This management report has been prepared taking into consideration the "Guide of recommendations for the development of management reports of listed companies", published by the CNMV in July 2013.

1. COMPANY'S STANDING

IBERDROLA has undergone a wide-ranging transformation over the last ten years which has enabled it to advance through the ranks to become the number one Spanish energy group, one of the Spanish main companies in the Ibex 35 by market capitalization, the world leader in wind energy, and one of the world's top power companies.

Our work has led us to an international reference position, becoming one of the leading operators in the United Kingdom, one of the most important electrical companies in the United States of America, the largest private generator of Mexico and has strengthened its leadership as an electricity supplier by number of customers in Brazil.

Strategic Projection

This positive evolution has been made possible thanks to a strategic vision that has enabled IBERDROLA to anticipate the needs of the energy sector throughout three stages:

- 2001-2006: planning over these years was focused on energy business growth principally in Spain and Latin America, with the company succeeding in doubling its size and profits by the end of the period. Installed capacity rose from 16,500 to 30,500 MW while net earnings came to EUR 1,660 million in 2006.

- 2007-2013: the strategy was marked by strong international expansion and consolidation. During this period, IBERDROLA carried out the integration of the Scottish company Scottish Power, the North American company Energy East (called Iberdrola USA until 16 December 2015, date in which the friendly integration with UIL Holdings Corporation was consumed, resulting in a new company, AVANGRID, and the Brazilian ELEKTRO, as well as the expansion of its activities in renewable energy.

- 2014-2016: IBERDROLA has continued making great efforts to optimize the Group´s operational and financial management in order to keep advancing with respect to meeting the targets set in Forecast 2014-2016. The company will continue developing its sustainable business and long term model through its investment programme which amounts to EUR 11,200 million, allocated mainly to areas of power transmission and distribution (T&D) and renewable energy in their reference markets.

AVANGRID, one of the largest electricity utilities in the United States

Notable features of this third stage include Iberdrola USA's obtaining all necessary approvals to seal its friendly merger with UIL Holdings Corporation. Completion of the merger on 16 December 2015 gave rise to the new company AVANGRID. The Company, which boasts assets worth in excess of USD 35,000 million, was listed on the New York Stock Exchange on 17 December. The new company is one of the largest electricity utilities in the U.S. consolidating its position as the second largest wind energy operator, as the company has presence in 25 States. By its nature as a listed subholding it has full independence and strengthened autonomy.

1.1 Governance system

IBERDROLA and the companies belonging to the Group are committed to a mission, vision and values, approved by the Board of Directors.

The Group's mission is to create value in a sustainable way in the development of its activities for the society, citizens, customers and shareholders, being the leading multinational group in the energy sector providing quality service by using energy sources that respect the environment, innovating and considering its employees a strategic asset, encouraging their development, training and conciliation measures, favouring a good working environment and equal opportunities, committed to social return throughout its business, generating employment and wealth in their environment and all of these, going together with its strategy of social responsibility and compliance of tax rules.

This mission goes hand in hand with a vision based on the ambition to lead a better future, creating sustainable value with a top-quality service for people and communities in which the Group operates, incorporating twelve values: the creation of sustainable value, ethical principles, good corporate governance and transparency, development of the Group's human resources, social commitment, a sense of belonging, safety and reliability, quality, innovation, protection of the environment, a focus on the customer and institutional loyalty.

The Group's mission, vision and values inspire the contents of the Corporate governance system, a set of internal regulations which, in accordance with current legislation and utilising the corporate autonomy permitted by this legislation, furthers the Company's corporate purpose at the head of a multinational energy leader operating across a range of social and economic contexts, satisfaction of social interests, understood as the common interests of all the shareholders of an independent company determined to carry out its corporate purpose in a sustainable fashion and create long-term value, with a wide-ranging non-controlling and institutional shareholding structure.

The corporate governance system is based on the following principles:

1. Involvement of shareholders

   IBERDROLA believes it is vital to involve shareholders in corporate affairs, and it therefore operates a policy to involve them, establishing mechanisms and guarantees to this end.

2. Consideration of the legitimate interests of other stakeholders

   IBERDROLA and the Group pursue the corporate purpose in due consideration of the other legitimate public and private interests forming part of their business activity and institutional reality, especially those of the different communities and regions in which they operate, those of their employees, and of other Group stakeholders. To this end, IBERDROLA has a Policy of relations with stakeholders, the purpose of which is to implement a relations framework to make stakeholders part of the Group's business and activities through an effective coordination mechanism.

3. Balanced and diverse composition of the Board of Directors

   The composition of the IBERDROLA Board of Directors was devised to best suit the requirements of the various areas of business and markets in which the Group operates. Renewal of the Board is scaled, and the objective is that each year the appointment or re-election of approximately one quarter of Board members is submitted to a vote at the General Shareholders' Meeting.

4. A corporate and governance structure combining decentralised management with proper Group coordination

The corporate structure encompasses the Company (IBERDROLA, S.A.), subholding companies and business parent companies.

IBERDROLA, which performs exclusively the function of the parent company, is the company holding the stake of the subholding companies. Such entities group together equity stakes in the energy head of business companies carrying out their activities within the various countries in which the Group operates. This structure is rounded out with a country subholding company that groups together certain equity interests in other entities, including the non-energy head of business companies. One of the main functions of the subholding companies is the centralization of the common services provided to one another, always in accordance with the provisions of the applicable law.

This corporate structure has been successfully deployed in Spain, Mexico, Brazil and the UK, and produces a rapid streamlined process for ordinary management decisions to be taken by business parents, and introduces proper Group coordination, in exercise of the supervisory functions of subholding companies and IBERDROLA.

In the United States of America, the Company holds a majority stake in the subholding company listed on the New York Stock Exchange, Avangrid, Inc. For this company the Corporate governance system contemplates a special system of greater autonomy to properly protect the interests of non-controlling shareholders, boosting vigilance of operations in connection with other Group companies, and this gives it a greater measure of independence to coordinate its investees and run businesses.

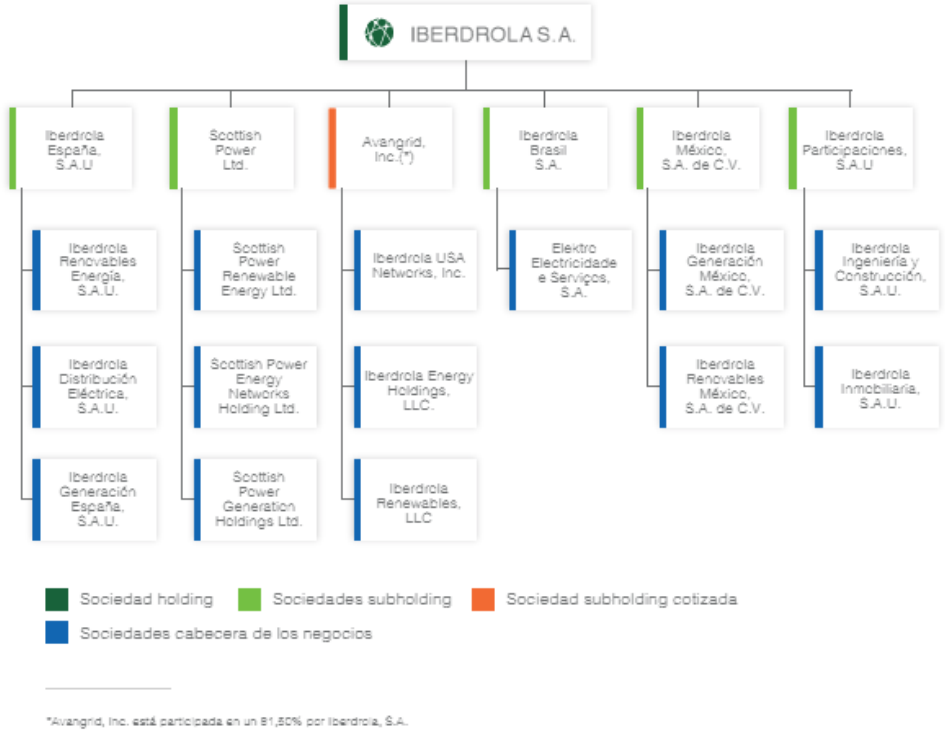
1.2 Scope of activities, sectors and geographical areas

Since 2011, the IBERDROLA Group's economic-financial and operational information has been grouped in the following lines of business: Network business, Generation and Retail businesses, Renewables business, and other businesses. The Corporation includes the costs of the Group's structure (Single Corporation), of the administration services of the corporate areas that are subsequently invoiced to the other companies through specific service agreements.

Given the nature of the activities carried out by the IBERDROLA Group, its organization responds to the strategic business units, rather than product and service lines. These businesses are managed independently, as they respond to different technologies, regulations, and geographic markets (Note 7).

The IBERDROLA Group has a decentralised structure and management model to approximate the decision taking to places where they should have effect, through the subholding companies and parent companies of the businesses. In addition, the independence and listed subholding companies' reinforced autonomy are guaranteed.

Simplified diagram of the Group's corporate structure



*Avangrid, Inc. está participada en un 81,50% por Iberdrola, S.A.

The corporate structure comprises the Company, country subholding companies, and business subholding companies.

The Company, which performs exclusively the functions of the parent company, is the entity that holds the equity stakes in the country subholding companies. Each country subholding company, in turn, groups together the business subholding companies that conduct their activities in each country in which the Group operates. The Group also has a subholding company that meets certain interests in other entities, including leading companies of non-energy businesses. Its main function consists on centralizing the common service providing to such companies, always in accordance with the provisions of applicable law.

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The Company's and the Group's governance conforms to the structure described above: separates the duties relating to strategy, oversight, and control of the Group as a whole, the duties of organisation and coordination of the businesses in each country and the multinational no-energetic business, as well as those of day-to-day administration and effective management of each business.

1.3 Governance system

The Company's and the Group's governance conforms to the structure described above: separates the duties relating to strategy, oversight, and control of the Group as a whole, the duties of organisation and coordination of the businesses in each country and the multinational no-energetic business, as well as those of day-to-day administration and effective management of each business.

It is established on the following bases:

a) The Board of Directors of the Company, which exclusively exercises holding company duties, has assigned powers relating to the establishment of the Group's policies and strategies and of the basic guidelines for the management thereof, as well as general oversight of the development of such policies, strategies and guidelines and of decisions on matters that are strategically significant at the Group level.

b) The chairman of the Board of Directors & chief executive officer of the Company, with the technical support of the Operating Committee, the Group's Business CEO and the rest of the management team, assumes the duty of organisation and strategic coordination of the Group through the dissemination, implementation and monitoring of the overall strategy and of the basic management guidelines established by the Board of Directors.

c) This organisation and coordination duty is strengthened through the boards of directors of country subholding companies, which includes independent directors, and their own audit committees, internal audit areas, and compliance units or divisions.

d) The business subholding companies of the Group assume decentralised executive responsibilities. They carry out the day-to-day administration and effective management of each of the businesses, and are responsible for the day-to-day control thereof. These business subholding companies are organised through their respective boards of directors and their own decision-making bodies.

The corporate and governance structure of the Group described above operates jointly with the Group's Business Model, which entails the global integration of the businesses and aims to maximise the operational efficiency of the different units. The Business Model ensures the dissemination, implementation and monitoring of the overall strategy and of the basic management guidelines established for each business, primarily through the exchange of best practices among the various companies of the Group, without detracting from their independence in decision-making.

In any case, the Company and the Group assume the commitments established by law in connection with the legal and functional separation of the companies carrying out regulated activities, while the country subholding companies ensure compliance with the law on this matter.

1.4 Organization of the Board, or bodies in which it delegates its decision, including control functions and the policy followed with minority interests.

A comprehensive description of the governance structure of the Company, functions and internal regulations of the committees can be seen in Appendix C of the Annual Corporate Governance Report, which forms part of this Management Report.

1.5 Vision and values

IBERDROLA works to be an energy company committed to ethics and respect for the environment as the foundation for a sense of belonging and for the trust of all persons and its various stakeholders.

IBERDROLA's vision, which brings together the economic, social and environmental aspects of sustainability, is based on six values representing firm commitments of the Company:

- Ethics and Corporate responsibility.
- Economic results.
- Respect for the environment.
- Sense of belonging and trust.
- Safety and reliability.
- Customer focus.

1.6 Business model

The business model defined in the IBERDROLA Group aims to supply reliable power of quality and environmentally respectful, throughout a long term sustainable industrial project.

The model is based on three pillars: a framework of trust based on an advanced corporate governance model; the vision and values of the Group approved by its management; and the differential elements that make IBERDROLA a different company:

- Focus in regulated businesses.
- International diversification.
- Clean and competitive energy commitment.
- Operational efficiency.
- Strength of the group.
- Global team committed and qualified.

1.7 Regulatory framework of the activities

A comprehensive description of sector regulation and operation of electric and gas system in the markets in which the Group operates can be seen in section 4 of this report.

1.8 Main products and services, production processes

The main products that IBERDROLA offers to its customers are power and natural gas, both in the wholesale and retail markets reaching the final consumer. Also offers a wide range of products, services and solutions in the fields of:

- Improving the quality of life, calm and safety of the consumer.
- Efficiency and energy services.
- Caring for the environment: renewable energy and sustainable mobility.
- Power quality and safety of the facilities.
- Installation of electrical infrastructure.
- Global management of facilities and energy supplies.

Through its subsidiaries it also provides engineering and construction services of power generation facilities, distribution and control; operation and maintenance of power generation facilities, management and promotion of the ground; and sale and rental of housing, offices and commercials. More detailed information can be found in www.iberdrola.com, in "customers" section.

As a general rule, companies directly manage the activities that belong to its core business, and outsource other estimated to be developed more efficiently by other specialized companies, which IBERDROLA requires certain quality standards and responsible behaviour in environmental, social and labour fields.

This information can be extended with corresponding indicators described in the Sustainability Report.

1.9 Strategic principles for the 2016-2020 period

IBERDROLA's outlook for 2016-2020 implements the company's sustainable business model, focusing on growth of regulated business and clean energies: geographic diversification in countries with high credit ratings; higher operating efficiency; financial solvency to take up growth opportunities in the markets in which it operates; higher returns to shareholders and a firm social commitment seeking to create value for all stakeholders.

IBERDROLA is undertaking a new era of investment and growth during which it expects to boost both the Group's EBITDA and net profits by an annual average of 6% between 2016 and 2020.

The Company's strategy will therefore focus chiefly on investment in high-quality assets in its main markets, operating efficiency, financial solvency and sustainability of its dividend.

Investment

The strategic basis presented by IBERDROLA in respect of 2016-2020 establishes a net investment programme of EUR 24,000 million in its main geographic and business areas, EUR 17,000 million of which are accounted for by investment focusing on growth. The company has now allocated almost EUR 22,000 million of its total investment to projects that are already ongoing or have been confirmed.

88% of the investment scheduled over the next five years will target regulated business or long-term contracts, mostly networks and renewable energies, providing the security, stability and visibility that characterise the Group's business model and will generate 81% of Group EBITDA by 2020.

The Group will focus primarily on two areas of business: electricity transmission and distribution networks, to which IBERDROLA will allocate 46% of total investments and, to a lesser extent, renewable energies, to which it will allocate 33% of the total amount forecast. 12% of total investment will be earmarked for generation and commercial business, and 9% of the remainder to regulated generation.

Main projects

- United Kingdom: IBERDROLA will continue to implement network infrastructures under the regulatory frameworks already approved for transmission and distribution (RIIO-T1 and RIIO-ED1). With respect to renewable energy projects in the UK, the company is building six new land-based wind plants with a combined power output of 450 MW, and is continuing its East of Anglia project in the North Sea which, along with the Wikinger offshore wind farm in the Baltic Sea (Germany), will add 1,100 MW to IBERDROLA's offshore installed power output.

- United States: Through AVANGRID, the Group will continue to invest in regulated business in the states of New York, Maine, Connecticut and Massachusetts, and hopes to add new transmission projects to the portfolio. IBERDROLA is also building four wind power plants in the US with a combined power output of 750 MW.

- Mexico: IBERDROLA's investment packages will focus on regulated generation and renewable energies, on the strength of the energy reform introduced in this country. The Company is building three combined-cycle plants and three cogeneration plants on long-term contracts, with a combined power output of 1,600 MW, and has plans for further investment in renewable energies in the years ahead.

- Spain: investment will focus on networks, where the distribution regulatory framework has been approved up to 2019.

- Portugal: the company has begun work on construction of a 1,200 MW hydroelectric storage facility at the River Támega, which should be up and running by 2023.

- Brazil: IBERDROLA is building seven wind plants with a combined power output of 180 MW, and is also involved in hydroelectric projects such as Belo Monte and Baixo Iguaçu along with NEOENERGÍA. In terms of networks, tariff frameworks have been approved for ELEKTRO (up to 2019), CELPE (up to 2017), COELBA and COSERN (up to 2018).

Operating efficiency

IBERDROLA, one of Europe's most efficient major electricity companies, will continue to boost its operating efficiency on the strength of technical progress in terms of the automation and digitalisation of all its businesses and processes.

Financial solvency

The Company will continue to hold a solid financial position that will enable it to take up growth opportunities in its markets and continue to improve its solvency ratios. Thus it intends to maintain operating cash flows above the levels of investment in all businesses.

Shareholder remuneration

The trend forecast for the period will enable the company to increase long-term remuneration for shareholders, in keeping with results, with a payout in the region of 65-75%. IBERDROLA intends to maintain the scrip dividend formula used in recent years, and the current number of shares - around 6,240 million - is kept steady through repurchase operations.

This caption of the management report of IBERDROLA contains forward-looking information, including financial projections and estimates and their underlying assumptions, statements regarding plans, objectives and expectations with respect to future operations, capital expenditures, synergies, products and services and statements regarding future performance or administrators estimates which are based on assumptions that are considered reasonable by them.

Although IBERDROLA believes that the expectations reflected in such forward-looking statements are reasonable, investors are cautioned that forward-looking information and statements are subject to various risks and uncertainties, many of which are difficult to predict and generally beyond the control of IBERDROLA, risks that could cause actual results and developments to differ materially from those expressed in, or implied or projected by, the forward-looking information and statements.

Forward-looking statements are not guarantees of future performance and have not been reviewed by the auditors of IBERDROLA. You are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date they were made. All subsequent oral or written forward-looking statements included in this report are expressly qualified in their entirety by the cautionary statement above. All forward looking statements included herein are based on the information available on the date hereof. Except for required by applicable law, IBERDROLA undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

2. BUSINESS EVOLUTION AND RESULTS

2.1 Operating highlights for the period

IBERDROLA's results in the period must be framed within the company strategy, which is defined by the growing weight of regulated activities (transmission and distribution) and the renewable business, both in the selection of investment opportunities and in the contribution to the Group's profits. Furthermore, fiscal year 2015 was positively affected by the appreciation of two of IBERDROLA's reference currencies, the US dollar and the Sterling pound, an effect partially offset by the depreciation of the Brazilian real.

In this respect, it is worth noting the following:

- In Spain, the period was characterized by a lower hydraulicity compared to the same period last year (-27.6%), as 2014 was a year in which extraordinary rainfall occurred, as well as an increase in the electric demand by 1.8%, and 1.6% in adjusted terms of working days and temperature. In this sense, we emphasize the evolution of the industrial sector of large consumers that grew 2.4% in the last 12 months.

- In the United Kingdom, the electricity demand dropped by 1.2% compared to 2014, whereas the gas demand (which does not include the generation consumption) increased by 2.2%, due to the low temperatures registered the first months of the year.

- IBERDROLA's operational area on the United States saw a 0.1% increase in electricity demand and a 5.7% in gas demand, as a result of the high temperatures registered in 2015.

- As for Brazil, the rate of growth of demand dropped by 1.6% compared to the same period of the previous year. Thus, ELEKTRO's demand decreases by 4.4%, while NEOENERGÍA's demand increases by 2.0%.

During financial year 2015, international markets of raw materials evolved as follows:

- The average price of Brent oil was USD 52.8 per barrel compared to USD 99.1 per barrel for the previous year (-47%).

- The average price of gas (TTF) over the period rose to EUR 19.8 per MWh compared to EUR 20.9 per MWh in 2014 (-5%).

- The average price of API2 coal was USD 55.9 per MT compared to USD 75 per MT (-25%) for the previous year.

- The average cost of CO_2 allowances dropped from EUR 7.7 per MT in 2014 to EUR 6.0 per MT in 2015 (-22%).

During 2015, the average evolution of IBERDROLA's main currencies compared to the Euro was as follows: the Sterling pound revaluated by 10.0% while the US dollar and the Brazilian real devalued by 16.5% and 18.3%, respectively.

In this context, IBERDROLA Group's total production in this period decreased by 1.6% to 130,594 GWh (132,726 GWh in 2014). The Net Production by geographical areas is the following:

Net Production (GWh)	2015	2014	% Change
Spain	54,453	59,413	-8.3
United Kingdom	18,448	18,720	-1.5
United States	17,015	17,157	-0.8
Mexico	38,866	35,845	8.4
Brazil	441	344	28.2
Rest of the world	1,371	1,247	9.9
Total	**130,594**	**132,726**	**-1.6**

At the end of 2015, IBERDROLA had 44,574 MW installed generation capacity, of which 62% produces emission-free energy while operating at a very low variable cost. In the table below distribution classified by countries and technologies is shown:

Countries	2015	2014	MW change (15-14)
Spain	25,607	24,701	906
United Kingdom	6,450	6,447	3
United States	6,294	6,294	-
Mexico	5,415	5,218	197
Brazil	187	187	-
Rest of the world	621	621	-
Total power (MW)	**44,574**	**43,468**	**1,106**

Technologies	2015	2014	MW change (15-14)
Hydraulic	10,392	9,486	906
Nuclear	3,166	3,166	-
Coal	3,178	3,178	-
Gas Combined Cycles	13,353	13,292	61
Cogeneration	299	296	3
Wind power, mini-hydraulic and other renewables	14,186	14,050	136
Total power (MW)	**44,574**	**43,468**	**1,106**

The following exceptional highlights should be noted with regard to the period analysed, compared with the previous fiscal year:

- The merge of IBERDROLA USA and the US company UIL, and its subsequent establishment as AVANGRID has been effective since last 16 December 2015. As a result, the Consolidated financial statements of the IBERDROLA Group include, at the year end, the following events of impact:

  - Profit and loss account: Lower EBITDA by EUR 60 million and Net Profit by EUR 45 million resulting from the inclusion of operating expenses as well as of the costs generated by the regulatory conditions established by the regulatory Authorities of the States of Connecticut and Massachusetts.

  - Balance sheet: The incremental debt originating from UIL (now integrated in AVANGRID) amounts to EUR 2,406 million, including the cash payment to UIL shareholders.

- In the Spanish network business, there was a reversal of tax provisions with a positive impact which brought EUR 220 million less corporate tax expenditure.

- The business in the United Kingdom has been negatively affected by the planned closure of the Longannet Coal Power Station for the end of the first quarter of 2016, whose impact increases the provisions item for the year 2015 by EUR 230 million after tax.
- Tax reduction in the United Kingdom (down to 18% in 2020), reflect positive results of EUR 170 million.
- The evolution of Renewables USA was affected by the low wind energy resource of the year, resulting from adverse weather conditions.

The optimisation of financial soundness and liquidity as strategic priorities are summarized as follows:

- Net Debt was EUR 28,067 million, with the leverage ratio increasing to 40.7% compared to 41.8% recorded in 2014. Excluding the impact of UIL's integration, Net Debt would reach EUR 25,661 million, with the leverage at 40.1%.
- The funds generated from operations in 2015 grew by 8.2% to EUR 5,907 million.
- Solvency ratios already reached the level expected for the end of 2016, with the target having been achieved a year in advance.

2.2 Business evolution

2.2.1 Analysis of the profit and loss account

The key figures for the financial year 2015 are as follows:

Millions of euros	2015	2014	% Change
Revenue	31,419	30,032	4.6
Gross margin [(1)]	12,843	12,180	5.4
EBITDA [(2)]	7,306	6,965	4.9
EBIT [(3)]	3,829	3,941	-2.8
Net profit	2,422	2,327	4.1

(1) Gross Margin: Revenue – Procurements

(2) EBITDA: Operating profit+ Amortisation and provisions

(3) EBIT: Operating profit

2.2.1.1 Gross Margin

Gross Margin came to EUR 12,843 million, a 5.4% increase compared to 2014.

Millions of euros	2015	2014	% Change
Network Business	5,514	5,241	5.2
Deregulated Business	4,841	4,733	2.3
Renewable Business	2,361	2,034	16.1
Other Businesses	235	216	8.8
Corporation and adjustments	-108	-44	145.5
Gross Margin	**12,843**	**12,180**	**5.4**

- **Network business**

The Network business increased its contribution by 5.2% to EUR 5,514 million (EUR 5,241 million in 2014).

Millions of euros	2015	2014	% Change
Spain	1,952	1,952	0.0
United Kingdom	1,472	1,331	10.6
United States	1,698	1,498	13.4
Brazil	392	460	-14.8
Total Network business	**5,514**	**5,241**	**5.2**

The Networks Business increased by 5.2% compared to 2014, reaching EUR 5,514 million, and showed positive trends in all countries. The most significant events of the year were the following:

- In Spain it reached EUR 1,952 million as a result of the application of RDL 9/2013 and despite the negative impact of EUR 40 million, the accrual of investments from previous years having been accounted for in 2014.

- The figure for the United Kingdom reached EUR 1,472 million (+10.6%) due to the Sterling pound appreciation (+10%). The greater base of assets to remunerate from the investments made and derived from applying the RIIO-T1 in Transmission, offset by the income profile defined in the new regulatory framework for Distribution RIIO-ED1, which will be in force from April 2015 to 2023.

- The contribution of Iberdrola USA for this period is EUR 1,698 million (+13.4%) with the appreciation of the US dollar.

- The Gross Margin for Brazil totalled EUR 392 million (-14.8%), affected by the depreciation of the Real and for an extraordinary profit accounted for in 2014, which is partially offset by the increase in ELEKTRO's tariffs (+38%) and affects the year-by-year comparison.

- **Deregulated Business**

The Deregulated Business (Generation and Retail) increased by 2.3% to EUR 4,841 million (EUR 4,733 million in 2014).

Millions of euros	2015	2014	% Change
Spain	2,971	3,068	-3.2
United Kingdom	1,306	1,205	8.4
Mexico	584	457	27.8
United States	-20	3	-766.7
Total Deregulated Business	**4,841**	**4,733**	**2.3**

- In Spain the figure reached EUR 2,971 million (-3.2%) despite the greater volume of energy sold, and mainly due to the greater procurement costs resulting from the different generation mix, a result of the drop in hydroelectric production (-30.3%) given the extraordinary hydraulic conditions of the previous year. Additionally, in March 2014, an extraordinary positive impact of EUR 43 million was registered in the gas business due to the renegotiation of contracts, which affects the year-on-year comparison. However, this effect was partially offset by the good performance of net operating expenses.

- The Gross Margin for the United Kingdom was EUR 1,306 million, positively affected by the appreciation of the Sterling pound. The generation business decreased its contribution due to the lower production (-1.5%) and the increase in costs (carbon tax). The commercial business improved due to the greater sales, which compensate the drop in tariffs and the increase of regulated costs (ROCs, DuOS and TuOS). It is noteworthy the good performance of the gas business in this period.

- Mexico contributed EUR 584 million to the Gross Margin (+27.8%) resulting from the new contracts with private clients and the appreciation of the US dollar.

- **Renewables business**

The Renewable business increased its Gross Margin by 16.1% to EUR 2,361 million (EUR 2,034 million in 2014).

Millions of euros	2015	2014	% change
Spain	751	728	3.2
United Kingdom	572	369	55.0
United States	822	736	11.7
Mexico and Brazil	93	93	0.0
Rest of the world	123	108	13.9
Total Renewable business	**2,361**	**2,034**	**16.1**

The main causes of this trend are:

- A lower production in Spain (-9.9%) offset by a recovery of prices (EUR +8, +14%), given that they were exceptionally low in 2014 due to the weather conditions and the impact of a regulatory reform during the first part of the year, means that the gross margin rose to EUR 751 million (+3.2%).

- An improved Gross Margin in the United Kingdom of EUR 572 million, due to the entry of new capacity (contribution of the offshore wind farm of at West of Duddon Sands) and the good wind conditions (production: +19.3%).

- A greater contribution from the US of EUR 822 million (+11.7%), due to the effect of the exchange rate, which offsets a lower wind power resource (production: -4.1%) and lower sale prices reached as a result of milder weather conditions than the previous year.

- A contribution from Latin America and the Rest of the World of EUR 216 million, the result of greater production and an improvement of wind power.

- **Other businesses**

The contribution of Other Businesses reached EUR 235 million, a 8.8% decrease (EUR 216 million in 2014).

2.2.1.2 Gross Operating result – EBITDA

Consolidated EBITDA increased by 4.9% up to EUR 7,306 million (EUR 6,965 million in 2014), where all businesses improved, with increases in Networks (+1.9%), Renewables (+18.6%) and Generation and Retail (+1.2%).

Millions of euros	2015	2014	% change
Network Business	3,602	3,535	1.9
Deregulated Business	2,320	2,292	1.2
Renewable Business	1,572	1,326	18.6
Other Businesses	-11	-17	35.3
Corporation and adjustments	-177	-171	-3.5
EBITDA	**7,306**	**6,965**	**4.9**

- **Net operating expenses**

In addition to the already explained Gross Margin, Net Operating Expenses increased by 5.4% to EUR 3,830 million (EUR 3,634 million in 2014), affected by the exchange rate, given that excluding this effect, it would have dropped by 1.6%. This item was affected by non-recurrent positive impacts (favourable decisions accounted in “External Services” heading), offset by higher non-recurrent costs related to the implementation of new IT systems in the United Kingdom and the increase in expenses generated from AVANGRID’s operation.

Millions of euros	2015	2014	% change
Network Business	1,413	1,275	10.8%
Deregulated Business	1,566	1,512	3.6%
Renewable Business	635	567	12.0%
Other Businesses	242	229	5.7%
Corporation and adjustments	-26	51	-151.0%
Net operating expenses	**3,830**	**3,634**	**5.4%**

- **Levies**

The Levies heading increased by 7.9% to EUR 1,706 million, mainly due to the positive impact of EUR 113 million recorded in 2014 due to the favourable decision regarding CO_2 rights deduction, which affects the year-on-year comparison, although it is partially offset by several positive legal decisions (EUR 48 million). Additionally, the Levies heading increased due to the impact of the exchange rate (EUR 85 million).

2.2.1.3. Net Operating result – EBIT

EBIT totalled EUR 3,829 million, a 2.8% decrease in comparison with 2014 (EUR 3,941 million).

Millions of euros	2015	2014	% change
Network Business	2,472	2,455	0.7
Liberalised Business	962	1,276	-24.6
Renewable Business	659	501	31.5
Other Businesses	-30	-24	25.0
Corporation and adjustments	-234	-267	-12.4
EBIT	**3,829**	**3,941**	**-2.8**

- **Amortisations and provisions**

Amortisations and Provisions increased by 15%, totalling EUR 3,477 million:

- Amortisation increased by 6.9%, to EUR 3,006 million. Its evolution is basically due to exchange rate, new assets put into operation in Network and Renewable businesses and the amortisation of new IT developments in the United Kingdom (FIS).

- The Provisions heading was EUR 471 million, with a greater expense of EUR 260 million, representing a 123.2% increase due mainly to non-recurring provisions in the United Kingdom deriving from the closure of the Longannet thermal power station (EUR 288 million), partially offset by the extension of the PTCs in the United States that reduce write-off of wind farms development costs (EUR 50 million).

2.2.1.4. Financial Result

Net financial result was EUR -1,023 million, which is 8.9% better than that achieved in the same period of the previous financial year (EUR -1,122 million in 2014), mainly resulting from the 8% decrease in the result associated to debt. The average cost was 4.05%, 30 bp lower than last year.

The negative impacts associated with the surplus generated in 2014 generated from the sale of the stake in EdP, the remuneration of the tariff shortfall and the derivatives result have been partially offset by the favourable result of several non-recurring contingencies which amount to EUR 101 million, including interest accrued in legal rulings, gains of FX hedging and the sale of the stake in Euskaltel.

2.2.1.5 Results of Companies Consolidated by the Equity Method

The “Results of companies consolidated by the equity method” heading reached EUR 55 million (-59.2% against EUR 135 million in 2014) as a result of the sale of the stake in BBE and the increase in book value of the stake in Gamesa registered in 2014, which affects the year-on-year comparison.

2.2.1.6 Income from Non-Current Assets

Income from Non-Current Assets amounted to EUR 125.1 million, EUR 247.8 million less than in 2014 (-49.5%). During 2015, the most significant operations have been the sale of direct holding of COELBA and COSERN (+EUR 74 million) to NEOENERGÍA and the proceeds of the arbitration in Bolivia (+EUR 32 million). During 2014, the sale of the portfolio of Itapebí (Brazil) and the NNB Development (Nuclear, United Kingdom), as well as the 25% equity share in BBE (CCGT in Spain) were the most significant operations amounting to EUR 244 million.

2.2.1.7 Net Profit

Lastly, Net Profit amounted to EUR 2,422 million, a 4.1% increase compared to the figure obtained in the same period of 2014 (EUR 2,327 million). Recurring Net Profit reached EUR 2,261.4 million (+7.0%) as the result of a good evolution of business and the year on-year comparison of specific items of each year.

With regard to the “Corporate tax” heading, it decreases by 37% and stands at EUR 527.1 million, as the result of the decline of the tax rate (from 30% to 28%) and the reversal of fiscal provisions of previous years, which brings about a positive impact of EUR 216 million, and to the positive impact due to the lower tax rate in the United Kingdom (EUR 168 million, of which EUR 163 are non-recurrent), which will stand at 18% tax rate in the year 2020.

2.3 Operative evolution of the period

2.3.1 Network business

A. Spain

IBERDROLA had almost 10.8 million supply points and its energy distribution for the year amounted to 94,113 GWh, a 2.2% increase compared to the previous year (92,131 GWh in 2014).

During 2015, the SAIFI indicator of supply quality was at 61.9 minutes against (55.7 minutes in 2014). It is important to note that this index was impacted by the strong rainstorm, wind and snow that affected the whole Iberian Peninsula at the end of January and that provoked many widespread incidents.

During this fiscal year, the investment made has made it possible to turn on the facilities included in the following table:

Physical units 2015		Total
Lines[1]	Overhead (km)	155
	Underground (km)	640
Substations	Transformer (units)	15
	Capacity increase (MVA)	1,229
	Substation (units)	11
Transformation centres	Centres (units) [3]	-476
	Capacity increase (MVA) [2]	54

(1) It includes the reduction occurred due to 132 kW lines changed into 220 kW, now owned by REE.

(2) 3 out of the 11 facilities have been fully renewed (STR Cáceres-3, STR Coria I and Móstoles). 4 facilities have been substituted (Gandía, Plasencia, Valle de Cárcer (Vilanova) and Villaverde PM) and the STRs Polígono-C and Legazpi have been dismantled.

(3) Reassignment of ownership of transformer substations.

In addition, during this year, 2.3 million smart meters with a remote management system were installed, within the STAR smart network project.

In line with this, at the end of 2015, IBERDROLA has completed the installation of 6,495 thousand smart meters in Spain. The Company has modernised the 62% of its metering fleet in Spain, overcoming the obligation of renovating 35% of their 10.5 million meters by the end of 2014. This initiative, carried out in ten regions, will conclude in 2018 and has an overall investment of EUR 2,000 million.

B. United Kingdom

IBERDROLA has approximately 3.5 million electricity distribution supply points. The volume of distributed electricity during 2015 was 34,009 GWh (34,217 GWh in 2014), a 0.6% drop compared to the previous year.

Customer Minutes Lost (CML) and the number of consumers affected by interruptions per every 100 customers (Customer Interruptions, CI) are:

	2015		2014	
	CML	CI	CML	CI
Scottish Power Distribution (SPD)	34.7	46.6	34.4	48.0
Scottish Power Manweb (SPM)	35.2	31.5	38.0	33.7

Both CI and CML meet the quality requirements established in the regulation.

C. United States

- **Distribution**

  IBERDROLA USA has 2.203 thousand supply points in the United States. The distributed volume of electricity during the year has been 32,047 GWh, a 0.4% increase compared with the previous year (31,934 GWh).

The System Average Interruption Frequency Index (SAIFI) and the Customer Average Interruption Duration Index (CAIDI) are as follows:

	2015		2014	
	SAIFI	**CAIDI**	**SAIFI**	**CAIDI**
Central Maine Power (CMP)	0.72	1.70	1.80	1.86
NY State Electric & Gas (NYSEG)	0.56	2.08	1.03	1.97
Rochester Gas & Electric (RGE)	0.41	1.79	0.76	1.74

The indicators of the three companies meet with the objectives established under the relevant regulatory agreements.

- **Transmission**

Construction works for the transmission project in Maine finished with a total budget of USD 1,400 million. Construction works continue for a little further extension of this project, Lewiston Project, whose budget amounts to USD 41 million.

- **Gas**

The number of gas users in the states of New York and Maine at the end of 2015 was nearly 572 thousand, to whom 31,652 GWh have been supplied, a 5% drop compared to previous year. Taking into account the integration of UIL, the number of gas consumers amounts to 982 thousand.

D. Brazil

The demand evolution for the Brazilian distributors COELBA, COSERN, CELPE and ELEKTRO has remained similar to the previous year levels reaching 54,000 GWh (54,010 GWh in 2014) during 2015.

Energy distributed (GWh) 100% of business	**2015**	**2014**	**% Change**
COELBA	18,871	18,380	2.7
COSERN	5,512	5,462	0.9
CELPE	13,426	13,235	1.4
ELEKTRO	16,191	16,933	-4.4
Total	**54,000**	**54,010**	**0.0**

The number of customers served by the distributors at the end of the year reaches 13 million.

Number of customers (million)100%	2015	2014
COELBA	5.7	5.6
COSERN	1.3	1.3
CELPE	3.5	3.4
ELEKTRO	2.5	2.4
Total	**13.0**	**12.7**

With regard to regulated electricity generation, the capacity of the projects in operation at December 2015 is 3,585 MW (IBERDROLA's percentage 951 MW).

Regarding the projects under construction, the pace of construction is on schedule, so that the dates remain as planned.

Plant	MW	Attributable MW	Year
Baixo Iguaçu	350	137	2018
Belo Monte	11,233	438	2016-2018
Total	**11,583**	**575**	

2.3.2 Deregulated business

A. Spain and Portugal

A.1. Generation

IBERDROLA'S installed capacity in Spain (excluding the renewable business) totalled 19,745 MW (18,836 MW in 2014):

Installed capacity	2015	2014	Change
Hydroelectric	9,713	8,807	906
Nuclear	3,166	3,166	-
Coal	874	874	-
Gas combined cycles	5,694	5,694	-
Cogeneration	298	295	3
Total	**19,745**	**18,836**	**909**

In addition, the Spanish peninsular energy balance is characterized by a high renewable production (36.8% of the total) and a higher thermal production comparing to 2014, both coal production (+23.8%) and gas generation (+18.7%). The demand shows an increase of 1.8%, despite in terms adjusted to the number of working days and the temperature, the increase is 1.6%. It is worth noting the evolution of electricity consumption of the group of companies that in the last 12 months showed a 1.8% growth, broken down as +2.4% for industrial consumers and -1.0% for service consumers.

Regarding IBERDROLA, during 2015, the production increased by 8.1% to 43,338 GWh.

The yearly trend analysed by technology is as follows:

GWh	2015	2014	% Change
Hydroelectric	12,488	18,029	-30.7
Nuclear	23,082	24,370	-5.3
Coal	3,684	2,514	46.5
Gas combined cycles	2,293	633	262.2
Cogeneration	1,791	1,611	11.2
Total net production	**43,338**	**47,157**	**-8.1**

- Hydroelectric production decreased by 30.7% comparing to the previous year due to lower rainfall in the period.

- Hydroelectric reserve levels were 53% (equivalent to 6.008 GWh).

A.2 Retailing

Supplied energy (electricity and gas) in Spain came to 58,280 GWh (55,819 in 2014), 49,949 GWh of electricity y 8,364 GWh of gas.

Electricity sales on the deregulated market in 2015 increased by 7.1% amounting to 41,008 GWh compared to 38,300 GWh supplied in the same period of 2014. Regarding the electricity supplied at the PVPC, it amounts to 8,911 GWh.

The gas retailed in the free market in 2015 increased by 9.8% up to 8,364 GWh compared to 7,616 GWh supplied in 2014.

In Portugal, IBERDROLA supplied 6,718 GWh during 2014 compared to the 6,563 GWh supplied in 2014 (+2.4%), being the second seller in the Medium Voltage industrial clients.

B. United Kingdom

B.1. Generation

At 31 December 2014 and 2015, installed capacity in the UK amounted to 4,835 MW.

(MW)	2015	2014	% Change
Hydroelectric	563	563	-
Coal	2,304	2,304	-
Gas combined cycles	1,967	1,967	-
Cogeneration	1	1	-
Total United Kingdom	**4,835**	**4,835**	**-**

With regard to production from traditional electricity generation, it decreased by 5.6% to 14,754 GWh compared to 15,637 GWh in 2014.

Coal plant production dropped by 18% to 7,813 GWh compared to 9,523 GWh in the same period of the previous year, due to the high activity of ancillary services in Longannet lowering production and to the drop of the spreads due to the increase of costs derived from “Carbon Tax” and the low prices of electricity.

The highlights by generation technology are as follows:

GWh	2015	2014	% Change
Hydroelectric	704	730	-3.6
Coal	7,813	9,523	-18.0
Gas combined cycles	6,235	5,381	15.9
Cogeneration	2	3	-33.3
Total United Kingdom	**14,754**	**15,637**	**-5.6**

B.2. Retailing

Regarding sales, during 2015 customers have been supplied with 20,458 GWh of electricity and 32,055 GWh of gas (20,142 GWh of electricity and 30,826 GWh of gas supplied during 2014). At 31 December 2015, SCOTTISH POWER had 3.3 million electricity customers and 2.2 million gas customers.

C. Mexico

IBERDROLA remains the leading private producer in the country with 5,048 MW (4,987 MW in 2014) in installed capacity.

The electricity supplied from the combined cycle and cogeneration plants amounted to 38,128 GWh (35,175 GWh in 2014), equivalent to a load factor of 86% given that generation with natural gas is the basis for electricity generation in Mexico. Cumulative availability of the Mexico plants was 96%.

The award by the Federal Committee of Electricity (CFE) of Mexico of the North East plant under the Independent Energy Producer category stands out in 2015, with a 25-year contract for 857 MW in the municipality of El Carmen (Nuevo León). This plant, for which the project has already started, will be operational in 2018. Furthermore, two new cogeneration projects have started in construction in 2015, with a joint capacity of 106 MW.

In addition to the three previous projects, there are six new plants under construction. Three of them will be operational in 2016: the 300 MW combined cycle plant in Baja California III (25 years contract with CFE), a 50 MW cogeneration plant and a new 300 MW combined cycle unit in the Dulces Nombres plant in Monterrey for private customers.

With all of this, in 2018, IBERDROLA's operating thermal capacity in Mexico in fully consolidated projects will reach 6,700 MW.

Mexico's energy reform, and within it the reform of the electricity sector, continues following the calendar of planned events. With the basic regulatory phase having finished with the publication of the Electricity Market Guidelines, the Short Term Electricity Market entered into effect in January 2016, and the first auctions of capacity, energy, and clean energy certificates will be carried out in the first half of 2016. The reforms are a great opportunity for additional business growth in the coming years.

D. Gas storage in US and Canada

Gas storage facilities operated by the Company in 2015 totalled 2.4 bcm. In addition, the Company had 1.6 bcm of contracted or managed capacity.

2.3.3. Renewable business

At the end of 2015, the renewables business had an installed capacity of 14,184 MW (14,049 MW in 2014).

The renewable production decreased by 2.6% to 31,228 GWh (32,062 GWh in 2014).

During the last year, IBERDROLA installed 139 MW in new renewable installations.

Installed MW	2015	2014	MW change
Wind Energy Spain	5,508	5,508	-
Wind Energy USA	5,484	5,484	-
Wind Energy United Kingdom	1,614	1,611	3
Onshore	*1,420*	*1,417*	*3*
Offshore	*194*	*194*	-
Wind Energy Mexico	367	231	136
Wind Energy Brazil	187	187	-
Wind Energy Rest of the World	615	615	-
Total wind energy	**13,775**	**13,636**	**139**
Other renewables	**409**	**413**	**-4**
Total installed capacity	**14,184**	**14,049**	**135**

A. Onshore Wind Energy

After the addition of 139 MW during the last year, IBERDROLA reached a total installed onshore wind capacity of 13,581 MW.

- United States

  The Company is present in 18 States with a total installed capacity of 5,484 MW.

- United Kingdom and Republic of Ireland

  Installed capacity at the end of 2015 amounted to 1,405 MW in the United Kingdom and 15 MW in the Republic of Ireland after having installed 3 MW during the year.

- Brazil

  Six projects for a total of 174 MW in wind energy won the 'Leilãos' (tenders) that took place in 2014. Works are under way on the wind farms of Calango 6 (30 MW), Santana I (30 MW) and Santana II (24 MW).

- Mexico

  During 2015, the installation of a wind farm of 70 MW in the Estate of Oaxaca and another wind farm of 66 MW in the Estate of Puebla are remarcable.

B. Offshore Wind Energy

Currently, the renewables business is developing offshore wind projects mainly in the United Kingdom, Germany and France.

In the United Kingdom, in 2014, the Company went into operation of the West of Duddon Sands project located in the Irish Sea with a capacity of 389 MW which is being jointly developed at 50% with Dong Energy (194.5 MW correspond to IBERDROLA).

IBERDROLA continues the Wikinger offshore project development, up to 350 MW in the Baltic Sea (Germany). The project is in the component manufacturing phase with a view to starting offshore works in 2016 and going into operation in late 2017.

IBERDROLA is developing in the United Kingdom the "East Anglia" project in the North Sea. In February 2015, the East Anglia I project secured a Contract for Difference in the first auction of its kind in the United Kingdom, for a maximum capacity of 714MW; the project has made progress during 2015, with a view to a final investment decision and the signing of the contract with Siemens for the supply of 102 wind turbines of 7MW.

In April 2012, the consortium formed by IBERDROLA and the French company EOLE-RES was awarded by the French Government the exclusive rights for the operation of the offshore wind farm of Saint-Brieuc, with a capacity of 500 MW. In 2013, the project was technically redefined with the aim of using a more modern machine, 8 MW of unit power, made by ADWEN (Joint venture between Areva and Gamesa). In October 2015, the project submitted its application for a construction license. In 2016, the Company will work towards answering the requests from the French administration within the process for approval of the license, as well as on the consolidation of the main supply agreements for the future farm.

C. Other technologies

The Renewable business has facilities of other renewable technologies in various countries making a total of 409 MW, which breakdown is presented in the following table:

MW installed	2015	2014	Country
Mini-hydraulic special regime	130	130	Spain
Mini-hydraulic ordinary regime	173	176	Spain
Solar thermal hybrid	50	50	Spain
Photovoltaic	56	56	USA (50MW) Greece (6MW)
Waves	-	1	UK
Other Renewables	**409**	**413**	

3. LIQUIDITY AND EQUITY RESOURCES

3.1 Leverage

Adjusted net financial debt at 31 December 2015 increased by EUR 2,448 million to EUR 28,067 million compared to the EUR 25,619 million at 31 December 2014, as a result of the acquisition of UIL in 16 December 2015. Excluding this effect, the net financial debt of 2015 would amount to EUR 25,661 million, a 0.2% increase comparing to the previous period. Financial leverage stood at 40.7% compared to 41.8% in the same period of the previous year, since the Equity Resources increase more than debt.

	2015	2014
Equity	**40,956**	**35,705**
Gross Debt	30,340	28,191
Cash	-1,153	-1,805
Asset Derivatives and others	-1,120	-767
Adjusted net debt	**28,067**	**25,619**
Leverage	**40.7%**	**41.8%**

3.2 Credit rating of IBERDROLA senior debt

Agency	Rating[(1)]	Outlook	Date
Moody´s	Baa1	Stable	8 April 2015
Fitch	BBB+	Stable	25 March 2014
Standard & Poors	BBB	Positive	30 April 2015

(1) Warning: The above ratings may be revised, suspended or withdrawn by the rating agency at any time.

3.3 Debt structure

Regarding the evolution of the financing cost of the Company, at 31 December 2015 it stood at 3.57% compared to 4.14% in the same period of the previous year (Note 25 of the Consolidated financial statements).

The structure of the debt by interest rate and currency can be seen in Notes 5 and 25 of the Consolidated financial statements.

In accordance with the policy of minimizing the financial risks of the Company, foreign currency risk has continued to be mitigated through the financing of international businesses in local currencies (Sterling pound, Brazilian real, US dollar, etc.) or in their functional currencies (US dollar, in the case of Mexico). The percentage of the debt registered in USD increases up to 29.8%, caused, mainly, by the integration of UIL.

IBERDROLA has a strong liquidity position at the end of 2015 exceeding EUR 8,000 million, equivalent to more than 28 months of the Company's financing needs (Note 50 of the Consolidated financial statements).

Credit line maturities	*(Millions of euros)* Available
2016	915
2017	330
2018 and onwards	5,809
Total credit lines	**7,054**
Cash and Short Term Fin. Invest.	1,153
Total adjusted liquidity	**8,207**

IBERDROLA has a varied debt maturity profile, with an average maturity of approximately six years, as a result, among other factors, of the active management of liabilities carried out during this financial year. IBERDROLA's debt maturity profile at the end of 2015 can be seen in Note 25 of the Consolidated financial statements.

3.4 Working capital

Working capital shows a decrease of EUR 322 million since December 2014 as a result mainly due to several different effects partially offsetting one another:

- A decrease of "Current financial assets" mainly due to the proceeds of regulatory fees for tariff shortfall that amount to EUR 360 million.

- Asset and liability balances with Public Administrations amount to, all together, a reduction of working capital of EUR 201 million.

- The increase in both the Commercial debtors and creditors result, all together, in a decrease of working capital of EUR 21 million.

	Dec. 2015	Dec. 2014	Change
Assets held for sale	44	-	44
Nuclear fuel	350	320	30
Inventories	1,797	2,039	(242)
Current trade and other receivables	5,370	4,819	551
Current financial assets	687	1,047	(360)
Asset derivative financial instruments [(1)]	339	314	25
Public Administrations	678	700	(22)
CURRENT ASSETS [(1)]:	**9,265**	**9,239**	**26**
Provisions	245	221	24
Liability derivative financial instruments	324	349	(25)
Trades and other payables [(2)]	7,332	6,760	572
Public Administrations	1,251	1,474	(223)
CURRENT LIABILITIES [(2)]:	**9,152**	**8,804**	**348**
NETWORKING CAPITAL	**113**	**435**	**(322)**

(1) It does not include cash or debt asset derivatives.

(2) It does not include financial debt and debt liabilities derivatives.

4. INDUSTRY REGULATION AND FUNCTIONING OF THE ELECTRICITY AND GAS SYSTEM

Both IBERDROLA and some of the fully or proportionately consolidated subsidiaries engage in electricity business activities in Spain and abroad (see the Appendix to these Consolidated financial statements) that are heavily affected by the respective regulatory frameworks. Following is a description of the main regulations affecting the IBERDROLA Group.

4.1 European Union

In the member states of the European Union in which IBERDROLA is present, particularly in the UK and Spain, it should comply with EU regulations.

The aim of the European legislation is the constitution of unique gas and electricity markets in order to facilitate the exchange of this type of energy and allow any consumer in the European Union to deal freely with any supplier in the EU. In this respect, there are two types of legislation: the directives, which set out common criteria to be observed in internal markets and which the member states should transpose into national legislation; and the Regulations, which establish norms for the supranational issues, especially those related to the transit of gas and electricity, and are applicable directly.

Another set of regulations that indirectly affects the energy sector are those arising from the energy and climate policy agreed in 2007. It involves the triple objective of reducing emissions of greenhouse gases (GHGs) by 20%, setting a quota of renewable energy of 20% and a target for reducing consumption by 20%, all by 2020. To meet these objectives by 2020 there have been four documents accompanying the legislation: the reform of the Emissions Trading System, EU (EU-ETS), the national targets for emissions from non-EU ETS, the national objectives on renewable energy and carbon capture and storage.

Since 2009, these institutions have worked to implement the regulation approved in that year related to, on the one hand, the internal gas and electricity markets and, on the other hand, to promote renewable energy and to combat climate change. This regulation will be reviewed from 2016 to 2020.

In October 2014, the European Council agreed new targets for 2030: a 40% reduction in GGE compared to 1990, a share of 27% for renewable energy and a reduction in consumption, also of 27%. It also agreed to ensure that in 2020 the electricity exchange capacity among countries was at least 10% of the installed capacity. The legislation arising from these agreements has yet to be developed.

The legislation on infrastructures is also relevant. The European Union has powers with regards to trans-European networks, specifically those of energy. During the last few years, various regulations and programmes have been created to promote a greater connectivity among the Member States. Specifically, programmes like the Trans-European Energy Networks (TEN-E), the European Energy Programme for Recovery (EEPR) and the Connecting Europe Facility (CEF). Lastly, in December 2014, the European Council approved the creation of a Strategic Investment Plan for the European Union, to mobilize EUR 315,000 million in 2015 – 2017. It will be structured as a European Fund for Strategic Investments allocated to investments in infrastructure, including energy and renewable energy networks. The regulations implementing the Plan will be developed during 2015. In January 2015, the European Commission submitted the proposal of a Regulation on the European Fund for Strategic Investments to create the required legal framework. On 27 May 2015, an agreement was reached between the Council, the Parliament and the European Commission on the proposed Regulation.

On 25 February 2015, the European Commission launched a framework strategy for a resistant Energy Union with a Forward-Looking Climate Change Policy, that includes fifteen action points to be implemented during the mandate of the current European Commission, including, among others, setting out the goals of an energy union and the steps the Commission will take to achieve it, a new legislation to redesign and reform the electricity market, ensure the supply for electricity and gas, EU funding for energy efficiency, a new renewables energy package and a structural reform of EU-ETS. On 18 November 2015, the European Commission presented its first State of Energy Union reporting advances achieved in 2015 and steps to be undertaken in 2016. A guidance on Governance of the Energy Union process was also provided.

On 15 July 2015, the European Commission has published a package of documents that anticipated legislative action in the field of energy markets. Among the numerous published documents, the following stand out for our interest:

- **Communication on market design**: analysis of the EC on the functioning of the market and their suggestions for improvement, which include removing price caps as well as a better integration of renewables in the market. Also, the EC raises proposals on capacity mechanisms.

- **Communication on retail market ("New Deal" for customers)**: analyses the functioning of the retail market and makes proposals for improvement to facilitate greater interaction with the client (improvements on information issues and development of new products and agents). Linked to this communication, has published a document of "best practices" in self-consumption.

- **Reform of the ETS directive**: legislative proposal to be sent to the European Parliament and the Council for processing. Covers, inter alia, MSR, and the protection of sectors in leak of carbon.

Other EU regulation

The following regulations of significance to the energy sector were approved in 2015:

- The Regulation (EU) 2015/1222 of 24 July 2015 established a guideline on capacity allocation and the management of accumulations in the interconnection. This regulation lays down detailed guidelines on cross-zonal capacity allocation and congestion management in the day-ahead and intraday markets, including the requirements for the establishment of common methodologies for determining the volumes of capacity simultaneously available between bidding zones, criteria to assess efficiency and a review process for defining bidding zones. This Regulation shall apply to all transmission systems and interconnections in the Union, except for the transmission systems on islands which are not connected with others.

- On 9 October, the Decision 2015/1814 of the European Parliament and The Council was published, concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme, amending the Directive 2003/87/EC. The market stability reserve will be established in 2018 and the placing of allowances in the reserve must be operating from 1 January 2019. It was established with the aim of reducing the quantity of 900 million allowances from auctioning volumes during the period 2014-2016 that shall not be added to the volumes to be auctioned in 2019 and 2020 but shall instead be placed in the reserve. Each year, a number of allowances equal to 12% of the total number of allowances in circulation, shall be deducted from the volume of allowances to be auctioned by the Member States and shall be placed in the reserve over a period of 12 months beginning on 1 September of that year, unless the number of allowances to be placed in the reserve would be less than 100 million. In any year, if the total number of allowances in circulation is less than 400 million, 100 million allowances shall be released from the reserve and added to the volume of allowances to be auctioned by the Member States.

- On 28 November, the Directive 2015/2193 of the European Parliament and The Council, of 25 November 2015, was published, on the limitation of emissions of certain pollutants into the air from medium combustion plants. This Directive establishes the mandatory register of this units, specific limit for certain components (sulphur dioxide, nitrogen oxides, ammonia and volatile organic compounds) and rules to control other pollutants (carbon monoxide). The maximum deadline of adaptation contemplated in the Directive for certain existing plants is 2030.

Industry Regulation in Spain

The National Commission for Market and Competition (Comisión Nacional de Mercado y Competencia - CNMC) is as a public body attached to the Ministry of Economy and Competitiveness and is subject to parliamentary scrutiny. It has the functions of market regulation and supervision.

Industry regulation and functioning of the electricity system in Spain

Currently, the electricity sector is regulated by the Electricity Industry Law 24/2013, of 26 December.

This note describes the principles that govern the Law 24/2013.

1. **Separation of activities:**

   The regulation establishes a separation between the activities carried out in the competitive sector and others that are considered to be regulated activities. Companies that carry out any activities defined by the law as regulated (economic and technical management of the system, transmission and distribution) must have these as their sole corporate purpose and cannot, therefore, engage in unregulated activities (generation, retailing, or other activities unrelated to electricity or activities abroad). However, in group of companies in compatible activities performance will be allowed provided that these are executed by different companies. In addition, it prescribes a separation between regulated and deregulated activities for accounting purposes.

2. **Competition in the power generation activity through the following measures:**

   - The electricity production is developed in a free competence environment.

- Generation dispatch is established by daily market. Producers of electricity, other than the special cases and exceptions provided in the law, tender hourly bids for electricity sales of each of the production units owned by them. The operating order of the production units is established on the basis of the lowest bids made until demand is satisfied in each programming period and the energy produced in each programming period remunerated at the price matched between supply and demand. There is also the option of recourse to the intraday markets (six every day), where operators can adjust their positions in respect to their daily programmes. Meanwhile, the production facilities contribute to the provision of whatever additional services may be necessary to guarantee an adequate supply, obtaining additional remuneration for such services.

- In addition to the market remuneration, the Ministry of Industry, Energy and Tourism may establish remuneration entailing payment for capacity. In this regard, the orders ITC 2794/2007, ITC 3860/2007 and ITC 3127/2011 regulate capacity payments, which consist of an investment incentive, an environmental incentive and an of availability service. The Royal Decree-Law 13/2012 temporarily modifies the investment incentive and the environmental incentive until a new capacity payment system is developed.

- The installation of the new generating facilities is deemed to be deregulated, without prejudice to the obtainment of the necessary authorisations.

- Producers are entitled to use in their generating facilities the primary energy sources that they deem most appropriate, subject to such restrictions in respect to the environment, etc. as might be provided for in current legislation.

- In December 2014, the Royal Decree 134/2010 introduced an ongoing procedure until December 2014, called supply security restrictions, which encourages the use of local coal.

- On 10 June 2014, the Royal Decree 413/2014 was published, which regulates the electric energy production activity generated from renewable, cogeneration and waste resources and establishes the methodology for the specific remuneration regime which applies to facilities that do not meet the minimum necessary to cover the costs that allow them to compete on an equal level with other technologies in the market, obtaining "reasonable return" relating to the installation type applicable in each case. The new specific remuneration system consists of the sum of:

    - a “remuneration for investment” (EUR/MW) to cover, where applicable, the investment costs that cannot be recovered from the electricity sale in the market;

    - a “remuneration for the operation” (EUR/MWh) to cover, where applicable, the difference between the operation costs and income coming from the electricity market.

- This new specific remuneration system will be calculated on the basis of a standard installation during its regulatory lifetime and referenced to the activity carried out by an efficient and well-run company according to the following:

    - the standard revenues for selling the energy;

    - the standard operation costs needed for the activity; and

    - the standard value of the initial investment.

This remuneration regime will be based on a fair-rate of return of the investments, defined on the basis of 10 years Government bonds plus a differential, initially fixed on a 300 basis points for the first regulatory period that ends on 31 December 2019 (this is, 7.398% before taxes).

Six year regulatory periods and three year regulatory sub-periods have been set. The remuneration parameters related to the market price forecasts may be changed every three years, including the deviations produced in the sub period. The standard parameters of the installations may be changed every six years, except for the initial investment value and the regulatory lifetime, that will remain unchanged during the installations' regulatory lifetime. The investment return rate may be changed by law also every six years, but only for the remunerations in the future. The return on operation in circumstances where the operating cost of a technology is dependent on fuel prices may be changed at least once a year. The last order published regarding to update this operational costs is the Order IET/1345/2015.

The standard value of the investment for new installations will be defined through a competitive tendering process.

On the other hand, Royal Decree 413/2014 established that an order from the Ministry of Industry, Energy and Tourism will establish a classification of standard installations in terms of the technology, installed capacity or any another characteristic that may be considered necessary for the application of this remunerative scheme. Hence, on 20 June 2014, the Ministry published the Order IET/1045/2014, of 16 June 2014 approving the remuneration parameters for standard installations already in operation.

The Order IET/1345/2015 establishes the methodology for updating the remuneration to the operation of facilities with specific retribution regime for such facilities established in the Order IET/1045/2014 and which has been approved by the ministerial order a remuneration value of operation except zero and whose operating costs depend essentially on the price of fuel. Update methodology is based on the evolution of fuel prices and, in the case of technologies that mainly use natural gas, it is also considered the variation of tolls for access to the gas network.

The Royal Decree 947/2015 establishes a call for granting the specific remuneration system for new facilities producing electricity from biomass in the mainland electricity system and for wind technology. They will be allocated up to 200 MW and 500 MW for biomass and wind (new or repowering), respectively. The allocation procedure and compensation parameters are developed in the ministerial order IET/2212/2015 of 23 October. Finally, the resolution of 30 November 2015 the Ministry of Energy announces the auction.

In the Resolution of 18 December 2015, the Ministry of Energy establishes the criteria to participate in the system adjustment services and approves certain testing procedures and operating procedures for their adaptation to the Royal Decree 413/2014 of 6 June, by which the activity of electricity production is regulated from renewable energy, cogeneration and waste. With this Resolution renewable installations may participate in adjustment services of the electricity system effectively and on equal conditions with other conventional technologies, thus improving competition in these markets. This represents an unprecedented advance in Europe.

3. **Guarantee of the proper functioning of the system, by using the following measures:**

   - System operation: Red Eléctrica de España, S.A. carries on the transmission management and system operation activities. As system operator, it is responsible for managing the adjustment markets to guarantee a balance between energy demand and generation.

   - Functioning of the market: With the creation of the Iberian Electricity Market (*Mercado Ibérico de la Electricidad,* - MIBEL), since July 2006, the Portuguese and Spanish forward markets have operated on an integrated basis and, since July 2007, so have the short-term markets (daily and intra-day). Currently, the Iberian Market Operator (*Operador del Mercado Ibérico* - OMI) is responsible for the operation of MIBEL. OMI was originated in the merge of OMIE (OMI-Spain), responsible for the management of the daily and intra-day markets, and OMIP (OMI-Portugal), responsible for the forward market.

4. **Legislation applying to regulated activities:**

   The Law 24/2013 established that distribution and transmission are classified as regulated activities that are not subject to the free competition and market regime.

   The Royal Decree-Law 9/2013 fixes the transitory methodology that will govern the transmission and distribution activities until the new royal decrees related to transmission and distribution are approved. It established that, on the one hand, for the revenue of these activities, an “efficient and well-run company” will be considered applying uniform criteria throughout the Spanish territory. On the other hand, it established that these economic regimes allow adequate revenue of a low-risk activity. The methodology used to calculate the revenue for the distribution activity defines a "regulatory assets base" for the activity that evolves upwards, according to the investments made, and downwards, according to the related depreciation, in order to fix its revenue. In the application of these principles it established a rate of return on assets linked to Government bonds plus a spread.

   Subsequently, the Law 24/2013, published on 26 December, introduced some modifications. The most relevant ones are the following:

   - Introduction of the "efficient and well-run company" concept, considering these activities as low risk.

   - The regulatory periods extend to six years.

   - For regulatory purposes, the accrual and collection of the remuneration generated by the installations that entered into operation in the year n starts in the year n+2.

   - The assets in operation not fully depreciated will receive an investment remuneration considering their net value for the financial remuneration. The financial remuneration rate will be based on ten year Government bonds plus an appropriate spread for a low risk activity.

   Finally, on 30 December 2013, two royal decrees were published regulating the new remuneration methodology of the transmission (Royal Decree 1047/2013) and distribution (Royal Decree 1048/2013) activities were, developing the regulatory and tax measures that started on the second half of 2013.

The methodology set out in the Royal Decree is based on new standard investment and operating costs. The aim is to reduce costs, introducing efficiency mechanisms and limitations concerning the annual investment volume. The recalculation of the base remuneration will be carried out during its first year of implementation, which includes the initial regulatory asset of the companies, that can vary with respect to the one recognised on the Royal Decree-Law 9/2013. Investment limits are also established (sector's maximum 0.13% GDP). The financial remuneration rate of the asset embodies the principles established in the new Electricity Industry Law, referenced to the ten years Government bonds plus an appropriate spread for a low risk activity.

The Royal Decree 1048/2013 includes changes in the existing incentives, in quality (it may fluctuate between +2% and -3% of the Company's remuneration) and losses (it may fluctuate between +1% and -2%). A new incentive regarding fight against fraud is created, which may reach 1.5% of the Company's remuneration. For the application of the new remuneration model contained in the RD 1048/2013, its regulatory development must be published; until then, as established in the RD, the remuneration scheme of the RDL 9/2013 will be maintained.

The remuneration system culminates with orders IET/2659/2015 and IET/2660/2015, published on 12 December 2015, which determine the type installations and unit values to consider when calculating the remuneration for 2016 and following.

5. Tariffs or access tolls:

Access tolls are uniform across the country and are collected by the distributors and carriers, which act as the collection agents of the Electricity System.

The Royal Decree-Law 14/2010, of 23 December, extended the application of access tolls to electricity producers of both the ordinary and the special regime, and established that the producers would be regulated taking into consideration the energy fed into the grid. In addition, provided that the tolls to be paid by the electricity producers have not been implemented, this royal decree-law establishes that an access toll of EUR 0.5 per MWh fed into the grid will be applied to producers that are connected to the grid.

Subsequently, the Royal Decree 1544/2011, of 31 October implemented the aforementioned regulation of access tolls for electricity producers.

On 1 February 2014, the ministry published the Order IET/107/2014, of 31 January, which revised the electric power access tolls for 2014 and includes two main aspects: firstly, it changes the weighting of the fixed part of the access tolls (paid on the basis of the contracted capacity); secondly, the tolls were increased to cover the growth of the regulated costs.

Lastly, the Law 32/2014, of 22 December, on Metrology, modifies the Law 24/2013 on the Electricity Sector, clarifying that the legal authority to establish the structure and conditions applicable to the access tariffs for transportation and distribution networks corresponds to the Government.

Finally, the Order IET/2444/2014 continued access tolls established in 2014, and the pricing structure of power and energy defined in 2014.

6. Progressive deregulation of the electricity supply and introduction of the retailing activity

The supply of electric power is completely deregulated and all consumers must contract the supply of electricity with a retailer. From 1 July 2009, those consumers who fulfil certain criteria have been able to opt to contract electricity with a "Last Resort Retailer" (*Comercializadora de Último Recurso* - CUR), which from July 2014 will become a Reference Retailer (*Comercializadora de Referencia* - COR), with the Last Resort Rate, now the Voluntary Price for the Small Consumer (*Precio Voluntario para el Pequeño Consumidor* - PVPC). The Last Resort Rate (*Tarifa de Último Recurso* - TUR) has been kept for vulnerable consumers and those who do not fulfil the requirements for the PVPC, temporarily do not have a current contract with a free market distributor.

The Law 3/2014, of 27 March, obliges the reference distributors to offer contracts in which the price of electric power is fixed for a specific period for consumers with a right to the PVPC.

The Royal Decree 216/2014, of 28 March, establishes the methodology for calculating the voluntary prices of electric power for the small consumer and their legal regimen for contracting. It determines the structure of the PVPC that will be applicable to low voltage consumers with a contracted capacity up to 10 kW. Similarly, it determines the procedure for calculating the production cost of electric power on the basis of the hourly price in the daily market during the billing period. In addition, as established by Law 3/2014, it provides the alternative of the consumer to contracting an electricity price fixed for a year with the reference distributor.

This legislation provides the Spanish electricity sector with three forms in which distributors can supply power to consumers:

- Reference supply
    - PVPC: the method that applies by default from 1 July 2014 if the consumer was subject to the previous TUR.
    - Annual fixed price in a regulated market offered by the reference distributor.
- Contracting in the deregulated market by contracting freely with a distributor.
- Last Resort Supply: a form of supply applicable to vulnerable consumers and those who do not fulfil the requirements for the PVPC and temporarily do not have a current contract with a free market distributor.

The Resolution of 2 June 2015 of the State Secretariat for Energy approved six procedures necessary for billing hourly to those consumers covered by the PVPC. This resolution establishes a period of adaptation of IT systems until 1 October 2015. From this date onwards, all consumers having an hourly meter should be billed according to the hourly consumption and price.

A Supreme Court ruling of 3 November 2015 was published on 6 February 2016, cancelling the fixed sales margin used to calculate the PVPC as remuneration for main distributors. The Supreme Court withdrew the sum of 4 €/kW/year as of 1 April 2014, and ordered the government to set a new value after adopting a calculation methodology. Until then billing will continue at the current rate as a provisional value, as stipulated in the Ministerial Order IET/2735/2015 on electricity charges for 2016.

7. Price formation and tariff structure

The Law 24/2013 regulates the aspects relating to the PVPCs, which are defined as the maximum prices that the distributors that assume the reference supply obligations will be able to charge.

They will be calculated as the sum of the following items:

- The production cost of electricity, based on market mechanisms, taking account of the average price expected in the production market during the invoicing period.

- The corresponding access tariffs and charges, and

- The corresponding distribution costs.

8. Social Tariff

The Royal Decree-Law 9/2013 creates the social tariff for certain consumers with certain social, consumption and purchase power characteristics supplied at the TUR at their normal residence and the financing of the social tariff costs. This tariff is calculated as 75% of the PVPC. Until these social and economic indicators are developed for application, the social tariff will apply to individuals in their normal residence supplied under the last resort scheme with contracted capacity of less than 3 kW, to large families or families whose members are all unemployed and to certain pensioners 60 years old or older receiving minimum pensions.

Such costs shall be borne by the parent company of the vertically integrated companies. The allocation of the social tariff costs among such companies will be made according to the number of supplies connected to the distribution network and the number of customers of the retail business of the Group.

The Royal Decree 968/2014, of 21 November, develops the methodology for fixing the percentage shares of the amounts to be financed with regard to the social tariff. These percentages will be calculated annually by the CNMC for each business group, as the relation among (i) a figure that will be the sum of the annual averages of the number of feeds connected to the distribution networks of the distributors and of the number of customers of the distributors in which the group participates and (ii) another figure that will correspond to the sum of all the annual average values of feeds and customers of all the business groups that should be considered for the effects of this sharing.

On 20 October 2015, the Ministry published the Order IET/2182/2015, of 15 October, which sets the percentage shares of the amounts to be financed with regard to the social tariff for 2015. According to this order, IBERDROLA should finance the 38.26%.

9. Load Manager

The Royal Decree-Law 6/2010 introduced the figure of the load manager as another agent in the electric system.

The Royal Decree 647/2011, which was approved in May 2011, regulates the functions of these load managers that are defined as "*companies that, as consumers, are authorised to resell electricity for power recharging services. Load managers are the only subjects with wholesale customer character under the terms provided by the applicable Community regulations.*" The mentioned royal decree sets forth the requirements and obligations of these agents. It also created a new super off-peak tariff applicable to contracts of up to 15 kW, thereby creating a third hour period (from 1 a.m. to 7 a.m.) aimed at encouraging the charging of electric vehicles in this period.

10. Emission allowances

Regarding environment regulations, the Directive 2003/87/CE is remarkable, relating to the issuance of CO_2 emissions allowances, which affects the industry and electricity companies to deliver an emission allowance for each ton of CO_2 emitted by a plant. The goal for 2020 is that emissions from sectors covered by the EU ETS will be 21% lower than in 2005.

In 2009, within the European Union's Green Package for energy and climate change, the Directive 29/2009/EC was approved, introducing changes and extending the European Union emissions trading system beyond 2012. The phase 3 (2013-20), significantly different from previous phases, is based on rules which are far more harmonised than before. The main changes in the Directive were: the default method of allocating allowances is auctioning, instead of free allocation, although transitional free allocation is envisaged in some cases; extension of the periods of compliance to be followed by consecutive periods in which the amount of rights is determined on an European Union-wide scale; it also provides that allowances can be carried over one period to the next. As a result of the new rules, since 2013, IBERDROLA has no longer had the right to receive any free allocation.

The auctioning of allowances is governed by the EU ETS Auctioning Regulation. This covers the timing, administration and other aspects of auctioning to ensure it is conducted in an open, transparent, harmonised and non-discriminatory manner. Two auction platforms are in place: European Energy Exchange-EEX (common platform for the large majority of countries participating in the EU ETS) and Futures Europe - ICE (acts as the United Kingdom's platform). Member States' shares in the auctioning volume in 2013 to 2020 are distributed as follows: 80% on the basis of their share of verified emissions in 2005 or the average of the 2005-2007 period; 10% are allocated to the least wealthy EU member states as an additional source of revenue to help them invest in reducing the carbon intensity of their economies and adapting to climate change; the remaining 2% is given as a 'Kyoto bonus' to nine EU Member States which by 2005 had reduced their greenhouse gas emissions by at least 20% of levels in their Kyoto Protocol base year.

A surplus of emission allowances has built up in the EU ETS since 2009, largely due to the economic crisis (which has reduced emissions more than anticipated) and high imports of international credits. This has led to lower carbon prices and thus a weaker incentive to reduce emissions. The European Commission is addressing this through short- and long-term measures. As a short-term measure the European Commission postponed in February 2014 the auctioning of 900 million allowances until 2019-2020 (backloading).

As a long-term solution, a new stability reserve of the Market Stability Reserve (MRS) will be introduced in 2018, operating from 1 January 2019. The reserve will address the current surplus of allowances and improve the system's resilience to major shocks by adjusting the supply of allowances to be auctioned. It will operate entirely according to pre-defined rules. The backloading was also amended by MSR Decision, passed in October 2015: backloaded allowances will not return to the market, instead they will be introduced in MSR.

11. Revenue shortfall

Electricity Industry Law 54/1997, of 27 November 1997, introduced the liberalisation of electricity generation and electric power trading. The difference between the access tariff revenue established by the Government and real costs related to these tariffs resulted in a revenue shortfall which led to problems and modifications in the functioning of the system.

To fund this shortfall, which is deferred through the recognition of long-term collection rights recovered by the annuities incorporated in annual fees, a series of measures have been adopted.

The first measure was Royal Decree-Law 6/2009, of 30 April 2009, that set limits to the increase of the shortfall and defined a framework for the gradual sufficiency of the access tolls. It also addressed the mechanism for funding the tariff shortfall through a securitisation fund set up for this purpose, Electricity Deficit Redeeming Fund (*Fondo de Titulización del Déficit del Sistema Eléctrico* - FADE).

As measures adopted since 2009 proved to be insufficient throughout 2013, the Government carried out a process of regulatory and tax reform for the electricity sector. As a step prior to this reform, Law 15/2012 established new taxes and Royal Decree-Law 9/2013, was approved, adopting urgent measures to guarantee the financial stability of the electric system methodology for the calculation of the remuneration of the transmission and distribution activities, special regime and capacity payments, among other measures.

Finally, Law 24/2013 is governed by the principle of economic and financial sustainability of the electricity system, meaning that any regulatory measure which causes an increase in costs or a reduction in income for the electricity system should incorporate an equivalent reduction of other cost items or an equivalent increase in income that ensures the equilibrium of the system. Thus, the possibility of new shortfalls accumulating, as have occurred in the past, is ruled out.

This principle is reinforced with the obligation to automatically review the tolls and fees if the temporary imbalances between revenues and costs of the electricity system exceed the following limits from 2014 onwards:

- 2% of the income estimated for the system in a given year.
- The accumulated debt due to imbalances in preceding periods may not exceed 5% of the income estimated for the system in a given year.

The part of the imbalance that, without exceeding such limits, is not compensated by increases in tolls and fees will be financed by the parties to the settlement system in proportion to the remuneration that corresponds to them for their activities.

The amounts contributed by this concept will be returned in the corresponding settlements after five years with an interest rate.

In contrast to the previous system, these imbalances will not be financed exclusively by large companies and the collection rights corresponding to income shortfall may not be assigned to the Securitisation Fund of the Electricity System Debt after 1 January 2013.

With regard to the excess income that could arise, it will be used to compensate imbalances from previous years and, as long as there are debts pending from previous years, the access tolls and fees may not be revised downwards.

Royal Decree 680/2014, of 1 August, regulates the procedure of budgeting, recognition, settlement and control of the surcharges on the production of electric power in the isolated electricity systems of the non-peninsular territories charged to the central state budget, thus developing the provisions of Law 24/2013, which established that from 1 January 2014, 50% of these surcharges would be financed against the central state budget.

At the end all this measures have enabled that the final liquidation of 2014 closed with a surplus for EUR 550.3 million. This surplus will not be used as an income in the regulated settlement of the current financial year.

12. Self-supply

Self-consumption is regulated for the first time in the Law 24/2013 and defined as the electric energy provided by generation installations associated with a consumer. Self-consumers must pay the same access tariff for the consumed energy (either taken from the network or from its own installation) as other customers. In addition, a mandatory register for self-consumption installations is created.

Later, Royal Decree - Law 9/2015 of 10 of July modified Law 24/2013 to establish the possibility of setting reductions in tolls, fees and costs for certain categories of consumers for which the maximum contracted power consumption and generation installed shall not exceed 10 kW. This measure is exceptionally and it will be implemented as long as the safety and economic and financial sustainability of the system is ensured.

Finally, Royal Decree 900/2015 of 10 of October regulated the administrative, technical and financial conditions of the self-consumption modalities. It differences two types of self-consumption:

- Supply with self-consumption: in the case of a consumer in a single electricity supply point or installation that has inside a network of one or more installations to generate electricity for self-consumption and were not recognised in the administrative record of energy production facilities. In this case, there will be a single subject, which will be the consumer. The contracted power shall not exceed 100 kW and discharges energy to the grid will not receive monetary compensation.

- Production with self-consumption: in the case of a consumer in an electricity supply point or installation, which is associated with one or several production facilities duly registered in the administrative record of energy production facilities. In this case there will be two subjects, which will be the consumer and the producer.

Regarding the economic regime, and until charges associated with system costs are approved, the self-consumer must pay a fixed charge related to the maximum power generation for manageable generation facilities in the tariff period and a variable charge applicable to the self-consumed energy. Consumers included in the modality of supply with self-consumption which power contracted is less than or equal to 10 kW will be exempt from the temporal charge for the self-consumed energy. Apart from the charges for costs and system services, self-consumers also pay networks tolls for the networks´ use like other consumers.

13. Interruptibility

The interruptibility service for a consumer consists of the reduction of its contracted capacity in response to a reduction order from the system operator. This order will be given taking account of the needs that arise in the operation of the electricity system, according to criteria of security and lowest cost.

The system operator will request the execution of the capacity reduction option, following economic and technical criteria:

- Economic criteria: In situations where the application of the service has a lower cost than that of the adjustment services of the system.

- Technical criteria: As a rapid response mechanism in emergency situations in the operation of the system.

To execute the option, the system operator will send a power reduction order to the service providers who will reduce their active power demanded until the committed residual power values are fulfilled.

The allocation of the interruptibility service will be carried out through an auction procedure managed by the system operator, as established in Order IET/2013/2013, therefore guaranteeing the effective provision of the service and its execution at the lowest cost for the electricity system.

The Resolution of 10 October 2014 of the State Secretariat for Energy, approves the characteristics of the competitive auction procedure for the allocation of the interruptibility demand management service for the 2015 electricity season (applicable from 1 January 2015 to 31 December 2015). Among others aspects, this resolution defines the maximum amounts to be auctioned for each type of product, the starting price, the period of delivery of the interruptible power and the date of each auction for the allocation of the interruptibility demand management service for the season (the auctions took place from 17 November 2014 to 21 November 2014). Subsequently, an extraordinary auction, approved by means of the Resolution of 17 December 2014, was carried out.

The Resolution of 9 July 2015 of the State Secretariat for Energy approves the calendar of the competitive auction for the allocation of the interruptibility demand management service for the 2016 electricity season. The auction took place between 3 August 2015 and 4 September 2015.

14. Energetic efficiency

Energetic efficiency is an essential aspect of the European 2020 strategy for sustainable growth and one of the most effective forms of strengthening the security of energy supply and reducing emissions of greenhouse gases and other pollutants. In this sense, the European Union has set itself the target of achieving a 20% improvement in energy efficiency by 2020.

Law 18/2014, of 15 October, approving measures for growth, competitiveness and efficiency, contains a set of mechanisms designed to achieve the energy saving targets established in the Energy Efficiency Directive. To this end, it created the National Energy Efficiency Fund, managed by the Institute for the Diversification and Saving of Energy (*Instituto para la Diversificación y Ahorro de la Energía* - IDAE) and financed by an annual contribution from all suppliers of gas and electricity, wholesalers of oil products and of liquid petroleum gases, according to their sales. Order IET/289/2015, of 20 February, established the contribution obligations for 2015.

Finally, Law 8/2015, of 21 May 2015, modified Law 18/2014 and established that the obliged entities must make an annual contribution from 2016 onwards to the National Energy Efficiency Fund in four instalments: on 31 March, 30 June, 30 September and 31 December of each year. In addition, in order to establish the annual contribution for each obliged entity, positive or negative adjustments can be made, resulting from data provided by the obliged entities, such as sales and other variables, and data set out by the relevant ministerial order of the previous year.

Industry regulation and functioning of the gas system in Spain

The natural gas sector in Spain has undergone significant changes in its structure and operation in the last ten years, from a monopoly to a fully open market, driven mainly by the deregulation measures in European Directives (2009/73/EC is currently in force) aimed at opening up markets and creating a single European gas market.

These liberalised principles have been incorporated and developed in Spanish law through Law 34/1998 of the Hydrocarbon Sector, which began the deregulation process and, more recently, through the Law 12/2007 and the Royal Decree-Law 13/2012 which completed the process.

The Hydrocarbon Industry Law (1998) laid the foundations for the new gas system, particularly with regard to the separation of activities (regulated and deregulated), the introduction of third-party access to the regulated network, the abolition of the former concessions for piped gas supply and their conversion into regulated administrative permits, and the establishment of a timetable for progressive market deregulation.

In line with these principles, the gas system has been structured around two types of activities: regulated activities (regasification, storage, transmission and distribution) and deregulated activities (trading and supply).

The Hydrocarbon Industry Law 34/1198 provided for the legal separation of deregulated and regulated activities and the segregation for accounting purposes of the various regulated activities. In addition, with the publication of Law 12/2007, Spain moved a step closer to achieving functional separation between network activities and deregulated activities and between network activities and technical system management. In 2012, Royal Decree-Law 13/2012 was approved, transposing Directive 2009/73/EC, and established further measures of separation in management of the transmission network.

Although the Hydrocarbon Industry Law established the general principles underpinning the new Spanish gas system, the sector's deregulation did not come into practice until 2001, following publication of Royal Decree-Law 6/2000, on urgent measures to intensify competition in the goods and services markets, and Royal Decree 949/2001, regulating third party access to gas installations and establishing an integrated economic system for the natural gas sector.

The first of these decrees enacted certain elements of the Hydrocarbon Industry Law with the aim of fostering measures that would facilitate the elimination of entry barriers for new supply companies. In particular, it created the technical system manager (ENAGAS, S.A.), provided for a 25% gas release under the contract for natural gas brought from Algeria through the Maghreb pipeline, and brought forward the timetable for deregulation.

The second, Royal Decree 949/2001, established firstly the specific terms and conditions for third-party network access and, secondly, a remuneration system for regulated activities and a cost-based system of tariffs, tolls and fees structured according to pressure levels and consumption bands.

The remuneration assigned to each company as well as the tariffs, tolls and fees are updated periodically by ministerial orders and resolutions.

The economic system also established a settlement procedure that would allow for redistribution of revenues collected in the form of tariffs, tolls and fees between the various regulated activities in accordance with the remuneration method established. The body responsible for effecting this redistribution is the Ministry of Industry, Energy and Tourism.

Other issues related to the regulation of the transmission, distribution and supply businesses, the administrative authorisation procedures for natural gas facilities and the regulation of certain aspects of the supply business are dealt with in Royal Decree 1434/2002.

As for the technical operation of the system, the operating regulations are established in Order ITC 3126/2005 enacting the gas system technical management rules. Inter alia, these regulations established that each operator is individually responsible for maintaining its liquidity and enacts specific protocols for the conduct of the technical system manager in exceptional operating circumstances.

Despite the sector's progressive deregulation, prevailing regulations uphold the state's obligation to ensure the safety and continuity of supply. To this end, Royal Decree 1766/2007 stipulates that direct market suppliers and consumers must maintain minimum security stocks equivalent to 20 days' consumption. In addition, it limits the maximum percentage of gas supplies that may be sourced from a single country to 50%.

The State also maintains responsibility for obligatory planning work for certain infrastructures (for example, gas pipelines forming the core transmission network, the secondary transmission network, the determination of the total liquid natural gas regasification capacity necessary to supply the system and core natural gas storage facilities). For all other infrastructures, the state's planning work is provisional only. In 2012, Royal Decree-Law 13/2012 enacted a series of measures to halt the construction of new infrastructure in a context of falling demand for gas.

As mentioned above, in Spain the deregulation process was completed with Law 12/2007 transposing Directive 2003/55/EC. The two key changes enacted by this law were the elimination of regulated supply and the functional separation between network activities and deregulated activities.

As in the electricity sector, from 1 July 2008, all customers in Spain are free to choose their supplier of gas, although there is a tariff of last resort, a regulated price eligible for customers of low pressure natural gas with an annual consumption of less than 50,000 kWh. The price is automatically calculated additively and is called tariff of last resort.

The Law 18/2014, on measures for growth, competitiveness and efficiency, and previously the Royal Decree-Law 8/2014, established the principle of economic and financial sustainability for the gas system. This principle is reinforced with the obligation to automatically review tolls and fees if the annual imbalance between revenues and costs of the gas system exceeds the following limits:

- 10% of the income receivable for the year; or
- 15% of the sum of the annual imbalance plus annual payments recognised and pending amortisation.

The part of the imbalance that, without exceeding the above limits, is not compensated by the increase in tolls and fees will be financed by the parties to the settlement system in proportion to their remuneration. The amounts contributed will be returned in the following five years and will earn an interest rate equivalent to the market rate.

The shortfall accumulated at 31 December 2014 will be financed by the owners of the installations during a period of 15 years.

On the other hand, the remuneration of the regulated activities will be based on the costs necessary for an efficient and well-managed company to carry out the relevant activity, following the principle of performing the relevant activity at the lowest cost for the gas system. In addition, the remuneration of regulated activities will be on the basis of six-year regulatory periods. However, it is possible to adjust every three years the remuneration parameters in exceptional circumstances. The first regulatory period ends on 31 December 2020.

The remuneration system for distribution is based on the remuneration of the previous year, adjusted for changes in productivity and new customers.

The remuneration system for transmission, storage facilities and regasification is based on the net value of the associated assets. In addition, the associated operating and maintenance costs and premiums for continuity of service are also factored in to calculate the remuneration system.

The Hydrocarbon Industry Law has been modified by Law 8/2015, of 21 May 2015.

The main aspects introduced by Law 8/2015 regarding the gas system are:

- The creation of an organised wholesale gas market.
- The designation of the operator of the regulated gas market.
- Some measures relating to minimum security stock levels are adopted.
- CORES (*Corporación de Reservas Estratégicas de Productos Petrolíferos*) is enabled to constitute, maintain or manage natural gas and liquefied natural gas strategic stocks.
- Pursuant to the Efficiency Fund (*Fondo Nacional de Eficiencia Energética*) the law permits the refund of contributions when necessary (in case of mistake, for example).
- Incentives established, benefiting the landowners and regions where the activities of exploration and production with conventional and non-conventional (including fracking) techniques are developed.
- Inspections may be carried out by any natural gas installation company (not only distribution companies).

Finally, Royal Decree 984/2015 of 30 October 2015 ***regulates the organised wholesale gas market and the third party access to the facilities of the natural gas system.*** This market will initially include the negotiation of short-term standardized products by an electronic platform managed by the market operator (MIBGAS-OMEL), with a centralised collateral management. In addition, this market will centralize the hiring capacity through an electronic platform managed by the Technical System Operator (ENAGAS), with standardized products and auction procedures.

Industry regulation in the UK

The principal laws that govern Scottish Power Ltd.'s (hereinafter, **SCOTTISH POWER**) activities are the Electricity Act 1989 (**Electricity Act**) and the Gas Act 1986 (**Gas Act**), as substantially amended and supplemented by numerous subsequent enactments, including the Gas Act 1995, the Utilities Act 2000, the Energy Act 2004, the Energy Act 2008, the Energy Act 2010, the Energy Act 2011, the Energy Act 2013 and various EU directives. These specific energy laws are supplemented by UK and the EU legislation relating to competition and consumer protection.

1. The Regulatory Authorities

The principal regulatory authority for utilities is the Gas and Electricity Markets Authority (**GEMA**), comprising a chairman and other members appointed by the Secretary of State for Energy and Climate Change. GEMA is supported by the Office of Gas and Electricity Markets (**OFGEM**). The main instrument of regulation used by GEMA is the licencing regime which in most cases requires the various aspects of the energy industry to be carried out under a licence to which standard conditions apply. In addition, there are a number of statutory obligations, known as relevant requirements, which are enforced by GEMA as if they were licence conditions.

GEMA's principal objective is to promote the interests of present and future consumers and promote effective competition. Under the Energy Act 2010, the interests of such consumers must be taken as a whole, including their interests in the reduction of greenhouse gases and in the security of the supply of gas and electricity to them.

In furthering this objective GEMA must ensure that all reasonable demands for electricity and gas are met, ensure that licence holders are able to finance the activities they are obliged to undertake, and contribute to the achievement of sustainable development. Further provision concerning the duties of GEMA has been made by the Energy Act 2013, but the provisions in question are yet to be implemented.

GEMA's functions include the granting of licences (and their revocation in certain limited circumstances), the making of changes to licence conditions (including the operation of price controls for the monopoly network functions), the review of industry code modifications, operating schemes for promoting renewable electricity and energy efficiency, and the enforcement of the industry's obligations.

GEMA has the power to impose monetary penalties for past and ongoing breaches of licence conditions and relevant requirements and it can order that redress is provided to consumers. Fines and redress orders for a particular breach can in aggregate be up to 10% of the licensee´s applicable turnover.

The principal Regulatory Authority for competition matters is the Competition and Markets Authority (**CMA**). They can undertake general market investigations and, working concurrently with GEMA, can investigate potential breaches of competition law in the utility field. Consumer protection matters are enforced by the CMA, OFGEM and Local Authority Trading Standards departments.

a) *Licences*

Companies within the SCOTTISH POWER Group hold licences for various functions including:

- the supply of electricity;
- the generation of electricity;
- the distribution of electricity in the South Scotland area, in the Merseyside and North of Wales area;
- the supply of gas;
- the shipping of gas (that is, arranging for the insertion, the transmission, and the removal of it from the public network); and
- the transportation of gas to certain specific sites (such as proposed new gas fired power stations).

The third package of European Union Directives on electricity (2009/72/EC) established additional restrictions to the ownership of transmission companies. On 19 June 2012, Scottish Power Transmission Limited (SPTL) was certified by OFGEM, in accordance with the Directive's Article 9, with the European Commission approval, on the basis that SPTL's arrangements guarantee more efficient independence than the ITO provisions under the Directive's Chapter V. As a result, the provisions relating ownership separation do not apply to SPTL.

The conditions of licences regulate such matters as:

- for network licences: the quality of service and the charges that can be made.
- for supply to domestic consumers: consumer protection provisions including rules on standards of conduct, simpler tariffs, provision of information, debt and disconnection, cost reflective pricing, in relation to payment methods, information supply to customers and on fair trading.
- for most types of licence: rules requiring adherence to industry codes that set down the detailed technical rules for operating the industry, and providing for OFGEM to determine whether proposed changes to the codes should go ahead.

The Gas Act 1995 and Utilities Act 2000 introduced standard licence conditions to ensure that all holders of a particular licence type are subject to the same conditions. Under the Electricity and Gas Regulations 2011 (Internal Markets), modifications of individual or standard licencing terms no longer require the holders´ consent. However, affected licence holders and other parties can appeal to the Competition Commission (CMA since April 2014) on both procedure and substance, except where legislation allows the Secretary of State to modify licence conditions for certain specified purposes (typically the delivery of industry wide reforms). In most cases, these powers are time limited. Changes to licence conditions can also be made without the right of appeal in pursuance of a European Union obligation, using powers in the European Communities Act 1972.

When OFGEM makes a decision on modifying an industry code which runs contrary to the views of the relevant industry governance body, the decision can, with certain exceptions, be appealed to the CMA.

2. Competition Legislation

GEMA also has concurrent powers with the CMA to apply the Competition Act 1998, the Fair Trading Act 1973 and the Enterprise Act 2002 to the energy sector in Great Britain. Accordingly, GEMA can levy fines of up to 10% of turnover for breaches of the prohibitions of anticompetitive agreements or the abuse of a dominant position.

Under the Enterprise Act, GEMA and the CMA have powers to initiate a market investigation where it appears that competition has been prevented, restricted or distorted by any feature of a market, so far as it relates to commercial activities connected with the generation, transmission and supply of gas and electricity (and where it would not be appropriate to operate by the provisions of the Competition Act 1998 or using any other powers). If the GEMA or CMA finds such adverse effects on competition, it is required to take proportionate steps to remedy them. The CMA's powers are extensive and can range from changes to licences to forced divestments, if they are justified by the evidence and findings.

b) *CMA market investigation into energy*

A market investigation was initiated on 26 June 2014 by GEMA. The investigation is into the operation of retail gas and electricity markets for domestic and small business consumers, and the wholesale markets that support such supply. On 7 July 2015, the CMA published its provisional findings and a "remedies notice" containing suggested remedies. The provisional findings concluded that competition in the wholesale gas and electricity markets works well and that the presence of vertically integrated firms does not have a detrimental impact on competition. No strong case was found for returning to the old "pool" system for the Wholesale Electric Market (*Mercado Eléctrico Mayorista* – MEM).

However, a number of adverse effects on competence were identified in the retail market, some due to over-regulation, but mainly focussed on the possibility that people on standard variable tariffs may be losing out through lack of engagement in the market. The CMA has put forward a number of remedies for consideration. Most are focussed on increasing competition in this segment, but they have also suggested (while recognising the difficulties) a transitional safeguard regulated tariff to apply while other changes take effect. This would be set above the "efficient" level of pricing, with the aim of mitigating the damage to competition that might otherwise arise. The CMA has also made a number of wider proposals including zonal charging for transmission losses, tighter control of non-competitive low carbon contracts, changes to industry code governance, and reforms to regulatory policy including GEMA's duties.

After an extension of the deadline, the investigation must be completed by 25 June 2016.

c) *EU Regulation on Energy Market Integrity and Transparency (REMIT)*

GEMA also enforces REMIT in the United Kingdom. It has the power to levy unlimited fines for breaches and since 13 April 2015 can initiate criminal prosecutions for breach of the market manipulation element of REMIT against both companies and the individual employees involved. In the case of individuals, the penalty can include imprisonment for up to two years.

d) *Price controls*

Prices for the sale of electricity and gas by utilities to final consumers are not currently controlled in the United Kingdom. Nowadays, there is no controlled tariff for certain categories of consumer, although all the major suppliers must offer special discounts for certain disadvantaged customers under the Warm Homes Discount programme. The total cost of discounts of the Warm Home Discount programme for SCOTTISH POWER in 2014-2015 was 6 Sterling pounds per customer account (counting gas and electricity separately) and, like any other costs, suppliers are free to pass on the cost to their tariffs. OFGEM has implemented licence modifications requiring any price variation by payment method to be cost reflective.

In 2014 and 2015, suppliers must pay 12 Sterling pounds to each person who is a domestic electricity customer on a specified date in each year, and the United Kingdom Government in turn repays that sum from taxpayer funds to the suppliers upon production of suitable evidence. This arrangement effectively takes the cost, but not the administration of the Warm Home Discount programme in relation to the public purse in those two years. This requirement expires after 2015.

Similarly, there are currently no controls other than those established in the Competition Act 1998 and the Transmission Constraint Licence Condition (TCLC), on prices charged to commercial customers or on other prices in the wholesale electricity and gas markets.

TCLC prohibits electricity generators from making excessive profits resulting from balancing actions. OFGEM has published guidelines on the interpretation and application of the TCLC. Enforcement decisions under the framework of the TCLC are subject to review by the Competition Appeal Tribunal, rather than the review by the courts applicable to other GEMA enforcement decisions. The condition expires five years after its enactment, having been implemented on 29 October 2012, and is renewable for another two years.

OFGEM has implemented electricity market liquidity obligations for large integrated supply and generation businesses, including SCOTTISH POWER. These include obligations to facilitate trading with smaller companies and also an obligation to market make in a number of wholesale products during two specified “windows” in each business day. Although the prices of bids and offers are not regulated, the licence condition limits the spread between them. There are rules designed to give some protection to obligated licences in fast or volatile markets. To date, no material costs have arisen from this obligation.

Following the Retail Market Review, OFGEM has implemented limits on the products that can be sold in the domestic energy market.

These include restrictions on the number and composition of tariffs (with a maximum of four basic tariffs plus variations according to parameters such as form of payment, meter type and region). The CMA has proposed removing these restrictions. There are also information requirements and requirements for notifying customers of lower tariffs. OFGEM has also implemented code of conduct for customer treatment which covers all aspects of the supplier-client relationship.

The networks are considered to be a natural monopoly. Therefore, their prices have been controlled and this is now achieved through the new RIIO framework (Revenue = Incentives + Innovation + Outputs). This involves setting a revenue profile for an eight year period (with a limited revision every four years) based on the regulator's assessment of the costs of an efficient network operator and the likely capital programme (aided by a business plan submitted by the Company) in order to calculate the revenue needed to meet a target return on investments. The formula uses a Market Indicator for setting the debt cost, and phases in (for electricity) an asset depreciation period of 45 years, replacing the 20 year period used previously. Various incentives have been added to the formula which also takes account of inflation in order to calculate the permissible revenues for the network.

Under the RIIO framework, there is a greater emphasis on outputs and innovation, as well as on the role that network companies can play in developing a sustainable energy sector.

In the transmission business, SPTL's new RIIOT1 framework became effective from April 2013. In distribution, the new RIIO for the Scottish Power network in the south of Scotland and in the Manweb area was accepted on 3 March 2015 by Scottish Power Energy Networks and came into force on 1 April 2015. An appeal made to the CMA by British Gas Trading Ltd, alleging that the controls are too generous, was determined by the CMA on 29 September 2015, rejecting most of the British Gas appeal, but a small adjustment was allowed, which affected the prices set for 2016/17 and later years. The net effect on Scottish Power's distribution licensees is a revenue reduction of GBP 19 million over the 8 years RIIO ED1 period. The parallel appeal by NPG had no impact on the Scottish Power licenses.

OFGEM has brought forward proposals for competitively tendering the construction of large, new and separable transmission projects. This may lead to a few transmission developments being taken forward by others.

3. Other issues

Other key elements of the regulatory regime in the United Kingdom include:

The Renewables Obligation (RO)

The United Kingdom Government intends to source 30% of electricity from renewable sources by 2020. To this end, the RO Orders (which apply separately to different parts of the United Kingdom within a unified scheme) place obligations on suppliers of electricity to source an increasing proportion of their electricity from renewable sources (based on the expected level of renewable energy production in each year plus a 10 per cent spread in order to prevent certificate prices from falling sharply). Suppliers meet their obligations by presenting sufficient Renewables Obligation Certificates (ROCs) or by paying an equivalent amount into a fund.

The proceeds of the fund are paid back to those suppliers that have presented ROCs in proportion to the number of ROCs presented. Since April 2009, the RO has been banded so that differing technologies receive different levels of support depending on the expected costs. The revision of this framework concluded in 2012 and, as a result, projects starting after 1 April 2013 (or later for some technologies) will receive revised levels of support.

The RO will close for new projects no later than 31 March 2017 and it will be replaced by a new help system based in Contracts for differences (CFDs) that is part of the Electricity Market Reform (EMR). For solar photovoltaic generation plants above 5MW, the RO closed in April 2015. The Government has also proposed to close the RO in April 2016 for onshore wind and solar photovoltaic plants at 5 MW or below, in both cases subject to grace periods. The RO will remain in place for facilities entering the scheme before the relevant closure date; payments will continue until 31 March 2027 for projects that started generation before 1 April 2009 and for 20 years after entry into the RO for later projects. The Energy Act 2013 envisages changing the RO in due course to payment of a premium on substantially similar terms.

Electricity Market Reform

The United Kingdom Government's EMR programme was substantially implemented during 2014. The principal elements are:

- a new incentive scheme, based on CFDs to support low carbon generation; and

- a capacity mechanism to support security of supply (market-wide auction mechanism).

The CFD allocations will take place within the constraints of a budget for low carbon support measures known as the Levy Control Framework (LCF). An initial tranche of contracts were approved during 2014 by the United Kingdom Government as part of a transitional "Final Investment Decision Enabling Process". The first allocation round took place on 4 February 2015 in two "pots"; one for established technologies (mainly onshore wind and solar) and a second one for less established technologies (mainly offshore wind). Scottish Power's 714 MW East Anglia ONE offshore Wind Farm achieved a contract in the auction at a price of GBP 119 per MWh.

Annual capacity mechanism auctions took place in December 2014 and 2015, for capacity delivery in winter 2018, 2019 and 2020, respectively. The auctions cleared at prices of GBP 19.40 per kW/year.

Revised figures for spending under the LCF were published on 25 November 2015 alongside the Autumn Statement. These indicated that the available funds to the end of the decade were projected to be overspent. While the announcements on early closure of the Renewables Obligation and other measures can be expected to limit costs, the Government has not at this stage come forward with revised projections that take these policy changes into account. Further details on the future levels of the LCF are likely to be published in 2016.

EU-ETS and United Kingdom Carbon Price Support

As in all EU Member States, generators in the United Kingdom participate in the EU-ETS. Since 2013, the Government is required to auction all allocations to the power sector. The Climate Change Act 2008 set out a trajectory towards reducing CO_2 emissions from 1990 levels by at least 80% by 2050, with interim reduction targets. The Carbon Price Support mechanism is a United Kingdom tax imposed on fossil fuels used for electricity generation at differential rates which simulate a charge on the CO_2 emissions. It was intended to smooth the path of carbon prices in the United Kingdom power sector in the event of instability in the EU-ETS, by topping up the EU-ETS price to a pre-set trajectory. In practice, the EU-ETS price is much lower than expected and in order to mitigate the impact on electricity prices, the United Kingdom Government has capped the Carbon Price Support tax at GBP 18 per tonne CO_2 until at least 2020.

Climate Change Levy (CCL) exemption

As announced in summer budget 2015 the exemption for renewable electricity from the Climate Change Levy (a tax on non-domestic electricity users) ended on 1 August 2015. This has removed a small additional revenue stream for renewable generators though its value was expected to decline in any event around 2020.

The Energy Companies Obligation (ECO)

Energy suppliers who supply over 250,000 domestic customers are required to achieve energy efficiency improvements among their customers. As with any other cost, the costs of making those improvements can be factored by suppliers into tariffs, subject to the need to remain competitive in the market. ECO ran from 1 January 2013 to 31 March 2015. A separate phase runs from 1 April 2015 to 31 March 2017. The Government has said that from April 2017, ECO will be replaced by a cheaper scheme costing GBP 640 million a year. Details are yet to be announced.

Coal closure

In November 2015, Secretary of State Amber Rudd announced plans to consult on requirements for all coal power stations without CCS to close by 2025. The detail of any proposed measures here is not available yet, but the impact on Scottish Power is assessed to be limited, given the planned closure of Longannet.

Pollution Control

The Integrated Pollution Prevention and Control (IPPC), the Large Combustion Plant Directive (LCPD) and the Industrial Emissions Directive (IED) cover the regulatory regime for controlling the pollution from certain industrial activities, including thermal combustion generation, and impose limits on various categories of emissions. In particular, the LCPD limits the emission of sulphur dioxide (SO_2), oxides of nitrogen (NO_x) and particles from power stations, whereby operators of such plant had the option of meeting those requirements or accepting a limited hour derogation prior to closure by the end of 2015. The IED puts in place a similar regime for 2016 and beyond, with more stringent standards. The IED is transposed into United Kingdom law through the Pollution Prevention and Control (Scotland) Regulations 2012 and amendments to the Environmental Permitting (England and Wales) Regulations 2010. These controls are enforced by the Environment Agency or, in Scotland, the Scottish Environmental Protection Agency.

4.2 Industry regulation in USA

1. Electricity and natural gas distribution

Some of the most important specific regulatory processes that affect Iberdrola USA Networks, Inc. (hereinafter, IBERDROLA USA NETWORKS) include the Maine distribution tariff stipulation, the Maine transmission Federal Energy Regulatory Commission (FERC) Return on Equity (ROE) case, Reforming Energy Vision (REV) of New York.

The revenues of IBERDROLA USA NETWORKS are essentially regulated, being based on tariffs established in accordance with administrative procedures set by the various regulatory bodies. The tariffs applied to regulated activities in the United States are approved by the regulatory commissions of the different states and are based on the cost of providing service. The revenues of each regulated utility are set to be sufficient to cover all its operating costs, including energy costs, finance costs and the costs of equity, the last one reflects the Company's capital ratio and the reasonable return on equity.

Energy costs that are set on the New York and New England wholesale markets are passed on to consumers. The difference between energy costs that are budgeted for and those that are actually incurred by the utilities is offset by applying compensation procedures that result in either immediate or deferred tariff adjustments. These procedures apply to other costs, which are in most cases exceptional (effects of extreme weather conditions, environmental factors, regulatory and accounting changes, treatment of vulnerable customers, etc.) that are offset in the tariff process. Any delivery profit from New York that means a service company exceeds its profitability objectives (usually due to a better than expected cost efficiency), is shared among the service company and its clients, resulting in a decrease in the future tariff.

Each of the six supply companies in IBERDROLA USA NETWORKS, must comply with regulatory procedures that differ in form but in all cases conform to the basic framework outlined above. As a general rule, tariff reviews cover various years (three in New York) and provide for reasonable returns on equity, protection and automatic adjustments for exceptional costs incurred and efficiency incentives.

1.1 Maine

Central Maine Power (CMP) Distribution rate stipulation

On 1 May 2013, CMP submitted its required distribution rate request to the Maine Public Utilities Commission (PUC). After a 14-month review process, on 3 July 2014, CMP filed a rate stipulation agreement on the majority of the financial matters with the PUC. The stipulation agreement was approved by the PUC on 25 August 2014. The stipulation agreement also noted that certain tariff design matters would be litigated, which was ruled on by the PUC on 14 October 2014.

The tariff stipulation agreement provided for an annual CMP distribution tariff increase of 10.7% (USD 24.3 million). The rate increase was based on a 9.45% ROE and 50% equity capital. CMP was authorized to implement a Revenue Decoupling Mechanism (RDM) which protects CMP from variations in sales due to energy efficiency and weather. CMP also adjusted its storm costs recovery mechanism whereby it is allowed to collect in tariffs a storm allowance and to defer actual storm costs when such storm events exceed USD 3.5 million. CMP and customers share on a 50/50 basis the storm costs that exceed a certain balance, with CMP’s exposure limited to USD 3 million annually. Storm costs and RDM adjustments are reconciled annually and tariff rates are adjusted accordingly to recover or return adjustment balances.

CMP´s distribution stipulation provided for a separate regulatory filing for a new customer billing system replacement. In accordance with the stipulation agreement, a new billing system is needed and CMP made its filing on 27 February 2015 and is requesting a separate rate recovery mechanism. On 20 October 2015, the PUC issued an order approving a stipulation agreement authorizing CMP to proceed with the customer billing system investment. The approved stipulation allows CMP to recover the system costs effective with its implementation (currently expected in mid-2017).

The tariff stipulation does not have a pre-determined tariff term; CMP has the option to file for new distribution tariffs at its own discretion.

The tariff stipulation does not contain service quality targets or penalties and the rate stipulation also does not contain any earning sharing requirements.

Transmission – FERC ROE proceeding

CMP's transmission tariffs are determined by a tariff regulated by the FERC and administered by ISO New England (ISO-NE). Transmission rates are set annually pursuant to a FERC authorized formula that allows for recovery of direct and allocated transmission operating and maintenance expenses, as well as the return on assets invested. Prior to 16 October 2014, the FERC provided a base return on equity (ROE) of 11.14% and additional ROE incentives applicable to assets based upon vintage, voltage and other factors.

Complaint I: In September 2011, the Massachusetts Attorney general filed a complaint with the FERC saying that the New England transmission ROE was too high and should be lowered by 1.94%, to a value of 9.2%. On 16 October 2014, the FERC issued an order in the ROE case which concluded:

- The "base" ROE was set at 10.57% effective since 16 October 2014.
- There is a ROE cap on total ROE (base ROE plus incentive ROEs) of 11.74%, also effective since 16 October 2014.
- FERC changed its DCF approach from a single-step to a two-step. FERC determined that the long-term growth rate used in the two-step discounted cash flow analysis should be the gross domestic product deflator estimated at 4.39%. This aspect of their decision results from the "paper hearing" that FERC initiated in its June 2014 decision.
- During 2014 and 2015, CMP provided refunds for the period from October 2011 to December 2012 with a base ROE of 10.57% and an ROE cap of 11.74%.

Complaint II: Filed on 27 December 2012. On 19 June 2014, the FERC issued an order setting this case for settlement and hearing, and set the refund effective date as of 27 December 2012.

- The parties entered settlement negotiations which ended in late October 2014 when the parties were unable to reach agreement.
- Hearings before a FERC Administrative Court took place between 25 June 2015 and 2 July 2015. FERC delayed the timetable but it still expects to make its final decision by 3Q 2016.

Complaint III: Filed in August 2014, reiterates the same position as in Complaint II. FERC consolidated Complaints II and III (see Complaint II for information).

CMP reserved for refunds in 2013 and 2014. The 2013 reserve was USD 6.6 million associated with Complaint I. In 2014, CMP recorded an additional reserve of USD 29.9 million associated with Complaints I, II, and III.

1.2 New York

New York State Electric & Gas Corporation (NYSEG) and Rochester Gas and Electric Corporation (RG&E) Tariff Plans:

On 16 September 2010, the New York Public Service Commission (NYPSC) approved a new tariff plan for electric and natural gas service provided by the companies effective between 26 August 2010 and 31 December 2013. The tariff plans contained continuation provisions beyond 2013 if NYSEG and RG&E did not request new tariffs to come into effect, in which case the then current base tariffs would stay in place.

The revenue requirements were based on a 10% allowed ROE applied to an equity ratio of 48%. If annual earnings exceed the allowed return, a tiered Earnings Sharing Mechanism (ESM) would capture a portion of the excess for the benefit of customers. The ESM is subject to specified downward adjustments if the companies fail to meet certain reliability and customer service measures. Key components of the tariff plan include electric reliability performance mechanisms, natural gas safety performance measures, customer service quality metrics and targets, and electric distribution vegetation management programmes that established threshold performance targets. There will be downward revenue adjustments if the companies fail to meet the targets. The companies met all of the service quality targets through 2014 but missed a customer service metric in 2015 due to severe weather in February 2015.

The 2010 rate plans established Revenue Decoupling Mechanisms (RDM) intended to remove company disincentives to promote increased energy efficiency. Under the RDM, electric revenues are based on revenue per customer class rather than billed revenue, while natural gas revenues are based on revenue per customer. Any shortfalls (excesses) between billed revenues and allowed revenues will be accrued for future recovery (refund).

2015 NY Rate Filings

On 20 May 2015, NYSEG and RG&E filed electric and gas rate cases with the NYPSC. The companies are requesting rate increases for NYSEG Electric, NYSEG Gas and RG&E Gas, while for RG&E Electric are requesting rate decreases.

NYSEG Electric is requesting USD 126 million (7% overall) in additional annual delivery revenue to recover prior storm costs, move to a full cycle vegetation management trim programme in line with best industry practice, and earn an adequate return on its investment. RG&E Electric is proposing a USD 10 million rate decrease (1% overall) reflecting the return to customers of funds collected during its 2010 rate plan associated with management efficiencies and costs lower than set levels. NYSEG Gas and RG&E Gas are requesting additional revenues of USD 38 million (8% overall) and USD 20 million (5% overall), respectively.

The companies are requesting a 10.06% return on equity and a 50% equity ratio. The rate filings are for one year but the companies have indicated their interest in pursuing a multi-year settlement.

The NYPSC Staff and other parties filed testimony in September 2015 opposing the rate increase requests. The NYPSC Staff proposed a delivery increase of USD 11.8 million for NYSEG electric and delivery rate decreases for RG&E Electric of USD 23.4 million, delivery decrease of USD 2.8 million for NYSEG gas and a delivery decrease of USD 2.9 million for RG&E gas. The NYPSC proposed an 8.7% ROE and a 48% equity ratio. NYPSC also proposed to offset the NYSEG electric storm deferral balance of USD 262 million with excess depreciation reserve amounts which NYPSC Staff claims is USD 665 million at NYSEG Electric and USD 129 million at RG&E Electric. The NYPSC stated it was open to discussing a multi-year rate plan for the companies.

Other parties including the Division of Consumer Protection, Utility Intervention Unit, the New York State Office of General Services, Multiple Intervenors, Nucor Steel Auburn, Ince., Pace Energy and Climate Center, WalMart Stores, Upstate New York Laborers' District Council, Greenidge Generation, LLC and International Brotherhood of Electrical Workers, Local Union 10 also filed direct and responsive testimony opposing certain aspects of the companies' rate requests.

In October 2015, the companies filed rebuttal testimony opposing the NYPSC Staff's adjustments including their proposal to offset deferred storm costs with excess depreciation reserve values. The companies also updated their rate request values to USD 166 million for the two electric businesses and USD 59 million for the gas businesses.

In October 2015, the parties agreed to commence settlement negotiations. The companies agreed to extend the suspension period through August 2016 in order for settlement discussions to take place. The companies' suspension agreement was subject to a make-whole provision. Settlement negotiations have occurred since October and have continued into February 2016.

The companies are unable to predict the outcome of the proceeding but would expect any decision to occur by the second quarter of 2016.

Reforming the Energy Vision:

April 2014, the NYPSC commenced a proceeding titled Reforming the Energy Vision (REV), which is an initiative to reform New York State's energy industry and regulatory practices. REV has followed several simultaneous paths: Track 1 deals with market design and platform technology and Track 2 deals with the regulatory reform. REV's objectives include the promotion of more efficient use of energy, increasing the utilization of renewable energy resources such as wind and solar power (in support of New York State's renewable energy goals) and a wider deployment of "distributed" energy resources, such as micro-grids, in-situ power supplies, and storage.

Track 1 of this initiative involves the examination of the role that distributors will have in the enablement of market-based deployment of distributed energy resources to promote load management, system efficiency, and peak load reductions. NYSEG and RG&E are participating in all aspects of the REV initiative with other New York utilities, as well as providing their unique prospective. NYPSC Staff has conducted public statement hearings across New York State regarding REV.

Other REV-related proceedings have also been initiated by the NYPSC, each of which follow its own schedule. These proceedings include the Clean Energy Fund, Demand Response Tariffs, Community Choice Aggregation, Large Scale Renewables, and Community Distributed Generation.

Track 2 of the REV initiative is also under development, and through a NYPSC Staff's Whitepaper review process, is examining potential changes in current regulation, tariff, market design and incentive structures which could better align utility interests with achieving New York State's and NYPSC's objectives. New York's utilities will also be addressing related regulatory issues in their individual rate cases.

Reliability Support Service Agreement in the Ginna Nuclear Power Plant

The Ginna Nuclear Power Plant (GNPP), which is a subsidiary of Constellation Energy Nuclear Group, LLC (CENG), owns and operates the R.E. Ginna Nuclear Power Plant, a 581 MW single-unit pressurised water reactor located in Ontario, New York. In May 2014, the NYISO did a reliability study, confirming that the Ginna Facility needs to remain in operation to avoid bulk transmission and non-bulk local distribution system reliability violations in 2015 and 2018.

On 11 July 2014, GNPP filed a petition requesting that the NYPSC would initiate a proceeding to examine a proposal for the continued operating. Ginna asserted that in the two preceding years (i.e., 2012 and 2013), it had sustained cumulative losses of nearly USD 100 million (including the allocation of CENG corporate overhead) and that "CENG has not been compensated for any operational risk or an appropriate return on its investment over this period." Based on the results of the 2014 Reliability Study, GNPP requested that: 1) the NYPSC determine that the continued operation of the Ginna Facility is required to preserve system reliability; and 2) the NYPSC issue an Order directing RG&E to negotiate and file an RSSA for the continued operation of the Ginna Facility.

In November 2014, the NYPSC ruled that GNPP had demonstrated that the Ginna Facility is required to maintain system reliability and that its actions with respect to meeting the relevant retirement notice requirements were satisfactory. The NYPSC also accepted the findings of the 2014 Reliability Study and stated that it established "the reliability need for continued operation of the Ginna Facility that is the essential prerequisite to negotiating an RSSA." As such, the NYPSC ordered RG&E and GNPP to negotiate an RSSA.

On 13 February 2015, RG&E submitted to the NYPSC an executed Reliability Support Services Agreement (RSSA) between RG&E and R.E. Ginna Nuclear Power Plant, LLC (GNPP). RG&E requested that the NYPSC accept the RSSA and approve cost recovery by RG&E from its customers of all amounts payable to GNPP under the RSSA utilising the cost recovery surcharge mechanism.

On 21 October 2015, RG&E, Ginna Nuclear Power Plant, LLC, New York Department of Public Service, Utility Intervention Unit and Multiple Inspectors filed a Joint Proposal with the NYPSC for approval of the RSSA, as modified. The Joint Proposal provides a term of the RSSA from 1 April 2015 through 31 March 2017. RG&E shall make monthly payments to Ginna in the amount of USD 15.42 million RG&E will be entitled to 70% of revenues from Ginna's sales into the New York Independent System Operator ("NYISO") energy and capacity markets, while Ginna will be entitled to 30% of such revenues. The signatory parties recommend that the NYPSC authorize RG&E to implement a rate surcharge (referred to herein as the "rate surcharge" or "RSSA surcharge") effective 1 January 2016 to recover amounts paid to Ginna pursuant to the RSSA. RG&E's payment obligation to Ginna shall not begin until the rate surcharge is in effect and FERC has issued an order authorizing the agreement. RG&E will use deferred rate credit amounts (regulatory liabilities) to offset the full amount of the Deferred Collection Amount (including carrying costs), plus credit amounts to offset all RSSA costs that exceed USD 2.25 million per month, not to exceed a total use of credits in the amount of USD 110 million, applicable through 30 June 2017. To the extent that the available credits are insufficient to satisfy the final payment from RG&E to Ginna then the RSSA surcharge may continue past 31 March 2017 to recover up to USD 2.25 million per month until the final payment has been recovered by RG&E from ratepayers. The commission has not ruled on the settlement agreement and the companies expect a ruling in the second quarter 2016.

NY Transco

Subsidiaries of National Grid, Central Hudson and NYSEG/RG&E, along with an affiliate of Con Edison and Orange and Rockland Utilities, are part of a new organization, New York Transco LLC. New York Transco LLC is focused on developing electric transmission to meet future electricity needs of all New Yorkers and will develop and New York transmission projects upon receipt of all necessary regulatory approvals.

NY Transco members are requesting regulatory approval for a group of transmission projects expected to cost USD 1,700 million, with NYSEG/RG&E allocated an equity contribution of USD 183 million over the period 2015 through 2018. Additional projects may be developed in the future. Equity investments will be expressly contingent on receiving necessary regulatory approvals and acceptable economic returns. The investment will be made through an Iberdrola USA Networks subsidiary, Iberdrola USA Networks New York Transco, LLC, constituted on 3 November 2014.

NY Transco filed with FERC in early December 2014. The filing requests a formula base ROE of 10.6%, plus 150 basis points ROE incentives. The filing also requests recognition of construction work in process, abandoned plant, regulatory asset for pre-commercial costs and 60% leverage for five years. Various parties, including the NYPSC, have protested the filing at FERC. NY Transco anticipates a FERC decision in 2015.

On 2 April 2015, the FERC issued an order granting, inter alia, applicants' request for a 50 basis point adder for NY Transco's membership in the New York Independent System Operator, Inc. ("NYISO"), subject to the adder being capped within the zone of reasonableness after a determination of where within that zone its base level ROE should be set. The Commission also set the formula rate and base ROE issue for hearing and settlement judge procedures. In addition, the FERC rejected the applicants' cost allocation method for the TOTS Projects because it would allocate costs to LIPA and NYPA that they did not voluntarily agree to pay.

After several months of negotiations, on 5 November 2015, applicants, on behalf of the settling parties, filed the settlement with the FERC, which reflects the agreement of the settling parties to resolve all outstanding issues associated with the TOTS Projects, including issues related to the TOTS Projects that were set for hearing and issues pending on rehearing before the FERC in file number ER15-572-000. The settling parties agreed that the FERC file number ER15-572-000 shall remain open but held in abeyance with respect to the applicants' AC Projects, as they may be modified during the NYPSC/NYISO selection process. Within 30 days after the NYISO's viability and sufficiency assessment, the settling parties will agree in good faith on a date not more than three months later to resume settlement negotiations in file number ER15-572-000 to resolve the rates, terms, and conditions to be approved by the Commission for the applicants' AC Projects. On or after that date, the applicants will file a new Section 205 filing to address the cost allocation methodology to be applied to the AC Projects. The FERC is expected to rule on the settlement in the first quarter of 2016.

2. Electricity generation from renewable energy resources

In the United States, numerous State Governments and the Federal Government have adopted measures and implemented numerous regulations designed to foster the development of electricity production from renewable resources. State programmes have generally come in the form of: 1) Renewable Portfolio Standards (RPSs) that usually require utilities to generate or purchase a minimum amount of renewable electricity; and 2) tax incentives. To date, the Federal Government has primarily supported renewable energy development through tax credits for production and investment as well as accelerated tax depreciation.

Twenty-nine states and the District of Columbia have adopted mandatory RPS requirements, which vary across the states but will generally range from 15-33% of the generation by 2025. The requirements are typically implemented through a system of tradable renewable energy certificates that verify that a kWh of electricity has been generated from a renewable resource. Several state legislatures have debated whether to repeal or roll back significantly their RPS requirements. In 2014 Ohio enacted legislation to freeze its RPS programme until 2017; in 2015, Kansas replaced its mandatory RPS with a 20% voluntary standard as part of a compromise that retained existing property tax exemptions. In contrast, California in 2015 enacted legislation to increase the state RPS to 50%.

Most states also offer a variety of tax incentives to promote investment in renewable energy resources. For instance, Washington and Colorado, among other states, exempt the sale and use of renewable energy equipment from taxation, which reduces development costs substantially. Several states reduce property tax requirements on renewable generation facilities through enterprise zones or similar designations, while Minnesota has substituted a property tax in lieu of fix production tax. Other states, such as Texas, boost the construction of electrical infrastructure (Competitive Renewable Energy Zones) to ease the transportation of renewable electricity towards load points.

In 1992, the US Congress enacted legislation that established a Production Tax Credit (PTC) of USD 15 per MWh (adjusted for inflation) for the production of electricity from wind power facilities for the first ten years of a project's operation. This programme has been renewed on several occasions and has been expanded to include the production of electricity from several other renewable resources, including biomass, geothermal, solid urban wastes and hydroelectric power. In 2005, Congress established a 30% investment tax credit (ITC) for solar power projects. The PTC, which is currently valued at USD 23 per MWh, was extended and phased out by the Congress on 18 December. Developers that start construction on a wind project before 2017 will qualify for the full credit, while those starting construction between 2017 and 2019 will qualify for a reduced-value credit. These qualifying facilities may also elect to take a 30% ITC rather than the PTC. Solar ITC was also extended and phased out by Congress on December 18. Developers that start construction on a solar project before 2020 will qualify for a 30% investment tax credit (ITC). Projects for which construction begins after 2019 are eligible for a lower ITC. The purposes of the PTC and ITC are to make electricity production from renewable resources more competitive relative to fossil fuel and nuclear power facilities.

In addition to the PTC and ITC, renewable energy facilities are eligible for accelerated five-year tax depreciation on their investments. This programme is known as the Modified Accelerated Cost Recovery System. As a result of legislation enacted in 2008, 2009, 2013 and 2014, many facilities placed in service between 2008 and 2014 qualified for bonus depreciation which allowed 50% depreciation deduction in the year a facility was placed in service. On December, Congress enacted legislation to extend and phase out bonus depreciation. Companies can through 2017 deduct 50% of certain capital investments during the year the investment is made. If the investment occurs in 2018, companies can deduct 40% and if it occurs in 2019 only 30% of deduction is allowed.

With respect to interstate transmission networks, the FERC has adopted a series of requirements on transmission operators to improve access and reduce costs for variable generation like wind and solar power. FERC Order 764 is driving changes in scheduling practices and other activities that will increase forecasting accuracy and reduce needed reserves, resulting in lower technology integration costs.

3. Integration of UIL

The most important issue from a regulatory point of view has been the merger approval by the competent authorities.

The merger took place on 16 December 2015 and from then until the end of the year there is nothing to emphasize in regulatory matters.

4.3 Industry regulation in Mexico

The Mexican electric regulatory framework is currently under a deep transformation, due to the energy reform that began at the end of 2013 with the amendment of the Mexican Constitution, continued with the issuance of a set of new laws and rulings for hydrocarbons and electricity and is now at the level of regulatory provisions being issued thus transforming the energy sector as a whole. Although the energy reform is aimed mainly at the hydrocarbons sector, it will also offer new business opportunities in the generation, transmission, distribution and management of electricity infrastructure. This transformation has the purpose of opening up the energy sector to private investment in the activities that were previously reserved to the Government.

Activities like petroleum treatment and refinement; natural gas processing; exporting and importing hydrocarbons and petroleum products; the transport, storage, distribution, compression, liquefaction, decompression, re-gasification, marketing and sale to the public of natural gas, hydrocarbons, petroleum products and petrochemicals, along with the management of integrated systems are now open to private investment, and governed by the regulations the Hydrocarbons Law.

As a consequence of this constitutional reform, nine new laws were enacted during 2014 and 2015 and 25 regulations were either created or reformed. Concurrently with the COP 21 in Paris, the Mexican Congress and Senate passed the Energy Transition Law (*Ley de Transición Energetica* - LTE), which creates binding obligations for clean energy generation and emission reductions targets for the future, which brings a strong legal framework to the development of clean energy projects in Mexico.

Through transitory provisions, the previous regulatory framework will continue being applicable to IBERDROLA's existing businesses and facilities, which provides stability and legal certainty in the Mexican regulatory context.

1. *The Electric Reform*

The Mexican Constitution, amended in December 2013, states that the planning and control of the national electrical system, as well as the energy distribution and transmission public service are competency of the Government of Mexico. Power generation, except for the nuclear one, and its retail are opened to private investment.

Regarding the transmission and distribution network, the Mexican Government may grant contracts to private companies to perform services, including owning and operating infrastructure under the terms established by the Law.

The Electricity Industry Law (*Ley de la Industria Eléctrica* - LIE) regulates activities in the electricity sector in Mexico. According to the LIE, the private companies can now generate and sell electricity under an organised Wholesale Electric Market, and also invest in transmission and distribution infrastructure, under specific Public-Private Associations and other legal structures described therein.

2. *Energy Secretariat*

As part of the Energy Reform, the Energy Secretariat (*Secretaría de Energía* - SENER) has been empowered to coordinate the centralised planning and coordination of the energy policy, both for hydrocarbon and electric subsectors. SENER is also in charge of guaranteeing the implementation of the laws derived from the reform including the LTE issued recently for the transition to clean energy and emission reduction.

During the first half of 2015, SENER issued the mandatory requirement of Renewable Energy Certificates (RECs) for year 2018, with a target of 5% of the total consumption. During the second half of 2015, SENER published the Wholesale Electric Market guidelines and called for the first long term auction for RECs, capacity and energy, to be completed by the first half of 2016.

Regarding the coordination and planning of the national electric network, SENER issued the National Electric Grid Development Programme (*Programa de Desarrollo del Sector Eléctrico Nacional* - PRODESEN).

3. *Regulatory Body*

As part of the energy reform in Mexico, the country enacted the new regulatory bodies law in August 2014 (the Regulatory Body Law) that established that the regulatory bodies in charge of coordinating activities in the energy field are the National Hydrocarbons Commission (*Comisión Nacional de Hidrocarburos* - CNH) and the Energy Regulatory Commission (*Comisión Reguladora de Energía* - CRE).

By means of this law, the CRE and the CNH are granted the most power and authority as regulatory bodies in the energy sector. They have their own legal status, as well as budgetary, technical and governance autonomy. Both commissions have a similar governance authority of seven commissioners and an executive secretary.

The CNH and the CRE hold substantial power and authority over the hydrocarbons and electricity industry regulation.

CRE has existed since 1995 as a public body with power and authority to grant permits and publish administrative provisions in the fields of electricity, gas transport and some regulated tariffs for natural gas and liquefied petroleum gas.

As a result of the Energy Reform, the CRE's powers were increased significantly to transportation and commercialisation of hydrocarbon and derivatives, such as gasoline, petrol, diesel fuel oil, etc.

Regarding the electricity sector, CRE regulates the issuance of future changes to the MEM; defines the terms and conditions of auctions and bidding processes; supervises the MEM operation; SENER develops the first bases rules the transactions between generators and energy providers; authorises the contract and auction models; regulates reliability, capacity requirements and operational costs; determines the regulated tariffs and contract models for services involving transmission, distribution and basic supply of electricity, authorises models related to technical specifications for connecting power stations and users, intelligent networks, etc. Other roles of CRE include granting permits to market participant and RECs registry, resolution of controversies and enforcing fines related to non-compliance of market participants.

Regarding the hydrocarbon sector, the CRE regulates and promotes the development of transportation, storage, distribution, compression, liquefaction and regasification activities. It must also supply the public with fuel, natural gas, liquefied petroleum gas, oil wells, petrochemicals as well as the transmission through pipelines, storage, distribution and supply of renewable energies to the public.

The CNH has the fundamental objective of regulating and supervising the exploration and extraction of hydrocarbons. It is responsible for the promotion, tendering and undersigning of contracts for this activity.

4. National Agency for Energy Control (CENACE)

Mexico has created the National Agency for Energy Control (*Centro Nacional de Control de Energía* - CENACE) as a decentralised public body with authority to perform the operational control of the national electricity grid and the Wholesale Electric Market. CENACE has full autonomy and acts under the authority of SENER and CRE, in order to control the participation of generators and suppliers in the market, acquire and provide electricity and capacity under competitive basis, summon and manage the auctions of capacity, energy and RECs.

CENACE guarantees open access to the transmission and distribution facilities to all market participants, public and private.

CENACE also operates and oversees the preparation of proposals for planning and expansion of the entire national electricity grid through its development programme (PRODESEN), which is then supervised and issued by SENER and thereafter by CRE.

During the first half of 2015, CENACE received from CFE all the relevant assets related to its roles, issued its internal organisational by-laws, delivered the draft of the PRODESEN to SENER and issued the first version of interconnection criteria.

During the second half of 2015, CENACE issued de bidding package for the first long term auction for capacity, RECs and clean energy.

5. CFE´s Law

The CFE's Law, issued in August 2014, states that CFE becomes a productive state-owned production company wholly owned by the Federal Government. The new CFE has budgetary and governance autonomy, with Board of Directors formed by members of the incumbent secretariats (SENER, Hacienda, etc…) and independent board members. This law aims to regulate the organisation, administration, operation, control, evaluation and accountability of CFE and to establish the special regime for productive enterprises subsidiaries and subsidiaries, compensations, acquisitions, leases, services and works, assets, liabilities, state dividend, budget and debt.

During the first half of 2016, the CFE is expected to undergo a legal separation of its generation, transmission, distribution and sales activities so that other parties will have open access to the grid and levelled play roles for the wholesale electricity market.

6. Transmission and Distribution

As per the LIE, the Mexican Government will continue performing the transmission and distribution activities ("T&D") for electricity as a strategic regulated public service through state-owned production companies (EPE) or their subsidiaries. CFE´s legal separation will allow it to create these entities as regulated open access companies. The LIE provides opportunity for T&D activities and related services to be subcontracted with private companies through public-private agreements, so that financing, installation, maintenance, management, operation, expansion, rehabilitation, surveillance and preservation of the required infrastructure can be performed as services provided to the T&D regulated companies.

7. Generation and Retail

The LIE provides that generation and retail can be performed by any private or public entities subject to the compliance of permitting and market rules. Generation plants 0.5 MW or larger require a permit from the CRE.

The LIE provides that electric retail requires a permit and may have two modes: 1- basic supply with regulated tariff (for those consumers with a lower demand of 1 MW from August 2016) or 2- qualified supply through the wholesale electricity market at liberalized conditions for consumers with a demand of 1 MW or more.

SENER may revise and reduce the threshold of 1 MW for the possibility of qualifying consumers for the liberalised conditions. However, becoming a qualified consumer is optional and only mandatory for new costumers.

8. Geothermal energy

The Geothermal Energy Law and its corresponding ruling regulate the exploration and use of underground geothermal resources to generate electricity. The private sector can participate through auctions to obtain exploitation rights of geothermal resources. Additionally, the National Water Law was also amended in order to provide special status to the "geothermal water" compatibly with the Geothermal Energy Law.

9. Wholesale electricity market

The LIE foresees the creation of the Wholesale Electric Market where generators and suppliers can interact to buy and sale the energy, capacity, ancillary services, CECs and financial transmission rights according to market rules. CENACE will operate this market and control the national electricity grid.

CENACE will determine the transaction prices based on the bids and offers it receives within the market. Energy prices will be nodal and marginal.

Finally, the wholesale electricity markets started at the end of January 2016.

10. National content

The LIE will not demand a minimum percentage of national content. However, it points out that SENER will establish the minimum percentages and other conditions for national content in terms of contracts it generates. The Treasury Secretary will establish the criteria to measure the level of domestic content in the electricity sector.

11. Surface use and occupancy

The LIE provides that transmission and distribution, being for public service, must be treated as strategic activities in terms of rights of way. This allows greater access to the facilities and rights of way to the national electricity grid. The CRE will issue provisions that will secure access to the power lines and fair compensation to the land owners.

12. Previous regime for permits, centrals and electric industry contracts

All the permits and contracts granted and executed under the repealed Public Power Service Law (*Ley del Servicio Público de Energía Eléctrica* - LSPEE) will remain under the same terms and conditions, and can be amended as provided there. Once the MEM starts operating, the holders of these legacy contracts - self supply and Independent Power Producers ("IPP") will have the alternative to migrate partially or completely to the new LIE, provided that the existing IPP will remain in effect to the end of their contractual term prior to the migration and that Legacy Connection Contracts (*Contratos de Interconexión Legados* - CIL) of the self-supply projects will not be renewed upon their termination.

Permit requests for self-supply, co-generation, small-scale production, imports or exports made before august 2014 will be resolved under the LSPEE terms and conditions, provided that their facilities must start operating before 31 December 2019.

13. Electricity tariffs

Since 2016, the CRE will assume the responsibility of issuing the regulated electricity tariffs (transport, distribution, basic supply and last reserve supply). Tariffs will be based on the recovery of generation costs, connection services, transport and distribution costs, clean energy certificates and other recoverable costs and collection targets. It is expected that these tariffs will use the same or similar formulas as the previous regime during a transitory period from 2016 to 2018. The adjustments starting in 2016 will be based primarily on the legal separation of CFE entities and the contracts for basic supply based on regulated profitability of CFE subsidiaries. As the main mechanism to promote the reduction of non-technical losses arising from customer's fraud, CRE will impose collection targets on the distribution companies.

14. Natural Gas Transportation System

As part of the Energy Reform, the former owner of the Natural Gas Transportation System, PEMEX, has been split in the following subsidiaries: Pemex exploration and production, Pemex industrial transformation, Pemex perforation, Pemex logistics, Pemex co-generation and services, Pemex fertilisers and Pemex ethylene, as provided under the PEMEX Law enacted in August 2014.

This law transformed PEMEX into a state-owned production company which performs business activities and aims to profitability goals.

Concurrently with this transformation, the natural gas transportation system has been transferred from PEMEX to CENAGAS, the National Operator of the Natural Gas Pipeline Grid in order to promote an open market for transportation, distribution and commercialisation of the gas. According to the principle of asymmetrical regulation, PEMEX cannot integrate transportation and commercialisation of gas under the same company anymore.

CENAGAS has issued the 5 year strategic natural gas development programme. As part of this programme, and in order to promote the reduction of fuel oil consumption, CFE has called for several bidding processes to contract natural gas transportation service from pipelines to be owned by private companies. It is expected that the vast majority of these pipelines will be operational by 2018, thus increasing the natural gas fired power generation, and reducing CO_2 emissions from the fuel oil based generation. Simultaneously, the Government is promoting multiple gas pipelines intended to expand the existing gas transportation system through CENAGAS.

The natural gas transport and storage systems incorporated into the new integrated tariff scheme must meet the criteria of forming part of an interconnected system, thus providing benefits, improving the safety, continuity, redundancy levels and efficiency of integrated systems.

The legacy transportation permits (permits given before the electric reform) for self-supply and the long term natural gas supply contracts with Pemex required by the electric plants will remain in effect and will not be adversely affected by these changes in the regulatory framework.

4.4 Industry regulation in Brazil

1. *Tariffs*

Electricity distribution activity carried out by joint ventures, such as Companhia de Eletricidade do Estado da Bahía, S.A. (COELBA), Companhia Eletricidade do Rio Grande do Norte, S.A. (COSERN), Companhia Energética de Pernambuco, S.A (CELPE) and Elektro Electricidade e Serviços, S.A. (ELEKTRO), which operate in Sao Paulo and Mato Grosso do Sul, is subjected to federal regulation in Brazil.

The Brazilian regulatory framework is based on a system of price cap that is revised every four or five years, depending on each company's concession contract and is updated annually by the regulator. COELBA and COSERN have a five-year term and CELPE and ELEKTRO have a four-year term.

Tariffs are updated annually by the National Energy Agency (*Agência Nacional de Energia Elétrica* - ANEEL), through the annual adjustment process that considers inflation, an ex-ante efficiency factor and variations on non-manageable costs components, such as energy purchase costs and transmission tolls.

Tariffs have two components:

- **Component A**: corresponding to energy purchases, power transmission services contracts and to other costs that are out of a distributor company administration and passed through to the end tariff.

- **Component B:** determined as the sum of (i) the return on the non-depreciated regulatory remuneration base (regulatory WACC applied to the replacement cost of non-depreciated distribution installations and other assets), (ii) the return on capital (a depreciation index applied to the gross asset base) and (iii) the operation and maintenance expenses, and the expense for the uncollectible turnover (the regulator defines late payment rates depending on the kind of grant). This last subcomponent is calculated through a benchmarking model which compares all power distributors in the country and determinates efficient cost levels.

In June 2014, ANEEL opened the first debate on the fourth cycle of tariff review in a public hearing, discussing proposals to change the methodology used to calculate operating costs, cost of capital (WACC), regulatory asset base (RAB), along with uncollectable revenues and distribution losses.

In May 2015, methodologies dealing with Fourth Tariff Review Cycle were approved and applied to ELEKTRO in its tariff review in August 2015. The main points, in summary, are:

- **WACC:** approved regulatory WACC for Fourth Cycle is 8.09% real after taxes. This is higher than Third Cycle's 7.5%.

- **OPEX:** The OPEX to be used in the first year of the cycle was confirmed and represents a positive margin to efficient companies.

- **Non-technical losses:** In the case of efficient companies, the target will be defined by the historical average instead of the historical minimum.

- **Uncollectable revenues:** benchmarking approach defines the uncollectable, wherein it is used the bad debt database of 49-60 months. Pass through of uncollectable revenues related to sector fees and tariff flags revenues. The result represented an improvement from what was proposed.

- **Third-party assets (special obligations):** inclusion of a fee to operate third-party assets. This is an important improvement compared with previous cycles.

- **X Factor:** The approved X factor for the sector is 1.53% (versus 1.91% from ANEEL's first proposal).

- **Regulatory Asset Base (RAB) and Non-Electrical Assets:** The new methodology for RAB was not applied in ELEKTRO's review but will be applied to NEOENERGIA's distribution companies. According to the new methodology, the values of assets' additional costs and minor components are now given by a reference price database. Also, Non-Electrical Assets' methodology had a data update and it is expected to better reflect companies' costs.

On 25 August 2015, ANEEL approved ELEKTRO's Fourth tariff review, which raised its tariffs in 4.2% on average (0.68% for residential clients and 9.32% for industrial clients). Some highlights of Fourth Cycle are: all investments made were recognized in the RAB, higher remuneration rate (from 7.5% to 8.09%, after taxes), positive OPEX margins, third party asset's remuneration and smaller x Factor.

The aim of the annual review is to ensure that component A´s costs are passed on to consumers and that component B´s costs perform in line with inflation and with the pre-determined efficiency factor. An annual tracking account mechanism is used to register component A's unbalances, which should be passed through to tariffs in the following tariff process.

Also regarding distributors' financial exposure due to a rise in costs in early 2015, an extraordinary tariff review occurred in order to preserve financial and economical balance.

2. *Energy Purchase*

For the business of power generation, the review of the sector model introduced in 2004 brought new guidelines for planning responsibilities and expansion generation fleet, significantly reducing risk of further rationing. This expansion is being pursued via public tendering of generation projects in which the successful bidder is the supplier that offers the lowest price in Brazilian Reais per MWh generated, in exchange the successful bidder is awarded a concession or permit of 20 to 35 years (depending on the technology) to operate a power station under a Power Purchase Agreement (PPA) at a price that is an outcome of the tender.

Since 2013, Brazil has undergone some important structural changes in electricity regulation.

In Law 12.783 (the former Provisional Act 579) of 11 January 2013, the Federal Government made official a decrease in electricity tariffs (which led to an extraordinary tariff revision applied on 24 January 2013) and established standards for the renewal of concessions for generation, transmission and distribution expiring between 2015 and 2017. This law allowed power companies to extend their concessions by early renewal of their contracts under specific conditions. As a result of these new rules some generators decided not to renew their concessions. The energy from generators that decided to renew concessions was allocated to Distribution System Operators (DSOs) through quotas, which, however, were not sufficient to meet market needs. Additionally, some PPAs from new energy auctions were suspended or postponed due to delay of construction schedules or revocation by ANEEL.

Thus, mismatches between energy requirements (load) and resources (PPAs) led DSOs to purchase energy in the spot market, raising their costs and significantly affecting their cash flow. In addition, hydrologic conditions have been unfavourable since the final quarter of 2012, with low reservoir levels together with poor performance of rainfalls and inflows, which increased substantially the spot price and thermoelectric generation. The corollary was a significant increase in energy costs, which temporarily impacted earnings of distributors.

Part of this rise in costs was compensated for using funds managed by Government through energy development account and by means of loans underwritten by various financial institutions, centralised in ACR (Account for Regulated Environment) Accounts. These resources were approximately BRL 10 billion to cover non-recurring expenses incurred in 2013 and BRL 18.8 billion to cover those during 2014. The remaining part of non-recurring costs, which wasn´t covered by these funds, was passed through to consumers in the annual adjustment of the tariffs.

These financial resources helped to minimise distributors' liquidity problems in 2013 and 2014, but according to International Financial Reporting Standards (IFRS), DSOs were not allowed to recognise regulatory assets and liabilities on their balance sheets. ANEEL therefore opened Public Hearing 61/2014 to discuss whether distributors' concession agreements should be amended allowing the compensation of regulatory assets and liabilities at the end of the concession period, in order to allow its recognition in the distributors' financial statements. This amendment was signed by distributors in November 2014, and these assets and liabilities are presently recognised according to IFRS.

During Public Hearing 64/2014, ANEEL discussed quotas allocation criterion, regarding the energy from generators whose concessions had expired. Federal Decree 7805/2012 established the allocation of new energy quotas in conformity with the size of the market (except the allocation that happened in 2013, which didn’t follow this guideline in order to achieve equal tariff reductions between DSOs). As a result, ANEEL approved an allocation criterion that favours exposure to the spot market in 2015 but that follows the proportion of market size in the following years.

In 2015, minimum and maximum limits for spot prices were changed, after discussion within the Public Hearing, these values went from BRL 15.62 and BRL 822.83 per MWh in 2014 to BRL 30.26 and BRL 388.48 per MWh respectively. This change allowed a significant reduction in the exposure of DSOs´ cash flows.

On 15 May 2015, MME (Ministry of Mines and Energy) instructed ANEEL to promote auction for bidding 29 hydroelectric concessions located in the states of Goiás, Paraná, São Paulo, Minas Gerais and Santa Catarina. The Provisional Measure 688 was published in August and established a “bonus” for the generation’s grant to be pay to Federal Union by the winning bidder of each lot of power plants. By signing the contract, concessionaire shall receive in its Annual Revenue Generation (RAG) a portion of bonus grant’s return.

The auction was held on 25 November, and the biggest buyer agent was China Three Gorges, which successfully bid the plants Jupiá and Ilha Solteira. The auction had an average discount of 0.32% and the average price was BRL 125 MWh, without the additional costs of connection and fees. Government collected through bonus for the generation grant BRL 17 billion. The quotas average price has increased in relation to the practiced prior to the auction, given the incorporation of bonus grant’s return in the revenue of generators.

After great tensions related to the lack of rainfall in 2014 and early 2015 (which raised the imminent possibility of rationing), storage reservoirs, especially in Southeast and Midwest, were able to recover and close the month of November at 27.55% of capacity, well above the recorded for the same period of 2014. The year's closing forecast is 33.8% of its capacity.

Despite improved hydrological conditions, economic slowdown observed for three consecutive quarters had significant negative effects on the distribution market. Given that prospects for 2016 are a negative growth of Brazilian GDP, it is expected that the decline in the energy sector’s market continues, especially affected by the drop in industrial demand. Thus, the distributors are facing a plausible scenario of overcontracting (above 105%) for the next year. By December 2013, all energy contracts for the year 2016 had already been carried out with completely different projections of the ones checked today, and therefore variations on events outside the managerial scope of distribution combined with unfavorable market conditions have resulted in overcontracting (despite the Company's efforts to mitigate them). The main factors responsible for this scenario are the quotas, migration of potentially free and special customers to free market and other variations resulting from higher market fall than frustration of the energy auctions. Once DSOs have identified difficulties, negotiations have started with MME and ANEEL to counteract the unmanageable effects and neutralize the risks.

3. Other Regulatory Changes

On 29 December 2014, by virtue of Resolution 4947/2014, the introduction of the system of tariff flags was approved starting in January 2015. The procedure provides for short-term adjustments to be made to tariffs through the use of triggering indicators in the energy cost component in final tariffs. Tariff flags are determined on a monthly basis and their purpose is to mitigate the exposure of distributors' cash flows to high energy prices by reducing the difference between the price paid for energy by distributors and the price paid by consumers to distributors through tariff. A green flag signals low energy purchasing costs and does not change tariffs paid by consumers. A yellow flag signals that power generation costs are rising due to use of thermal energy in the generation mix and leads to a BRL 25 MWh increase in price. A red flag signals a situation where the costs of providing electrical utilities are becoming even more expensive due to the use of inefficient thermal power stations and results in a BRL 55 MWh increase in tariff. The values of each tariff flag are revised annually or when necessary. On 28 August 2015, since the most expensive thermal plants were shut down, therefore lowering generation costs, ANEEL ruled that this flag would have its additional cost reduced from BRL 55 MWh to BRL 45 MWh.

In order to equalize impact of high energy costs for all DSOs in 2015, revenues due to tariff flags have been shared among DSOs. Decree 8401/2015 created an account for centralising resources from tariff flags and commanded that monthly ANEEL must calculate the required amount to be transferred among DSOs, through this account. By Resolution 689/2015, ANEEL approved a new regulation to deal with flags resources' surplus. In the case when revenues are higher than costs, surplus is kept by distributors and then returned to customers as lower tariffs in next tariffary event.

Resolution 687/2015 introduced changes in Resolution 482/2012, which regulates micro and mini distributed generation. It defines micro and mini DG as a renewable or combined cycle power plant, limiting micro DG to 75 kW, and mini DG to 3 MW for hydraulic generation, and 5 MW for renewables. By this resolution, virtual energy compensation is now allowed between different consumption points. The amount of compensation depends on the distance between generation and consumption points. It also introduced the concept of "shared" energy contracts that allow consumers to form groups. These groups are able to invest in a distributed generation plant and define the way this energy will be shared among its members.

On 27 August 2015, the Public Hearing to set **ABRACE**'s associates' tariffs (Brazilian Large Industrial Energy Consumers and Free Consumers Association). CDE ("*Conta de Desenvolvimento Energético*") charge is calculated proportionally to the level of consumption for all the consumers, which means that the largest consumers pay consequently more. ABRACE disagrees with CDE's calculation method and has won an injunction that allows the association not to pay a part of the charge. The result of this Public Hearing will not have impacts in ELEKTRO's results, but is a temporally cash flow mismatch. On September 24, ANEEL's board meeting discussed the results of the Public Hearing. ANEEL's decision is to publish the new tariff value of ABRACE's associates according the injunction determines. The impacts will be retroactive to the injunction date; 3 July 2015. ANEEL is trying to revert the judicial decision. **ABRADEE** (Brazilian Electricity Distributors) has filled an injunction in order to protect DSOs from any effects. There is still no judicial decision; therefore ABRACE's injunction still in play.

In 2015, several concession contracts will be renewed. ANEEL discussed this topic in a Public Hearing and formulated a new contract. The DSOs must accomplish the following criteria:

I. Efficiency in quality of service;

II. Efficiency in economic and financial management;

III. Operating and economic rationality;

IV. Reasonable and affordable prices.

Non-compliance with annual targets may result in capital contribution obligations for the shareholders controlling the concession. The concessionaire's failure to reach the annual targets for two consecutive years during the first five-year period may result in the termination of the concession. If the current concessionaire does not meet the new conditions, the concession will be auctioned.

With regard to the sub-transmission assets transfer, in 2015, a Public Hearing was opened in order to collect subsidies from agents to the proposal designed by ANEEL. It was expected that the subject would be collecting subsidies until the end of the first half of 2016. However, the proposal placed by ANEEL displeased many of the agents involved, and there is still strong resistance to the transfer by the transmission agents. Thus, the regulatory agency has suspended the proposal to improve it, which will come back to debate in 2016.

Regarding the structural projects, Energia Sustentável do Brasil S.A. (ESBR), the consortium responsible for the UHE Jirau plant, is immersed in legal battles with ANEEL and ABRADEE for the delay of the project, caused, among other reasons, by workers' strikes and conflicts in construction sites. In April 2015, ANEEL decided that the Company would be entitled to claim only 52 days of "non-responsibility" for the delay, despite the request of the Company for 535 days. The Court decision of May 2015, however, ratified an injunction of ESBR, exempting ESBR from a penalty and granting a postponement in the work schedule of 535 days.

Due to the amendment of Jirau's contract, there is more than one schedule for the construction of the hydroelectric plant, what makes any interpretation of legal decisions very complex.

In September 2015, ANEEL presented a request for suspension of the Court decision, and ABRADEE presented an appeal pleading the invalidity of Jirau's sentence for the fact that DSOs were not represent in the Court proceedings, being the signatories of the PPAs and being directly affected by the process, since the application of the exempt of responsibility can make them exposed to the spot market. At the end of the month, ABRADEE obtained an injunction to the Court decision to protect DSOs from the financial effects.

ABRADEE's injunction was nullified in late November 2015, leaving distributors as debtors of BRL 3.7 billion against ESBR. On 1 December 2015, another legal decision was issued. However, CCEE (*Cámara de Comercialização de Energia Elétrica*) and ABRADEE have divergent approaches, the first one considering that Jirau has a credit and the second one considering that Jirau has a debt. ANEEL has already been required by ABRADEE to assist in the interpretation of the decision.

5. MAIN RISKS AND UNCERTAINTIES

5.1 Risk Management System

The IBERDROLA Group is exposed to various inherent risks in the countries, industries and markets in which it operates and the businesses it carries out, which could prevent it from achieving its objectives and executing its strategies successfully.

The Company's Board of Directors, aware of the importance of this matter, promotes the necessary mechanisms so that the risks relevant to all of the Group's activities and businesses are appropriately identified, measured, managed and controlled, and has established, through the Group's general risk control and management policy, the basic mechanisms and principles necessary for the appropriate management of risk-opportunity with a level of risk which allows:

- attain the strategic objectives formulated by the Group with controlled volatility;
- provide the maximum level of assurance to the shareholders;
- protect the results and reputation of the Group;
- defend the interests of shareholders, customers, other groups interested in the progress of the Company, and of the society in general; and
- ensure corporate stability and financial strength in a sustained manner over time.

For the development of the aforementioned commitment, the Board of Directors and its Executive Committee have the cooperation of the Audit and Risk Supervision Committee, which, as a consultative body, monitors and reports upon the appropriateness of the assessment system and internal control of significant risks, acting in coordination with the audit committees existing in other companies of the Group.

Every action aimed at controlling and mitigating risks will consider the following basic action principles:

a) Integrate the risk-opportunity vision into the Company’s management, through a definition of the strategy and the risk appetite and the incorporation of this variable into strategic and operating decisions.

b) Segregate functions, at the operating level, between risk-taking areas and areas responsible for the analysis, control, and monitoring of such risks, ensuring an appropriate level of independence.

c) Guarantee the proper use of risk-hedging instruments and the maintenance of records thereof as required by applicable law.

d) Inform regulatory agencies and principal external players, in a transparent way, regarding the Group risks and the operation of the systems developed to monitor such risks, maintaining suitable channels that favour communication.

e) Ensure appropriate compliance with the corporate governance rules established by the Company through its Corporate governance system and the update and continuous improvement of such system within the framework of the best international practices for transparency and good governance, and implement the monitoring and measurement thereof.

f) Act at all times in compliance with the law and the Company's corporate governance system and, specifically, with the values and standards of conduct established in the *Code of Ethics*, and pursuant to the principle of zero tolerance of illegal acts and fraud set forth in the *Crime Prevention and Anti-Fraud Policy*.

The *Risk control and management general policy* and its basic principles are implemented by means of a comprehensive risk control and management system, supported by a Corporate Risk Committee and based upon a proper definition and allocation of duties and responsibilities at the operating level and upon procedures, system methodologies and tools suitable for the various system stages and activities including:

a) The ongoing identification of significant risks and threats based on their possible impact on key management objectives and the financial statements (including contingent liabilities and other off-balance risks).

b) The analysis of such risks, both at each corporate business or function and taking into account their combined effect on the Group as a whole.

c) The establishment of a structure of policies, guidelines, and limits, as well as of the corresponding mechanisms for its approval and implementation, which effectively contribute to risk management being performed in accordance with the Company's risk appetite.

d) The measurement and controlling of risks by following procedures and standards which are homogeneous and common to the Group as a whole.

e) The analysis of risks associated with new investments, as an essential element of decision-making based upon profitability-risk.

f) The maintenance of a system for internal controlling of compliance with policies, guidelines and limits, by means of appropriate procedures and systems, including the contingency plans needed to mitigate the impact of the materialisation of risks.

g) The periodic monitoring and control of profit and loss account risks in order to control the volatility of the annual income of the Group.

h) The ongoing evaluation of the suitability and efficiency of applying the system and the best practices and recommendations in the area of risks for its eventual inclusion in the model.

i) The audit of the system by the Internal Audit.

In addition, the *Risk control and management general policy* is further developed and supplemented by the *Corporate risk policies* and the *Specific risk policies* established in connection with certain businesses and/or companies of the Group, which are listed below and are also subject to approval by the Company's Board of Directors.

Corporate risk policies structure:

a) Corporate risk policies:

- Corporate credit risk policy
- Corporate market risk policy
- Operational risk policy in market transactions
- Insurance policy
- Investment policy
- Financing and financial risk policy
- Treasury share policy
- Risk policy for equity interests in listed companies

- Reputational risk framework policy
- Purchasing policy
- IT policy
- Cybersecurity risk policy

b) Risk policies for the various businesses of the Group:

- Risk policy for the deregulated business of the IBERDROLA Group
- Risk policy for the renewables business of the IBERDROLA Group
- Risk policy for the network business of the IBERDROLA Group
- Risk Policy for the non-energetic business of the IBERDROLA Group

The *Risk control and management general policy*, as well as the *Summary of the corporate risk policies* and the *Summary of the specific risk policies* for the various businesses of the Group are available on the corporate website (www.iberdrola.com).

In order to align the risk impact with the established risk appetite, the Executive Committee of the Board of Directors, acting at the proposal of the business or corporate divisions involved and upon a prior report from the Group's Risk Committee, annually reviews and approves specific guidelines regarding the Group's risk limits.

Pursuant to established guidelines, the competent administrative bodies of each company of the Group, within such company's area of responsibility, reviews and approves the specific risk limits applicable to each of them.

The companies and corporate functions of the Group are responsible for implementing, within their areas of activity, the control systems required for compliance with the *Risk control and management general policy* and with the limits thereunder.

The risk factors to which the Group is generally subject are listed below:

a) Corporate Governance Risks: the Company assumes the need to safeguard the social interest of the Company and the strategy of sustained maximisation of the economic value of the Company and its long-term success, in accordance with social interest, culture and the Group's corporate vision, taking into account the legitimate public and private interests that converge in the conduct of all business activities, particularly those of the various stakeholders and communities and regions in which the Company and its employees act. A fundamental requirement for the foregoing is compliance with the Company's Corporate governance system, comprising the By-Laws, the Corporate policies, the internal corporate governance rules and the other internal codes and procedures approved by the competent decision-making bodies of the Company and inspired by the good governance recommendations generally recognised in international markets.

b) Market risks: defined as the exposure of the Group's results and assets to changes in market prices and variables, such as exchange rates, interest rates, commodity prices (electricity, gas, CO_2 emission rights, other fuel, etc.), prices of financial assets and others.

c) Credit risks: defined as the possibility that a counterparty fails to perform its contractual obligations, thus causing an economic or financial loss to the Group. Counterparties can be final customers, counterparties in financial or energy markets, partners, suppliers, or contractors.

d) Business risks: defined as the uncertainty regarding the performance of key variables inherent in the business, such as the characteristics of demand, weather conditions, the strategies of different players, and others.

e) Regulatory risks: defined as those arising from regulatory changes made by the various regulators, such as changes in compensation of regulated activities or in the required conditions of supply, environmental regulation, tax regulation including risks relating to political changes that might affect legal security and the legal framework applicable to the businesses of the Group in each jurisdiction, the nationalisation or expropriation of assets, the cancelation of operating licenses and the early termination of contracts with Government.

f) Operational, technological, environmental, social and legal risks: defined as those related to direct or indirect economic losses resulting from inadequate internal procedures, technical failures, human error, or as a consequence of certain external events, including the economic, social, environmental, and reputational impact thereof, as well as legal and fraud risks. The said risks include those associated with information technology and cybersecurity, as well as the risk of technological obsolescence, among others.

g) Reputational risks: potential negative impact on the value of the Company resulting from Company's behaviour below the expectations created among various stakeholders: shareholders, customers, media, analysts, Government, employees, and society in general.

Owing to its universal and dynamic nature, the system allows for the consideration of new risks that may affect the Group as a consequence of changes in its operating environment or revisions of objectives and strategies, as well as adjustments resulting from ongoing monitoring, verification, review and supervision activities.

The Audit and Risk Supervision Committee of the Board of Directors periodically monitors the evolution of the Company's risks:

- It reviews the Group's risk quarterly reports, which include monitoring compliance with risk limits and indicators and updated key risk maps, submitted by the Group's director of corporate risks.

- It coordinates and reviews risk reports sent periodically, at least semi-annually, by the audit and compliance committees of the main subsidiaries of the Group, being included the subholding companies of the main countries where the Group operates that, along with the risk director appearances are used to prepare a risk report for the Board of Directors at least semi-annually.

For further details, see the section *Control systems and risk management of the Corporate Governance Report 2015*.

5.2 Credit risk

The IBERDROLA Group is exposed to credit risk arising from its counterparties (customers, suppliers, financial institutions, partners, etc.) default on their contractual obligations. The exposure may arise with regard to unsettled amounts, the cost of substituting products not supplied and also, in the case of dedicated plants, outstanding amounts.

The credit risk is managed and limited in accordance with the type of transaction and the creditworthiness of the counterparties. A specific corporate credit risk policy is in place which establishes criteria for admission, approval systems, authorisation levels, scoring tools, exposure measurement methodologies, etc.

With regard to credit risk on trade receivables, the historical cost of defaults has remained moderate and stable at close to 1% of total turnover of this activity, despite the current difficult economic environment. Regarding other exposure (counterparties in transactions with financial derivatives, placement of cash surpluses, transactions involving energy and guarantees received from third parties), no significant defaults or losses were incurred in 2015 or 2014.

At 31 December 2015 and 2014, there is no significant credit risk concentration in the IBERDROLA Group.

5.3 Financial risk

5.3.1 Interest rate risk

The IBERDROLA Group is exposed to the risk of fluctuations in interest rates affecting cash flows and market value in respect of items in the balance sheet (debt and derivatives). In order to adequately manage and limit this risk, the IBERDROLA Group manages annually the proportion of fixed and variable debt and establishes the actions to be carried out throughout the year: new sources of financing (at a fixed, floating or indexed rate) and/or the use of interest rate derivatives.

Debt arranged at floating interest rates is basically tied to Euribor, Libor-GBP and Libor-USD and to the most liquid local reference indexes in the case of the borrowings of the Latin American subsidiaries.

The debt structure at 31 December 2015, once considered the hedge provided by the derivatives traded, is included in the Note 5 of the Consolidated financial statements.

Given the composition of the IBERDROLA Group's debt at year end, between fixed and floating interest rate (46% fixed / 54% floating), and assuming it remains the same in the future, the impact on profit and loss of a potential rise of 25 basis points (0.25%) in the benchmark rates mentioned in the previous paragraph would be EUR 40 million (higher finance cost).

5.3.2 Foreign currency risk

As the IBERDROLA Group's presentation currency is the euro, fluctuations in the value of the currencies in which borrowings are instrumented and transactions are carried out with respect to the euro, mainly the Sterling pound, the US dollar and the Brazilian real, may have an effect on the finance costs, profit and equity of the Group.

The following items could be affected by foreign currency risk:

- Proceeds from energy supplies and payment for energy supplies and raw materials purchased in currencies other than the euro.
- Settlement of financial operations to hedge the price of energy commodities.
- Debt denominated in currencies other than the local or functional currency of the IBERDROLA Group companies.
- Collections and payments for supplies, services or equipment acquisition in currencies other than the local or functional currency.

- Income and expenses of certain foreign subsidiaries indexed in currencies other than the local or functional currency.
- Profit or loss on consolidation of foreign subsidiaries.
- Consolidated carrying amount of net investments in foreign subsidiaries.

The IBERDROLA Group reduces this risk by

- Ensuring that all its economic flows are carried out in the currency of each Group company, provided that this is possible and economically viable and efficient, through the use of derivatives if not.
- As far as possible, this covers the risk of transfer of earnings scheduled for the current year, thereby limiting the ultimate impact on Group earnings.
- Mitigating the impact on the consolidated net asset value of a hypothetical depreciation of currencies due to Group's investment in foreign subsidiaries by maintaining foreign currency debt, as well as through financial derivatives.

The debt structure at 31 December 2015, once considered the hedge provided by the derivatives traded, is included in the Note 5 of the Consolidated financial statements.

Considering the composition of the finance cost in foreign currency in 2015 (59% EUR, 21% USD, 15% GBP, 5% BRL), a 5% rise in the main currencies and assuming it remains the same in the future would have a negative impact on profit and loss of EUR 24 million (higher consolidated finance cost in euros).

5.3.3 Liquidity risk

Exposure to adverse situations in the debt or capital markets or in relation to the IBERDROLA Group's own economic/financial situation may hinder or prevent the IBERDROLA Group from obtaining the financing required to properly carry on its business activities.

The IBERDROLA Group's liquidity policy is aimed at ensuring that it can meet its payment obligations without having to obtain financing under unfavourable terms. For this purpose, various management measures are used such as the arrangement of committed credit facilities of sufficient amount, deadline and flexibility, diversification of the coverage of financing needs through access to different markets and geographical areas, and diversification of the maturities of the debt issued.

The sum of cash, liquid assets and committed undrawn credit facilities would sufficiently cover the Group's expected liquidity requirements for a period of over 24 months, excluding the arrangement of any new credit.

The figures relating to changes in the Company's debt are included in Notes 25 and 50 to the Consolidated financial statements.

5.4 Country risk

The activities of the different businesses that the IBERDROLA Group developed are submitted, in greater or lesser extent depending on their characteristics, to various risks inherent to the country where they operate:

- Imposition of monetary and other restrictions on the movement of capital
- Changes in the market
- Economic crises, political instability and social unrest affecting operations
- Nationalisation or expropriation of assets.
- Exchange rate fluctuations
- The cancelation of operating licenses
- The termination of Government contracts
- Changes to administrative policies and regulations in the country

The results of our international subsidiaries, their market value and their contribution to the Group may be affected by such risks.

The IBERDROLA Group's main operations are focused on Spain, United Kingdom, USA, Brazil and Mexico, countries with low or moderate risk, whose credit ratings are as follows:

Country	Moody´s	S&P	Fitch
Spain	Baa2	BBB	BBB+
United Kingdom	Aa1	AAA	AA+
United States	Aaa	AA+	AAA
Brazil	Baa3	BB+	BB+
Mexico	A3	BBB+	BBB+

The presence in countries other than the ones mentioned above is not significant at Group level from an economic point of view.

5.5 Activity risks

The activities of the various businesses developed by the IBERDROLA Group are subject to various risks including market, credit, operational, business, regulatory and reputational risks arising from the uncertainty of the main variables that affect them.

5.5.1 Regulatory and politic risks

Companies in the IBERDROLA Group are subject to laws and regulations concerning prices and other aspects of their activities in each of the countries in which they operate. The introduction of new laws and regulations or amendments to the already existing ones may have an adverse effect on the Group’s operations annual results and economic value of businesses.

The following paragraphs are a few of the new major regulatory measures that were approved in 2015 or are due to be implemented in 2016:

- Spain:

  Approval of Ministerial Order IET/2660/2015 of 11 December 2015 approving unit remuneration for electricity distributors, establishing the first regulation period up to 31 December 2019.

- United Kingdom:

  The approval of the new remuneration framework for electricity distributors in the UK, RIIO-ED1, which will regulate income over an eight-year period between April 2015 and March 2023.

  There is uncertainty concerning potential measures approved as a result of the analysis of the electricity retail market performed by the CMA, the UK's competition authority, and the measures approved to finalise regulation of the obligation to fit smart electricity and gas meters.

- United States:

  Approval of the new PTC tax incentive scheme for renewable energies, valid up to the year 2020.

  There is uncertainty concerning the forthcoming review of tariffs for the gas and electricity distribution companies NYSEG and RG&E.

- Brazil:

  Approval of Elektro's four-year tariff review, which came into force on 27 August 2015, by Brazilian regulator ANEEL, valid up to August 2019.

- Mexico:

  Uncertainties about the Energy Market Reform currently being drawn up which, according to the best information available, could affect the profitability of assets dedicated to selling electricity to private partners and the outlook for plants currently under construction.

5.5.2 Network business risk

The regulations of each country in which the IBERDROLA Group's network businesses operate establish regularly revised frameworks, guaranteeing that these businesses will receive reasonable and predictable returns. These frameworks include penalties and bonuses for efficiency, service quality and, eventually, for default management, which have a minor, immaterial impact overall. Significant structural amendments to these regulations could pose a risk to these businesses.

In general, the profitability of the IBERDROLA Group's network businesses is not exposed to demand risk, except for the Brazilian subsidiaries.

The IBERDROLA Group's network businesses in Spain and the United Kingdom do not sell energy and, therefore, they are not exposed to any market risk associated with energy prices.

The network businesses in Brazil and some USA sell energy to regulated customers at a price determined by certain previously approved tariffs. In the event a prudent management policy is followed regarding supply and in accordance with that established by the regulator, the regulatory frameworks in both countries guarantee sums will be collected in subsequent tariff readjustment reviews for possible purchase price deviations from those previously recognised in the tariff.

Given the above, in the case of extraordinary events (extreme drought in Brazil as happened in 2014, catastrophic storms in USA, etc.), occasional temporary gaps between payments and collections may arise with an impact on the cash flows of some of these businesses and ultimately on profits recognised under IFRS.

5.5.3 Renewable business

The regulations of each country in which the Group operates establish regulatory frameworks aimed at promoting the development of renewable energies based on formulas which may include premiums, green certificates, tax or regulated tariff deductions, which allow investors to obtain sufficient and reasonable return. Any change to the aforementioned regulation may represent a risk for said business.

In addition to the aforementioned regulatory risk, Group's renewable energy businesses may be subject, to a greater or lesser extent, to wind resource risk and market risk.

The Group considers that the wind resource risk is mitigated through the high number of wind power farms available and their geographic diversification, and the trend to compensate less wind energy periods with those with high wind energy on the medium term.

Regarding the electricity price risk the following should be mentioned:

- ***Renewables business – Spain***

Subsequent to the approval of the new regulatory framework (Royal Decree-Law 9/2013, of 12 July, Law 24/2013, of 26 December, Royal Decree 413/2014, of 6 June, and Ministerial Order IET/1045/2014, of 16 June), all renewable energy generated is remunerated at market price plus a premium per MW. This guarantees a reasonable regulated return based on a recognised standard investment. This return is readjusted every three years within predetermined bands to cover any possible deviation in market price. This premium per MW is not applicable for wind farms brought on line during and before 2004. As a result, initially all output would be fully or partially exposed to market risk.

- ***Renewables business – United Kingdom***

The renewables business in the UK is partially exposed to the risk of fluctuations in the market price of electricity in the UK, since the obtained revenue comprise income from the energy sold and income from the sale of renewable energy certificates.

- ***Renewables business – United States and other countries***

The renewables businesses in the other countries in which the Group operates sell their energy, preferably at a fixed price, whether through regulated tariffs or through long-term power purchase agreements (PPAs).

However, in the USA, 33% of the energy produced is sold to the market in more or less short terms.

With electricity prices around USD 30 per MWh, a 5% change in prices could give rise to an impact of EUR ±8 million in operating results.

The positions exposed to market risk of the renewables businesses in Spain and the UK are managed and included in their position in the Deregulated businesses in these countries, to be hedged in the most efficient manner possible.

5.5.4 Deregulated electricity and gas generation and retailing businesses Commodity price risk

The activities of the Group's deregulated businesses are subject to a range of market, credit, operating, business and regulatory risks, coming from the uncertainty of the main variables that affect them, such as: fluctuations in commodity prices, changes in hydroelectric and wind energy production (of both the Group's and of third parties), changes in electricity and gas demand, and plant availability.

The main variable that affects IBERDROLA's result in terms of raw materials' market price, is the electricity price. However, in many countries, electricity prices are strongly correlated with the price of the fuels used in its production. Therefore, risk studies are carried out on fuel price trends.

In the case of fuel and CO_2 emission allowances, these risks are evident in:

- The electricity generation and retailing business, in which the IBERDROLA Group is exposed to variations in the price of CO_2 emission rights and in the sale price of electricity, as well as to variations in fuel costs (mainly gas and coal).

- The gas retailing business, in which a large portion of the IBERDROLA Group's operating expenses relate to the purchase of gas for customer supplies. The IBERDROLA Group is therefore exposed to the risk of variations in the price of gas.

- Unhedged energy transactions (discretionary trading).

To a large extent, the mutual closing out of positions by the generation business and retailing business mitigates the market risk to which the Group is exposed. The remaining risk is mitigated by diversifying sale and purchase agreements, and specific clauses therein, as well as by arranging derivatives.

- ***Deregulated business in Spain***

  Commodities' Price risk

Given current market conditions, the production price of the coal-fired power plants defines, to a large extent, the price of electricity in Spain since coal is the marginal technology necessary to cover electricity demand. Consequently, the price of coal conditions revenues from the other less expensive technologies which are used to cover demand. With coal prices around USD 45 per t, a 5% change in the prices could give rise to an impact of EUR -20/+20 million on operating results.

The price of CO_2 influences the cost of production in coal-fired power plants. With coal prices around EUR 8.5 per t, a 5% change in the prices could give rise to an impact of EUR -10/+10 million on operating results.

The majority of gas supplied in Spain is paid indexed to the price of oil by means of complex formulas. IBERDROLA has these types of agreements for the supply of gas, as well as other types of fixed-price supply and with prices not indexed to the market price of oil. These agreements are used for electricity generation, for the consumption of its final customers and for sale to other intermediaries. Due to the fact that the electricity generation margin is covered by the contracting formulas of the system operator, only residual risk remains in sales to final customers and third parties. The risk assumed is reduced and depends on the correlation between the price of oil and the European and international gas prices. In the event of a 5% fluctuation in the oil price, the risk would be EUR -3/+2 million.

Hydraulic risk

Despite having a large water storage capacity, IBERDROLA's results depend significantly on the flow contributions. The changes in output with respect to the average value can be up to -4,000 GWh in a dry year and +5,000 GWh in a wet year, the variability would be between EUR -150/+100 million. The loss of profit is not covered as it is an IBERDROLA's inherent risk.

Demand risk

Given the current market condition, where price is primarily determined by the generation cost of coal-fired plants, which make up around 15% of the generation mix, it is not considered that demand fluctuations will impact on marginal technology in the market. The impact on the market price of a 1% change in demand is therefore limited, amounting to approximately EUR 0.25 per MWh.

A moderate drop in demand in Spain does not affect the scheduled output of the Group's nuclear, hydroelectric and wind power plants, since there is a mandatory electricity market in Spain guaranteeing the efficient dispatch of output from all technologies.

Nevertheless, there could be an impact if a drop in electricity demand entails an equivalent reduction in the Group's retail sales and consequent narrowing of margin. This is mitigated to some extent by increasing sales of own energy on the wholesale market.

Taking both effects into account, it is estimated that a 1% fluctuation in demand would have an impact of EUR ±15 million overall.

Operational risk

From the perspective of its impact on business results, the main risk arises from nuclear power plant outages (due to stoppages for fuel reloading, in accordance with a pre-established schedule) and hydroelectric power plant outages which are not associated with a large storage reservoir (flow facilities, in which water is not storable). As a result of such outages, production and, therefore, the margin associated with this production are lost. This risk is managed through excellence in the operating and maintenance practices of the plants and a culture focused on total quality and the reduction of operational risks, which allow the impact of this risk to be kept low.

- ***Deregulated business – United Kingdom***

Commodity price risk

The IBERDROLA Group will not count on having coal plants in the UK after the closure of current plant Longannet planned for the end of March 2016.

In the British market, geared towards thermal power generation, the clean spark spread has become the appropriate index to follow the uncertainty of the margins of coal-fired power plants. Despite the fact that commodities (coal, CO_2 and electricity) are listed separately, the uncertainty of the unit margin is studied since it has been detected that it is a better indicator of the uncertainty of the results. With clean spark spread levels around GBP 3 per MWh, a 5% change in the spreads could give rise to an impact of EUR ±1 million on operating results.

In addition to its use as fuel in combined cycle power plants, IBERDROLA sells gas to customers in the United Kingdom and has long-term gas agreements to do so. A portion of the aforementioned agreements has their price linked to the British wholesale markets and, therefore, they do not represent any risk for the Company. However, there are agreements for which the price is fixed and which are linked to other indexes. These represent a risk if the price of gas changes. At the current levels, a 5% change to the price would have an impact of EUR ±8 million on results.

Demand risk

Electricity consumption demand is usually one of the most significant risk factors for any company. However, IBERDROLA currently purchases from third parties a significant portion of the energy it sells (1,800, 2,500 and 4,100 GWh in 2015, 2014 and 2013, respectively, of a total amount of electricity sold of 22,000 GWh/year), since it is more profitable to do so under current market conditions than IBERDROLA producing it and using its own thermal power plants. From a business perspective, fluctuations in electricity demand mean that additional amounts of electricity need to be purchased or that these acquisitions need to be reduced. In any case, the profit or loss IBERDROLA obtains from this intermediation is low and much lower than that obtained from its own output. Thus, demand fluctuations have a small impact on profit or loss of EUR ±10 million for every 1% fluctuation in customer demand.

Operational risk

From the perspective of its impact on business results, the main risk arises from outages at the Longannet coal-fire plant and the combined cycle power plants. With regard to these outages, all profit or loss obtained from production is committed, although the high operating and maintenance standards of the plants and a culture focused on total quality and the reduction of operational risks, allow the impact on this risk to be kept low. Loss of profit from this type of events (material damages or machinery malfunctions) is covered by an insurance policy after a certain deductible level, which is marked by the risk retention level that IBERDROLA can assume and the insurance conditions that the market offers for risks of these types.

- ***Deregulated business – Mexico***

Commodity price risk

Electricity generation at Iberdrola Generación Mexico is gas-intensive. Gas prices therefore comprise an essential component of this risk.

Approximately 85% of the electricity generated in Mexico is sold through long-term sales agreements (to CFE and, to a lesser extent, other major industrial customers), whereby the risk associated with the price of gas for generating this electricity is passed on.

The remaining energy is sold to customers at a price linked to the official tariffs published by CFE. These tariffs depend on the price of the various fuels, specially fuel-oil, diesel, natural gas and coal.

As a result, there is a risk associated with the price of these fuels on the international markets:

- A 5% change in fuel-oil or diesel prices (which are closely linked) would give rise to a EUR ±3 million change in results.
- A 5% change in the natural gas price would give rise to a EUR ±1 million change in results.
- A 5% change in the price of coal would give rise to a EUR ±1 million change in results.

Demand risk

The structure of the agreements IBERDROLA has entered into in Mexico isolates the business results from electricity demand fluctuations. Revenues come mainly from plant availability and only the sales indexed at the official Mexican tariff are subject to a certain extent by the fluctuation in demand. Nonetheless, most of the plants have committed sales exceeding their production capacity and therefore a shift in demand would not have an impact on their operations or results as the electricity generated would be sold to another customer. Changes in electricity demand in Mexico therefore have no effect on results.

Operational risk

From the perspective of its impact on business results, the main risk arises from combined cycle power plant outages. With regard to these outages, all profit or loss obtained from production is compromised, although the high operating and maintenance standards of the plants and a culture focused on total quality and the reduction of operational risks, allow the impact of this risk to be kept low. Loss of profit from this type of event (material damages or machinery malfunctions) is covered by an insurance policy after a certain deductible level, which is marked by the risk retention level that IBERDROLA can assume, and the insurance conditions that the market offers for risks of these types.

- ***Deregulated business – United States and Canada***

Commodity price risk

IBERDROLA's business in the United States and Canada is geared towards natural gas transport and storage. As a result, the risk assumed mainly arises from fluctuations in the price of natural gas over time. There is no risk arising from the price levels but rather from the difference in the price of natural gas between the period of high prices (winter) and the period of low prices (summer). In the event the difference between both periods is USD 0.35 per MWh, if the aforementioned difference were to fluctuate by 5%, the uncertainty of the results would be EUR ±3 million.

Operational risk

The business's gas storage facilities are exposed to operational risks associated with outages impeding the injection or extraction of gas, gas storage leaks and shifts in geological structures that hinder recovering injected gas.

IBERDROLA mitigates such risk by conforming to the highest standards of predictive and corrective maintenance, and permanently monitoring the geological parameters of the storage facilities. This will enable it to respond quickly to any potential threats that may be identified.

- ***Gas supply operations***

The IBERDROLA Group maintains an adequate balance in the global mix, both in terms of the number of supplier countries and the type of supply (gas via pipelines or GNL), which is demonstrated in that it has five suppliers from different areas (Norway, Nigeria, Algeria and Qatar, among others).

In the Spanish case, gas supply is guaranteed through long-term agreements. The 13% of this mix of agreements is at a fixed price and the remainder is linked to the prices of various fuels on international markets.

Approximately the 25% of long-term gas agreements in the United Kingdom are at a fixed price, while the others are indexed to electricity, gas and other petroleum products on international markets, and to inflation in the UK.

Gas supply in Mexico is secured through long-term agreements with PEMEX and CFE at a price linked to international natural gas prices in the US.

The gas business in the United States and Canada involves natural gas storage, whereby net gas purchases are not necessary over and above the fuel needed for the transfer, injection and extraction thereof. These quantities are small and procured gradually on local gas markets without the existence of long-term supply agreements.

- ***Unhedged energy transactions (discretionary trading)***

Discretionary trading of electricity, gas, emissions allowances and other fuels and associated products performed by some of the Group's businesses is residual and the overall risk thereof is mitigated using individual stop-loss limits, whose total aggregate can never exceed 2% of the consolidated net profit for the period, pursuant to the market risk policy approved by Iberdrola, S.A.'s Board of Directors.

IBERDROLA has reduced discretionary trading in recent years in line with the widespread move away from market speculation. At 31 December 2015, the notional value of derivatives used in speculative trading (calculated in accordance with the criteria set forth in the European Market Infrastructure Regulation (EMIR)) was below EUR 150 million versus EUR 200 million at 31 December 2014.

5.5.5 Other operational risks

During 2015, all of the IBERDROLA Group’s activities, direct or indirect losses may arise as a result of inadequate internal procedures, technical failures, human error or external factors.

Any of these risks could cause damage or destruction to the IBERDROLA Group's facilities, as well as injuries to third parties or damage to the environment, along with the ensuing lawsuits, especially in the event of power outages caused by accidents at our distribution networks and possible penalties imposed by the authorities.

Although many of these risks are unpredictable, the IBERDROLA Group mitigates them by carrying out the necessary investments, implementing operation and maintenance procedures and programmes (supported by quality control systems), planning appropriate employee training, and taking out the required insurance covering both material damages and civil liability.

In relation to the insurance cover, IBERDROLA has international insurance programmes to cover equity (insurance for material damages, machinery breakdowns, loss of profits, damages from natural disasters and risks arising from construction work) and third-party liabilities (general civil liability, liability for environmental risks, professional civil liability, etc.).

However, this insurance does not completely eliminate operational risk, since it is not always possible, or it is not in its interest to pass such risk on to insurance companies and, in addition, cover is always subject to certain limitations.

Specifically, the IBERDROLA Group is also exposed to the following operational risks:

- Risk of malfunctions, explosions, fire, toxic spillages or polluted emissions in gas and electricity distribution networks and generating plants. Risks in connection with cybersecurity. Threats or vulnerabilities concerning data, control systems or Group information and communications systems, and any consequences arising from access to, use, disclosure, deterioration, interruption, unauthorised modification or destruction of information or information systems.
- Risks concerning extreme meteorological conditions and other instances of force majeure.
- Risk of sabotage and/or terrorism.

- ***Risks in connection with nuclear business***

The IBERDROLA Group's nuclear power plants in Spain are also exposed to risks relating to their operations and risks arising from the storage and handling of radioactive materials.

- Constitutional Spanish law caps the liability of nuclear power plant operators in the event of a nuclear accident at EUR 700 million. This liability for a nuclear accident must be compulsorily insured by the operator of Spanish nuclear power plants. The IBERDROLA Group meets this obligation by taking out Nuclear Civil Liability insurance policies for each plant. However, Law 12/2011, of 27 May, concerning civil liability for nuclear damage or damage caused by radioactive materials, will increase the operator's liability ceiling and the consequent ceiling on mandatory insurance to EUR 1,200 million for nuclear power plants. The law will enter into force when all signatories of the Paris and Brussels Agreements ratify the 2004 Amendment Protocols, as established in these agreements.

- Accordingly, it is important to point out the indirect economic risk to which the aforementioned power plants are exposed as a result of a possible serious incident in Spain or in other country could affect the periodic renewals of their compulsory operating licences and the increase in their safety investments.

- ***Operational risk of operations in markets***

Market trading conducted by the Group's various energy trading desks and treasury dealers is also exposed to operational risk due to possible inappropriate processes, technological faults, human error, fraud or any other external or internal event.

This risk in mitigated by following the operational risk policy when trading on the market based on a robust risk control culture, a proper segregation of duties, the publication of clear processes and policies and secure and flexible information systems. This policy sets specific thresholds and guidelines applicable to all trades performed in accordance with the principle of proportionality.

- ***Environmental risks***

IBERDROLA accepts that the environment places constraints on all human activities and is a factor of companies' competitiveness, and it is committed to promoting innovation in this field and also ecoefficiency, to gradually reducing the environmental impact of its activities, facilities, products and services, and striving to ensure that its activities' development is congruent with future generations' legitimate right to an appropriate environment.

The Group undertakes and promotes this commitment through its policies. IBERDROLA currently has three specific policies in order to manage environmental issues: environmental policy, anti-climate change policy and biodiversity policy, which set forth the principles through which the Company will continue to improve its environmental management.

IBERDROLA was also included, for the twelfth consecutive year, on the global Dow Jones Sustainability Index, a worldwide benchmark for recognition of companies' contributions to sustainable development, as well as on other prestigious international sustainability indexes. It is the only utility company to have earned this distinction since the index since was created in 1999.

5.5.6 Legal risks

The IBERDROLA Group companies are part of a certain in-court and out-of-court disputes within the ordinary course of their activities, the final result of which, in general, is uncertain. An adverse result, or an out-of-court resolution thereof or other proceedings in the future could have a material adverse effect on our business, financial situation, operating results and cash flows. However, the Group's legal advisers believe that the outcome of the aforementioned disputes will not have a significant effect.

Note 43 of the Consolidated financial statements contains a more detailed description of the most significant matters regarding "Contingent assets and liabilities".

5.6 Risks materialised during the year

See *Risk management and control systems* of the *2015 Corporate governance report*.

6. SIGNIFICANT SUBSEQUENT EVENTS TO YEAR END

Subsequent events to year end are described in Note 50 of the Consolidated financial statements.

7. RESEARCH AND DEVELOPMENT ACTIVITIES

For the IBERDROLA Group innovation is the most important toll in order to ensure the sustainability, the efficiency and competitiveness. The R&D&I efforts are directed at optimising operating conditions, improving safety, reducing environmental impact and developing technologies which permit future energy challenges to be met. IBERDROLA also opens up new business opportunities in the energy sector through innovation. During 2015, projects related to smart grids, clean energy generation, offshore wind and new technologies and business models are the ones that highlight.

Thanks to the ongoing commitment to innovation, it was recognised as the most innovative Spanish utility company and the fourth most innovative in Europe according to the European Commission.

IBERDROLA Ventures – PERSEO is IBERDROLA's corporate venture capital programme for investing in innovative technologies and business models that guarantee a sustainable energy model. In 2015 the company and CDTI took up a stake in the Basque company Atten2, a spin-off from IK4-Tekniker designing, manufacturing and selling sensors to monitor the status of fluids in industrial applications. On its social investment programme, the company has invested in SunFunder, which funds off-grid solar energy projects in emerging countries in Africa, Latin America and Asia.

As part of a clear strategy, set out in the 2015-2017 Innovation Plan, innovation is IBERDROLA's primary tool to guarantee the Company's sustainability, efficiency and competitiveness, focusing on three main issues:

- Efficiency, geared towards a continuous streamlining of our operations, managing the useful lives of facilities and equipment, cutting operation and maintenance costs, and reducing our environmental footprint with the aim of adapting to an environment which is more and more demanding and strives to improve constantly from the technological, processes and operations point of view. More than 200 R&D&I, all of which are expected to have an effect on business in the short/medium term, are now ongoing thanks to the involvement of all the IBERDROLA Group employees.

- New products and services, in response to customers' needs in an increasingly global and competitive market. These projects deploy existing technology to produce business models offering power supply, facilities and technologies that are increasingly more efficient and environment-friendly such as energy efficiency, electric vehicles, smart grids and distributed energy resources.

- Disruptive business models and technologies that assist us in undertaking the energy challenges ahead. And adapting to the changes that are arising from the electric sector. Through PERSEO, IBERDROLA's corporate venture capital programme, we invest in new disruptive technologies and areas of business focusing on making the energy model sustainable.

Thanks to our human and economic resources allocated to innovation – EUR 3,747 thousand at IBERDROLA and EUR 196,450 thousand at Group level – we are now at the forefront of development of new products, services and business models that are transforming the energy sector.

Some of the most innovative ventures by major area are as follows.

7.1 Renewable energies

In 2015, Innovation activities in Renewables have focused primarily on:

- Improving the efficiency of our operating assets,
- Improving the integration of renewable energies,
- Developing new designs or processes for construction in progress or for future or ongoing projects associated with offshore wind power.

Efficiency improvement in Wind Farms is aimed at reducing operating and maintenance costs and improving production.

The field of energy resources continues with the development of an internal model for the design of wind farms based on fluid dynamics and the use of supercomputers. The works are focused on the parameterization of the orographic conditions and the implementation of a model with forest, which allow a further progress regarding current business models.

The best use of the oils used in the gearbox of wind turbines is being analysed in order to extend its useful life and optimize the maintenance operations.

Among the available tools to manage the exploitation of the wind farms, it is working on the continuous optimization of the production prediction to reduce the deviations from the actual production (Meteoflow). Also it is enhancing the monitoring of the main equipment of the turbines and their yields by an alerts interface and Indicators in order to diagnose anomalies and / or prevent future failures (Diagnosis Matrix). Finally, some tools have been implemented to optimize the scheduling maintenance work and the use of mobile devices for the completion of work orders.

Among the projects to promote the integration of renewable energy highlights Smartwind project, which aim is the implementation of models and simulations for storage use associated to a wind farm in order to provide auxiliary services such as reducing production deviations offered. Newplavol project focuses on photovoltaic storage.

Innovation in offshore wind projects is essential to reduce costs and to limit risks in ongoing and future projects. In Wikinger wind farm it has been realized a validation campaign of the design of the jacket foundation pile (responsible for setting the foundations to the ground) because of the special characteristics of the bottom of the sea with significant improvements achieved. Also it is important to mention the innovative design of the offshore substation for that park on their consistent in its execution in two pieces with limitations of weight and size to be transported. In the MARINEL project alternatives have been analysed for these types of difficulties, such as self-installable substations. Another project of special interest is the replacement of offshore meteorological towers which require costly foundations for their installation by floating stations with an alternative measuring system known as LIDAR (Light Detection and Ranging). Leanwind project’s main objective is to reduce costs over the park´s life and the supply chain by the principles of "lean" application and the development of innovative solutions and tools. The Best Paths project analyses the HVDC (High Voltage Direct Current) multiterminal networks and from different suppliers to see interactions with electric equipment of wind turbines in a scenario in which the offshore wind will be connected to the network.

Finally, initiatives specifically orientated to sustainability such as BRIO project, should be highlighted, which aims to analyse the wind farm after its useful life and the valuation of the high value-added components of the wind turbine blades.

7.2 Clean generation technologies

During 2015, efforts in the area of generation focused on operating efficiency and flexibility, environmental protection, and improved plant safety.

Operating efficiency and flexibility, and improved plant safety: the FILTRACIONES project has been launched to develop a new methodology for efficiently inspecting waterways. In the field of installation safety, the INSROCA, SIRO and ECRIGEN projects drew to a close with the development of experimental prototypes and new methodologies in order to contribute to the structural integrity of generation assets and lengthen their life cycle.

MIGRES and RESONUC were the stand-out nuclear projects. The first involves identifying and developing a new end-to-end process for managing control bars and channels in order to ensure they are more sustainably managed. The RESONUC project focuses on identifying and developing a technological solution for mitigating resonance in critical systems at nuclear facilities, thereby ensuring they perform as well as possible as a significant contributor to nuclear plant safety and reliability.

Environmental: Iberdrola remains firmly committed to reducing the environmental impact of its generating plants, backing an ambitious project entitled CO2FORMARE to find a solution to the problem of macrofouling in the cooling systems of electricity generating plants in a sustainable manner and mitigating the environmental impact both emissions into the atmosphere and the aquatic environment. During 2015, the technical know-how obtained in the COEBEN-II project, conducted at the Velilla del Rio Carrión thermal power plant are being incorporated to the plant in Lada and Longannet in order to adequate them to the environmental requirements which are more and more restrictive, offering an alternative to high cost commercial solutions.

7.3 Commercial Area - New projects and services

Innovation is essential in commercial activity, in order to offer customers the products and services best adapted to their needs. Thus in 2015 IBERDROLA has launched:

- New products such as "*Planes a tu Medida*" (Plans to suit you): a new category of products that lets customers choose the plan best suited to their lifestyles, with no need to make any changes to their consumption habits. To date 7 plans have been created with a range of alternatives: *Contigo Elige 8 horas, Contigo Noche, Contigo Fin de Semana, Plan Estable, Contigo Verano, Contigo Invierno* and *Plan 8.760 horas*.
- New services such as:
    - Smart Solar Iberdrola: comprehensive package that will include the design, assembly and connection of a fully customised solar installation, as well as a finance plan, advice, all-inclusive maintenance, and the possibility to manage and supervise their facilities using web tools and innovative applications. The Company will also be offering all the back-up energy that may be needed. Customers will then be able to generate and consume their own electricity, thereby optimising consumption and improving the energy efficiency of their facilities.

- "*Hogar Inteligente Iberdrola*" or Iberdrola's Smart Home: a product focusing on efficient heating management, consisting of a smart thermostat with an Internet connection, easily programmed and controlled by a mobile phone, enabling our household customers to save up to 37% on their annual heating bills.
- Moreover, IBERDROLA continues working on its initiative in electric mobility, consistent with its strategy in support of sustainable development and its commitment with innovation, developing new recharging services and participating in programmes of R&D&I, financed with community and regional funds, such as Remourban and Azkarga. Also notable is its participation in the European GRID4EU innovation project on smart networks, providing the customers with real-time information on their electricity consumption, together with flexible rates by time periods so that they can manage their consumption more efficiently.

7.4 Smart grids

During 2015, Iberdrola Distribution has continued to increase its efforts in R&D projects, related to smart grids in the Spanish and European field. The Group's R&D activity in the Networks area focuses on optimizing the distribution grid, with an emphasis on worker safety, environmental issues, and the improvement in the quality of supply. In Europe, Iberdrola heads up the UPGRID project through which it intends to strengthen its capability as an integrator of active demand and low-voltage distributed generation. The IGREENGrid and DISCERN projects continue. The former aims to develop precise methodologies for integrating renewable assets into the electricity distribution grid, while the latter is benchmarking the different smart grid solutions and looking for the best combination of architectures and that will put end in 2016. The projects ADVANCED and GRID+ have concluded and the European Commission decided to continue this activity through the new project GRID++ (with EASE), participating through EDSO4SG. In Spain, IBERDROLA finished in 2015 PRICE project aims to cover the needs identified for the development of an intelligent network within a framework of efficiency, safety and sustainability. In the area of overhead line maintenance and normalisation, IBERDROLA leads MATUSALEN to develop a tool for determining the ageing of medium-voltage cables in underground lines and SILECTRIC projects to develop new insulators for high-voltage overhead lines and equipment which will be finished in 2017. TABON project finished at the end of 2015 to develop a line inspection and verification solution.

Along the same lines, projects are underway in UK to drive the development of smart grids. Three mayor projects are currently being developed: ARC project, which aims to speed up the process of connecting renewable assets to the distribution grid; FLEXNET project, in order to develop solutions and technologies which improve and increase network capacity by 20% and VISOR project that implements a monitoring system of transmission network to know the capability and the dynamic performance during the planning and operation. It is important to mention ROAMES project, which objective is to look for optimize the use of LIDAR technology for network management and surrounding vegetation, which allows savings of 20-60% on the cost of deforestation. In Brazil, there are ongoing innovative projects for the inspection of distribution networks like VANTS and ROBÔ; projects for the installation of underground networks in the cities, in order to reduce the impact of air lines and projects to improve protection among others. It is important to mention, ELEKTROBUS project, which aim is to develop a prototype vehicle with an electric propulsion system through ultra-capacitors.

In USA, the INTEGRATED AERIAL DAMAGE ASSESSMENT SYSTEM Project, which objective is to develop an aerial system for evaluating damage to the electricity grid caused by severe storms.

7.5 IBERDROLA Ventures – PERSEO

IBERDROLA Ventures – PERSEO is IBERDROLA's Corporate Venture Capital programme, which has a budget of EUR 70 million for investing in innovative technologies and business models that guarantee a sustainable energy model. Since it was established in 2008, over EUR 50 million has been invested in start-ups which are developing technologies and new businesses in the global energy industry. Through this programme, IBERDROLA offers entrepreneurs, especially in the UK, the US and Spain, its investor support, its expertise, its base of 32 million customers and more than 45 GW of installed capacity. Additionally, it contributes to develop an innovative and dynamic business network in the energy sector.

The programme focuses on several areas of interest including:

- Customer oriented solutions: energy efficiency, active demand management, Green mobility, etc.
- Distributed Energy Resources: generation and storage innovative solutions.
- Renewable energies: technology linked to renewable generation (solar, eolic, offshore), etc.
- New technologies for the O&M of energy infrastructures (robotics, sensors, software, etc.).

The current investment portfolio covers a wide and diverse range of projects under the umbrella IBERDROLA Ventures-Perseus, together with other funding programmes for technology suppliers and projects with a high social component.

The most notable activities in 2015 included:

- An investment together with CDTI within the programme “INNVIERTE” from the basque company Atten2, spin-off of IK4-TEKNIKER and headquartered in the Technology Park in Eibar, Gipuzkoa .The company focuses on designing, manufacturing and marketing of sensors for monitoring the status of fluids, primarily oil, in industrial applications. Its first products, OilHealth and OilWear are sensors with applications in monitoring oil in wind turbines.
- Within the area of social investment, an investment in the company SunFunder which has created a financing platform for financial and corporate investors to participate in a diversified portfolio of solar projects with no connection to the network in emerging countries in Africa, Latin America and Asia. To date, SunFunder has financed projects worth more than USD 5 million benefiting more than 360,000 users.

8 ACQUISITION AND DISPOSAL OF TREASURY SHARES

The Group's treasury share policy establishes the following:

Treasury share transactions are considered those transactions carried out by the Company, whether directly or through any of the Group's companies, the object of which are Company shares, as well as financial instruments or agreements of any type, traded or not in the stock market or other organised secondary markets, which grant the right to acquire from, or the underlying security of which are, Company shares.

Treasury share transactions will always have legitimate purposes, such as, among others, to provide investors with liquidity and sufficient depth in the trading of Company shares, to execute treasury share purchase programmes approved by the Board of Directors or General Shareholders' Meeting resolutions, to fulfil legitimate commitments undertaken in advance or any other acceptable purposes in accordance with applicable regulations. Under no circumstances shall the purpose of the treasury share transaction be to interfere with the free establishment of prices. In particular, any conduct referred to in article 83.ter.1 of the Securities Market Law and article 2 of Royal Decree 1333/2005, of 11 November, implementing the Securities Market Law related to matters of market abuse.

The Group's treasury share transactions will not be carried out, under any circumstances, based on insider information.

Treasury shares will be managed providing full transparency as regards relationships with market supervisors and regulatory organisations.

Note 20 of the Consolidated financial statements presents the movements of IBERDROLA's shares in the Group companies' portfolios in the last years. Likewise, other information on transactions in 2015 and 2014 is presented in the following chart:

Treasury shares	Number of shares	Nominal value (thousands of euros)	Cost (thousands of euros)	Average price (euros)	Total outstanding shares	% shareholding
Balance at 1 December 2013	**34,519,418**	**25,890**	**137,559**	3.98	**6,239,975,000**	**0.55**
Acquisitions	176,365,850	132,274	896,183	5.08		
Disposals	(16,432,991)	(12,325)	(82,842)	5.04		
Redemption	(133,467,000)	(100,100)	(616,886)	4.62		
Balance at 31 December 2014	**60,985,277**	**45,739**	**334,014**	5.48	**6,388,483,000**	**0.95**
Acquisitions	162,118,086	121,589	938,283	5.79		
Disposals	(148,483,000)	(111,362)	(827,884)	5.58		
Redemption	(6,984,197)	(5,238)	(38,955)	5.58		
Balance at 31 December 2015	**67,636,166**	**50,728**	**405,458**	5.99	**6,336,870,000**	**1.07**

Treasury shares of Scottish Power	Number of shares	Nominal value (thousands of euros)	Cost (thousands of euros)	Average Price (euros)	Total outstanding shares	% shareholding
Balance at 1 December 2013	**2,191,332**	**1,643**	**12,472**	5.69	**6,239,975,000**	**0.04**
Acquisitions	503,448	378	2,688	5.34		
Scrip	89,616	67	-	-		
Redemption	(787,974)	(591)	(3,455)	4.38		
Balance at 31 December 2014	**1,996,422**	**1,497**	**11,705**	5.86	**6,388,483,000**	**0.03**
Acquisitions	438,580	329	2,759	6.29		
Scrip	66,375	50	-	-		
Redemption	(862,814)	(647)	(4,301)	4.98		
Balance at 31 December 2015	**1,638,563**	**1,229**	**10,163**	6.20	**6,336,870,000**	**0.03**

In 2015 and 2014, treasury shares held by the IBERDROLA Group were below the legal limit established.

Lastly, the conditions and time periods of the current mandate of the Board of Directors to acquire or transfer treasury shares are detailed below.

At the General Shareholders' Meeting on 26 March 2010, shareholders expressly agreed to delegate powers to the Board of Directors, with powers of substitution, pursuant to the provisions of the Spanish Corporations Law, to carry out derivative acquisition of shares in Iberdrola, S.A. under the following conditions:

a) Acquisitions may be made directly by IBERDROLA or indirectly through its subsidiaries. The process excludes any subsidiaries carrying out regulated business pursuant to the provisions of the Electricity Sector Law and the Hydrocarbons Law.

b) Acquisitions may be made by purchase transactions, swaps or any other form permitted by law.

c) Acquisitions may be made up to the maximum legal threshold (i.e. 10% of share capital).

d) Such acquisitions may not be made at a price higher than the market price or lower than the nominal value of the share.

e) Authorisation was granted for a maximum period of five years since approval of the resolution.

f) A restricted reserve shall be created in equity in the purchasing company equivalent to the value of the parent's shares under assets. This reserve must be maintained as long as the shares are not disposed of or cancelled in accordance with the Spanish Corporations Law.

Shares acquired under these powers can be transferred or cancelled or used for the compensation systems as provided for in the Spanish Corporations Law. They may also be used to develop programmes that encourage participation in the Company's share capital such as the dividend reinvestment plan, loyalty bonuses and other similar instruments.

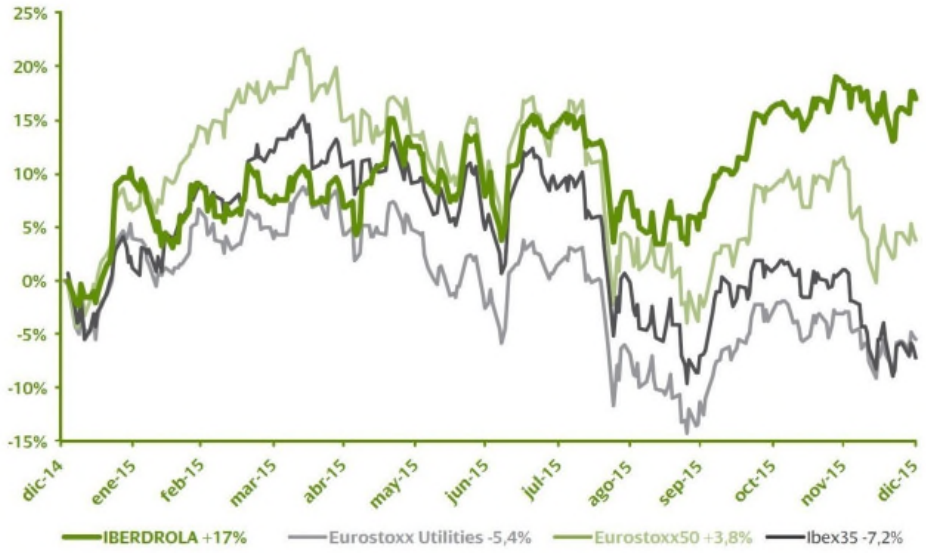
- **Stock market data**

		2015	2014
Stock market capitalisation (*)	Millions of euros	41,506	35,756
Earnings per share	Euros	0.381	0.359
P.E.R. (share price at year end/profit per share)	Times	17.19	15.59
Price / Carrying amount (capitalisation on carrying amount at year end)	Times	1.12	1.02

(*) 6,336,870,000 shares at 12/31/2015 and 6,388,483,000 shares at 12/31/2014

- **The IBERDROLA share**

Stock market performance of IBERDROLA compared to the indexes:



	2015	2014
Number of shares outstanding	6,336,870,000	6,388,483,000
Share price at year end	6.550	5.597
Average share price for the year	6.12	5.27
Average daily volume	31,140,116	39,916,924
Maximum volume (06/26/2015 – 04/10/2014)	90,216,773	422,630,657
Minimum volume (12/24/2014 – 12/24/2014)	4,571,334	8,042,962
Dividends paid (euros)	0.276	0.275
- Gross interim dividend (12/19/2014 – 01/30/2014)[(1)]	0.127	0.126
- Gross complementary dividend (07/03 y 07/22/2015 - 07/03 y 07/22/2014)[(2)]	0.144	0.144
Attendance bonus	0.005	0.005
Dividend yield [(3)]	4.21%	4.91%

[(1)] Purchase price of rights guaranteed by IBERDROLA.

[(2)] Complementary dividend in cash (07/03/2015 and 07/03/2014 = EUR 0.03 and purchase price of rights guaranteed by IBERDROLA: 07/22/2015 and 07/22/14 = EUR 0.114).

[(3)] Interim dividend, complementary dividend and attendance bonus for attending the General Shareholders' Meeting/share price at period end (not including the purchase price of rights guaranteed by IBERDROLA over the 2014 interim dividend paid on 12/19/2014 of EUR 0.127 per share gross.

9 FURTHER RELEVANT INFORMATION

9.1 Environmental issues and sustainability

9.1.1 Environmental issues

IBERDROLA accepts that the environment places constraints on all human activities and is a factor of companies' competitiveness, and it is committed to promoting innovation in this field and also eco-efficiency, to gradually reducing the environmental impact of its activities, facilities, products and services, and striving to ensure that its activities are congruent with future generations' legitimate right to an appropriate environment.

The Group undertakes and promotes this commitment through its policies, IBERDROLA currently has three specific policies in place to manage environmental issues: its environmental policy, its anti-climate change policy and its biodiversity policy, which set forth the principles through which the Company will continue to improve its environmental management.

Moreover, for the thirteenth consecutive year IBERDROLA featured on the global Dow Jones Sustainability Index, a worldwide benchmark for recognising corporate contributions to sustainable development, and also on other internationally renowned sustainability indexes. It is the only utility to have earned this distinction since the Index was created in 1999.

9.1.2 Sustainability

IBERDROLA's contribution to sustainable development takes form in certain social responsibility practices which address the needs and expectations of their stakeholders, with which the Company maintains a series of lines of communication and dialogue open through which it is able to: communicate objectives, initiatives and achievements obtained in the three areas of sustainable development (economic, environmental and social) and receive evaluations and requests from the interested parties.

Sustainability indicators	**2015**	**2014**
Contribution to GDP (Gross Margin) (*)	0.55%	0.57%
Contribution to GDP (Revenue) (*)	1.39%	1.42%
Net profit (millions of euros)	2,422	2,327
CO_2 Emissions in the period (gr. CO_2/kWh): Total	225	212
CO_2 Emissions in the period (gr. CO_2/kWh): Spain	103	58
CO_2 Emissions in the period (gr. CO_2/kWh): SPW	530	596
Total production free of emissions (GWh)	67,868	75,585
Production in Spain free of emissions (GWh)	46,658	54,655
Production free of emissions out of total production (%)	52%	57%
Production in Spain free of emissions out of total production (%)	86%	91%
Total installed capacity free of emissions (MW)	27,744	26,702
Total installed capacity in Spain free of emissions (MW)	18,741	17,838
Total installed capacity free of emissions (%)	62%	62%
Total installed capacity in Spain free of emissions (%)	73%	72%
Specific SO_2 emission Global mix (g/kWh)	0.125	0.154
Specific particles emission Global mix (g/kWh)	0.011	0.011
Specific NOx emission Global mix (g/kWh)	0.230	0.236

(*) Source: IBERDROLA's results and Quarterly Spanish National Accounting - Spanish National Institute of Statistics – INE (Database 2010, Last data published 3Q 2015).

9.2 Iberdrola Foundation

In 2015, the Group allocated EUR 11,645 thousand to financing the various foundations (EUR 8,406 thousand to Group foundations and EUR 3,239 thousand to associations and entities whose goals are in the interest of the general public).

The main recipient of the funding was Iberdrola Foundation, which received EUR 6,169 thousand. Information on its goals and activities is available at: www.fundacioniberdrola.org. Iberdrola Foundation is a private, non-profit, cultural foundation, founded by the Company. Its mission is to develop initiatives which effectively contribute to improving the quality of life of the people in the regions and countries where the Group acts, especially in the areas of energy sustainability, art and culture, as well as solidarity and social initiatives. The foundation may act independently to achieve its goals and is fully functional and autonomous. Without prejudice to its collaboration with other entities, Iberdrola Foundation coordinates and executes the Group's corporate social responsibility strategy, so that it is in line with the purpose for which it was created and as assigned thereto by the Board of Directors.

Iberdrola Foundation coordinates its welfare work in the United Kingdom through the Scottish Power Foundation, which was granted EUR 1,022 thousand. In the United States, this work is carried out through the Avangrid Foundation with a budget of EUR 919 thousand, and in Brazil through the Instituto Iberdrola Brasil, receiving EUR 296 thousand.

In 2016, the Group intends to follow a policy aimed at financing activities of interest to the general public in line with that followed in 2015 as regards amount and allocation.