



Regulation in Spain: situation and outlook

- Investor Relations Days -



Palma de Mallorca, June 2006

Summary

- In recent months, positive headway has been made on regulation, primarily the creation of a stable model for the island and non-mainland electrical systems (SEIEs), and breaking the cap on tariffs that has been in place since the end of 2002.
- The regulatory process is underway again and further headway is expected in the coming months.
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The 2005-09 Business Plan included very conservative forecasts

Spain: conservative regulatory assumptions

		EBITDA impact 2009 vs. 2004 (€ million)
Distribution	Return on network expansion investments vs. current revenue model based on demand growth and efficiency factor (impact on Endesa proportional to its market share in distribution)	+300
Generation on the islands	Payment of fuel costs and returns on realised investments, as per Royal Decree 1747/2003 and further Ministerial Orders	+150
Revenue cap	No revenue recognition >€36/MWh in hydro and nuclear	-200
		+250

This scenario assumes the elimination of the current CTC mechanism and a tariff increase of only 3% per year

Regulatory scenarios of other market participants would provide an improvement of €500 million by 2009

Since then, major headway has been made in the sector

Implications

2006 tariff

- 4.48% nominal growth
- Overall 7.7% effect (lower nuclear moratorium charge and others*)

Elimination of 2% limit on tariff increases

Generation deficit

- Recognition of entire deficit

Market confirmed as reference point for value of energy

Non-mainland

- Methodology established to recognise costs and investments
- Operational procedures for system operation and dispatching

Stable future regulatory framework

* 4,48% (increase in Tariff RD) + 2,71% (reduction of nuclear moratorium charge from 3,04% to 0,33%) + 0,5% (surcharge for consumption above 1300 kWh for residential customers)

There will be other immediate progress

Implications

2006 tariff

- Further 1.5-2% tariff increase in June

Progress toward sufficient tariff

Generation deficit

- Recognised and securitised

Elimination of deficit-related risk

Distribution

- Methodology established to recognise costs and investments
- Increased remuneration

Stable future regulatory framework and greater income

The other big regulatory change in recent months is RDL 3/2006

The decree modifies how the
wholesale market works

Description

Day-ahead market

- Distributor and generator sales/purchases are netted and treated as a bilateral contract
- Provisional price for this contract set at €42.35/MWh

Emission rights

- Deduction of the value of the emission rights allocated in January and February to reduce the tariff deficit
- Starting in March, deduction of the impact of CO₂ internalization on energy sold to the pool

Its final impact will depend
on several pending issues...

- Price recognized to distributors for purchases of energy
- Mechanism for deduction of the impact of CO₂ internalization

... and on how long they last

- In its current form, the RDL is not sustainable
 - Fosters undesirable behaviour
 - The RDL itself states that the price of €42.35/MWh will have to be adjusted to market levels

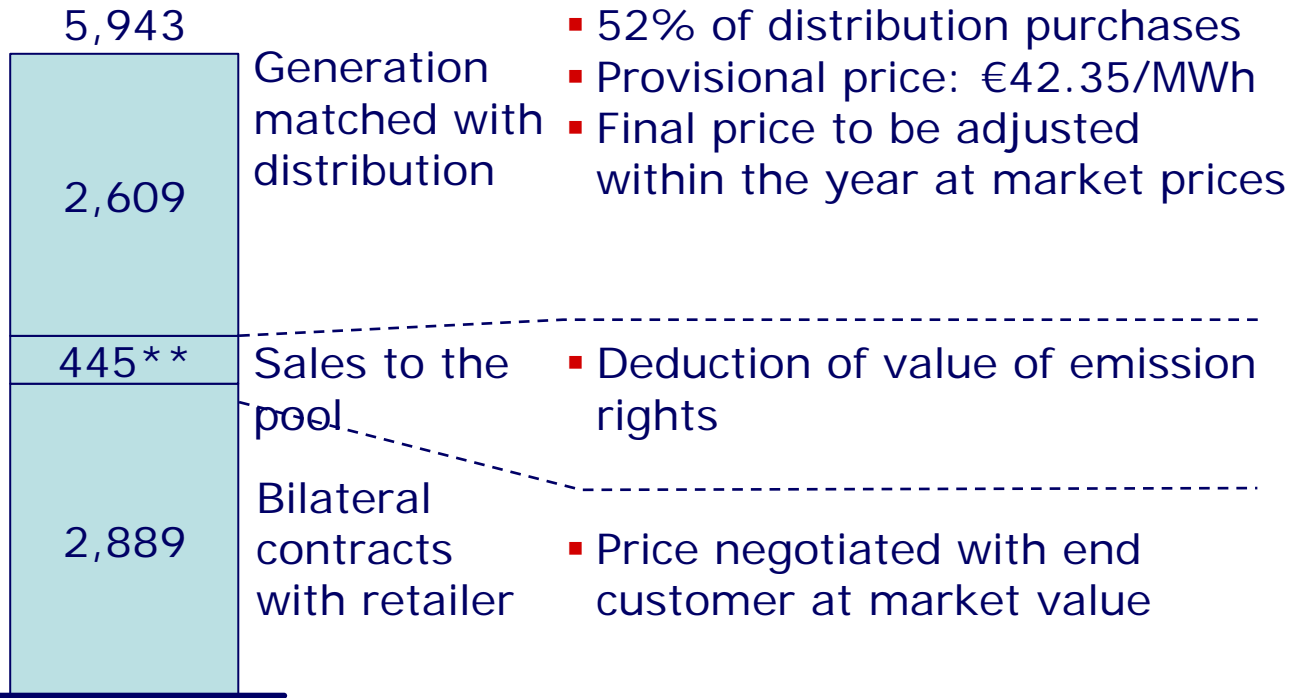
The impact of RDL 3/2006 on Endesa to March 31 is € 164 million

Provisional impact on 1Q06. Euros, mn

January - February
(non-recurring)

- Deduction of the value of the emission rights allocated for this period*

March
(recurring as long as the RDL is in place)



- 52% of distribution purchases
- Provisional price: €42.35/MWh
- Final price to be adjusted within the year at market prices

- Deduction of value of emission rights

- Price negotiated with end customer at market value

164

* Includes March 1 and 2

** 426 GWh corresponds to March 1 and 2

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Areas to be developed to achieve a fully deregulated market

Energy must be priced in line with market conditions

- 1 Sufficient and additive tariff

Deregulated activities

- Liquid, competitive marginal market
- Similar to other European markets

- 2 Reform of the pool
- 3 Encourage forward markets
- 4 Market solutions for large customers
- 5 A NAP 2008-12 that does not distort the market

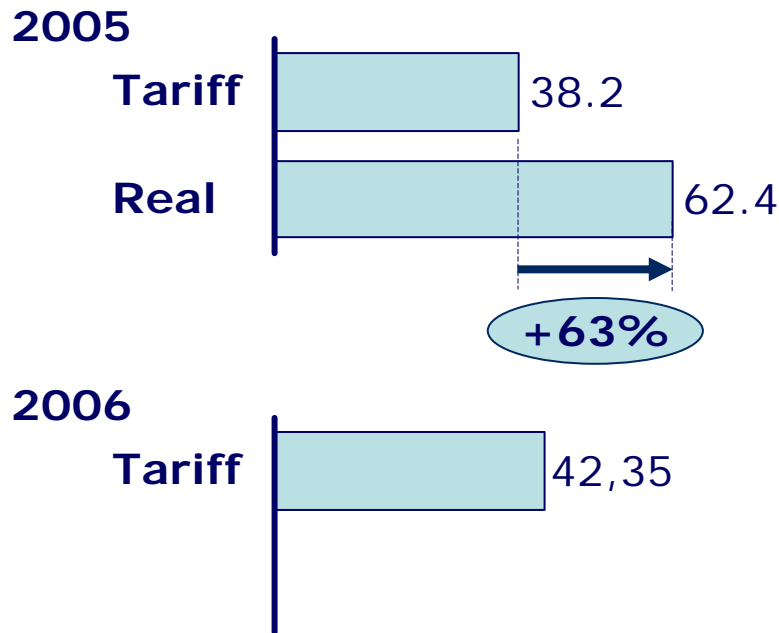
Regulated activities

- Stable regulatory regime that encourages efficiency

- 6 Establish a stable framework for distribution remuneration
- 7 Adjust remuneration for renewables

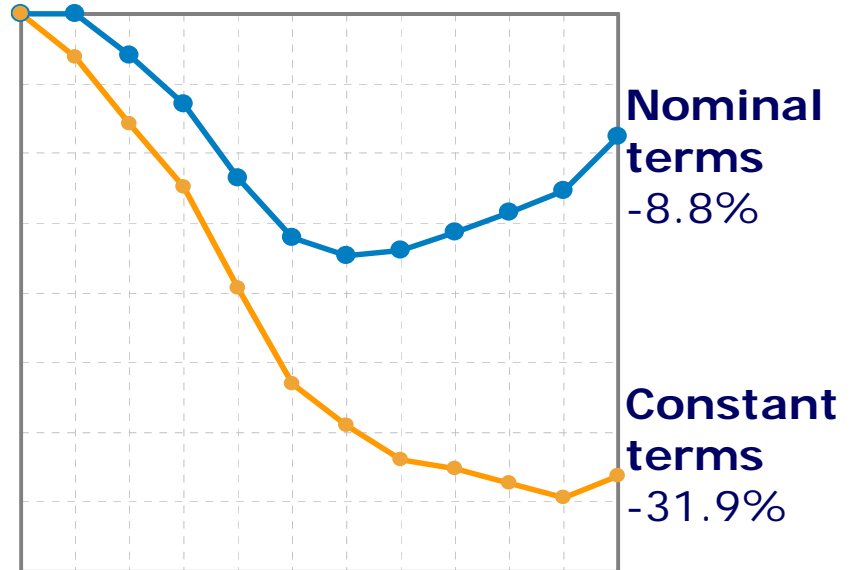
1 Current tariffs do not reflect market conditions

Energy price implicit in the tariff does not correspond to market values



Tariffs have been updated with total disregard for rising costs

Tariffs. 1996-2006

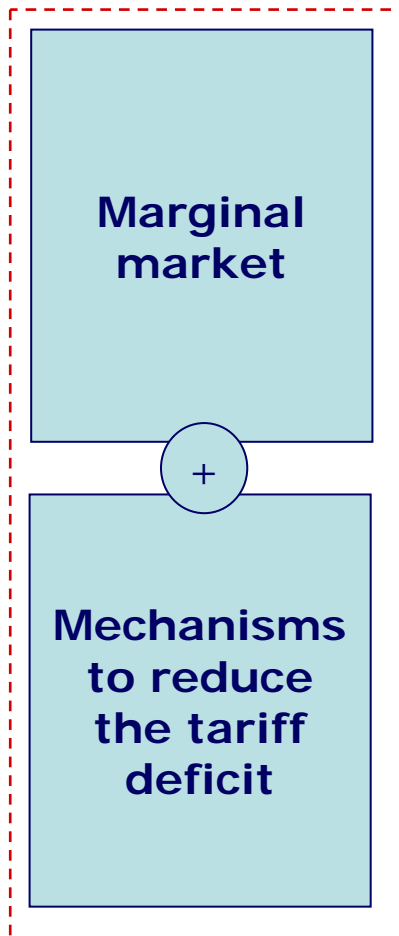


- Tariffs in Spain are lower than in most European countries

- In this period, oil prices have risen more than 350%

2 The pool currently needs several reforms to guarantee its proper functioning

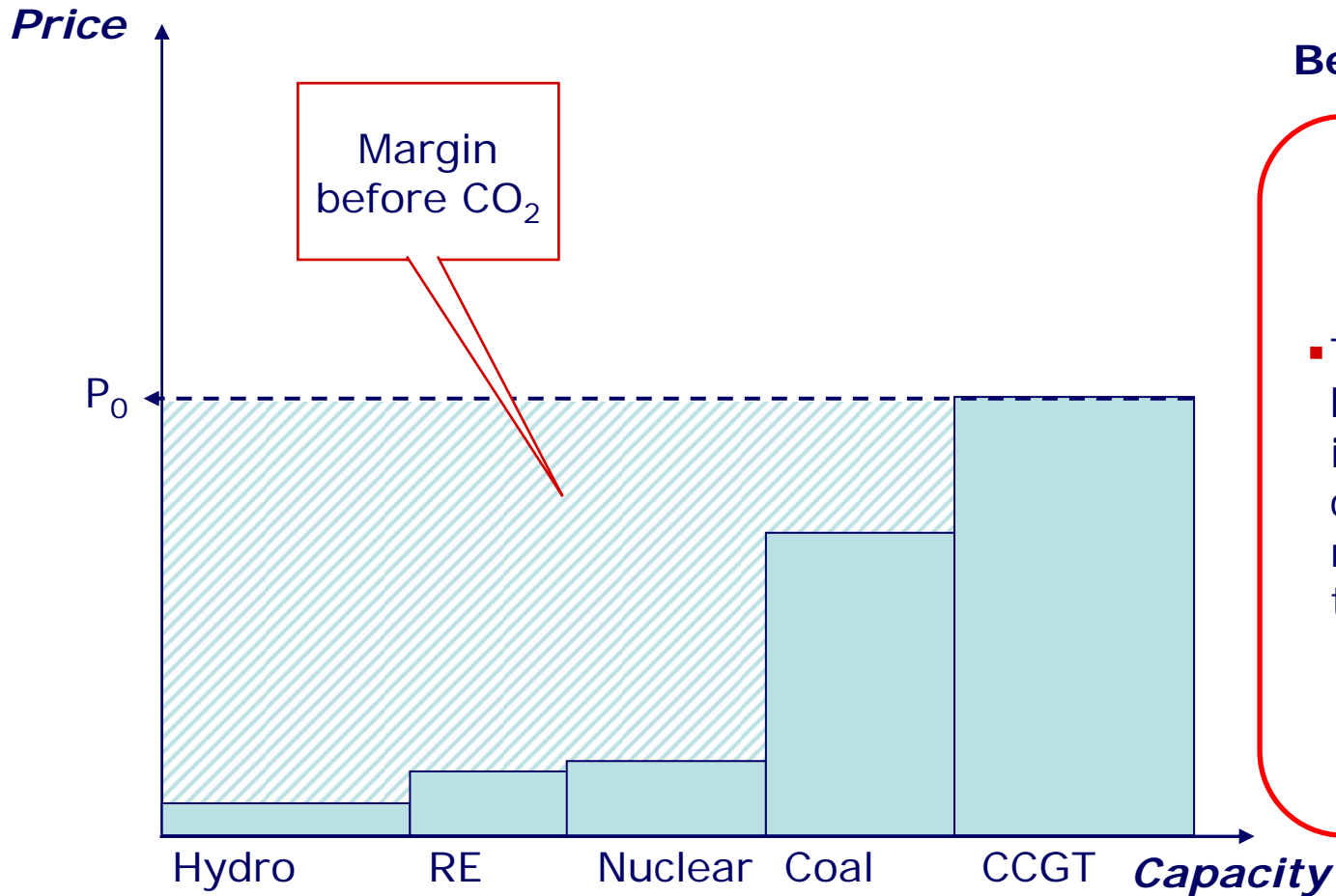
General scheme



Measures under discussion

- Eliminate the impact of internalization of the value of emission allowances on generators' income
- Recognize energy purchases by distributors at market values
- Exclude fuel oil plants from price formation at OMEL
- Mechanisms for supervision and rapid response in cases of abuse
- Balance and termination of CTC mechanism

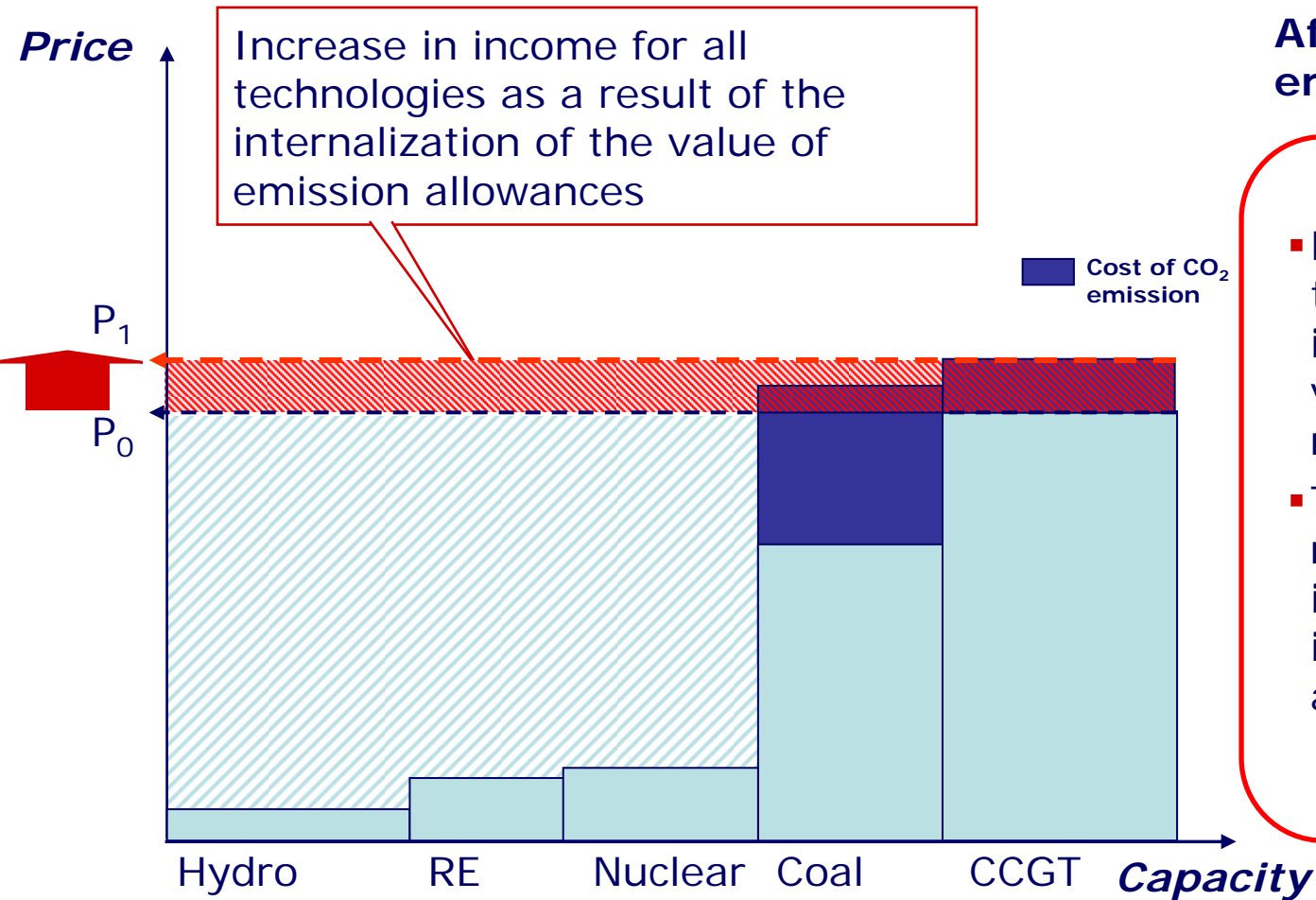
2 Eliminate the impact of internalization of the value of emission allowances on generators' income (1/5)



Before CO₂ ...

- The price received by all technologies is P_0 , which coincides with the marginal cost of the last technology

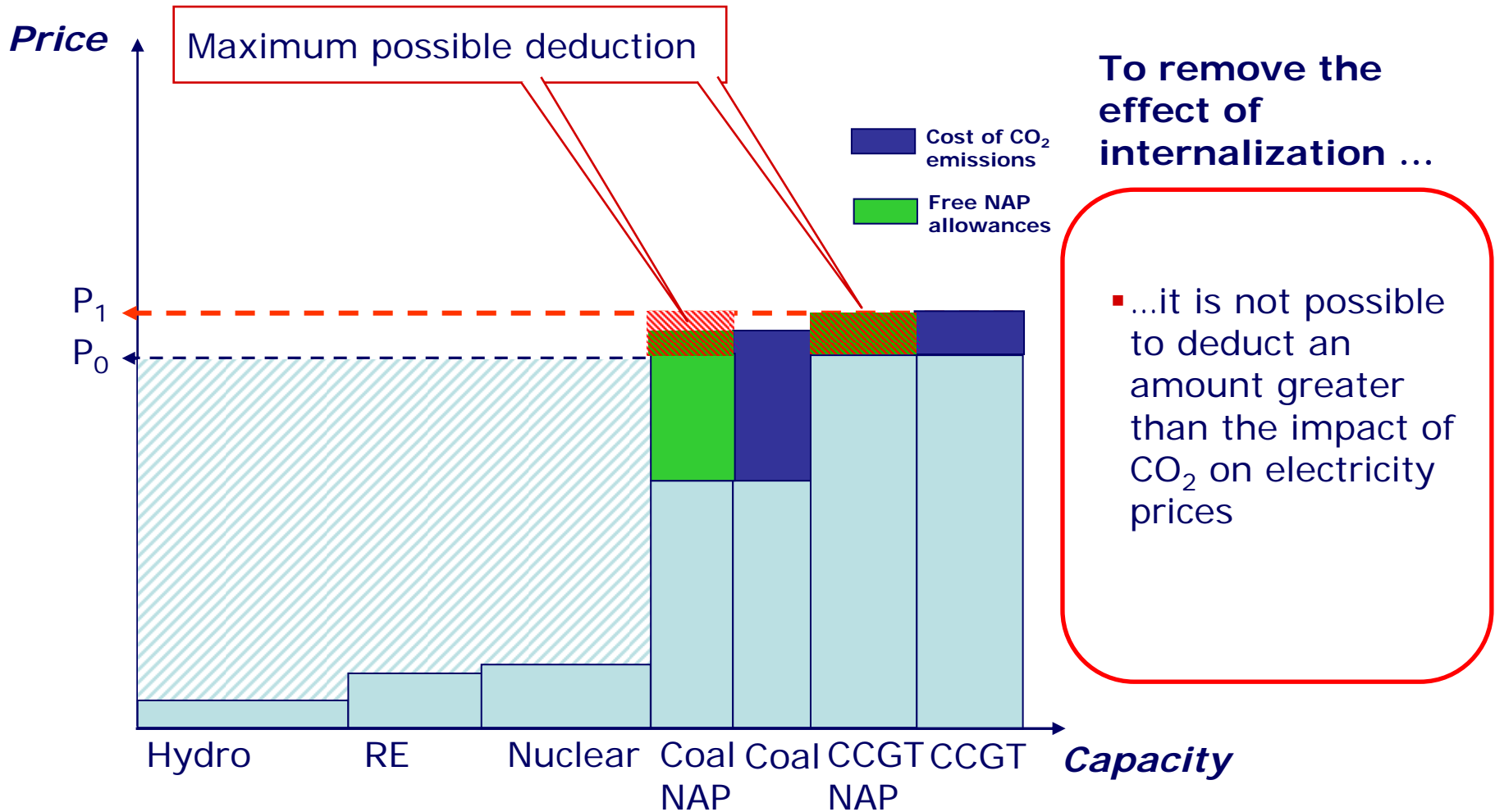
2 Eliminate the impact of internalization of the value of emission allowances on generators' income (2/5)



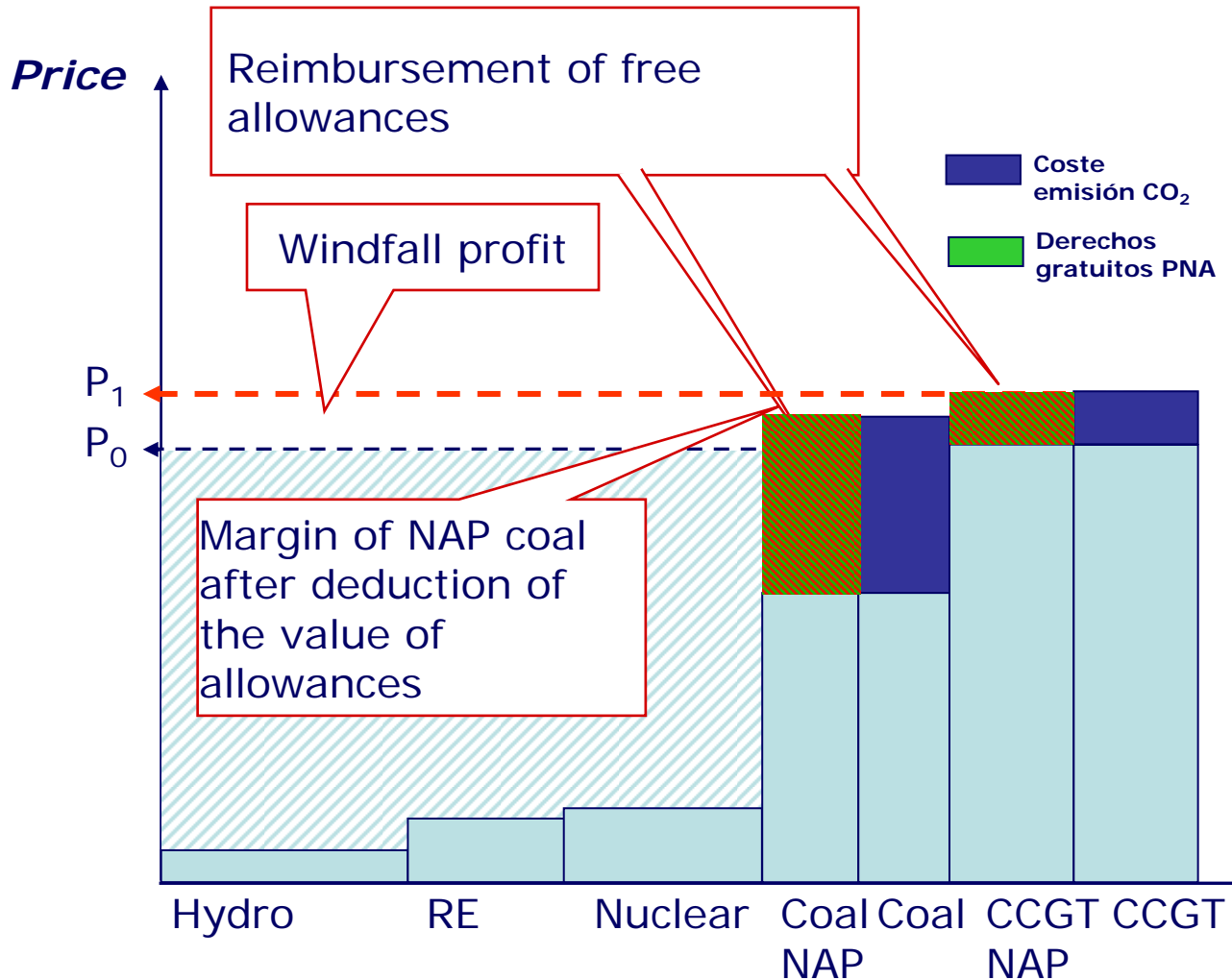
After introducing emissions trading ...

- Emitting technologies internalise the value of emission rights in their offers
- The market price rises to P_1 , increasing the income received by all technologies

② Eliminate the impact of internalization of the value of emission allowances on generators' income (3/5)



2 Eliminate the impact of internalization of the value of emission allowances on generators' income (5/5)



Reimbursement of free allowances would be discriminatory

- Does not eliminate the extraordinary margins for non-emitting technologies
- It is neutral on CCGT and penalizes coal units

Necessary steps

Design an organised forward market

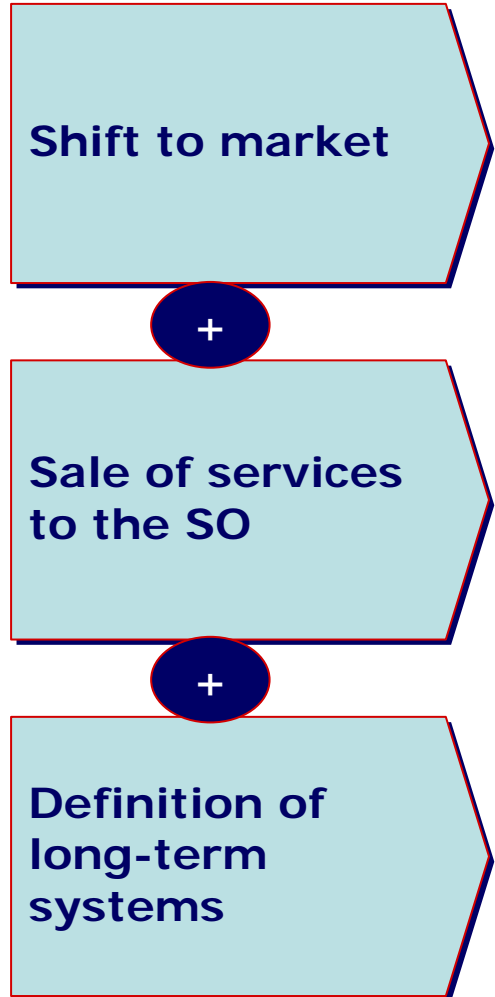
Promote liquidity

Content

- The forward market is the main trading mechanism in developed markets
- Standardised with other European markets (physical delivery, continuous trading, etc.)
- Distributors would buy in the forward market
- Virtual capacity auctions: if needed, generators would propose an auction scheme

- Large customers contribute more than Euro 1.2 billion to the deficit
- A market-based solution, using long term contracts, is needed

Components of a possible solution



Description

- All large customers gradually shift to market pricing
- Possible sale of services to the system operator (e.g. interruptible supply)
- Like schemes implemented in France and other countries

6 Distribution remuneration in Spain is much lower than in other European countries

Comparison of distribution remuneration in various European countries – Spain: base 100

	€/GW	€/MWh	€/cust.	€/km	€/km2
Spain	100	100	100	100	100
Portugal	141	169	126	133	168
Greece	134	138	114	134	125
Italy	123	128	124	138	297
Ireland	161	192	245	95	131
Average	140	157	152	125	180
Germany	219	192	239	241	637
Denmark	174	187	236	155	354
UK	112	115	152	198	367
Holland	163	124	195	208	770
France	141	143	220	192	283
Austria	217	170	268	221	306
Belgium	134	125	227	224	811
Sweden	135	140	445	155	108
Norway	94	92	462	136	79
Average	154	143	271	192	413

Countries with similar distribution networks: 25-80% more than Spain

50-300% more than Spain

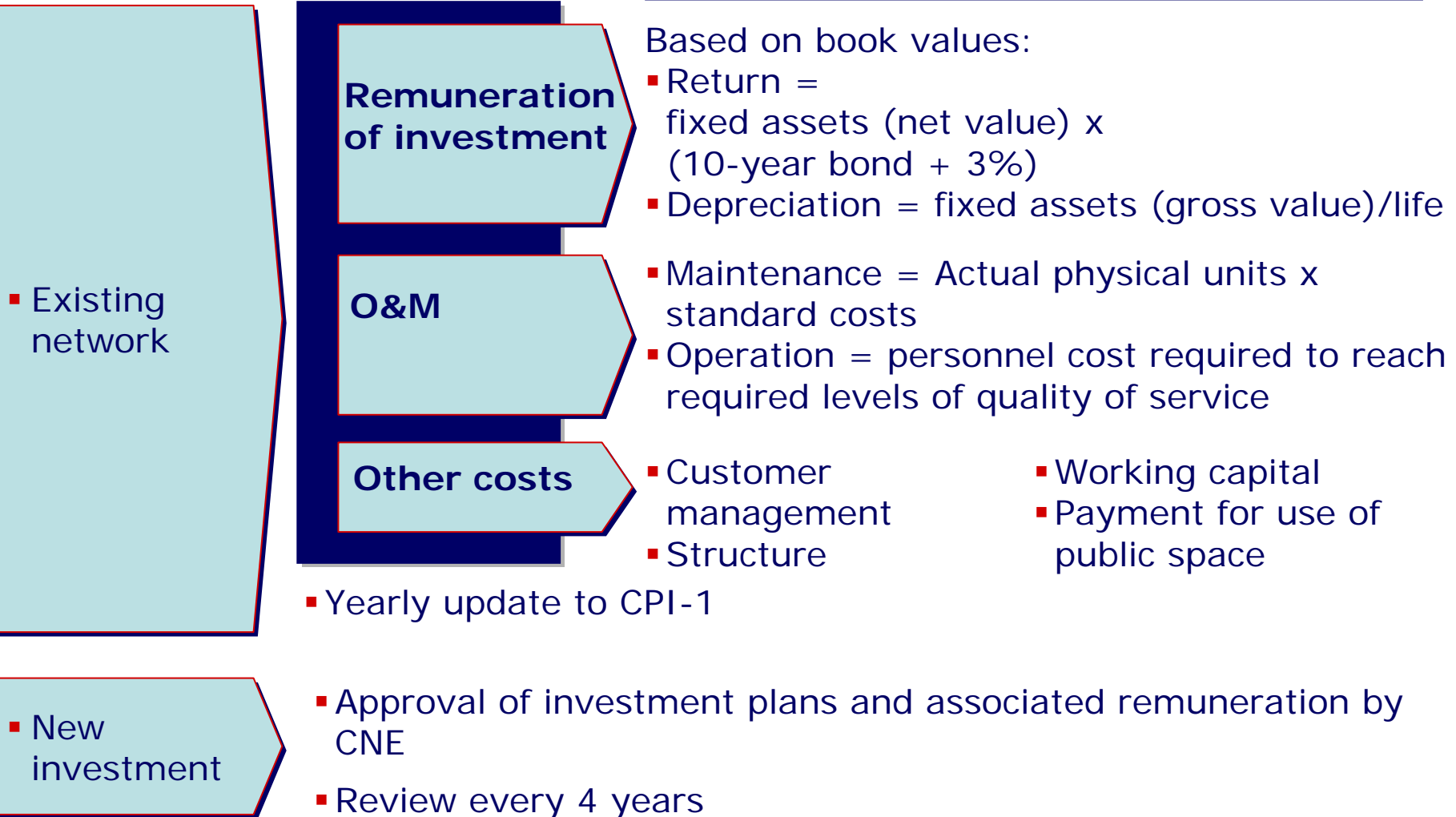
*Low and medium voltage lines, less than 100KV

Source: Eurprog, REE, PPC

6 Distribution: a remuneration system similar to the non-mainland systems is desirable

Costes

Descripción



Premiums for renewables adapted to new market conditions

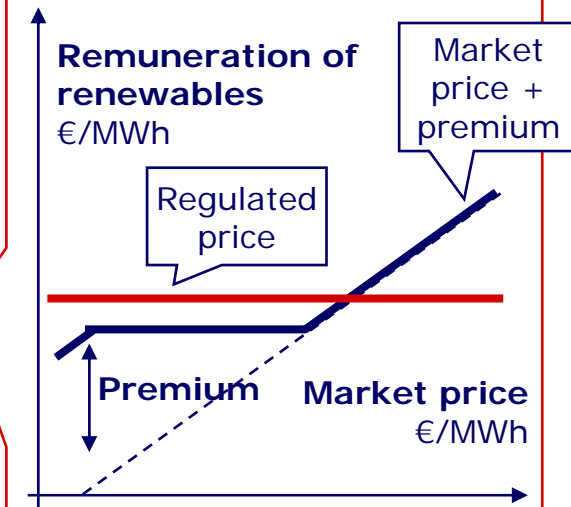
Current situation

- 16% yearly growth in installed capacity since 2000
- 20% of production and 25% of generation costs in 2005 (contribution to tariff deficit: more than 800 M€)
- Current premium is constant and was established when market prices were much lower than now

Steps to be taken

- Sales to distributors at regulated prices
 - de-link remuneration under the Special Regime (renewables) from tariff changes
- Sales to market:
 - variable premium, to be reduced when market price rises

How the proposal works



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Regulatory progress strongly suggests that the regulatory framework will be more positive than forecasted in the 2005-09 Business Plan

Business Plan 2005-09

Current outlook

Tariff increases

- Around 3%

- It is likely that growth may be above this level

Wholesale market

- Virtual contracts at €36/MWh for hydro and nuclear energy

- Market prices for all technologies with a possible mechanism to reduce income

Non-mainland

- Coverage of fuel costs and guaranteed return on investments

- Stable framework for remuneration of investment and costs, with various levers available to create value

Distribution

- Guaranteed return on investments and standard O&M costs

- Stable framework for remuneration of investment and costs, with various levers available to create value

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