

**GAS NATURAL FENOSA**



## **Consolidated Directors' Report**

## **1. Business performance**

### **2010 Analysis**

Net profit amounted to €1,201 million in 2010, an increase of 0.5% with respect to last year. The additional provision allocated for risks arising from the dispute with Sonatrach impacted the year's earnings, which were supported nevertheless by the incipient recovery in energy demand in Spain, the growing contribution from the company's international businesses, and the income from the disposal of gas distribution assets in the Madrid region.

The provision booked according to the best estimate made based on the, information available on the evolution of the litigation with Sonatrach, the negotiations underway, and the amounts to be passed on, and adequately covers the risks described, both for the retroactive period and for the additional period until 31 December 2010.

GAS NATURAL FENOSA has appealed the ruling on its dispute with Sonatrach before the Federal Swiss Court, which granted precautionary measures including the suspension of execution until the Court can decide on the appeal filed by GAS NATURAL FENOSA.

Consolidated EBITDA amounted to €4,477 million, an increase of 14.1% with respect to last year, mainly as a result of the fact that Unión Fenosa was not fully consolidated until 30 April 2009. EBITDA was able to offset the additional provision for risks related to the dispute with Sonatrach and was supported by the growth in earnings from regulated activities, which were boosted by the growing contribution from those activities outside Spain and by improved operating efficiency. It is also worth noting the management of the global energy supply portfolio, against a backdrop of significant volatility, which stabilised its contribution to earnings.

The results obtained in this context highlight the fundamental value of GAS NATURAL FENOSA's business model, which is based on an appropriate balance of regulated and liberalised gas and electricity businesses, including a growing, diversified international presence.

The expanding contribution from GAS NATURAL FENOSA's international activity, primarily through regulated or quasi-regulated activities in Latin America, evidences the robustness of the business model, contributing to 28.8% of EBITDA.

The company's expeditious divestment of assets which are either non-strategic or whose sale was agreed with Spain's National Competition Commission (CNC) is enabling the company to gradually normalise its leverage (59.6% at 31 December 2010).

## Main financial aggregates

	2010	2009	%
Net sales	19,630	14,873	32.0
EBITDA	4,477	3,923	14.1
Operating income	2,893	2,445	18.3
Net income attributable to parent Company	1,201	1,195	0.5
Investments	1,553	15,243	-
Net financial debt (at 31/12)	19,102	20,916	(8.7)

## Main physical aggregates

### Gas and electricity distribution:

	2010	2009	%
Gas distribution (GWh):	411,556	402,692	2.2
Europe:	210,561	233,080	(9.7)
Tariff gas sales	2,741	3,000	(8.6)
TPA (third parties access)	207,820	230,080	(9.7)
Latin America:	200,995	169,612	18.5
Tariff gas sales	128,141	107,197	19.5
TPA	72,854	62,415	16.7
Electricity distribution (GWh):	54,833	34,973	56.8
Europa:	36,831	22,919	60.7
Tariff gas sales	2,372	3,521	(32.6)
TPA	34,459	19,398	77.6
Latin America:	18,002	12,054	49.3
Tariff gas sales	16,979	11,314	50.1
TPA	1,023	740	38.2
Gas distribution conexions, ('000) (at 31/12):	11,361	11,534	(1.5)
Europe	5,696	6,112	(6.8)
Latin America	5,665	5,422	4.5
Electricity distribution connections ('000) (at 31/12):	9,436	9,144	3.2
Europe	4,535	4,505	0.7
Latin America	4,901	4,639	5.6
ICEIT (installed capacity equivalent interrupt time) (minutes)	61	59	3.4

## Energy businesses:

	2010	2009	%
Electricity generated (GWh):	58,130	52,553	10.6
Spain:	38,338	28,728	33.5
Hydroelectric	4,752	1,849	157.0
Nuclear	4,325	2,908	48.7
Coal	772	741	4.2
Oil/gas	32	4	700.0
CCGT (Combined cycle gas turbine)	25,928	21,192	22.3
Renewables	2,529	2,034	24.3
International:	19,792	23,825	(16.9)
Hydroelectric	132	61	116.4
CCGT	17,985	22,638	(20.6)
Oil-fired	1,675	1,126	48.8
Installed capacity (MW):	17,254	17,810	(3.1)
Spain:	14,637	13,410	9.1
Hydroelectric	1,860	1,860	-
Nuclear	589	589	-
Coal	2,048	2,048	-
Oil/gas	617	617	-
CCGT	8,565	7,322	17.0
Renewables	958	974	(1.6)
International:	2,617	4,400	(40.5)
Hydroelectric	33	33	-
CCGT	2,274	4,057	(43.9)
Oil-fired	310	310	-
Gas supply (GWh):	305,704	286,152	6.8
Spain	250,885	234,230	7.1
Rest	54,819	51,922	5.6
UF Gas <sup>(1)</sup> :			
Gas supply in Spain (GWh)	59,518	34,854	70.8
Rest (GWh)	27,774	10,785	157.5
Gas transportation – EMPL (GWh)	109,792	109,230	0.5

## Analysis of consolidated earnings

The acquisition of UNION FENOSA and its full consolidation in the consolidated net income from 30 April 2009 has given rise to significant variations against last year and does not permit a appropriate analysis of the business of GAS NATURAL FENOSA.

(1) Aggregates at 100%.

## **Net sales**

	2010	%s/total	2009	%s/total	% 2010/2009
Gas distribution	4,154	21.2	3,502	23.5	18.6
<i>Spain</i>	1,299	6.6	1,360	9.1	(4.5)
<i>Latin America</i>	2,645	13.5	1,959	13.2	35.0
<i>Rest</i>	210	1.1	183	1.2	14.8
Electricity distribution	3,272	16.7	1,863	12.5	76.5
<i>Spain</i>	884	4.5	523	3.5	69.0
<i>Latin America</i>	2,200	11.2	1,231	8.3	78.7
<i>Rest</i>	188	1.0	109	0.7	72.5
Electricity	6,470	33.0	4,447	29.9	45.5
<i>Spain</i>	5,420	27.6	3,476	23.4	55.9
<i>Latin America</i>	954	4.9	929	6.2	2.7
<i>Rest</i>	96	0.5	42	0.3	128.6
Gas	8,791	44.8	7,477	50.3	17.6
<i>Infrastructure</i>	264	1.3	276	1.9	(4.3)
<i>Supply and commercialisation</i>	7,678	39.1	6,853	46.1	12.0
<i>UF Gas</i>	849	4.3	348	2.3	144.0
Other activities	584	3.0	425	2.9	37.4
Consolidation adjustments	(3,641)	(18.5)	(2,841)	(19.1)	28.2
<b>Total</b>	<b>19,630</b>	<b>100.0</b>	<b>14,873</b>	<b>100.0</b>	<b>32.0</b>

Net turnover for 2010 totals Euros 19,630 million, an increase of 32.0% against last year, mainly as a result of the addition of UNION FENOSA as from 30 April 2009 last year and from 1 January 2010 this year.

## **EBITDA <sup>(1)</sup>**

	2010	%s/total	2009	%s/total	% 2010/2009
Gas distribution	1,620	36.2	1,485	37.9	9.1
<i>Spain</i>	915	20.4	927	23.6	(1.3)
<i>Latin America</i>	635	14.2	510	13.0	24.5
<i>Others</i>	70	1.6	48	1.2	45.8
Electricity distribution	1,062	23.7	637	16.2	66.7
<i>Spain</i>	645	14.4	385	9.8	67.5
<i>Latin America</i>	390	8.7	236	6.0	65.3
<i>Others</i>	27	0.6	16	0.4	68.8
Electricity	1,252	28.0	1,052	26.8	19.0
<i>Spain</i>	974	21.8	806	20.5	20.8
<i>Latin America</i>	263	5.9	242	6.2	8.7
<i>Others</i>	15	0.3	4	0.1	-
Gas	472	10.5	699	17.8	(32.5)
<i>Infrastructures</i>	191	4.3	181	4.6	5.5
<i>Supply and commercialisation</i>	57	1.3	396	10.1	(85.6)
<i>UF Gas</i>	224	5.0	122	3.1	83.6
Other activities	71	1.6	50	1.3	42.0
<b>Total</b>	<b>4,477</b>	<b>100.0</b>	<b>3,923</b>	<b>100.0</b>	<b>14.1</b>

(1) EBITDA = Operating profit + Depreciation + Operating provisions - Other income

Consolidated EBITDA for 2010 has totalled Euros 4,477 million, an increase of 14.1% against last year, mainly due to the addition of UNION FENOSA in a full year compared with last year.

The gas and electricity distribution activities in Spain and internationally represent 59.9% of the EBITDA of GAS NATURAL FENOSA.

The greatest contribution relates to the electricity activity in Spain, which accounts for 21.8% of consolidated EBITDA.

Other income includes the net gains from the divestments for the year, basically the sale of gas distribution points in the Region of Madrid.

### **Operating income**

	2010	%s/total	2009	%s/total	% 2010/2009
Gas distribution:	1,184	40.9	1,047	42.8	13.1
<i>Spain</i>	626	21.6	615	25.2	1.8
<i>Latin America</i>	516	17.8	407	16.6	26.8
<i>Other</i>	42	1.5	25	1.0	68.0
Electricity distribution:	618	21.4	399	16.3	54.9
<i>Spain</i>	420	14.5	262	10.7	60.3
<i>Latin America</i>	177	6.1	125	5.1	41.6
<i>Other</i>	21	0.7	12	0.5	75.0
Electricity	550	19.0	512	20.9	7.4
<i>Spain</i>	387	13.4	432	17.7	(10.4)
<i>Latin America</i>	154	5.3	78	3.2	97.4
<i>Other</i>	9	0.3	2	0.1	350.0
Gas	231	8.0	524	21.4	(55.9)
<i>Infrastructures</i>	141	4.9	133	5.4	6.0
<i>Supply and commercialisation</i>	12	0.4	339	13.9	(96.5)
<i>UF Gas</i>	78	2.7	52	2.1	50.0
Other activities	310	10.7	(37)	(1.5)	-
<b>Total</b>	<b>2,893</b>	<b>100.0</b>	<b>2,445</b>	<b>100.0</b>	<b>18.3</b>

The depreciation allowances have increased by 23.5% while provisions have increased from Euros 139 million to Euros 238 million, and, accordingly, operating profit totals Euros 2,893 million, an increase of 18.3%.

### **Financial results**

The cost of financial debt in 2010 was €924 million, i.e. higher than in 2009 due to the increase in average gross debt as a result of the debt taken on for the acquisition of UNION FENOSA and of consolidating that company and its subsidiaries.

The 2010 figure includes €103 million corresponding to the recognition in the consolidated income statement of the fees on the loan for the UNION FENOSA acquisition, which were pending recognition in the income statement, due to the cancellation of that debt. This item totalled €42 million in 2009.

Income from financial asset disposals in the current year corresponds to the sale of 5% of Indra Sistemas and the 35% stake in Gas Aragón, whereas in 2009 that item corresponded to the sale of the company's 5% stake in Enagás.

### **Results of entities accounted for using the equity method**

Income from holdings in entities accounted for using the equity method amounted to €5 million in 2010, compared with €59 million in 2009. This item includes €46 million contribution from UNION FENOSA while it was equity-accounted from 28 February 2009 to 30 April 2009.

### **Corporate Income tax**

GAS NATURAL FENOSA is taxed in Spain under the consolidated taxation system, in which the tax group is viewed as the taxpayer and its tax base is determined by aggregating the tax bases of its component companies. On 1 September 2009, as a result of the registration of the merger with Unión Fenosa, S.A. and Unión Fenosa Generación, S.A. in the Mercantile Register, the Unión Fenosa Tax Group ceased to exist and its component companies joined the Gas Natural Tax Group. The merger adopted the special tax-neutral regime established under Chapter VIII of Title VII of the Consolidated Text of the Corporate Income Tax Law.

The other Spanish-resident companies that are not part of the tax group file individual returns, and those not resident in Spain are taxed in their respective countries; the tax rate on company income (or the equivalent tax) that is in force is applied to income for the period.

The effective tax rate in 2010 was 24.9%. The difference between the theoretical tax rate and the effective tax rate was due to tax credits from reinvestment of extraordinary gains on the sale of gas distribution assets in the Madrid region, in compliance with competition rules, and to the application of different tax systems to companies operating outside Spain.

The effective tax rate for 2009 was 24.6%, due to tax deductions on the reinvestment of extraordinary gains on the sale of the 5% stake in Enagás, in compliance with competition rules, the application of different tax systems to companies operating outside Spain and the effect of net income from equity-accounted affiliates.

### **Minority interest**

The main items in this account are the minority shareholders of EMPL, the subgroup of subsidiaries in Gas Natural ESP (Colombia), gas distribution companies in Brazil, Electricidad Chiriqui and Electricidad Metro Oeste (Panama) and Kangra Coal (South Africa).

Income attributed to minority interest in 2010 amounted to €214 million, €19 million more than in the previous year.

### **Investments**

The breakdown of investments by type is as follows:

	2010	2009	%
Investments in Property, plant and equipment	1,394	1,721	-19.0
Investments in intangible assets	149	152	-2.0
Financial investments	10	13,370	-
<b>Total investments</b>	<b>1,553</b>	<b>15,243</b>	<b>-</b>

Due to IFRIC 12 adoption, investments in Argentina, Brazil and Italy are recorded as intangible assets.

Capital expenditure (intangible assets and property, plant and equipment) amounted to €1,543 million, 17.6% less than in 2009, due primarily to the completion of Combined cycle gas turbines (CCGT) construction.

Financial investments in 2009 amounted to €13,370 million, due basically to the acquisition of 80.5% of UNION FENOSA.

The breakdown of capital expenditure by line of business is as follows:

	2010	2009	%
Gas distribution:	367	498	(26.3)
Spain	221	358	(38.3)
Latin America	108	105	2.9
Other	38	35	8.6
Electricity distribution:	466	323	44.3
Spain	313	236	32.6
Latin America	137	78	75.6
Other	16	9	77.8
Electricity:	512	779	(34.3)
Spain	361	620	(41.8)
Latin America	149	146	2.1
Other	2	13	(84.6)
Gas:	67	176	(61.9)
Infrastructures	22	143	(84.6)
Procurement & supply	19	18	5.6
UF Gas	26	15	73.3
Other activities	131	97	35.1
<b>Total capital expenditure</b>	<b>1,543</b>	<b>1,873</b>	<b>(17.6)</b>

GAS NATURAL FENOSA allocated 23.4% of capital expenditure to the electricity business in Spain and 21.3% to electricity distribution in Spain.

The main investment projects in 2010 include the completion of the combined cycle plants in Malaga and the Barcelona Harbour and the roll out of wind farm projects.

A total of 14.3% of capital expenditure was allocated to gas distribution in Spain, which will enable the company to sustain a rapid pace of growth in distribution connections despite the economic slowdown in Spain.

### **Analysis of results by activity**

The acquisition of UNION FENOSA and its full consolidation in consolidated net income from 30 April 2009 gives rise to significant variations compared to last year.

### **Gas distribution in Spain**

This area includes regulated gas distribution, third-party access and secondary transportation, as well as the distribution activities that are charged for outside the regulated remuneration (meter rentals, customer connections, etc.) in Spain.

### **Results**

	2010	2009	%
Net sales	1,299	1,360	(4.5)
Purchases	(18)	(49)	(63.3)
Personnel costs, net	(67)	(62)	8.1
Other expense/income	(299)	(322)	(7.1)
<b>EBITDA</b>	<b>915</b>	<b>927</b>	<b>(1.3)</b>
Depreciation and amortisation	(289)	(315)	(8.3)
Change in operating provisions	-	3	-
<b>Operating income</b>	<b>626</b>	<b>615</b>	<b>1.8</b>



Net sales in the gas distribution business in Spain totalled €1,299 million, 4.5% more than in the same period of 2009. This is mainly caused by the sales of gas distribution assets in December 2009 in Cantabria, Murcia, Asturias and Basque Country and the sale of gas distribution assets in Madrid Region in April 2010. If this effect would have not been considered, net sales would have increased by 3.3%

EBITDA in 2010 amounted to €915 million, €12 million less than in 2009 due to the sale of the aforementioned assets with an impact on EBITDA of €67 million. If this effect would have not been considered, EBITDA would have increased by €55 million, mainly due to increase in regulated retribution.

### Main aggregates

The main aggregates in gas distribution in Spain were as follows:

	2010	2009	%
Gas TPA sales (GWh)	207,174	229,585	(9.8)
Distribution network (Km)	44,931	47,597	(5.6)
Change in connections points ('000)	84	101	(16.8)
Connection points (at 31/12)	5,274	5,698	(7.4)

Sales in the regulated gas business in Spain, which includes TPA services and secondary transportation, totalled 207,174 GWh, a 9.8% decrease year-on-year. This decrease was due basically to the sale of gas distribution assets in Cantabria, Murcia, Asturias, Basque Country and Madrid. If these sales are not considered, sales increase by 3.9% due to growth in residential consumption, driven by cold weather conditions, and a slight recovery in industrial consumption.

GAS NATURAL FENOSA continues to expand its distribution network, having added 1,152 km. in the last twelve months and connected another 33 municipalities in 2010. A total of 84,000 distribution connections were added in 2010, i.e. 16.8% less than in the same period of 2009, basically because of the impact of the economic crisis, although a recovery is visible in the fourth quarter of 2010. Both effects, not considering the aforementioned divestitures.

At 2010 year-end, the gas distribution grid measured 44,931 km., having decreased by 5.6%, and there were a total of 5,274,000 distribution connections, i.e. an decrease of 7.4%.

GAS NATURAL FENOSA has complied with the commitments to divest certain gas distribution assets under the plan of action approved by the National Competition Commission (CNC) in connection with the acquisition of UNION FENOSA.

On 31 December 2009, the company completed the sale of the low-pressure gas distribution assets in the Autonomous Regions of Cantabria (Gas Natural Cantabria, SDG) and Murcia (Gas Natural Murcia SDG), which represent 2,611 km of low-pressure distribution network, 256,000 distribution connections, and 3,500 GWh of gas per year; the bulk of the high-pressure distribution networks in the Principality of Asturias, Cantabria and the Basque Country (489 km, which carry 7,500 GWh of gas per year); and the business of supplying gas, electricity and services to households and SMEs in those regions (approximately 210,000 gas customers, 4,000 electricity customers and 67,000 energy service contracts).

On 31 March 2010, the distribution assets in the municipalities of the Madrid region were spun off into a company called Madrileña Red de Gas, in accordance with the plan approved by the National Competition Commission regarding the UNION FENOSA acquisition. On 30 April 2010, the company completed the sale of low-pressure gas distribution assets in 38 municipalities in the Madrid region, i.e. 507,726 distribution points and 3,491 km of low-pressure distribution networks.

On 29 December 2010, Spain's Ministry of Industry issued Order ITC/3354/2010, which established the tolls and fees for third-party access to gas installations in 2011 and updated certain aspects of the remuneration for regulated gas activities. The order maintained the system for calculating the distribution remuneration as amended the previous year, updating the remuneration for 2011 in accordance with the actual IPH index for 2009. The initial remuneration recognised for GAS NATURAL FENOSA in 2011 is €1,098 million.

The remuneration recognised for secondary transportation in 2011 amounts to €31 million.

### **Gas distribution in Latin America**

This division involves gas distribution in Argentina, Brazil, Colombia and Mexico.

	2010	2009	%
Net sales	2,645	1,959	35.0
Purchases	(1,748)	(1,217)	43.6
Personnel costs, net	(81)	(67)	20.9
Other expense/income	(181)	(165)	9.7
<b>EBITDA</b>	<b>635</b>	<b>510</b>	<b>24.5</b>
Depreciation and amortization	(112)	(92)	21.7
Change in operating provisions	(7)	(11)	(36.4)
<b>Operating profit</b>	<b>516</b>	<b>407</b>	<b>26.8</b>

Gas distribution results in Latin America improved in 2010 due to good business performance and favourable currency performance.

Net sales amounted to €2,645 million, a 35.0% increase due to higher sales and to currency fluctuations.

EBITDA amounted to €635 million, 24.5% more than in the same period in 2009, boosted by appreciation of local currencies (+13.5% on average). If currencies appreciation is not considered, EBITDA increases 6.6%.

Brazil and Colombia's contributions were particularly noteworthy: together they accounted for 79.2% of EBITDA.

### **Main aggregates**

The main physical aggregates in gas distribution in Latin America are as follows:

	2010	2009	%
Gas activity sales (GWh):	200,995	169,612	18.5

Tariff gas sales	128,141	107,197	19.5
TPA	72,854	62,415	16.7
Distribution network (Km)	64,492	62,315	3.5
Change in connections points ('000)	243	169	43.8
Connection points (000) (at 31/12)	5,665	5,422	4.5

The key physical aggregates by country in 2010 are as follows:

	Argentina	Brazil	Colombia	Mexico	Total
Gas activity sales (GWh)	74,621	64,212	16,160	46,002	200,995
Change vs. 2009 (%)	9.7	50.5	0.5	7.4	18.5
Distribution network	23,005	6,006	19,010	16,471	64,492
Change vs. 31/12/2009 (km)	269	74	1,559	275	2,177
Connections points ('000 at 31/12)	1,458	817	2,183	1,207	5,665
Change vs. 31/12/2009 ('000)	33	15	152	43	243

There were a total of 5,665,000 gas distribution connections in 2010. High year-on-year growth rates were maintained, and the number of distribution connections increased by 243,000; notably, Colombia added 152,000 distribution connections and exceeded 2 million customers due to a faster rate of customer acquisition in Bogotá and the Altiplano Cundiboyacense area.

Sales in the gas activity in Latin America, which include both gas sales and TPA services, totalled 200,995 GWh, an 18.5% increase with respect to the previous year, basically in the industrial sector and in supply to power plants in Brazil.

The distribution grid expanded by 2,177 km (+3.5%) in the last 12 months, to 64,492 km at the end of December 2010.

Highlights of activities in Latin America:

- In Argentina, negotiations with the government on the application of the new tariff framework are continuing.
- Sales to industry and power generation in Brazil increased (in the latter case, because of demand driven by intense heat in the south-east and south of the country).
- The number of vehicles in Colombia fitted to burn LNG increased by 5.5%, from 117,872 in December 2009 to 124,301 in December 2010. Gas Nacer, a gas distribution company present in 22 municipalities and with 50,000 customers, has been incorporated to consolidation scope in 2009
- On 8 February 2010, Comercializadora Metrogas (the distribution company in Mexico City) published the authorised tariffs in the Official Gazette of the Federation, which include a 30.5% increase in the third five-year period, effective 15 February 2010.

Also, on that same date, the Mexican government issued permission for all of Gas Natural Mexico's distribution companies to recover the gas hedging price via the distribution tariff, i.e. an additional 11% of the distribution tariff; for the distribution companies in Monterrey, Nuevo Laredo, Saltillo and Toluca, recovery of operating losses amounts to an additional 4% of the distribution tariff.

### **Gas distribution Other (Italy)**

The business in Italy also includes gas sales at the regulated tariff.

### **Results**

	2010	2009	%
Net sales	210	183	14.8
Purchases	(103)	(96)	7.3
Personnel costs, net	(15)	(15)	-
Other expenses/income	(22)	(24)	(8.3)
<b>EBITDA</b>	<b>70</b>	<b>48</b>	<b>45.8</b>
Depreciation and amortization	(22)	(21)	4.8
Change in operating provisions	(6)	(2)	200.0
<b>Operating income</b>	<b>42</b>	<b>25</b>	<b>68.0</b>

Gas distribution in Italy contributed €70 million in EBITDA, i.e. 45.8% more than in 2009.

The greater contribution to EBITDA is due to remuneration from regulated gas distribution which amounts to €19 million, which includes €3 million from 2009, in accordance with the regulator's resolution of November 2010.

On 28 December 2010, Gas Natural Distribuzione Italia acquired assets in the Sapri and Camerota municipalities via wholly-owned company Cilento Reti Gas Srl, commencing the Cilento project in the Campania region in southwest Italy. The project covers 29 municipalities with potential for 50,000 distribution connections.

In the last quarter of 2010, GAS NATURAL FENOSA was supplying gas in Italy under contract, and two shiploads of LNG (880 GWh) were regasified at the Panigaglia plant.

### **Main aggregates**

	2010	2009	%
Gas activity sales (GWh):	3,387	3,495	(3.1)
Tariff gas sales	2,741	2,974	(7.8)
TPA	646	521	24.0
Distribution network (km)	5,849	5,645	3.6
Connections points ('000) (at 31/12)	422	414	1.9

GAS NATURAL FENOSA in Italia now has 422,000 supply points in the gas distribution business, an increase against 31 December 2009 of 1.9%.

A total of 3,387 GWh of gas were distributed, i.e. 3.1% less than in 2009, mainly as a result of different weather conditions.

The gas distribution network expanded 204 km to 5,849 km at 31 December 2010.

### **Electricity distribution in Spain**

The electricity distribution business in Spain includes regulated distribution of electricity and network services for customers, basically connections and hook-ups, metering and other actions associated with third-party access to GAS NATURAL FENOSA's distribution network.

The bundled electricity tariff was abolished and the "last-resort" supply companies were designated on 1 July 2009; as a result, the distribution business ceased selling electricity in Spain on that date.

### **Results**

	2010	2009	%
Net sales	884	523	69.0
Purchases	-	-	-
Personnel costs, net	(108)	(71)	52.1
Other expenses/ income	(131)	(67)	95.5
<b>EBITDA</b>	<b>645</b>	<b>385</b>	<b>67.5</b>
Depreciation and amortization	(213)	(118)	80.5
Change in operating provisions	(12)	(5)	140.0
<b>Beneficios de explotación</b>	<b>420</b>	<b>262</b>	<b>60.3</b>

On 29 December 2010, Ministerial Order ITC/3353/2010 was published in the Official State Gazette, establishing tolls for third-party access as from 1 January 2011 and tariffs and premiums for special regime facilities.

The Order includes the definitive values for distribution remuneration for 2009 and 2010, which had been considered provisional to date. It also establishes the provisional remuneration for 2011. Specifically, the initial remuneration recognised for GAS NATURAL FENOSA in 2011 is €837 million for distribution and €51 million for transportation.

The revision entails booking, in 2010, the updated remuneration for 2009, which was approximately €35 million more than the amount initially booked. This, together with improvements in efficiency in the regulated business, provided EBITDA of €645 million, i.e. +67.5% with respect to 2009 and 11.8% in homogeneous terms.

A comparison of net turnover against last year is conditioned by the fact that 2009 only included the months from May to December, as opposed to the twelve months in 2010.

### **Main aggregates**

	2010	2009	%
Electric activity sales (GWh):	34,465	21,435	60.8
Tariff electricity sales	6	2,037	(99.7)
TPA	34,459	19,398	77.6
Connection points (000) (at 31/12)	3,719	3,698	0.6
ICEIT (minutes)	61	59	3.4

The company reached a record in 2009 in terms of quality of supply, measured by the ICEIT indicator (installed capacity equivalent interrupt time), which was slightly over 59 minutes (excluding force majeure). These figures were maintained in 2010, when the ICEIT indicator was 61 minutes.

GAS NATURAL FENOSA is committed to quality, proof of which lies in its capital expenditure plans and the operation and maintenance of the installations which are steadily being commissioned in all areas where it operates. In this regard, the ICEIT indicator has improved by 34 minutes since 2006 and is among the best in the industry.

The number of electricity supply points increased slightly in 2010 (+0.6%). Energy supply expanded by 60.8% which in homogeneous terms means 4.1%. Regulated-rate electricity sales in 2010 correspond to adjustments since, as of July 2009, energy is supplied only at the TPA tariff.

### **Electricity distribution in Latin America**

This division involves gas distribution in Colombia, Guatemala, Nicaragua and Panama.

#### **Results**

	2010	2009	%
Net sales	2,200	1,231	78.7
Purchases	(1,580)	(861)	83.5
Personnel costs, net	(54)	(31)	74.2
Other expenses/income	(176)	(103)	70.9
<b>EBITDA</b>	<b>390</b>	<b>236</b>	<b>65.3</b>
Depreciation and amortization	(89)	(44)	102.3
Change in operating provisions	(124)	(67)	85.1
<b>Operating income</b>	<b>177</b>	<b>125</b>	<b>41.6</b>

EBITDA in the distribution business in Latin America increased by 65.3% with respect to 2009 which in homogeneous terms equals to 17.8%; of special note was the increase in revenues due to a significant rise in demand in the region and appreciation of the Colombian peso. Excluding the currency effect, EBITDA expanded 4.8% with respect to 2009.

The Colombian distribution business contributed €227 million, a significant increase. This increase was due to the unusual length of the El Niño phenomenon and to incipient economic recovery in Colombia, where industrial activity has started to pick up again.

EBITDA of the distribution companies in Central America amounted to €163 million due to the increase in demand throughout the region (6.6%), offsetting higher fuel prices (up 20% on average) and the increase in the cost of unrecognised losses.

The increase in provisions is due primarily to the increase in sales in disadvantaged areas in Colombia where it is difficult to manage the electricity distribution business and the incorporation of UNION FENOSA's subsidiaries.

## Main aggregates

	2010	2009	%
Electric activity sales (GWh):	18,002	12,054	49.3
Tariff electricity sales	16,979	11,314	50.1
TPA	1,023	740	38.2
Connection points ('000) (at 31/12)	4,901	4,639	5.6

Electricity sales totalled 18,002 GWh, a 49.3% increase, and customer numbers increased by 5.6%, most notably in Colombia (due to updated censuses in disadvantaged neighbourhoods) and in Nicaragua (due to more effective campaigns to sign new customers).

The key physical aggregates by country in 2010 are as follows:

	Colombia	Guatemala	Nicaragua	Panama	Total
Electric activity sales (GWh)	10,099	1,934	2,424	3,545	18,002
Change vs. 2009 (%)	45.0	57.4	55.2	54.3	49.3
Connections points ('000 at 31/12)	2,198	1,422	808	473	4,901
Change vs. 31/12/2009 ('000)	104	50	88	19	261
Network loss ratio (%)	18.0	17.0	21.8	9.8	-

Energy demand in Central America increased by 5.7%, including a notable 6.1% increase in distribution in Panama due to the higher temperatures and customers' perception of lower tariffs, considering, in homogeneous terms the whole year instead of the may-december period.

The basic operating indicators in the business—the power loss ratio, and the debt collection index—remained stable with respect to the previous year despite delays with the plans to reduce losses and to cut off consumers for non-payment.

### Electricity distribution other (Moldova)

The business in Moldova consists of regulated distribution of electricity and the supply of electricity at the bundled tariff in the capital city and the central and southern regions.

## Results

	2010	2009	%
Net sales	188	109	72.5
Purchases	(143)	(82)	74.4
Personnel costs, net	(7)	(5)	40.0
Other expenses/income	(11)	(6)	83.3
<b>EBITDA</b>	<b>27</b>	<b>16</b>	<b>68.8</b>
Depreciation and amortization	(5)	(5)	-
Change in operating provisions	(1)	1	200.0
<b>Operating profit</b>	<b>21</b>	<b>12</b>	<b>75.0</b>



The current regulatory framework in Moldova, which includes explicit recognition of the capex plan and operation and maintenance at facilities, together with positive results obtained from boosting the energy efficiency of the distribution network, improved the margin on electricity by approximately 18% in the local currency compared with 2009.

Projects to improve operations, in both facility and customer management, are providing significant improvements in efficiency, measured in terms of operating expenses/electricity margin, which improved by almost 4 percentage points in local currency terms, in homogeneous terms.

This improved EBITDA by almost 21% in local currency terms; including the currency effect, EBITDA improved by 12.5% compared with 2009, in homogeneous terms.

These comparisons have been made in homogeneous terms, using a full year for 2009 instead of only the period from May to December included as a whole in consolidated earnings for 2009.

### **Main aggregates**

	<b>2010</b>	<b>2009</b>	<b>%</b>
Electric activity sales (GWh):	2,366	1,484	59.4
Tariff electricity sales:	2,366	1,484	59.4
TPA	-	-	-
Connection points (000) (at 31/12)	816	807	1.1

Against the backdrop of the economic slowdown, energy demand in Moldova expanded by 3.4% with respect to 2009, and the customer base grew by 1.1%. The impact of this growth is also visible in earnings as the power loss ratio continues to improve (now around 14%), while debt collection ratio is close to 100%.

The solid results are attributable to the good performance of leading operating parameters and the fact that supply quality figures are on target.

### **Electricity in Spain**

This area basically includes power generation in Spain, wholesale and retail electricity supply in the liberalised market in Spain, electricity supply at the last-resort tariff and wholesale electricity trading.

### **Results**

	<b>2010</b>	<b>2009</b>	<b>%</b>
Net sales	5,420	3,476	55.9
Purchases	(3,909)	(2,317)	68.7
Personnel costs, net	(130)	(86)	51.2
Other expenses/income	(407)	(267)	52.4
<b>EBITDA</b>	<b>974</b>	<b>806</b>	<b>20.8</b>
Depreciation and amortization	(537)	(360)	49.2
Change in operating provisions	(50)	(14)	257.1



<b>Operating Income</b>	<b>387</b>	<b>432</b>	<b>(10.4)</b>
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The net turnover from electricity activity in 2010 totals Euros 5,420 million, an increase of 55.9% over last year, basically due to the addition of UNION FENOSA.

EBITDA amounted to €974 million in 2010, a 20.8% increase year-on-year, considering the abovementioned reasons.

Electricity demand in mainland Spain increased by 3.4% in 2010 with respect to 2009. Correcting for calendar effects and temperatures, demand increased by 2.9%, returning to the upward trend in demand that began in the first half of 2010, following the sharp decline in 2009.

Net power generation in Spain accumulated increase in the year was 3.6%. The balance of international power flows was of net exports in physical terms, although the figure was 6.4 percentage points lower than in 2009. Exports rose 2.9% y/y in 2010, exceeding 8.3 TWh.

Special regime power generation declined by 3 points to 13.8% in 2010. Despite that, Special regime power generation reaches 34.8% of mainland electricity demand coverage, 3 percentage points more than 2009.

However, ordinary regime power output fell just by 0.7% in the full year.

Producible hydro-electricity in 2010 may exceed (PSS ratio), with respect to the historical average, 15%, i.e., statistically, only in 15 of every 100 years will there be as much precipitation as this year.

Nuclear output increased by 17.1% in the year; this figure was affected by changes in the dates of scheduled shut-downs.

Demand in 2010 exceeded 2009 by 8.7 TWh, i.e. barely a quarter of the 34 TWh increase in output by special regime facilities (due to added capacity), hydroelectric plants (greater precipitation) and nuclear plants (less maintenance down-time) compared with 2009. The thermal gap declined by 12 percentage points with respect to 2009, comprised basically of coal and CCGTs, which absorbed the downward adjustment between demand and generation.

Coal-fired output declined by 34.8% with respect to 2009, when it fell a notable 27% with respect to 2008.

Oil-fired output fell by 12.2% in the year, although it barely contributed half of one per cent of demand.

CCGT output fell by 17.3% in the full year; CCGTs contributed 24.4% of demand in the full year, six points less than in 2009.

In the fourth quarter of 2010, higher output by hydroelectric plants (due to greater precipitation) and special regime plants, especially wind failed to offset the effect of higher commodity prices and, therefore, production costs; consequently, the price increase continued, reaching €45.0/MWh in the year end, and some days exceeding €50/MWh (reaching the highest level for the year, €57.2/MWh, on 1 December).

The weighted daily average price in the electricity pool was €38.0/MWh in 2010, i.e. practically the same as in 2009.

As for other commodities, Brent crude rose to \$86.46/bbl in the fourth quarter of 2010. API 2, Europe's leading coal price indicator, increased to \$108.64/t in 4Q10, while the price of CO<sub>2</sub> emission rights (EUAs on Bluenext) was €14.74/t (maturing in the current year).

## Main aggregates

The main aggregates in GAS NATURAL FENOSA's electricity business in Spain were as follows:

	2010	2009	%
Installed capacity (MW):	14,637	13,410	9.1
Ordinary Regime	13,679	12,436	10.0
Hydroelectric	1,860	1,860	-
Nuclear	589	589	-
Coal	2,048	2,048	-
Oil/gas	617	617	-
CCGT	8,565	7,322	17.0
Special Regime	958	974	(1.6)
Electricity generated (GWh):	38,338	28,728	33.5
Ordinary Regime:	35,809	26,694	34.1
Hydroelectric	4,752	1,849	157.0
Nuclear	4,325	2,908	48.7
Coal	772	741	4.2
Oil/gas	32	4	700.0
CCGT	25,928	21,192	22.3
Special Regime	2,529	2,034	24.3
Electricity sales (GWh):	40,559	26,520	52.9
Liberalised market	30,179	17,297	74.5
Last resort tariff / regulated	10,380	9,223	12.5

Electricity production on the peninsula of GAS NATURAL FENOSA totalled 38.338 GWh in 2010, 33.5% higher than in 2009. Bearing in mind homogeneous values for 2009, this would be an increase of 1.4%. Of this figure, 35.809 GWh were generated under the Ordinary Regime, increasing by 34.1%, which in homogeneous terms is an increase of 0.7%. Generation under the Special Regime, which totalled 2.529 GWh, has increased by 24.3% (12.1% in homogeneous terms), a reduction of 1.6% in installed power, which in homogeneous terms represents an increase of 2.0%.

Hydro-electricity production during the year totals 4.752 GWh, an increase of 157.0%, which, taking into account the homogeneous aggregates, would be 40.3%, as a result of the hydrological characteristics of the beginning of the year. The year began with high precipitation in the first semester, turned average in the third quarter, and ended with a PSS average of 38%. The level of energy reserves in the water basins of GAS NATURAL FENOSA is 49% of full capacity.

Nuclear energy production has increased as a whole for the year by 48.7%, which in homogeneous terms is an increase of 7.9%, which has been due to the effect of the postponement of the programmed stoppages.

Most of the coal and fuel oil-fired thermal power stations ended 2010 with an increase in coal-fired production of 4.2% and an increase in fuel oil production of 700%, which is not very significant given their slight contribution to total production.

The company's CCGT output in 2010 totalled 25,928 GWh, a 22.3% increase with respect to 2009 but in homogeneous terms means a 1.0% decrease, contrasting with the 17.3% decline nationwide. This fact underlines the operating advantages of GAS NATURAL FENOSA's CCGTs.

In the last quarter of 2010, two CCGT units in Barcelona Port came on stream, the first with a gross capacity of 412.6 MW, and the second with 426.1 MW. These, together with the entry into service in July 2010 of the CCGT in Malaga (409 MW) brings the total ordinary regime installed capacity of GAS NATURAL FENOSA to 13,679 MW, i.e. up 10.0% with respect to 2009.

GAS NATURAL FENOSA's market share of ordinary regime power generation was 20.2% in December 2010, i.e. slightly higher than in 2009.

In electricity commercialisation, including the commercialisation of the deregulated market and last resort (last-resort tariff or TUR) market, sales have increased by 52.9% during the year, which in homogeneous terms is a decrease of 1.5% against the aggregates for last year.

Total emissions of CO<sub>2</sub> from thermal power plants and CCGTs affected by the regulation governing greenhouse gas emission trading was 9.8 million tonnes. GAS NATURAL FENOSA acquired the emission rights needed to cover its shortfall through the secondary market, primary projects and carbon funds, thereby managing its CO<sub>2</sub> emission right hedges for the 2008-2012 and post-Kyoto periods.

The company traded over 15,000 GWh in the Iberian electricity market in 2010.

Energy trading in the French and German electricity markets in 2010 was performed via Virtual Power Plant (VPP) auctions, energy sales in grid loss auctions in France, and sales in organised markets and OTC; the company managed more than 3,000 GWh.

As regards crossborder trading between Spain-France and Germany-France, GAS NATURAL FENOSA optimised and diversified its position, participating in the organised markets in those countries and buying interconnection capacity in short- and medium-term auctions, trading over 300 GWh in 2010.

### **Electricity Latin America**

This section includes electricity generation in Mexico, Puerto Rico, Costa Rica, Panama and the Dominican Republic.

Currently operational assets in Mexico are the Hermosillo (270 MW) and Naco Nogales (300 MW) power plants in Sonora state; the Tuxpan III and IV (1,000 MW) power plants in Veracruz state; and the Saltillo (248 MW) plant in Coahuila state; and the Norte Durango (450 MW) plant in the state of Durango, also in north-western Mexico.

On 24 December 2009, GAS NATURAL FENOSA reached an agreement to sell part of its power generation business in Mexico to Mitsui & Co. and Tokyo Gas Co. This transaction is part of the divestment plan, which will enable the company to attain a more balanced exposure to Mexico. The sale was completed on 3 June 2010.

The following assets were sold: the Anahuac, Lomas del Real, Valle Hermoso, Águila de Altamira and Saltillo power plants, as well as the Río gas pipeline and Compañía Mexicana de Gerencia y Operación, S.A. de C.V. (i.e. a total of 2,233 MW of installed capacity).

On 17 October 2009, GAS NATURAL FENOSA signed a draft agreement with Colener, Inversiones Argos and Bancolombia Corporación Financiera for the sale of its indirect stake in Colombian company Empresa de Energía de Pacífico (EPSA). On 9 December 2009, the Colombian Stock Exchange completed the transaction by transferring the shares. As a result, GAS NATURAL FENOSA divested 950 MW of installed capacity.

## Results

	2010	2009	%
Net sales	954	929	2.7
Purchases	(607)	(600)	1.2
Personnel costs. net	(19)	(14)	35.7
Other expense/income	(65)	(73)	(11.0)
<b>EBITDA</b>	<b>263</b>	<b>242</b>	<b>8.7</b>
Depreciation and amortization	(105)	(163)	(35.6)
Change in operating provisions	(4)	(1)	300.0
<b>Operating income</b>	<b>154</b>	<b>78</b>	<b>97.4</b>

EBITDA for the period totals Euros 263 million, 8.7% higher than last year, due to the inclusion of Mexico, the Dominican Republic and Panama for only 8 months in 2009 (May to December). After discounting in 2009 the sale of the business sold in Colombia and Mexico, EBITDA has increased by 20.1%, due mainly to the commercial start up of the Norte Durango plant, and the positive technical performance of the other plants in the area. Excluding the effect of the exchange rate, EBITDA has risen by 19.0%.

EBITDA in Panama was 61.7% higher than in the previous year as a result of power plants being dispatched to manage the water in the country's reservoirs.

EBITDA from the power plants in Puerto Rico and the Dominican Republic increased by 9.5% and 24.9%, respectively, due to higher sale prices and a higher level of dispatching.

## Main aggregates

Construction of the Norte CCGT in Durango state was completed on schedule. This 450 MW plant was awarded on 6 March 2007. Following the first firing of the gas turbine on 23 February 2010, the first synchronisation on 28 March, and performance tests, it commenced commercial operation on 7 August 2010.

	2010	2009	%
Installed capacity (MW):	2,505	4,288	(41.6)
Mexico (CCGT)	2,020	3,803	(46.9)
Puerto Rico (CCGT)	254	254	-
Panama (hydroelectric and thermal)	33	33	-
Dominican Republic (oil-fired)	198	198	-
Electricity generated (GWh):	19,147	23,471	(18.4)

Mexico (CCGT)	16,182	20,921	(22.7)
Puerto Rico (CCGT)	1,803	1,717	5.0
Panama (hydroelectric and thermal)	132	61	116.4
Dominican Republic (oil-fired)	1,030	772	33.4

Power production in 2010 amounted to 19,147 GWh, with a load factor of 75.4% and 92.9% availability.

### **Electricity Other (Kenya)**

This area refers to power generation in Kenya.

The entry into service of seven diesel generators (52 MW) in Kenya in the third quarter of 2009 led to a notable increase in power production.

### **Results**

	2010	2009	%
Net sales	96	42	128.6
Purchases	(71)	(33)	115.2
Personnel costs. net	(2)	(1)	100.0
Other expenses/income	(8)	(4)	100.0
<b>EBITDA</b>	<b>15</b>	<b>4</b>	<b>275.0</b>
Depreciation and amortization	(6)	(2)	200.0
Change in operating provisions	-	-	-
<b>Operating profit</b>	<b>9</b>	<b>2</b>	<b>350.0</b>

EBITDA has totalled Euros 15 million in 2010, an increase of Euros 11 million against the same period last year. Taking 2009 as a whole, the increase in EBITDA would total Euros 9 million, as a result of the increase in capacity mentioned above and the high level of availability during this period (91.4%), as a determining indicator of the revenues for capacity.

### **Main Aggregates**

The main aggregates of the activity are the following:

	2010	2009	%
Electric generation capacity (MW)	112	112	-
Electric energy production (GWh/year)	645	354	82.2

This year fuel-fired production in Kenya has increased by 82.2% against the period from May to December last year, reaching 645 GWh. This increase would be cut to 36.9% if we took the year as a whole. This increase has been due to the increase in capacity of the plant in the third quarter of 2009, in which 52 additional MW came on line commercially. Nevertheless, production has been negative impacted by the heavy rains in the country in the first few months of the year, which led to high levels of hydro-electric production.

### **Infrastructure**

This area includes the development of integrated liquefied natural gas (LNG) projects, hydrocarbon exploration, development and production, maritime transportation, and the operation of the Maghreb-Europe gas pipeline.

## Results

	2010	2009	%
Net sales	264	276	(4.3)
Purchases	(12)	(37)	(67.6)
Personnel costs, net	(6)	(7)	(14.3)
Other expense/income	(55)	(51)	7.8
<b>EBITDA</b>	<b>191</b>	<b>181</b>	<b>5.5</b>
Depreciation and amortization	(50)	(48)	(4.2)
Change in operating provisions	-	-	-
<b>Operating profit</b>	<b>141</b>	<b>133</b>	<b>6.0</b>

Net turnover from infrastructure activity has totalled Euros 264 million, a decrease of 4.3%.

EBITDA for 2010 totals Euros 191 million, 5.5% higher than last year. This increase is mainly due to the fact that the increased international transport revenues and cost containment have been partially offset by a lower margin on the sea transport business due to a greater level of occupancy of the fleet allocated to company transport, which involves less sub-chartering.

## Main aggregates

The main aggregates in international gas transportation are as follows:

	2010	2009	%
Gas transportation-EMPL (GWh):	109,792	109,230	0.5
Portugal-Morocco	29,052	28,705	1.2
GAS NATURAL FENOSA	80,740	80,525	0.3

The gas transportation activity conducted in Morocco through companies EMPL and Metragaz represented a total volume of 109,792 GWh, on par with the same period last year. Of that figure, 80,740 GWh were transported for GAS NATURAL FENOSA through Sagane and 29,052 GWh for Portugal and Morocco.

In the gas exploration and production area, a seismic survey was carried out in the second quarter of 2010 in the Tangier-Larache (Morocco) concession, in which GAS NATURAL FENOSA has a 24% stake, and the results have been processed and analysed in preparation for drilling in 2011.

In the integrated project being developed in Angola by GAS NATURAL FENOSA with Repsol (20%), drilling work continued in the Garoupa II block and a range of geological and geophysical surveys were conducted in that area.

On the other hand, public disclosure, filing of allegations and the preparation of environmental impact studies for the five projects that make up the exploration, production and storage that



GAS NATURAL FENOSA is planning for the next few years in the Guadalquivir Valley has continued. On 30 September 2010 the Environmental Impact Declaration for the first of the five projects was obtained. Thereafter, on 15 November 2010 the Government of Andalusia issued the Unified Environmental Authorization for this project, the step prior to its approval by the Ministry of Industry, Tourism and Trade.

GAS NATURAL FENOSA's projects to build two regasification plants in Italy (Trieste-Zaule and Taranto) continue to make progress towards obtaining the required permits and licenses. The Trieste-Zaule project obtained a positive report from the Ministry of Cultural Assets and Activities (MiBAC) in January 2009 and the Environmental Approval Decree in July 2009, culminating the permit process at national level. The process of obtaining permits for the Taranto project, as required under Italian legislation, is continuing. The permit process for Trieste is expected to conclude with the obtainment of the Single Authorisation for construction of the plant during 2011.

Both projects are on-shore, located in the port areas of the respective cities, and have a planned regasification capacity of 8 bcm/year; investment per terminal will be approximately €500 million. These plants will enable the company to diversify its sources of natural gas supply in Italy and provide continuity in this energy supply, in line with the objectives of the Italian government's energy policy.

### **Procurement and supply**

This area includes gas procurement and supply (wholesale and retail) in Spain and other countries, the supply in Spain of products and services related to supply, and supply of gas at the last-resort tariff in Spain.

### **Results**

	<b>2010</b>	<b>2009</b>	<b>%</b>
Net sales	7,678	6,853	12.0
Purchases	(7,345)	(6,044)	21.5
Personnel costs, net	(64)	(62)	3.2
Other expenses/income	(212)	(351)	(39.6)
<b>EBITDA</b>	<b>57</b>	<b>396</b>	<b>(85.6)</b>
Depreciation and amortization	(14)	(11)	27.3
Change in operating provisions	(31)	(46)	(32.6)
<b>Operating profit</b>	<b>12</b>	<b>339</b>	<b>(96.5)</b>

2010 includes the net effect of various non-recurrent items totalling Euros 305 million, including of special note, amongst others, the provision to the one already booked to date for the risks arising from litigation with Sonatrach.

Net sales amounted to €7,678 million, 12.0% more than last year. EBITDA in 2010 totalled €57 million, down 85.6% against last year, due primarily to the non-recurrent items mentioned above, and to a different market sales mix during the year, conditioned by the retail commercialisation area as a result of the adjustment of prices under the tariff of last resort.

Additionally, it must be also pointed the effect of the divestments made in December 2009 in the Region of Cantabria (Gas Natural Cantabria SDG) and the Region of Murcia (Gas Natural Murcia SDG), and the sales made in April 2010 of different natural gas commercialisation assets in the Region of Madrid.

Diversification of the portfolio of commodities and combined management of the commodity and dollar risks mitigated the decline in EBITDA in a context of significant volatility in the energy and currency markets.

## Main aggregates

The main aggregates in the gas procurement and supply activity are as follows:

	2010	2009	%
Gas supply (GWh)	305,704	286,152	6.8
Spain:	250,885	234,230	7.1
GAS NATURAL FENOSA supply <sup>(1)</sup>	184,744	182,299	1.3
Supply to third parties	66,141	51,931	27.4
International:	54,819	51,922	5.6
France	21,122	15,627	35.2
Other	33,697	36,295	(7.2)
Multiutility contracts (at 31/12)	1,520,758	2,125,270	(28.4)
Contracts per customer (at 31/12)	1,32	1,39	(5.0)

<sup>(1)</sup> Does not include exchange transactions with energy companies.

GAS NATURAL FENOSA supplied 184,744 GWh in the Spanish gas market, a 1.3% increase with respect to the same period last year, primarily due to greater gas consumption by residential and industrial customers, while sales to CCGT plants remained flat.. The company sold 66,141 GWh of gas to third parties for supply to the Spanish market, a 27.4% increase.

With a view to guaranteeing gas exports from Spain to Portugal, GAS NATURAL FENOSA is using the gas grid connections in Campomaior (south-east) and Valença do Minho (north).

Gas Natural Europe (the French supply subsidiary) has obtained its first customers in Belgium and Luxembourg, representing a contracted portfolio of over 200 million kWh in 2011. The company, which recently opened its first branches in Belgium and Luxembourg so as to extend its gas supply activities in Europe, is also considering an entry into other central European markets in the medium term by offering the combination of customised energy consulting with the advantage of a diversified, secure supply.

The French subsidiary, which has been supplying gas in the French market since 2005 and currently has 211 customers there (ranging from chemical, paper and other industrial companies to local government and the public sector), has opened a commercial office in Toulouse with a view to expanding in the south of France.

From the Paris office, GAS NATURAL FENOSA coordinates the revival of the wholesale gas business in Italy, where the company has obtained new customers. The portfolio under contract in Italy amounts to 2,200 GWh per year and Italian subsidiary Gas Natural Vendita also supplies energy to residential customers.

As for expansion in Europe, GAS NATURAL FENOSA was the first Spanish company to form part of the Zeebrugge gas hub in Belgium; it has just begun to make use of the resulting capacity to operate in that country by buying and selling gas in the Belgian wholesale market and to supply gas to the industrial and domestic market.

GAS NATURAL FENOSA continues to take steps to develop energy options for vehicles in Spain, in both the public and private sectors. GAS NATURAL FENOSA is an expert in



automotive LNG, a business which it already conducts in several Latin American countries and Italy, where automotive natural gas is widely used.

GAS NATURAL FENOSA undertakes end-to-end management of the process, from construction of service stations (capital cost and subsequent operation and maintenance) to the supply of compressed natural gas, thereby ensuring maximum availability of the facilities. GAS NATURAL FENOSA has 17 service stations and sold 299 GWh in 2010; it also has 5 customers in the pipeline which represent an additional 69 GWh/year of potential consumption.

During 2010, the company made significant progress in expanding the automotive gas market in Spain, including notably the new bus depot in Sanchinarro (Madrid) for the Madrid Municipal Bus Service, serving a fleet of approximately 400 buses. This is the largest automotive LNG installation in Europe in terms of both fleet size and compression capacity. The depot is estimated to reduce annual emissions of nitrogen oxides by 54 tonnes and particulate emissions by almost 4 tonnes, which will help attenuate Madrid's air quality problems.

GAS NATURAL FENOSA is also working on actions to foster energy efficiency and the rational use of energy in the field of mobility. In November 2010, GAS NATURAL FENOSA signed an agreement with Castrosua, a manufacturer of bus chassis, to cooperate on R&D for the development of hybrid compressed natural gas (CNG)/electric vehicles. GAS NATURAL FENOSA is also developing engines to allow the use of liquefied natural gas (LNG) in long-distance buses.

In the area of energy efficiency, GAS NATURAL FENOSA continues to work on projects in the residential, tertiary and industrial markets and actively promotes energy efficiency and saving. It has signed agreements with federations and associations of restaurants, services and shops in Tenerife, Las Palmas de Gran Canaria and Malaga to establish a framework for cooperation in energy efficiency actions as a basic principle for energy management by their members.

In 2010, GAS NATURAL FENOSA launched ServiElectric, a new nationwide service which provides corrective maintenance of electrical installations as a means of increasing the portfolio of value-added services for customers. This is a pioneering initiative in terms of the level of service and it obtained 22,000 contracts in 2010.

GAS NATURAL FENOSA continues to focus on adding features and signing up users for its on-line office; in 2010, the site logged 3.5 million transactions and a total of 740,000 customers registered as site users.

Also in 2010, GAS NATURAL FENOSA began marketing all its products and services throughout Spain and stepped up the pace of recovery in the residential market, tripling the number of customers who returned to GAS NATURAL FENOSA with respect to 2009.

GAS NATURAL FENOSA has a total of 1,520,758 contracts to maintain gas facilities and appliances for residential customers (in May the company divested 144,207 contracts in the Madrid region) based on its own operating platform consisting of over 149 associated firms connected via an wireless on-line system, which has enabled it to improve service performance and quality (our customers rate this as our top service).

## **UF Gas**

This area includes wholesale and retail gas procurement and supply performed by Unión Fenosa Gas, including the liquefaction plant in Damietta (Egypt), the Sagunto regasification plant, and the LNG tankers fleet.

## **Results**

Unión Fenosa Gas is owned 50% by GAS NATURAL FENOSA and is proportionately consolidated.

	2010	2009	%
Net sales	849	348	144.0
Purchases	(580)	(208)	178.8
Personnel costs, net	(12)	(8)	50.0
Other expenses/income	(33)	(10)	230.0
<b>EBITDA</b>	<b>224</b>	<b>122</b>	<b>83.6</b>
Depreciation and amortization	(146)	(70)	108.6
Change in operating provisions	-	-	-
<b>Operating profit</b>	<b>78</b>	<b>52</b>	<b>50.0</b>

EBITDA amounted to €224 million in 2010, which is an increase of 83.6% against last year, due to the addition in 2009 only of the period from May to December. In homogenous terms this is an increase of 4.7%, thanks to the economic boost recorded in the second half of the year. The good second-half performance was due to higher sales volumes in the Spanish market (gas sales rose 14% year-on-year) and favourable energy prices (Brent, the Spanish electricity pool, and coal).

### Main aggregates

The main aggregates for the UF Gas business are as follows:

	2010	2009	%
Gas supply in Spain (GWh)	59,518	34,854	70.8
Gas supply in International (GWh)	27,774	10,785	157.5
Liquefaction (GWh)	35,851	31,385	14.2
Regasification (GWh)	56,092	53,735	4.4

The gas supplied in 2010 has increased by 70.8% and totals 59.518 GWh. In homogeneous terms, this is an increase of 14% against the same period last year. The sales to industrial customers and combined cycle plants have increased by 8.9% and 12.6%, respectively, while the sales to commercialisers have fallen by 1.8%

A total of 27,774 GWh of energy was traded in international transactions.

During the period, the gas acquired under long-term contracts with Egypt and Oman covered most of the gas needs in the Spanish market; 25.7% of total gas needed to be obtained from other sources.

The main gas infrastructure (liquefaction, sea transport and regasification) maintained levels of availability and efficiency, in line with the same period last year.

At the end of July 2010, the Damietta (Egypt) liquefaction plant completed the work related to the first major inspection, in accordance with the maintenance plan, and it became available again at full efficiency in early August 2010.

The plant delivered 39 shiploads, of which 23 were for Unión Fenosa Gas, and the remainder for other operators.

The Sagunto regasification plant produced 56,092 GWh, i.e. 76 shiploads, of which 31 were for Unión Fenosa Gas (28,930 GWh, i.e. 51.6% of the total).

In May 2010, the dome was successfully placed on the fourth liquefied natural gas (LNG) storage tank at the Sagunto regasification plant. The new tank is scheduled to become operational in the first quarter of 2012 and will increase capacity by 150,000 m<sup>3</sup>.

On 6 September 2010, for the first time since becoming operational, the Sagunto plant took delivery of gas from Qatar in a Q-Max class LNG tanker, one of the largest in the world. The ship discharged almost all of its liquefied natural gas capacity in Sagunto. The Al Dafna, registered in Qatar, can transport 266,000 m<sup>3</sup> of LNG. A Q-Max LNG tanker can carry 80% more LNG than a conventional LNG tanker while consuming 40% less energy.

This was the largest LNG unloading operation in Spain to date. Sagunto has a dock to receive Q-Max methane vessels, although none have docked to date.

## **2. Risk factors related to the activity of GAS NATURAL FENOSA**

### **a) Uncertainty of the macro-economic environment**

In the last few months the international economy and financial system have gone through a period of considerable turbulence and uncertainty, especially in the financial markets, which began in August 2007 and which has deteriorated substantially since September 2008. This uncertainty has severely impacted the general levels of liquidity and credit available, as well as the terms and conditions for the same, which has contributed to an increase in the financial burden of homes and industrial customers of GAS NATURAL FENOSA, thus reducing their purchasing power and affecting demand adversely.

GAS NATURAL FENOSA cannot predict the trend in the economic cycle in the next few years nor whether there the current recession in the international economic cycle will take a turn for the worse.

### **b) GAS NATURAL FENOSA may not be successful in the roll out of its business strategy.**

Given the risks to which it is exposed and the uncertainties inherent in its business, GAS NATURAL FENOSA cannot ensure that it will be able to successfully implement its business strategy. The scope of and compliance with its strategic objectives are subject, amongst others risk factors, to:

- the lack of an increase in the number of supply points in Europe and Latin America, due to the fact that GAS NATURAL FENOSA cannot expand the distribution network;
- a failure to increase in the number of customers due to the lack of success of the marketing campaigns for deregulated market consumers;
- the enabling of take or pay clauses in supply contracts, which would involve the obligation to pay for a volume of gas exceeding the needs of GAS NATURAL FENOSA;

- the lack of success in the consolidation of the electricity production business in Spain conditioned by subsidised technology incentives;
- the incapacity to consolidate the multi-service business strategy or to increase the number of multi-product contracts per customer.

### **c) Regulatory risk**

GAS NATURAL FENOSA and its subsidiaries are obligated to comply with the legislation in the natural gas and electricity sectors. Especially, the gas and electricity distribution business is regulated in most of the countries in which GAS NATURAL FENOSA carries out this business.

The applicable legislation to the natural gas and electricity sectors in the countries in which the GAS NATURAL FENOSA Group operates is typically subject to periodical revision by the competent authorities. The introduction of modifications could impact the remuneration of the regulated activity, adversely affecting the business, profits, grants and the financial position of GAS NATURAL FENOSA.

In the event that public or private entities interpret or apply criteria other than those of GAS NATURAL FENOSA, its compliance would be questioned or challenged, and, if any non-compliance were proven, this could adversely affect the business, outlook, profits, grants and financial position of GAS NATURAL FENOSA.

### **Level of competitiveness in the commercialisation in the gas and electricity markets.**

GAS NATURAL FENOSA operates in a stiffly competitive environment in relation to its positioning in the gas and electricity markets in the different countries in which it is present. In particular, the processes of energy market deregulation both in Spain and in major markets has negatively impacted the energy price levels and the market share of end customer sales, especially in the gassistic area. A new loss of market share could adversely and significantly affect the turnover of GAS NATURAL FENOSA.

### **Divestments**

The National Anti-Trust Commission (CNC, Spanish acronym), by virtue of a resolution of its Board dated 11 February 2009, notified GAS NATURAL FENOSA on the following day that it had decided to subordinate the approval of the takeover of control of UNION FENOSA by GAS NATURAL to compliance by the latter to certain commitments agreed by GAS NATURAL FENOSA. For its part, the Second Vice-President of the Government and Minister of the Economy and the Treasury decided on 17 February 2009 not to refer the issue of this business concentration to the Council of Ministers, and notified GAS NATURAL FENOSA and the CNC of that decision on that date. Amongst the outstanding commitment mentioned above of special note is the divestment of 2.000 MW of electricity capacity through combined cycle technology, of which GAS NATURAL FENOSA on 12 July 2010 agreed to sell to a 400MW generator from the combined cycle plant in Plana del Vent to a Spanish subsidiary of the Alpiq Group, while giving it the right to exclusive use and operation of another 400 MW generator for a period of two years, on which it will be able to exercise a purchase option at the end of this period.

The sale of the assets required is subject to the review of the CNC, and the commitments to the CNC can be appealed by the competitors of GAS NATURAL FENOSA and by third parties with legitimate interests. In the event of a breach by GAS NATURAL FENOSA, or if there is a sale of assets under unfavourable terms, adverse material effects could impact the business, prospects, financial position and results of the Company.

Given that the gross amounts obtained from any sale will depend on the reigning market conditions, the competition for assets between buyers and other factors, many of which are beyond the control of GAS NATURAL FENOSA, the latter cannot ensure the amount of any sale or that it will be able to obtain the estimated market value of these assets.

#### **d) Operational risk**

GAS NATURAL FENOSA activities are exposed to different operational risks, such as breakdowns in the distribution network, electricity generation facilities and the gas tankers, explosions, polluting emissions, toxic spills, fire, adverse meteorological conditions, contractual breaches, sabotage or accidents affecting the gas distribution network or electricity generation assets, as well as defects and force majeure that could result in personal and/or material damages, impairment of facilities or property of GAS NATURAL FENOSA or their destruction. Events such as these, or the like, are unpredictable and can cause interruptions in the supply of gas and the production of electricity. In situations of this type, in spite of the existence of the pertinent coverage through risk insurance policies, insurance on potential loss of profit and damages, the financial position and results of GAS NATURAL FENOSA may be affected to the extent that these losses are not insured, or coverage is insufficient, or economic losses are generated as a result of the limitation of coverage or deductibles borne, as well as for potential increases of the prices of the premiums paid in the insurance market.

We should also mention that GAS NATURAL FENOSA could be subject to civil liability claims for personal and/or other damages caused during the ordinary course of its business. The filing of these claims could lead to the payment of indemnities under applicable legislation in those countries in which GAS NATURAL FENOSA operates, which could give rise, to the extent that these civil liability insurance policies do not cover the indemnities, to an adverse material effect on the business, outlook, financial position and results.

#### **e) Risks related to litigation and arbitration**

In the sector in which the GAS NATURAL FENOSA operates there has been in the last few years a trend to greater litigation, as a result of the volatility of oil prices and the increased competition in the deregulated market, amongst other factors. At this time GAS NATURAL FENOSA and its subsidiaries are parties to various legal proceedings, arbitration and regulatory actions. The adverse results of one or more of these proceedings (including any out-of-court settlements) could have an adverse material effect on the business, results and financial situation of GAS NATURAL FENOSA.

With regards to the dispute of GAS NATURAL FENOSA and Sonatrach on the price revision of the supply contracts for gas from Algeria through the Maghreb-Europe pipeline, in August 2010 a ruling was handed down that terminated the arbitration proceedings. The arbitration court decided Sonatrach had the right to a price increase as from 2007. The maximum retroactive bills invoiced by Sonatrach would total USD 1,970 million for the period until July 2010. The ruling was appealed by GAS NATURAL FENOSA before the Swiss Federal Court. Furthermore, GAS NATURAL FENOSA has petitioned for the commencement of the price revision process for these contracts in order to bear in mind the severe changes that have taken place, as well as the current situation in the world markets, especially the Spanish market, all of which is set forth in the respective contracts.

In November 2010 the Swiss Federal Court granted a cautionary injunction in relation to the arbitration ruling, suspending it until this Court decides on the appeal filed by GAS NATURAL FENOSA.

GAS NATURAL FENOSA and Sonatrach are in negotiations on the price revisions laid down in these contracts, and hopefully the result of which will be beneficial to both parties and will finally put an end to the dispute



In the event that none of the measures taken in relation to the above-mentioned ruling prosper, a part of the price increase will be passed on to customers, in accordance with contractual terms. In particular, article 15 of Royal Decree Law 6/2000/23 June contains that the holder of the contract for the supply of natural gas from Algeria, supplied through the Maghreb pipeline, has the obligation to supply it preferentially at the bundled tariff.

At 31 December 2010, the consolidated balance sheet of GAS NATURAL FENOSA includes a provision for the risks arising from the litigation with Sonatrach, according to the best estimate made based on the information available at the date of formulation of these Consolidated Annual Accounts on the evolution of the litigation, the negotiations underway and the amounts to be passed on, which adequately cover the risks described both for the retroactive period and for the additional period until 31 December 2010 the amount of which is not disclosed, in accordance with the provisions of paragraph 92 of IAS 37, given that it could seriously prejudice the position of GAS NATURAL FENOSA.

#### **f) Gas and electricity price risks.**

GAS NATURAL FENOSA is exposed to variations in crude oil, natural gas and electricity prices.

A major part of the operating expenses of GAS NATURAL FENOSA is linked to the purchase of natural gas and liquefied natural gas (LNG) for commercialisation on the deregulated market and to supply regulated markets. Likewise, its combined cycle plants use natural gas as fuel.

Although the prices that GAS NATURAL FENOSA applies to the sale of gas to its customers corresponds generally to market prices, in very volatile environments, the fluctuations in sale prices may not reflect the proportional fluctuations in the cost of raw materials. In addition to the costs related to the gas business, the rises in the prices of natural gas could lead to an increase in the costs of electricity production, given that the combined cycle plants of GAS NATURAL FENOSA use natural gas as fuel.

The GAS NATURAL FENOSA business includes, amongst other activities, the wholesale commercialisation of natural gas to electricity generators and other customers. With respect to these operations, the income and results of GAS NATURAL FENOSA usually depend to a great extent on the market prices in the regional markets in which it operates and in other competitive markets. As a result, the wholesale commercialisation of natural gas is exposed to the risk of fluctuation in raw material prices and the price of electricity.

The variations in the price of raw materials could adversely affect the results of GAS NATURAL FENOSA if the increase in generation costs is not recouped through sale prices of electricity, or in general, in the gasistic area, if we cannot attain a degree of efficiency in the management of the customer portfolio to permit a recovery through the commercialisation of the fluctuations in the energy scene.

#### **g) Gas Volume risk**

Most of the purchase of natural gas and liquefied natural gas (LNG) are made through long-term contracts that include clauses under which GAS NATURAL FENOSA has the obligation to make annual purchases for certain volumes of gas (known as “take or pay” clauses). Under these contracts, in spite of the fact that GAS NATURAL FENOSA does not need to acquire the gas volume agreed at a specific time, it will be contractually obligated to pay the minimum amount agreed under these “take-or-pay” clauses.

The aforementioned contracts contain certain gas volumes that relate to the estimated needs of GAS NATURAL FENOSA. However, the real needs may be lower than those forecasts at the time the contracts were signed. If there are significant variations in these estimates, GAS NATURAL FENOSA will be obligated to acquire a greater volume of gas than it actually needs, or failing this, to pay for a minimum amount of gas agreed, irrespective of whether it acquires the surplus over its needs, which could have an adverse, significant impact on the operating costs of GAS NATURAL FENOSA.

#### **h) Environmental requirements**

The activities of GAS NATURAL FENOSA are subject to compliance with extensive legislation on environmental protection.

GAS NATURAL FENOSA and its subsidiaries are subject to strict compliance with extensive legislation on environmental protection that requires, amongst other points, the preparation of environmental impact evaluation studies, obtaining the pertinent authorisations, licences and permits, as well as compliance with certain requirements, including, amongst others, the fact that:

- the environmental authorisations and licenses may not be granted or may be revoked due to non-compliance with the conditions that are imposed thereunder.
- the regulatory framework or its interpretation by the authorities could be modified or changed, which could lead to an increase in costs or deadlines in order to comply with the new regulatory framework.

#### **i) Interest and exchanges rate risk**

Variations in interest rates modify the fair value of the financial assets and liabilities that accrue a fixed interest rate, as well as the cash flows from financial assets and liabilities indexed to a floating interest rate, and, accordingly, they affect both equity and net incomes, respectively.

On the other hand, GAS NATURAL FENOSA is exposed to the risk related to the variation in currency exchange rates. These variations could affect, amongst other things, the debt of GAS NATURAL FENOSA denominated in non-euro currencies, to the operations that GAS NATURAL FENOSA carries out in other currencies that generate income denominated in another currency, as well as the counter-value of the cash flows related to the purchase and sale of raw materials denominated in non-euro currencies. The fluctuations in the exchange rate between the Euro and the US Dollar, the currency in which gas purchases are made by GAS NATURAL FENOSA are denominated in or pegged to, could also affect the results and financial position of GAS NATURAL FENOSA.

In spite of the fact that GAS NATURAL FENOSA has proactive management policies for the risks mentioned above in order to minimise their impact on its net income, in some cases these policies may be ineffective in mitigating the adverse effects inherent in the fluctuation in interest rates and exchange rates, and could adversely and significantly affect net income and the financial position of GAS NATURAL FENOSA.

#### **j) Impact of meteorological conditions**

Electricity and natural gas demand is linked to climate. A major part of gas consumption during the winter depends on the production of electricity and its use for heating, while during the summer months consumption depends on the production of electricity for air conditioning, basically. The income and net income of GAS NATURAL FENOSA from the distribution and commercialisation of natural gas could be affected adversely by warm falls or mild winters. Likewise, the demand for electricity could decline if summers are not hot, due to less demand

for air conditioning. Furthermore, the occupancy degree of hydro-electric plants depends on the level of precipitation where these installations are located, which can be affected by periods of drought.

The development of the electricity business of GAS NATURAL FENOSA is subject to different factors beyond the control of GAS NATURAL FENOSA, which are the following

- increases in the cost of generation, including the increases in the fuel price;
- loss of competitiveness with other technologies, due to the increase in the cost of generation using natural gas;
- a possible decrease in the growth rate of electricity consumption due to different factors, such as economic conditions or the implementation of energy savings programs;
- inherent risks in the operation and maintenance of electricity plants;
- the growing volatility in price due to the deregulation of the sector and changes in the market;
- a overcapacity situation of electricity production or in the markets in which GAS NATURAL FENOSA is the owner of generation plants or has an interest in them;
- the appearance of alternative energy sources due to the new technologies and growing interest in renewable energy and cogeneration.

#### **k) Exposure in Latin America**

A major portion of operating profit of GAS NATURAL FENOSA is generated by its Latin American subsidiaries. The operations in Latin America are exposed to different risks inherent in investment in that region. Amongst the risks factors linked to the investment and business in Latin America are:

- major influence on the economy by local governments;
- Significant fluctuation in the economic growth rate;
- High inflation rates
- Devaluation, depreciation or overvaluation of local currencies;
- Controls or restrictions on the repatriation of profits;
- Changing environment for interest rates;
- Changes in financial economic and tax policies;
- Unexpected changes in regulatory frameworks;
- Social tensions
- Political and macro-economic instability.

GAS NATURAL FENOSA cannot predict the way in which any future worsening of the political and economic situation in Latin American could take place or any other changes in legislation in the countries in which it operates.

### **3. Information under article 116 b of the Spanish Securities Exchange Act**

In accordance with the provisions of article 116 b of the Spanish Securities Exchange Act, Law 24/1988/28 July, enacted by Law 6/2007/12 April, the Board of Directors of Gas Natural SDG, S.A. adopted a resolution at its meeting of 29 January 2011 to approve this Report on the matters which, in compliance with the aforementioned provision, have been included in the Management Report for 2010.

a) The capital structure including securities that are not negotiated on regulated community markets, indicating, as the case may be, the different classes of shares and, for each class of shares, the rights and obligations they provide and the percentage of share capital represented:



Under articles 5 and 6 of the Articles of Association, the share capital of Gas Natural SDG, S.A. totals Euros NINE HUNDRED TWENTY ONE MILLION SEVEN HUNDRED FIFTY SIX THOUSAND NINE HUNDRED FIFTY ONE (921,756,951) that are fully subscribed and paid. The share capital is made up of 921,756,951 shares with a par value of Euro 1 each, represented by accounting entries and of the same class.

All the shares have the same economic and voting rights.

Furthermore, under article 33, paragraph one, of the Articles of Association, the shareholders who individually or grouped hold 100 shares can attend the General Meeting of Shareholders, provided that they are inscribed in the respective accounting register five days prior to the meeting, and have the respective attendance card accrediting their compliance with the aforementioned requirements, which will be expedited to the bearer by the entities legally entitled to do so.

b) Restrictions on the transfer of securities:

There are no restrictions on the transfer of securities. According to article 11 of the Articles of Association of Gas Natural SDG, S.A. the shares are transferable in the manner set down by current provisions in force. Notwithstanding the application of certain norms, which are set out below.

As a listed company, the acquisition of significant shareholdings is subject to notification of the issuer and the Spanish Securities Exchange Commission (*Comisión Nacional del Mercado de Valores – CNMV*) under article 53 of the Securities Exchange Act, Law 24/1988, article 23.1 of Royal Decree 1362/2007/19 October and Circular 2/2007/19 December of the CNMV, which sets the first notification threshold at 3% of share capital or voting rights.

Furthermore, as a listed company, and except of the exemption under the First Additional Provision of Royal Decree 1066/2007 the acquisition of 30% or more of share capital or voting rights of the Company requires the filing of a takeover bid under the terms set down in article 60 of the Securities Exchange Act, Law 24/1988.

c) The significant direct or indirect shareholdings in the share capital

At the 2010 year end the shareholders inscribed as significant shareholders were as follows:

Name or registered name of the shareholders	Number of direct voting rights	Number of indirect voting rights (*)	% of the total voting rights
CAJA DE AHORROS Y PENSIONES DE BARCELONA (LA CAIXA)	200	337,740,277	36.641%
REPSOL-YPF, S.A.	217,363,341	59,255,920	30.010%
CAIXA D'ESTALVIS DE CATALUNYA, TARRAGONA I MANRESA.	14,932,463	-	1.620%

(\*) Through:

Name or registered name of the indirect owner of the shareholding	Through: Name or registered name of the direct owner of	Number of direct voting rights	% of the total voting rights
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	the shareholding (*)		
CAJA DE AHORROS Y PENSIONES DE BARCELONA (LA CAIXA)	Criteria CaixaCorp, S.A.	337,740,277	36.641%
REPSOL YPF, S.A	Repsol Petróleo, S.A.	44,121,920	4.787%
REPSOL YPF, S.A	Repsol Exploración, S.A.	15,134,000	1.642%

d) Restrictions on voting rights:

There are no restrictions on voting rights.

e) Corporate agreements:

The Company is aware that the key shareholders, “la Caixa” and Repsol YPF, S.A. have entered into the following corporate agreements:

- Agreement of 11 January 2000.
- Novation of 16 May 2002.
- Addendum of 16 December 2002.
- Addendum of 20 June 2003.

Based on these agreements, LA CAIXA and REPSOL YPF, S.A. jointly hold a controlling position over Gas Natural SDG, S.A. for regulatory and anti-trust purposes, and jointly hold a shareholding in the company over 50%, and have appointed from amongst themselves more than half of the members of its governing body.

As a result of the filing of the prospectus for the takeover bid of the shares of Unión Fenosa, S.A. with the CNMV on 3 March 2009, which was approved on 18 March 2009, the CNMV indicated that the agreements mentioned above, with their contents as from the last novation in 2003, include elements of common management policy, relevant influence on the company and regulation of the voting rights which, as per current legislation in force, indicate the notion of concertation and grounds for the legal presumption of concertation as per article 5.1.b of RD 1066/2007. Consequently, according to the criteria of the CNMV, the joint control arising from the agreements, which materially remains unaltered, has been reclassified as a situation of concertation of both entities.

f) The regulations governing the appointment and replacement of the members of the governing body and the modification the articles of association of the company:

- f.1. The appointment and replacement of the members of the governing body is regulated by articles 41 and 42 of the Articles of Association and 11 to 15 of the Regulations on the Organisation and Functioning of the Board of Directors and its Committees.

Board of Directors.

- The administration of the company is entrusted to the Board of Directors, which will be made up of at least ten Members and a maximum of twenty.
- The General Meeting of Shareholders has the power to determine its number and the appointment and removal of Board Members.
- The office of Board Member can be renounced, revoked and re-elected.

- Those persons who have been declared to be incompatible to the extent and under the conditions set down by Law 12/1995/11 May and those who are subject to the prohibitions of article 124 of the Spanish Companies Act (art. 41 Articles of Association) cannot occupy offices in the Company and, as the case may be, exercise them.

#### Appointment of Board Members

- Board Members will be designated by the General Meeting of Shareholders or by the Board of Directors, in accordance with the provisions of the Spanish Companies Act and in the Articles of Association.
- The appointment will be of persons who, in addition to meeting the legal and statutory requirements are widely renowned and have the professional knowledge and experience to exercise their functions. The appointments proposed of Board Members to be submitted by the Board of Directors to the decision of the General Meeting of Shareholders and the appointments adopted by said body by virtue of their powers of co-optation legally attributed to them must be preceded by the respective report of the Appointments and Remuneration Committee. When the Board differs from the recommendations of this Committee it will have to motivate them and record in the minutes the reasons for its actions.
- An updated professional and biographical profile of all the Board Members will be posted on the website of the Company, as well as the other Boards of Directors on which they sit, whether of listed companies or not, indicating the type of Board Member, and, in the case of Members representing key shareholders, the shareholder they represent or with who they are related, the date of the first appointment as Board Member of the Company and their appointments thereafter and the shares in the Company and share holds they hold (art. 11 Regulations of the Board).

#### Duration and co-optation

- The duration of the office of Board Member is three years. At the end of this term for which they were designated, the Board Members can be re-elected.
- For the purposes of this article it shall be understood that the appointment will expire when, once the term is completed the following General Meeting of Shareholders has been held or the legal term for the convening of the following Ordinary General Meeting of Shareholders has elapsed.
- If during the term for which the Directors were appointed vacancies appear, the Board can designate from amongst the shareholders those persons that will occupy these offices under the next General Meeting of Shareholders (art. 42 Articles of Association).
- Board Members will exercise their office during a maximum term of three years, and can be re-elected. In no case shall the Independent External Board Members remain in their office as such for a period exceeding twelve years. The Board Members designated by co-optation shall exercise their office until the date of the next General Meeting of Shareholders (art. 13 Regulations of the Board).

#### Designation of Independent External Board Members

- Persons cannot be proposed or designated as Independent External Board Members who:

- a) Have been employees or Executive Offices of companies in the GAS NATURAL FENOSA Group, unless 3 or 5 years have elapsed, respectively, since the termination of their former relationship.
  - b) Receive from the company, or GAS NATURAL Group, any amount or benefit for items other than remuneration as Board Member, unless it is not significant. For the purposes of this section, the dividends and pension supplements received by Board Members for their former professional or labour relationship are excluded, provided that said supplements are unconditional and, consequently, the company that pays them cannot on its own account, without a breach of obligations, suspend, modify or revoke their accrual.
  - c) Be or have been for the last 3 years an external audit partner or responsible for the audit report, either of the Company or any Company in the GAS NATURAL FENOSA Group.
  - d) Be Executive Officers or top managers of a different company in which an Executive Officer or Top Manager of Gas Natural SDG, S.A. is an External Board Member.
  - e) Maintain or have maintained during the past year a major business relationship with the Company or any Company of the GAS NATURAL FENOSA Group, either on his own behalf or as a significant shareholder, Board Member or top manager of an entity that maintains or has maintained said relationship. Business relationships are defined as providing goods or services, including financial, advisory or consulting services.
  - f) Be significant shareholders, Executive Officers or top managers of an entity that receives or has received in the last 3 years significant donations from any of the companies in the GAS NATURAL FENOSA Group, excluding those who are mere trustees of a Foundation that receives donations.
  - g) Be spouses or persons bound by an analogous relationship of affectivity or consanguinity up to the second degree of an Executive Officer or Top Manager of the company.
  - h) Has not been proposed either by appointment or renewal by the Appointments and Remuneration Committee.
  - i) Are defined, in respect of a significant shareholder or represented on the Board, in any of the cases set out in letters a), e), f) or g) of this section. In the case of relatives under letter g), the limitation will be applied not only in relation to the shareholder but also in relation to its Board Members representing a key shareholder in the investee company.
- Board Members representing a key shareholder that are no longer such as a consequence of the sale of their shareholding by the shareholder they represented can only be re-elected as Independent Board Members when the

shareholder they represented until that time has sold all their shares in the Company.

- A Board Member that holds an interest in the Company can be an Independent, provided that he meets all the conditions set out in this article and, moreover, his shareholding is not significant (art. 12 Regulations of the Board).

#### Re-election of Board Members

- The Appointments and Remuneration Committee, in charge of evaluating the quality of the work and dedication to the office of the Board Members proposed during the preceding mandate, must report on the proposal to re-elect Board Members that the Board of Directors decide to nominate at the General Meeting of Shareholders (art. 14 Regulations of the Board).

#### Removal of Board Members

- Board Members will be removed from their office when the period for which they were appointed elapses and in all other cases set forth by current legislation, the Articles of Association and the Regulations in force.
- Board Members must submit their resignation to the Board of Directors and formalize, if the latter finds it appropriate, their respective resignation in the following cases:
  - a) When Internal Board Members resign from executive offices outside the Board to which their appointment was attached as Board Members.
  - b) When they meet the grounds of incompatibility or are prohibited under the Law, the Articles of Association or these Regulations.
  - c) When they seriously breach their obligations as Board Members, place the interests of the Company at risk.
  - d) When the reason for which they were appointed as Independent Board Members, Executives or Board Members representing a key shareholder disappears (art. 15 Regulations of the Board).

- After the removal from office, he will not be able to render services to a competing entity for a period of two years, unless the Board of Directors exempts him from this obligation or reduces its duration.

- When an independent Board Member resigns from office prior to the termination of his mandate for which he was elected, the reasons must be explained in a letter addressed to the other Board Members. The resignation will be reported as a relevant event. (art. 15 Regulations of the Board).

- f.2 In respect of the modification of the Articles of Association, articles 24, 32 and 68 of the Articles of Association and Article 2 of the Regulations of the General Meeting of Shareholders stipulate.

#### General Meeting of Shareholders

- The shareholders convened in a duly called General Meeting of Shareholders, will decide by a majority vote the issues that fall within the jurisdiction of the General Meeting of Shareholders.

- All the shareholders, including the opponents and those who have not participated in the meeting, are subject to the resolutions of the General Meeting of Shareholders (art. 24 Articles of Association).

Special resolutions and majorities. Constitution.

- In order for the ordinary or extraordinary General Meeting of Shareholders to be able to adopt a resolution to issue debentures, increase or decrease share capital, transform, merge or de-merge the company and, in general, make any modification to the Articles of Association, this will require, on first call, the presence of attending or represented shareholders holding at least (50%) of the share capital with voting rights. On second call twenty-five percent (25%) of said capital will be sufficient. (art. 32 Articles of Association).

Modification of the Articles of association

- The modification of the Articles of Association must be adopted at the General Meeting of Shareholders and requires the concurrence of the following requirements:
  - 1) The Board of Directors or, as the case may be, the shareholders proposing the resolution must present a written report justifying the modification.
  - 2) They must clearly explain at the meeting the points they wish to modify and the right of all the shareholders to examine, at the registered office, the full text of the modification proposed and the report on the same and to request that said documents be delivered to them free of charge.
  - 3) The resolution must be adopted by the General Meeting of Shareholders, in accordance with the provisions of the Articles of Association.
  - 4) In any case, the resolution will be recorded in a public deed, which will be inscribed in the Mercantile Register and published in its Official Gazette (art. 68 Articles of Association).

Powers of the General Meeting of Shareholders.

- The General Meeting of Shareholders, as the maximum decision-making body of the Company, has the power to adopt all types of resolutions regarding the Company, and, in particular:
  - I. Approve, as the case may be, the annual accounts of the Company and decide on the application of results, and approve, as the case may be, the consolidated annual accounts.
  - II. Appoint and remove the member of the Board of Directors, and, ratify or revoke the appointments made by cooptation by the Board and approve their management.
  - III. Appoint, as the case may be, or re-appointment, the Accounts Auditors.
  - IV. Agree on the issue of bonds, the increase or reduction in capital, the transformation, merger, demerger or winding up of the Company, and, in general, any modifications to the Articles of Association.



- V. Authorise the Board of Directors to increase share capital, in accordance with the provisions of article 153.1b) of the Spanish Public Limited Companies Act.
- VI. Authorise the derivative acquisition of treasury shares of the Company under the legal terms in force.
- VII. Confer upon the Board of Directors the powers which, for cases not foreseen, it deems necessary.
- VIII. Decide on the affairs that will be submitted to resolution by the Board of Directors.
- IX. Decide on the application of the remuneration systems consisting of the payment of shares or share options, and any other remuneration system that the value of the shares is indexed to, irrespective of who the beneficiary of said remuneration systems is.
- X. Decide on what is licit, especially in relation to the issues that are not especially regulated by the Articles of Association and are not exclusively the competence of the Board of Directors (art. 2 of the Regulations of the General Meeting of Shareholders).

g) The powers of the members of the Board of Directors and, in particular, those relating to the possibility of issuing or repurchasing shares:

The Company has conferred on the Chairman of the Board of Directors and the Chief Executive Officer broad powers of representation and management, which allows them to deal with the ordinary matters faced by the company, except those that cannot be delegated by Law, or by Articles of Association or Regulations that pertain to the General Meeting of Shareholders, the Board of Directors or its Committees.

In order to execute certain resolutions which, for various issues, require a specific mandate, the Board of Directors or the Executive Committee has conferred special powers upon the Chairman or the Chief Executive Officer, which expire after they are executed, in one single act.

The Board of Directors of the Company, by virtue of a resolution of the General Meeting of Shareholders of 20 April 2010, was authorised to increase capital by EUROS FOUR HUNDRED AND SIXTY EIGHT HUNDRED AND SEVENTY-EIGHT FOUR HUNDRED AND SEVENTY-FIVE (Euros 460,878,475) within a period of five years, through a cash disbursement or in one or several instalments, at the time and in the amount that the Board decides, by issuing ordinary, preferred or redeemable shares, with or without voting rights or premium, and without new authorization from the General Meeting, with the possibility of agreeing, as the case may be, to the full or partial exclusion of the preferred subscription right, as well as to modify the Articles of Association as required by the capital increase or increases under said authorization, if subscription falls short, in accordance with the provisions of article 153.1.b of the Spanish Public Limited Companies Act, thus voiding the authorisation adopted by the General Meeting of Shareholders of 26 June 2009.

The Board of Directors have not made use of the power conferred by the General Meeting of Shareholders of 20 April 2010.

Furthermore, the General Meeting of Shareholders of 20 April 2010, voiding the authorisation conferred upon the Board of Directors by the General Meeting of Shareholders of 26 June 2009, authorized the Board so that, within a period no greater than 5 in one time or more, up to a maximum of 10% of the share capital of the maximum number resulting from the application under current legislation at the time of acquisition of shares of the Company that are fully paid, without exceeding, amongst the shares acquired by the Company, and those held by the investee companies, the percentage mentioned above, or any other that is legally

established. The minimum and maximum price of acquisition will be the quotation price on the "Mercado Continuo" of the Spanish stock exchanges, within an oscillation of more or less 5%. In the event that the shares are not listed, the maximum and minimum price of acquisition will be established at one and a half and two times the carrying value of the shares, according to the last audited consolidated balance sheet. The Board of Directors is empowered to delegate this authorisation to the person or persons it deems suitable. This authorisation is understood to cover the acquisition of shares of the Company by investee companies.

The Board of Directors has not made use of this power conferred by the General Meeting of Shareholders.

h) The significant resolutions that have been executed by the Company and which come into force, are modified or conclude in the event of a change in control the company due to take over bid, and its effects, except when disclosure would be seriously damaging to the Company. This exception will not be applied when the company is legally obligated to divulge this information:

The Industrial Action Agreement entered into by REPSOL YPF and GAS NATURAL SDG, S.A., which constituted a relevant event, of which the Spanish Securities and Exchange Commission (Comisión Nacional del Mercado de Valores) was notified on 29 April 2005, as well as the Shareholders Agreement entered into by REPSOL YPF, S.A. and GAS NATURAL SDG, S.A. relating to REPSOL-GAS NATURAL LNG, S.L., include the change in control of the governing structure of either party to be cause for termination.

Likewise, the financing agreement entered into for the acquisition of Unión Fenosa, S.A. contemplates certain consequences, including termination, in the event of a change in control.

i) Agreements between the Company and its officers, management or employees who are entitled to indemnities when they resign or are dismissed unlawfully or if the labour relationship terminates as a result of a takeover bid:

The contract of the Chief Executive Officer contains a clause stipulating an indemnity that trebles his or her annual compensation in certain cases of termination of the relationship, and an indemnity of one year's remuneration in consideration for the post-contractual non-compete clauses for a period of one year.

The contracts entered into with the members of the Management Committee contain a clause that stipulates the minimum indemnity of two yearly pays of remuneration in certain cases of termination of contract and an indemnity equivalent to one yearly pay of fixed remuneration for the two-year post-contract non-compete clause.

Additionally, there are indemnity agreements with twenty-seven Executives, which amounts give them the right to receive a minimum indemnity in certain cases of termination of contract consisting of one year's pay. Furthermore, an indemnity is established equivalent to one year's pay of fixed remuneration a for post-contractual non-compete clause (non-compete and non-solicitation clause) for a period of two years as from the termination of the labour relationship.

#### **4. Environment and technological innovation**

Information on the environment is set out in Note 37 to the Annual Accounts.

GAS NATURAL FENOSA allocates a major portion of its resources and efforts to R+D+i, in order to optimise resources, develop new technologies and keep abreast of the technological advances in the sectors in which it operates.



GAS NATURAL FENOSA participates in domestic and international sectorial and business organisation. The collaboration in institutions of this type allows the Company to remain in the lead of sectorial knowledge and permits it to be identified as a benchmark in its various areas of activity.

## 5. Outlook

On 27 July 2010 GAS NATURAL FENOSA issued its new 2010-2014 Strategic Plan, which replaced the 2008-2012 Strategic Plan of GAS NATURAL and the Bigger Plan of UNION FENOSA.

Under the heading 'grow by integrating markets, the four basic axes on which the new Strategic Plan is based are to consolidate the current position of GAS NATURAL FENOSA in Spain and Latin America, vertically integrating up and midstream, entering new markets by replicating its business model in Spain, especially in markets in the Atlantic and Mediterranean basins, and, finally, opting decisively for continued emphasis on efficiency.

This Strategic Plan will allow GAS NATURAL FENOSA to position itself as a leading world company in gas distribution, a leader in efficiency in the Iberian Peninsula and Latin America, the third largest utility company in the Iberian Peninsula, the third largest LGN operator in the work and the third largest combined cycle operator in the world.

The acquisition of Unión Fenosa, S.A. by Gas Natural SDG, S.A. was adopted by the Spanish Anti-Trust Commission Council (*Consejo de la Comisión Nacional de la Competencia - CNC*) on 11 February 2009, subject to various commitments. Since then, GAS NATURAL FENOSA has carried out different transactions and agreements thanks to which it will meet most of the commitments imposed by the CNC:

- On 30 April 2010 GAS NATURAL FENOSA sold different natural gas commercialisation and distribution assets in the Region of Madrid.
- On 12 July 2010 GAS NATURAL FENOSA reached an agreement on the sale of the combined cycle plant in Plana del Vent to a Spanish company in the Swiss Alpiq energy group. This agreement represents the first step in the process of divestment of generation capacity through combined cycle plants, as imposed by the CNC and in which GAS NATURAL FENOSA continue working.

In addition to the divestments required to meet the obligations imposed by the CNC, throughout 2010 different agreements were reached on the sale of other assets:

- On 14 April 2010 GAS NATURAL FENOSA announced the completion of the private placement of its 5% stake in Indra Sistemas, S.A. (INDRA) and its final sale.
- On 3 June 2010 GAS NATURAL FENOSA completed the divestment of part of its electricity generation business in Mexico.
- On 2 August 2010, GAS NATURAL FENOSA and Enel Green Power agreed to terminate collaboration on renewable energies which until that date were carried out through Enel Unión Fenosa Renovables, S.A. (EUFER), the company in which company held a 50% stake. After the operation, each shareholder will receive approximately half the assets of EUFER. The transaction was approved in 10 November 2010 by the anti-trust authorities, and the parties are pending receipt of the regulatory and administrative authorisations required.
- On 30 November 2010 GAS NATURAL FENOSA sold certain assets that make up the electricity transport network to Red Eléctrica de España for Euros 47 million.

- On 17 December 2010 GAS NATURAL FENOSA sold its 35% interest in Gas Aragón, S.A. to Endesa Gas, S.A.U. The sale totalled Euros 75 million and generated gross gains of approximately Euros 40 million.

The combination of GAS NATURAL and UNION FENOSA permitted the identification of major operating and tax synergies. On 31 July 2008 operating synergies of Euros 300 million/year as from 2011 were announced.

Throughout 2009 these initial estimates and the final forecasts announced in November 2009 improved with the following synergies:

- Euros 350 million in annual operating synergies, of which Euros 260 million will be cost savings and Euros 90 million in income through synergies.
- Euros 200 million in CAPEX synergies.

Throughout 2010 these estimates have improved and the latest projections issued in November 2010 contemplate the following synergies:

- Euros 475 million in annual operating synergies, of which Euros 343 million would be cost savings and Euros 132 million revenues from synergies.
- Euros 275 million in CAPEX synergies.

Detailed action plans have been prepared and put into motion in order to reach the 2011 synergy target.

The organic growth and integration and use of operating synergies based on the integration of the assets of GAS NATURAL and UNION FENOSA, a balanced, moderate risk management, optimisation of the joint investment plan, and a decrease in the risk of execution of the growth strategy of the resulting group, should generate value for the shareholders of both companies.

With respect to financial discipline, GAS NATURAL FENOSA has the intention of optimizing its financial structure and maintaining a solid balance. GAS NATURAL FENOSA is reducing its debt thanks to divestments and cash generation from the businesses and expects that the leveraging will continue to diminish. In order to maximize the financial structure various bonds were issued in 2009 and 2010 totalling Euros 6,950 million. Also in January 2011 a 6-year bond issue was closed totalling Euros 600 million. GAS NATURAL FENOSA will continue to seek to optimize its financial structure in the financial markets.

## **6. Annual Corporate Governance Report**

Attached hereto as an Appendix to this Directors' Report, and forming an integral part of the same, is the Annual Corporate Governance Report for 2010, as required under article 526 of the Spanish Capital Companies Act.

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