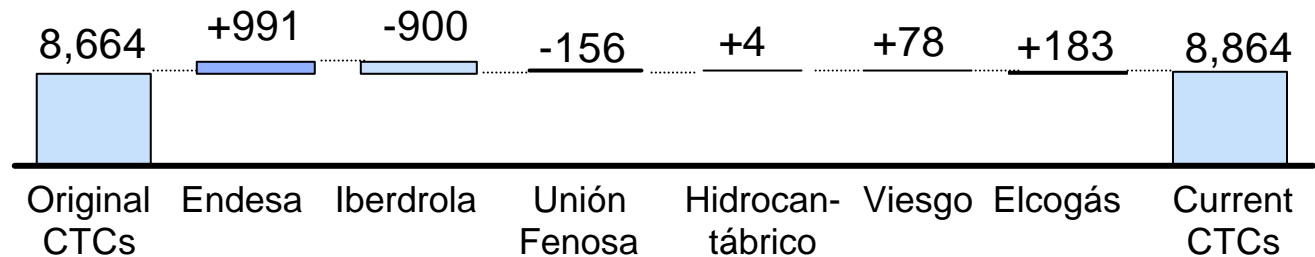
Breakdown of changes in CTCs by technology

Millions of 1997 Euros



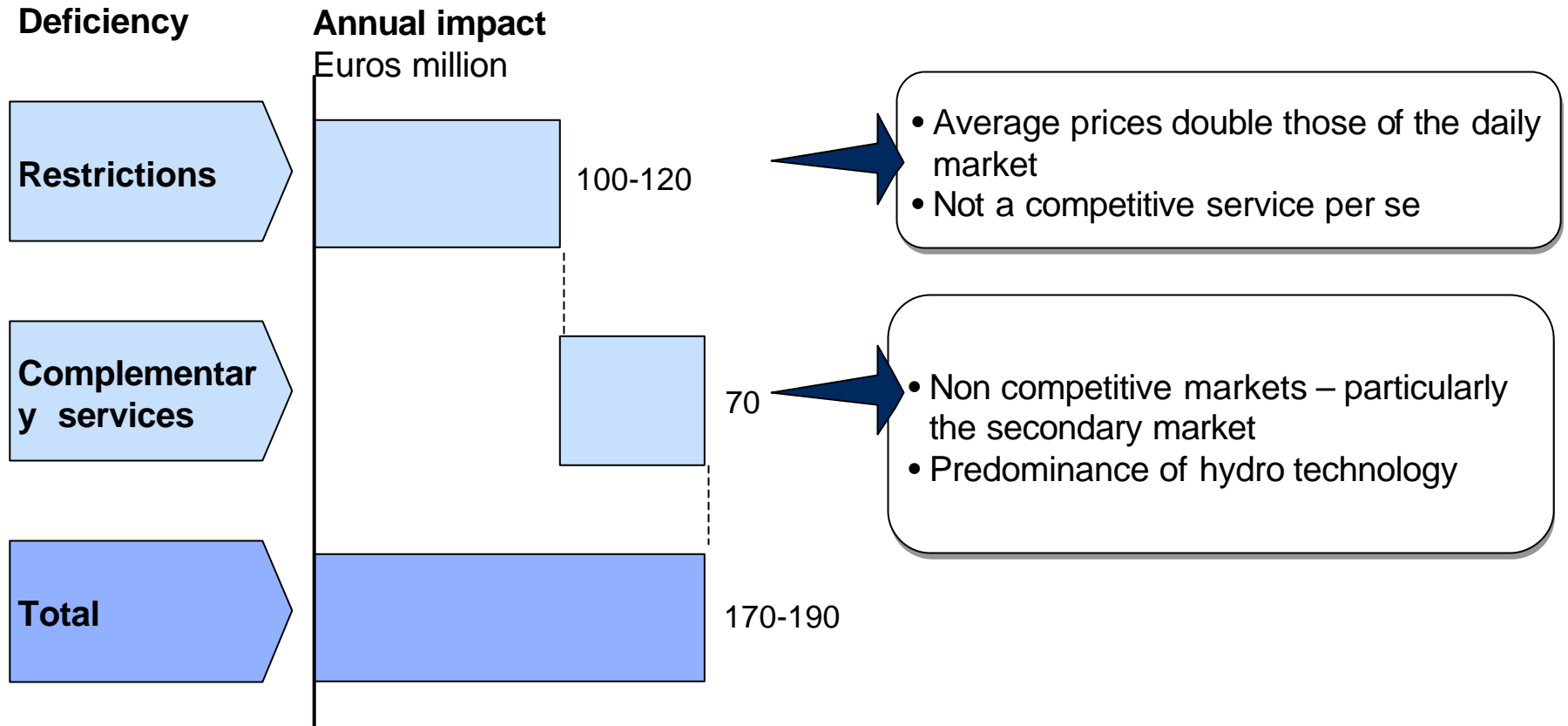
Breakdown of changes in CTCs by company

Millions of 1997 Euros



THE SPANISH ELECTRICITY MARKET SHOWS SERIOUS DEFICIENCIES WHICH NEED TO BE ADDRESSED MORE URGENTLY THAN THE CTC ISSUE

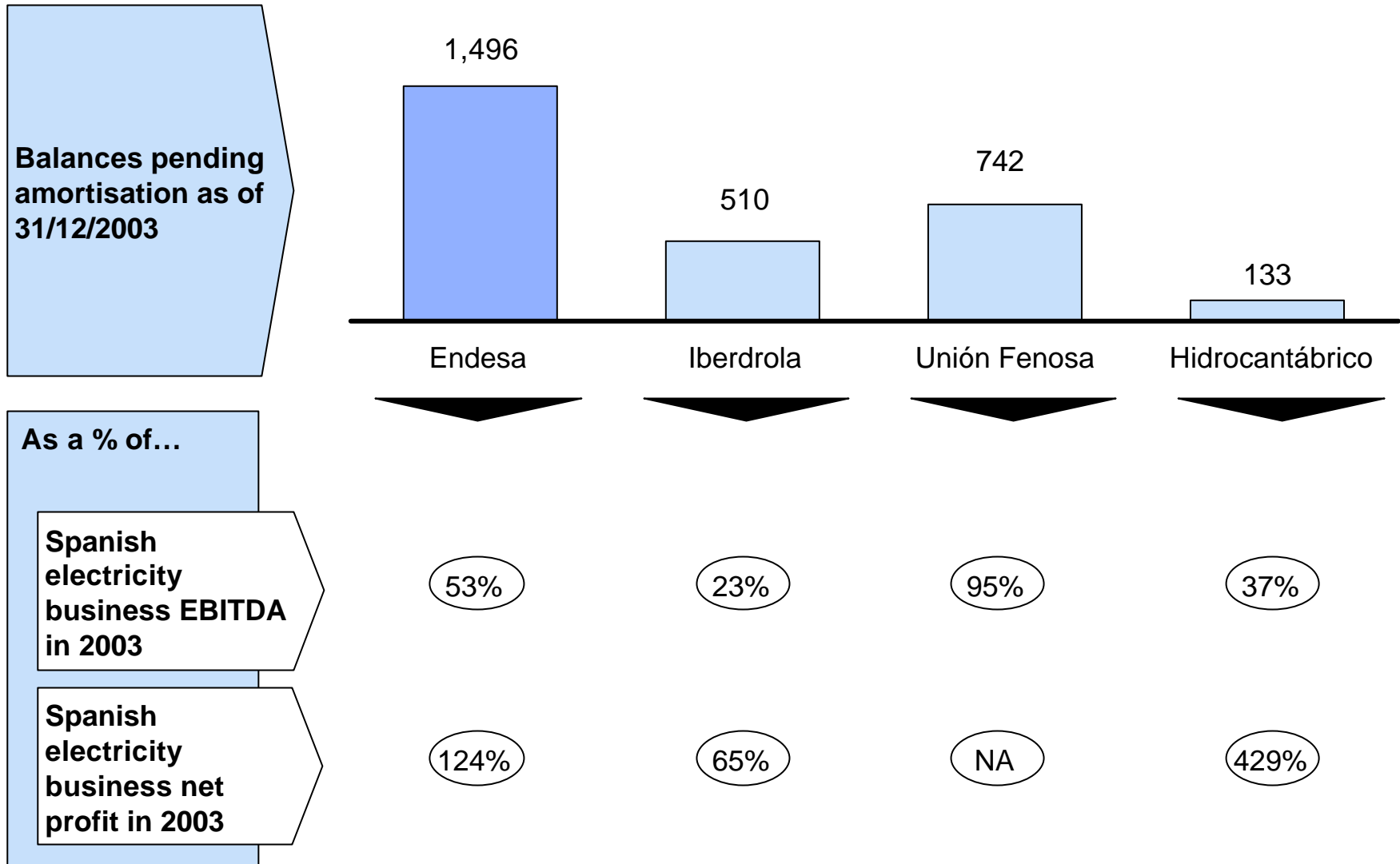
2004



- **CTCs do not distort the normal operation of the market**
- **However, it would make sense to “decouple” the recovery of CTCs from market prices**
- **The impact of the CTC recovery mechanism is much lower than the impact of the deficiencies described**

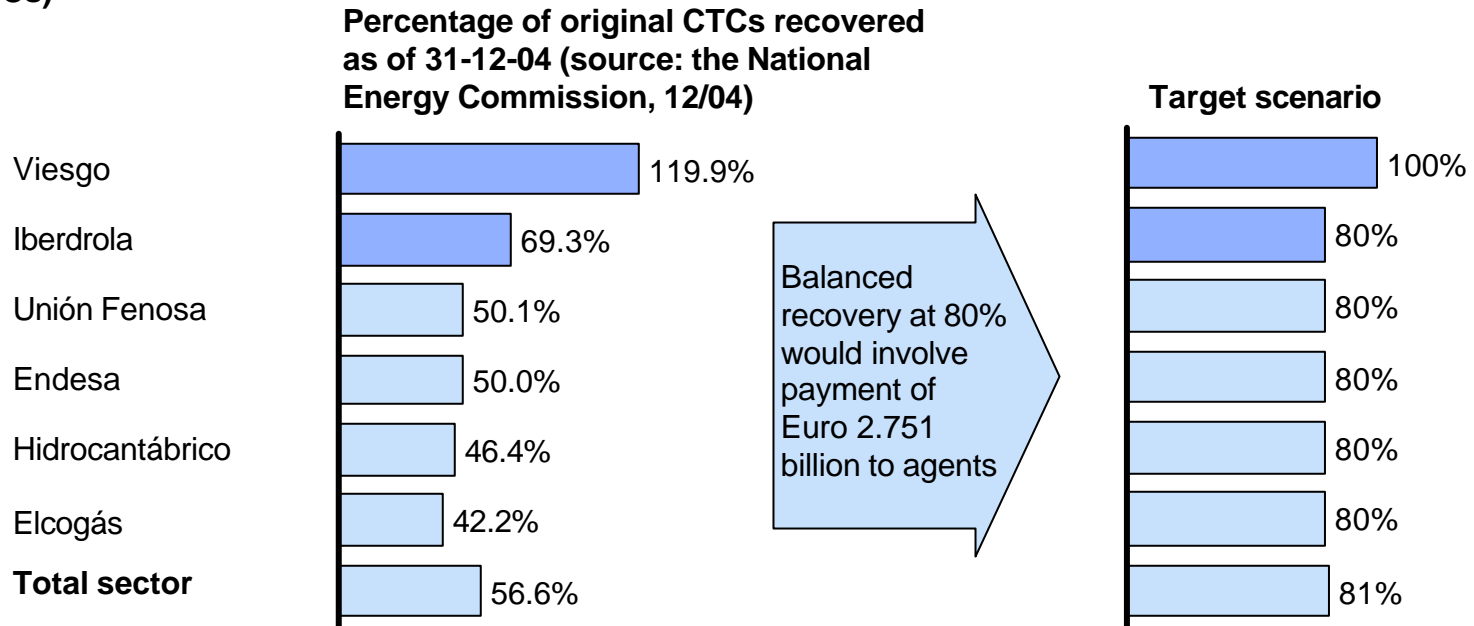
PENDING CTCs HAVE A SIGNIFICANT IMPACT ON THE COMPANIES' BALANCE SHEETS

Euro million



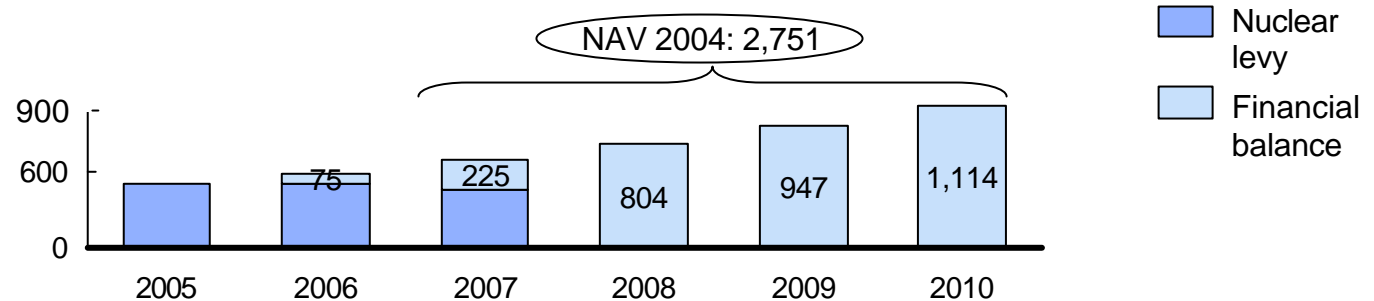
ENDESA'S PROPOSAL: (1) A BALANCED RECOVERY OF CTCs ...

Progress towards the target scenario: balanced recovery of 80% of the CTCs (general assignation of CTCs)

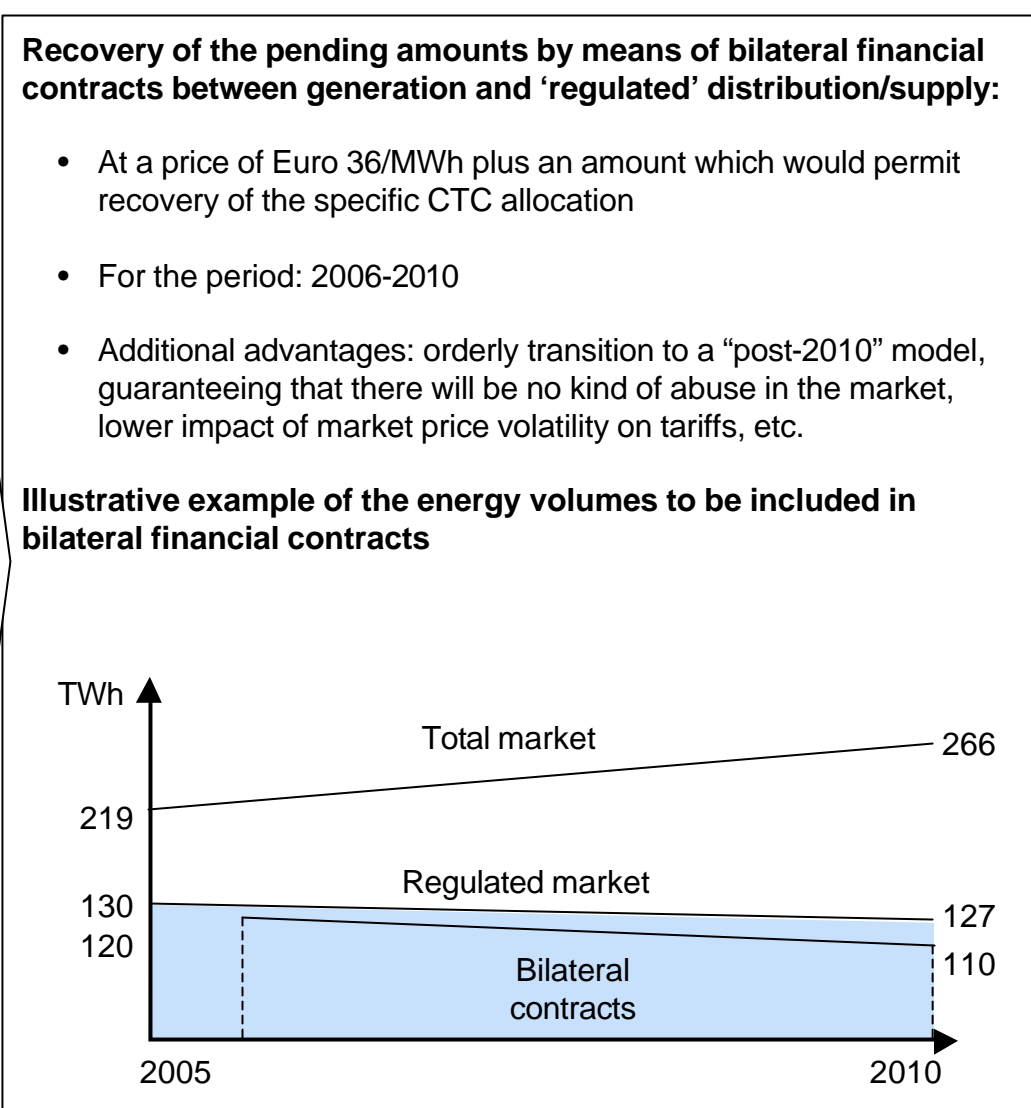
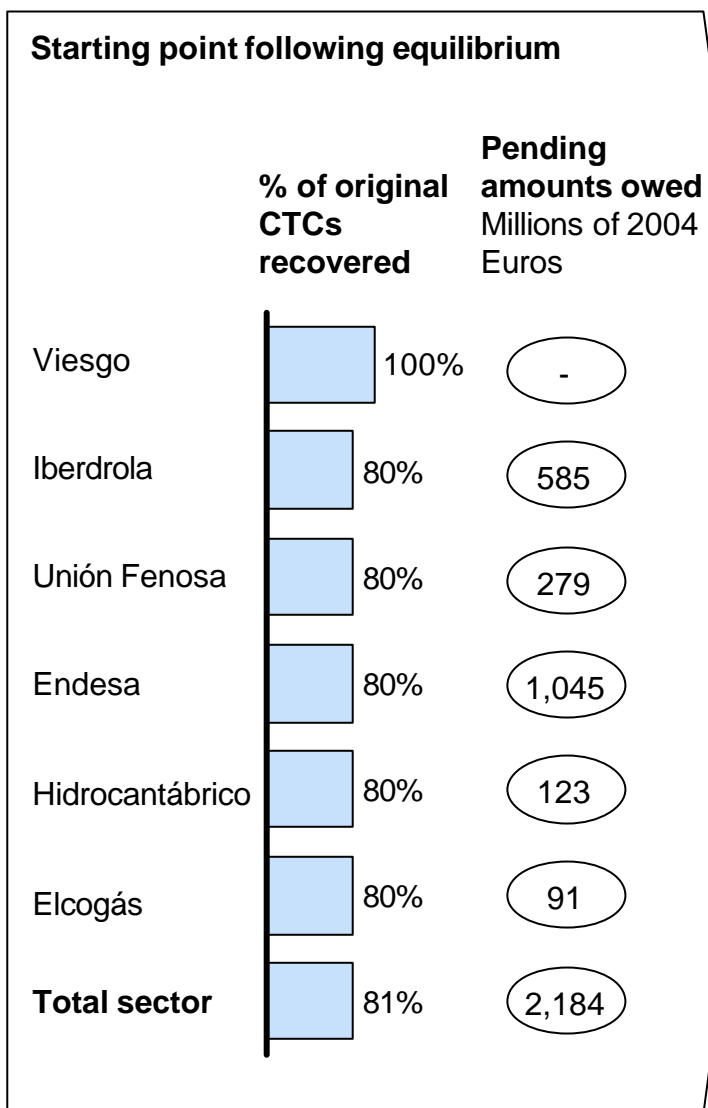


A possible means of achieving this balance – giving agents the right to charge a fixed amount after the nuclear moratorium levy has been fully paid out in 2007

Euro million



...AND (2) AVOIDING FURTHER DIFFERENCES IN THE RECOVERY OF PENDING CTCs



CONCLUSIONS

- CTCs are a regulatory concept provided for by law which are necessary to recover stranded investments. In this regard, CTCs are part of the companies' capital and their "recoverability" is legally guaranteed by state legislation
- New market entrants were aware of Act 54/1997 when taking relevant decisions
- CTCs have been recognised by the European Union, and are widely used by other countries
- There are significant differences in the degree to which agents have recovered their CTCs
- We highlight the following:
 - CTCs are similar concept to the nuclear moratorium levy, although the latter has been fully paid out to the relevant parties
 - CTCs have not yet been fully paid out
 - They do not affect the competitiveness of plants
 - Accounting wise, they play an important role on the companies' balance sheets
- Endesa's proposal is based on (1) balancing the degree to which the agents recover CTCs, and (2) establishing a scheme of bilateral contracts between generators with rights to CTCs and regulated electricity suppliers, which would enable the recovery of the remaining CTCs