IBERDROLA

OUTLOOK

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Regulation

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IBERDROLA

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Regulation Agenda

- **Spain**
- United Kingdom
- United States
- Brazil
- Mexico

Regulation
Spain: Tariff Deficit

Mechanisms to limit potential future deficits

1. Annual limit of 2% (or total accrued of 5%)

2. Any increase of regulated costs, or any decrease of regulated revenues will have to be offset by reductions in other costs, or by an increase in revenues to assure the economic balance of the system

Potential deficits will be financed
by all regulated activities from 2014

Iberdrola share in any potential financing would be lower than 15%, favourably comparing to the current 35%

Regulation
Spain: Remuneration Principles for regulated activities

Main principles

1. "Efficient and well managed company"

2. Standard Costs

3. Spanish bond yield + spread

4. General Reviews every 6 years

Regulation
Spain: Distribution

Comments

- A Regulatory Asset Value (RAV) is set. It corresponds to the implicit value in the prior remuneration methodology, and it can be updated in the future depending on the market value of the physical units.
- Operational costs standardization will benefit the most competitive companies.
- A remuneration scheme with no reference to the real cost of capital discourages investments. A business that requires continuous investment is not sustainable if it is remunerated at rates below its cost of capital.
- There is still time to develop the correct regulation for distribution activities, which incentivises investment, and especially new technologies.

Regulation
Spain: Special Regime

Key elements

- **The renewables energies support mechanism has been changed, actually, the so called "special regime" has been changed as a whole.** Basically, a new set of premiums on invested capacity are calculated to assure a return equivalent to the **Spanish Bond plus 300 bp**.
- Some facilities will get an additional revenue **if operational costs were higher than the power market price.**
- Standard costs will be defined, based in the average Capex per technology and year of commissioning. The resulting value for the asset will be adjusted **if during its past lifetime, it obtained returns over or below 7.5%**
- **Exceptionally, a specific remuneration scheme could be approved for new facilities** via competitive procedures**.**
- **Every 3 years premiums will be revised,** only to update for forward power prices

Regulation
Spain: Special Regime

Comments

- The asset value adjustment based on past returns, even for those installations that were selling to the market, is clearly retroactive.
- The asset remuneration depends on the guaranteed return and also on the forecast of power prices, which is an unknown price.
- For renewables, linking the return to the sovereign bond is of less importance than for distribution. The reason is that this business doesn't require a permanent and recurrent investment, as distribution does. It is closer to a financial type of business, especially first generation of thermo-solar plants. In this case, remuneration has to guarantee, at least, the servicing of debt.
- The oldest investments have been the most impacted by the reform. Paradoxically, those were the ones that needed less support and showed a progressive and more orderly development.

Regulation
Spain: Special Regime

Impact of measures by technology

Measure (Eur M)	Wind	T. Solar	PV	Rest	Total
Law 15/2012	227	373	215	311	**1,126**
RD-l 2/2013	187	286	86	73	**632**
RD-l 9/2013	622	-79	467	1,192	**2,202**
Total impact	**1,036**	**580**	**768**	**1,576**	**3,960**

	Wind	T. Solar	PV	Rest	Total
Premiums before measures (Eur/MWh)	41	305	402	70	**95**
Premiums after measures (Eur/MWh)	19	208	306	34	**58**
% Reduction	53%	32%	24%	51%	**39%**

The most efficient technologies (wind and cogeneration), and the cleanest one (wind), are impacted the most

Regulation
Spain: Wholesale market

Key elements

- **Capacity payments decrease 50%.** This measure will mainly affect CCGTs
- Next market reform should **integrate renewable production**
- With this purpose, it would be necessary to provide **depth and stability to the forward market**
- Additionally, the **firm capacity should be properly market priced**, so it can be contracted by generators who lack this capacity guarantee, and so, they would be able to sell their energy in the forward market

Regulation
Spain: Wholesale market

Comments

- Capacity payments already were completely insufficient to cover the CCGT fixed costs, that remain in losses
- It is not consistent to reduce capacity payments when renewable production, which is not manageable, contributes more than 50% of demand and, consequently, an important capacity reserve margin is required to manage the inherent volatility of this type of generation
- Regulation should support national industry, but to use interruptibility payments for this purpose is discriminatory for other industries and generators. These payments are 20 times higher than the equivalent cost of reserve MW provided by generators

Regulation
Spain: Key aspects of the sector modifications

It is not a proper reform of the sector, but mainly a fiscal reform, with the objective of eliminating the tariff deficit

Estimation of 2014 impact of the approved modifications (Eur M)*

Main modifications approved (annual impact)	Sector	Iberdrola		
		Before July	*After July*	*Total*
1. Taxes on generation, partially passed through to customers	2,907	568		568
2. Generation adjustments (capacity payments)	325		70	70
3. Transmission and Distribution adjustments	1,445	244	132	376
4. Special regime premiums adjustments	3,098	56	240	296
5. Costs assumed by the National Budget				
CO_2 Auctions	344			
50% non mainland costs	903			
TOTAL	**9,022**	**868**	**442**	**1,310**

**Excluding Social Bonus*

Regulation

Spain: Measures to reduce the impact of the new modifications

Decrease in Spanish operational costs

Internalization of taxes in power market bids

Adaptation of power dispatching policies according to new revenues allocation

Adaptation of the generation portfolio

Defence before the Courts of the interests of our shareholders, against impacts derived from several modifications of doubtful legality (distribution remuneration, retroactive actions, etc.)

Regulation
Spain: Consequences of the regulatory and tax modifications

Tariff deficit is over, at the expense of companies and consumers, reducing the costs previously assumed by the National Budget

Nevertheless, the costs of generation and distribution in Spain are the lowest in Europe

The final consumer bill has increased over 5%, maintaining electricity prices in Spain among the highest in Europe

Electricity tariff continues to include over Eur 15 bn of costs not related to the service representing 40% of the total end consumer price

Regulation
Spain: Pending reform

These modifications have not eliminated from the tariff those costs not related to the electricity supply that it currently bears (40% of the bill paid by the consumer)

They are a consequence of the extra costs from environmental and social policies, tariff deficit, etc., that, due to their nature , should be externalised from the electricity bill paid by the consumer

It is a problem that not only affects Spain, but also a significant part of Europe, particularly countries that have incentivised the development of renewable energies

The solution not only depends on Spain, but also the EC has to define guidelines in order to homogenise the treatment of these costs that are a consequence of European energy policy

In summary, it is Europe who has to establish homogeneous criteria to decide how these costs are paid, which is crucial to European industry competitiveness

Regulation Agenda

Spain

United Kingdom

United States

Brazil

Mexico

Regulation
United Kingdom

United Kingdom: Energy sector environment

ISSUE	IBERDROLA VIEW
Networks	• Distribution: Framework already defined until March 2015 (DPCR5) • Transmission: Business plan RIIO-T1 already defined for 8 years (until 2021)
Renewables support	•RO support levels unaffected, auctions for onshore wind under new CfD system. Good sites still look OK

United Kingdom: Energy sector environment

ISSUE	IBERDROLA VIEW
Capacity mechanism	• Should be positive to reduce uncertainty in the generation activity • CO2 price floor under pressure
Ofgem / OFT / CMA Comp Assessment	• Uncertainty about the regulator's approach to increase competition between traders with the aim of reducing supply costs
Energy prices and consumer bills	• Government focus: increase competition and cutting green levies on bills

The regulator should find a balance between its goal of reducing the cost of supply and the need to attract investments for generation, distribution and transmission projects forecast by the government

**OFT: Office of Fair Trading / CMA: Competition and Markets Authority / Comp Assessment: Competition Assessment*

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Regulation
United States

CMP rate case to be completed in July 2014. FERC decision on transmission ROE expected in 2014. NY regulatory model review

NY Rate cases	• Rate Plans reached in 2010 continue until Companies file for change
NY Regulatory model review	• Priority to facilitate investment in transmission and smart grids
CMP Transmission	• Initial recommendation issued in August 2013 • Final decision expected in 2014
CMP Rate Case plan	• New tariffs in July 2014
Renewable prospects	• President Obama proposes to eliminate tax incentives for fossil fuels and invest more in “technologies of the future” (possible extension of PTCs) • Current energy prices imply new investments to depend on state renewable obligations (Renewable Portfolio Standards)

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Complex hydro conditions to keep spot prices high in the coming months

- **Maintain regulatory framework compatible with promoting investment**
  - ✓ Keep reasonable WACC
  - ✓ Hold efficient cost recognition rules
- **New rate cases: 2015 Elektro and 2017/18 Neoenergia**
- **Annually, tariffs review as a function of inflation and demand**

- **Present spot electricity prices are at historically high levels**
- **Distributors in talks with Government and regulator for compensation of energy imbalances, as agreed in 2013**

Regulation Agenda

Spain

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Mexico

Regulation Mexico

Expansion of the business taking advantage of the Energy Reform opportunities

Opportunities of Energy Reform[1]

Generation investments required over US$ 25,500 MM in 2014-2020

17,092 MW of new capacity in the period 2014-2020

"At the end of the period, practically in the whole country natural gas will be used in a larger proportion to produce electricity"[1]

Additional opportunities in Transmission and Distribution

(1) Source: http://www.sener.gob.mx/res/PE_y_DT/pub/2013/Prospectiva_del_Sector_Electrico_2013-2027.pdf

Regulation
Mexico

Most of our output delivered to the CFE with fixed dollar denominated revenues and no fuel price risk

Contracts with the CFE allow for improvement in revenues if we outperform the operating parameters committed in our offers (power, heat rate, availability, etc.)

Opportunities to increase the sale of electricity to private customers

Closely following the opportunities that the ongoing energy reform may offer