GAS NATURAL SDG, S.A. AND ITS SUBSIDIARIES

Audit Report independent,
Consolidated Annual Accounts at 31 December 2016 and
Directors' Report for 2016

Gas Natural Fenosa
2016 Annual Report

CONSOLIDATED ANNUAL ACCOUNTS

Gas Natural Fenosa
Consolidated Balance Sheet (Million Euros)

	31.12.16	31.12.15
ASSETS		
Intangible assets (Note 5)	10,920	10,525
Goodwill	5,036	4,962
Other intangible assets	5,884	5,563
Property, plant and equipment (Note 6)	23,627	23,693
Investments recorded using the equity method (Note 7)	1,575	1,730
Non-current financial assets (Note 8)	1,907	1,387
Deferred income tax assets (Note 21)	872	1,070
NON-CURRENT ASSETS	**38,901**	**38,405**
Non-current assets held for sale (Note 9)	-	955
Inventories (Note 10)	758	826
Trade and other receivables (Note 11)	4,999	5,191
Trade receivables	4,348	4,521
Other receivables	489	472
Current tax assets	162	198
Other current financial assets (Note 8)	389	365
Cash and cash equivalents (Note 12)	2,067	2,390
CURRENT ASSETS	**8,213**	**9,727**
TOTAL ASSETS	**47,114**	**48,132**
NET EQUITY AND LIABILITIES		
Share capital	1,001	1,001
Share premium	3,808	3,808
Reserves	9,549	9,077
Treasury shares	(21)	-
Net income for the year attributed to the equity holders of the parent company	1,347	1,502
Interim dividend	(330)	(408)
Adjustments for changes in value	(129)	(613)
Available-for-sale financial assets	7	4
Hedging operations	47	(119)
Currency translation differences	(183)	(498)
Net equity attributable to the equity holders of the parent company	**15,225**	**14,367**
Non-controlling interests	**3,780**	**4,151**
NET EQUITY (Note 13)	**19,005**	**18,518**
Deferred income (Note 14)	842	853
Non-current provisions (Note 15)	1,248	1,488
Non-current financial liabilities (Note 16)	15,003	15,653
Borrowings	14,997	15,599
Other financial liabilities	6	54
Deferred income tax liability (Note 21)	2,509	2,543
Other non-current liabilities (Note 18)	1,331	944
NON-CURRENT LIABILITIES	**20,933**	**21,481**
Liabilities related to non-current assets held for sale (Note 9)	-	585
Current provisions (Note 15)	158	193
Current financial liabilities (Note 16)	2,599	2,595
Borrowings	2,437	2,446
Other financial liabilities	162	149
Trade and other payables (Note 19)	4,072	4,008
Trade payables	3,274	3,096
Other creditors	692	777
Current tax liabilities	106	135
Other current liabilities (Note 20)	347	752
CURRENT LIABILITIES	**7,176**	**8,133**
TOTAL NET EQUITY AND LIABILITIES	**47,114**	**48,132**

Notes 1 to 38 form an integral part of these Consolidated annual accounts

Gas Natural Fenosa
Consolidated Income Statement **(Million Euros)**

	2016	**2015**
Sales (Note 22)	23,184	26,015
Procurements (Note 23)	(15,420)	(17,997)
Other operating income (Note 24)	265	257
Personnel costs (Note 25)	(1,013)	(973)
Other operating expenses (Note 26)	(2,467)	(2,360)
Depreciation, amortisation and impairment expenses (Notes 5 and 6)	(1,759)	(1,750)
Release of fixed assets grants to income and others (Note 14)	43	64
Gain/(loss) on disposals of tangible fixed assets (Note 27)	51	-
Other results (Note 28)	122	5
OPERATING INCOME	**3,006**	**3,261**
Financial income	131	140
Finance expense	(954)	(1,032)
Variations in fair value of financial instruments	(2)	(1)
Net exchange gains/losses	-	(1)
NET FINANCIAL INCOME (Note 29)	**(825)**	**(894)**
Profit/(loss) of entities recorded by equity method (Note 7)	(98)	(4)
PROFIT/(LOSS) BEFORE TAXES	**2,083**	**2,363**
Income tax expense (Note 21)	(416)	(573)
NET INCOME FOR THE YEAR FROM CONTINUING OPERATIONS	**1,667**	**1,790**
Net income for the year from discontinued operations, net of taxes (Note 9)	44	34
CONSOLIDATED NET INCOME FOR THE YEAR	**1,711**	**1,824**
Attributable to:		
Equity holders of the parent company	1,347	1,502
From continuing operations	1,325	1,491
From discontinued operations	22	11
Non-controlling interests (Note 13)	364	322
Basic and diluted earnings per share in euros from continuing operations attributable to the equity holders of the parent company (Note 13)	1.33	1.56
Basic and diluted earnings per share in euros attributable to the equity holders of the parent Company (Note 13)	1.35	1.57

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Gas Natural Fenosa
Consolidated Statement of Comprehensive Income **(Million Euros)**

	2016	2015
CONSOLIDATED NET INCOME FOR THE YEAR	**1,711**	**1,824**
OTHER COMPREHENSIVE INCOME RECOGNISED DIRECTLY IN NET EQUITY	**445**	**(410)**
Items that will not be transferred to profit/(loss):		
Actuarial gains and losses and other adjustments (Note 15)	(51)	7
Tax effect (Note 21)	13	(2)
Items that will subsequently be transferred to profit/(loss):		
Valuation of available-for-sale financial assets	4	5
Tax effect valuation of available-for-sale financial assets (Note 21)	(1)	(1)
Cash flow hedges	111	(120)
Tax effect cash flow hedges (Note 21)	(31)	28
Currency translation differences	378	(358)
Equity-consolidated companies	22	31
Cash flow hedges	2	(8)
Tax effect cash flow hedges (Note 21)	-	1
Currency translation differences	20	38
RELEASES TO INCOME STATEMENT	**115**	**(26)**
Valuation of available-for-sale financial assets	-	-
Cash flow hedges	106	(46)
Tax effect cash flow hedges (Note 21)	(28)	12
Currency translation differences	32	-
Equity-consolidated companies (Note 7)	5	8
Cash flow hedges	9	10
Tax effect cash flow hedges (Note 21)	(2)	(2)
Currency translation differences	(2)	-
OTHER COMPREHENSIVE INCOME FOR THE YEAR	**560**	**(436)**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	**2,271**	**1,388**
Attributable to:		
Equity holders of the parent company	1,801	1,093
Non-controlling interests	470	295

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Gas Natural Fenosa
Statement of changes in consolidated net equity (Million euros)

	Net equity attributable to the Company's equity holders						
	Share Capital	**Share Premium and reserves**	**Treasury shares**	**Adjustments for changes in value**	**Subtotal**	**Non-controlling interests**	**Total Net equity**
Balance at 1.1.15	**1,001**	**11,877**	**-**	**(199)**	**14,141**	**3,879**	**18,020**
Total comprehensive income for the year	-	5	-	(414)	**1,093**	295	**1,388**
Dividends distribution (Note 13)	-	542	-	-	**(920)**	(188)	**(1,108)**
Business combinations (Note 31)	-	-	-	-	**-**	5	**5**
Other variations (Note 13)	-	53	-	-	**53**	160	**213**
Balance at 31.12.15	**1,001**	**12,477**	**-**	**(613)**	**14,367**	**4,151**	**18,518**
Total comprehensive income for the year	-	(30)	-	484	**1,801**	470	**2,271**
Dividend distribution (Note 13)	-	579	-	-	**(923)**	(214)	**(1,137)**
Business combinations (Note 31)	-	-	-	-	**-**	-	**-**
Other variations (Note 13)	-	1	(21)	-	**(20)**	(627)	**(647)**
Balance at 31.12.16	**1,001**	**13,027**	**(21)**	**(129)**	**15,225**	**3,780**	**19,005**

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Gas Natural Fenosa
Consolidated cash flow statement **(Million euro)**

	2016	2015
Income before tax	**2,083**	**2,363**
Adjustments to income (Note 30):	**2,495**	**2,599**
Depreciation, amortisation and impairment expenses (Note 5, 6 and 9)	1,759	1,791
Other adjustments to net income (Note 30)	736	808
Changes in working capital (Note 30)	**5**	**(75)**
Other cash flow generated from operations (Note 30):	**(1,208)**	**(1,387)**
Interest paid	(793)	(898)
Interest collected	31	24
Dividends collected	79	82
Income tax paid	(525)	(595)
CASH FLOW GENERATED FROM OPERATING ACTIVITIES(1)	**3,375**	**3,500**
Cash flows into investing activities:	**(2,556)**	**(2,065)**
Group companies, associates and business units (Note 31)	(331)	(99)
Property, plant and equipment and intangible assets	(2,147)	(1,894)
Other financial assets	(78)	(72)
Proceeds from divestitures:	**653**	**436**
Group companies, associates and business units (Note 9 and 28)	405	97
Property, plant and equipment and intangible assets	222	1
Other financial assets	26	338
Other cash flows from investing activities:	**49**	**69**
Other proceeds/(payments) from/(of) investing activities (Note 14)	49	69
CASH FLOWS FROM INVESTING ACTIVITIES (1)	**(1,854)**	**(1,560)**
Receipts/(payments) for equity instruments:	**(27)**	**270**
Issue (Note 13)	-	986
Acquisition (Note 13)	(27)	(716)
Receipts and payments on financial liability instruments:	**(243)**	**(2,100)**
Issue (Note 16)	7,826	5,943
Repayment and amortisation (Note 16)	(8,069)	(8,043)
Dividends paid and remuneration of other equity instruments (Note 13)	**(1,526)**	**(1,070)**
Other cash flows from financing activities	**(61)**	**(123)**
CASH FLOW GENERATED FROM FINANCING ACTIVITIES(1)	**(1,857)**	**(3,023)**
Other variations in cash and cash equivalents	**(42)**	**-**
Effect of changes in exchange rates	**55**	**(99)**
VARIATION IN CASH AND CASH EQUIVALENTS	**(323)**	**(1,182)**
Cash and cash equivalents at beginning of the year (Note 12)	2,390	3,572
Cash and cash equivalents at year end (Note 12)	2,067	2,390

(1) Includes cash flows from continuing and discontinued operations (Note 9).

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Notes to the consolidated annual accounts of Gas Natural Fenosa for 2016

Note 1. General information

Gas Natural SDG, S.A. is a public limited company that was incorporated in 1843. Its registered office is located at 1, Plaça del Gas, Barcelona.

Gas Natural SDG, S.A. and its subsidiary companies ("Gas Natural Fenosa") form a group that is mainly engaged in the supply, liquefaction, re-gasification, transport, storage, distribution and commercialisation of natural gas, as well as the generation, transport, distribution and commercialisation of electricity.

Gas Natural Fenosa operates mainly in Spain and also outside Spain, especially in Latin America, in the rest of Europe and Africa.

Note 4 includes financial information by operating segment and geographic area.

Appendix I lists the investee companies of Gas Natural Fenosa.

The shares of Gas Natural SDG, S.A. are listed on the four official Spanish stock exchanges, are traded simultaneously on all four ("mercado continuo"), and form part of the Ibex35.

Note 2. Regulatory framework

2.1. Regulation on the natural gas industry in Spain

<u>Main characteristics of the natural gas industry in Spain</u>

The Spanish gas sector is regulated by Law 34/1998, October 7, on the hydrocarbons sector, as amended by Law 12/2007, July 2, Royal Decree-law 13/2012 and Law 18/2015, May 21, as well as Law 18/2014, and by its enabling regulations, the most relevant being Royal Decree 1434/2002, December 27, Royal Decree 949/2001, August 3 and Royal Decree 984/2015, 30 October.

The Ministry of Energy, Tourism and the Digital Agenda (MINETAD) previously denominated Ministry of Industry, Energy and Tourism (MINETUR) is the competent organisation in the regulation of the gas and electricity industries, while the National Markets and Competition Commission (CNMC) is the regulatory authority in charge of maintaining and ensuring effective competition and transparent functioning of the Spanish energy industries. Prior to the publication of Law 3/2013 of June 4, these functions were performed by the National Energy Commission (CNE), which was integrated into the CNMC. The Ministries belonging to the Regional Governments have competencies in legislative enactment and regulatory powers.

Furthermore, the Technical Manager of the System, Enagás, S.A., is responsible for the appropriate functioning and coordination of the gas system. It should therefore be borne in mind that Law 12/2007 limits the shareholding in Enagás, S.A. to a maximum of 5% of its share capital, and voting rights to 3% in general, and the voting rights of participants in gas activities to 1%, and, in any case, the sum of the interest of the shareholders undertaking activities in the gas sector cannot exceed 40%.

In general, the Spanish gas sector has the following main characteristics:

- It is an industry in which regulated and unregulated activities coexist. The regulated activities consist of transport, regasification, storage and distribution of natural gas. The non-regulated activities comprise generation, supply and retailing of natural gas.

- The natural gas sector is practically entirely dependent on foreign supplies of natural gas, which represent almost 99.9% of the natural gas supply in Spain.

- Under EU legislation (Directives 2003/55/CE of June 26, and 2009/73/UE), the supply of natural gas in Spain is totally de-regulated, and all Spanish consumers can freely choose their natural gas provider as from 1 January 2003. The deregulation procedure for the industry has been reinforced substantially by the disappearance as from 1 July 2008 of the bundled tariff of distribution companies and the subsequent right of consumers to participate in the deregulated market (although as indicated further below a tariff of last resort has been maintained for consumers of lower consumption).

Regulation of natural gas activities in Spain

The natural gas activities are divided into: 1) regulated activities: transport, storage, regasification and natural gas distribution; and 2) non-regulated activities: production, supply and commercialisation of natural gas.

2.1.1. Regulated activities

Regulated activities are characterised by:

- *Need for prior government authorisation:* The undertaking of regulated activities requires prior regulated administrative authorisation. In order to obtain this authorisation, the applicant must basically demonstrate its legal, technical and economic capacity to exercise this activity.

- *Remuneration established by legislation:* The general directives that set the remuneration for these activities are governed by Law 18/2014 and Royal Decree 949/2001, while the specific remuneration to be received is updated annually by ministerial order.

  Thus, the economic framework of these activities tries to incentivise grid development and allow the companies that undertake them to ensure the recovery of the investments made and the operating costs incurred.

  The regulatory framework for the natural gas industry in Spain has a procedure for settlement compensation amongst companies in the sector for net invoicing of gas acquisition and other costs, so that each company receives the appropriate remuneration for their regulated activities.

- *Subjection to specific obligations of third party access to the network and unbundling:* The carrying out of the regulated activities is subject to specific obligations to ensure the development of competition in retailing. The two main obligations in this sense consist of permitting access by third parties to the transport and distribution pipelines (including regasification and storage) and the obligation to keep the regulated and non-regulated activities separate.

Royal Decree 948/2015, October 30, regulates access by third parties to the network, which is managed by a single telematic platform, as well as the rights and obligations of each person involved in the system, changing the procurement regime capacity established in 2001 by Royal Decree 949/2001. The owners of the transport and distribution pipelines have the right to receive tolls and levies in consideration for this access, which are revised annually under ministerial order.

The legislation establishes the duty of functional separation, which means not only accounting separation, in order to avoid cross-subsidization and increase the transparency of the calculation of rates, tolls and levies, and legal separation, through separate companies, but also the requirement of independent operation of the regulated subsidiary company in relation to the other companies in the group.

2.1.1.1. Transport

The transport activity includes re-gasification, storage and transport of gas in the strict sense through the basic high pressure gas pipeline network:

- *Re-gasification:* Natural gas is imported to Spain through a pipeline network (in gas form) and by gas tankers (in liquid form, hereon, liquefied natural gas). The re-gasification is the activity that involves the conversion of liquid natural gas, stored in cryogenic tanks generally at re-gasification plants, into a gaseous state, and then pumped into the national gas pipeline network.

- *Transport*: once the natural gas is imported or produced and, if necessary, regasified, it is injected in gas form into the high pressure gas pipeline transport network. The transport network crosses most regions in Spain and transports the natural gas to the major consumers, such as electricity plants and industrial customers and local distributors.

  The transport network is owned mainly by Enagás, S.A., although certain Gas Natural Fenosa companies own a small proportion of it.

- *Storage*: facilities consist basically of underground tanks, which are necessary to ensure a constant supply of natural gas unaffected by seasonal changes and other demand peaks. These facilities also serve to fulfil the obligation established by Royal Decree 1766/2007 (28 December) to maintain minimum security reserves. Prevailing legislation allows unregulated underground storage facilities with third-party access, negotiated and previously authorised by the Spanish Government, although there are currently no such facilities.

  On October 4, 2014, Royal Decree-Law 13/2014, October 3, was published, on urgent measures relating to the gas system and ownership of nuclear plants. With respect to the gas sector, this Royal Decree-Law is intended to resolve the technical situation at the Castor natural gas storage facility and to resolve the waiver of the concession submitted by the holder (Escal UGS, S.L.). Specifically, the facility was put into hibernation, the concession to operate the storage facility was terminated and the administration and maintenance of the facility was assigned to Enagás, S.A., the related costs being remunerated by the gas system. Finally, the amount of Euros 1,351 million was recognised to be payable to Escal UGS, S.L., based on the value of the investment. This sum was paid by Enagás, S.A. in exchange for a debt claim against the gas system for the coming 30 years that may be assigned to third parties.

2.1.1.2. Distribution

Natural gas is transported from the high pressure transport pipeline network to the final consumer through the medium and lower pressure transport pipeline network.

The distribution business is based on a system of administrative authorisations that carry no exclusive use rights. A zone distributor has preference to obtain authorisations for adjoining zones.

A distributor's activity is restricted to the expansion and management of distribution networks; it cannot market power because specifically authorised supply companies are entrusted with last-resort supplies, as mentioned in point 2.1.2.2.

Law 18/2014 (17 October) established certain principles and regulations designed mainly to guarantee the gas system's economic and financial sustainability:

- The principle of the gas system's economic and financial sustainability is established, whereby any regulation relating to the sector that entails an increase in costs for the gas system or a reduction in revenue must also bring an equivalent reduction in other cost items or an equivalent increase in revenue to ensure a balance in the system.

- The principle of economic and financial sustainability means that the revenue generated from the use of the facilities must meet all system costs. Gas system revenue will be employed solely to remunerate the regulated activities performed to supply gas.

- Annual mismatches between system costs and revenue are limited and may not exceed 10% of revenue payable for the period; the sum of the annual mismatch and recognised outstanding yearly payments may not exceed 15%. If this sum is exceeded, tolls will be automatically revised to cover the portion that exceeds said limits. The portion of the mismatch which, without exceeding the limits, is not offset by the rise in tolls and charges, will be financed by the parties subject to the settlement system, in proportion to the remuneration applicable to them; they will be entitled to collect mismatch contributions over the following five years and an interest rate will be applied on market terms.

- The remuneration methodologies regulated in the natural gas sector will take into consideration the costs necessary for the activity to be performed by an efficient, well-managed company under the principle whereby the activity must be performed at the lowest possible cost to the system.

- Six-year regulatory periods have been established for the remuneration of regulated activities, allowing for possible adjustments every three years to the system's remuneration parameters (including unit reference values for customers and sales, operating and maintenance costs, etc.) in the event of significant changes to revenue and cost items. The first regulatory period will end on 31 December 2020.

- The remuneration system for transmission, regasification and storage facilities is based on consistent principles: use of the asset's net value as a basis for calculating investment remuneration, inclusion of variable remuneration based on gas transported, regasified or stored by asset type, and elimination of all automatic review procedures for values and parameters based on price indices.

- With respect to new secondary transmission facilities, remuneration is included in the remuneration methodology for distribution facilities, linking remuneration to growth in customers and to new demand generated.

- Having regard to distribution facilities, remuneration is maintained for each distribution company and all its facilities based on the number of customers connected and the volume of gas supplied. Automatic reviews are eliminated, and the parametric remuneration formula is stablished to distinguish, in the remuneration category for supplies at pressures equal to or below 4 bars, between consumers with an annual consumption of less than 50 MWh and consumers with a higher consumption, so as to guarantee the adequacy of system revenue at all consumption levels, taking into account toll revenue in each case.

- In order to incentivise network expansion to non-gasified zones and bring remuneration into line with actual costs incurred by companies, different unit values are used depending on whether or not customers are in recently-gasified municipalities.

- As regards the gas system's accumulated deficit at 31 December 2014, it is being recognised. This deficit will be financed by facility owners over a 15-year period; annual payments will be included as a system cost and an interest rate will be recognised on similar terms to market rates.

- The departure relating to remuneration for natural gas under the Algeria contract, supplied through the Maghreb pipeline, and assigned to the tariff market, as a result of the Award issued by the Paris International Court of Arbitration on 9 August 2010, has been recognised in as a system cost. The amount of Euros 164 million will be paid as from 2015 over five years, applying market conditions.

Order IET/2736/2015 of 17 December 2015 established the remuneration for regulated gas sector activities for 2016.

Order IET/1977/2016 of 23 December 2016 established the remuneration for regulated gas sector activities for 2017. Additionally, this Order updated the tolls and levies for third-party access to gas facilities.

2.1.2. Unregulated activities

2.1.2.1. Supplies

Taking into account the small volume of natural gas production in Spain, this section will centre on the international supply of natural gas.

The supply of natural gas in Spain is carried out mostly through gas operators such as Gas Natural Fenosa through long-term contracts with gas producers. This supply, although it is an unregulated activity, is subject to two types of limitations, the purpose of which consist basically of ensuring the diversification of supply and the introduction of competition into the market: 1) no country can supply more than 60% of the gas imported into Spain; and 2) no business person or group can contribute as a whole natural gas for consumption in Spain that is greater than 70% of national consumption, excluding self-consumption.

2.1.2.2. Commercialization

Pursuant to 12/2007 Law and its enabling regulations, natural gas is supplied exclusively by supply companies, the former tariff supply operations previously performed by distribution companies having been eliminated. The Law recognises that consumers connected at less than 4 bars who do not exceed a certain consumption threshold (50 MWh/year) are entitled to be supplied at a maximum price referred to as the social tariff or last-resort tariff (TUR).

The TUR calculation includes raw material costs, access tolls, supply costs and supply security costs.

The Ministry of Industry, Energy and Tourism issued Order ITC/1506/2010 (8 June), whereby the last-resort tariff for natural gas will be established in a ruling from the Directorate General for Energy Policy and Mines. The fixed and variable terms of the tariffs will be reviewed when there is a modification of the tolls and levies for access to the system or in the waste coefficients in force. The variable term will be reviewed quarterly, as from the 1st day of the months of January, April, July and October of each year, provided that the cost of raw materials varies upward to downward by 2%.

As regards energy efficiency, Royal Decree-Law 18/2014, stipulates the following:

- The national energy efficiency obligations system is created, whereby gas and electricity supply companies, oil product wholesalers and liquefied petroleum gas wholesalers will be allocated an annual energy-saving quota (saving obligations). Aggregate saving obligations will be equal to the target allocated to Spain in Directive 2012/27/EU.

- The National Energy Efficiency Fund allow the implementation of economic and financial support mechanisms, technical assistance, training and information, or other measures to enhance energy efficiency in different sectors, which are necessary to achieve the Energy Efficiency Directive's objectives.

- The financial equivalence of the saving obligations will be determined based on the average cost of the support mechanisms, incentives and measures required to mobilise the investments necessary to fulfil the annual saving target, through actions by the National Fund, based on the findings of the technical analysis by the Institute for Energy Diversification and Saving.

- The Government is also authorised to establish and develop a final energy savings accreditation system, by issuing Energy Saving Certificates (ESC). Once launched, this will allow companies to progressively fulfil their saving obligations by directly promoting energy efficiency enhancement actions that fulfil the necessary guarantees.

An annual ministerial order stipulates each liable party's obligations to make contributions to the National Energy Efficiency Fund. Order IET/289/2015 established obligations in 2015 and Order IET/359/2016 established the obligations for 2016.

Law 8/2015 was published on 22 May 2015, amending Law 34/1998 on the Hydrocarbons Sector and regulating certain tax and non-tax measures relating to hydrocarbons exploration, investigation and exploitation. This law creates an organised wholesale market and designates the organised gas market operator; the aim is to integrate, into the organised gas market, activities carried on throughout the Iberian Peninsula, in both Spain and Portugal.

On 31 October 2015, Royal Decree 984/2015, October 30, was published, regulating the organised gas market and third-party access to natural gas system facilities; on 9 December

2015, the Ruling of 4 December 2015 from the Secretary of State for Energy was published, approving market rules, the standard-form contract and the organised gas market rulings. The organised gas market became operational in December 2015, managed by MIBGAS.

The Resolution of 6 June 2016 of the Secretary of State for Energy (SEE) was published on 11 June 2015, and approved various provisions concerning the organised gas market, including the figure of market makers, the acquisition of cushion gas for Yela and the acquisition of heel gas and base gas.

The SEE Resolution of 2 August 2016 was published on 5 August 2016, and approved the rules for the management of guarantees in the gas system. This Resolution lays down a standardised model for the provision of guarantees and determines the amount and duration of guarantees for mismatches in the virtual handover point and of guarantees required for contracting capacity, defines the valid instruments for concluding guarantees and, finally, establishes the protocol for communication with the Guarantee Manager and the action protocol in the event of non-compliance.

In addition, The SEE Resolution of 2 August 2016 was published on 5 August 2016, approving the framework contract for access to the facilities of the Spanish gas system. The purpose of the framework contract is for users (supply companies or direct customers in the market) to contract services for accessing the gas system facilities, excluding the contracting of handover point access services, to or from a gas pipeline connection with Europe.

The tariff of last resort (TUR) has fluctuated as follows in 2016:

- On 30 December 2015, the DGPEM Ruling of 23 December 2015 was published, entailing an average 3.4% cut in the TUR applicable as from 1 January 2016.
- On 31 March 2016, the DGPEM Ruling of 29 March 2016 was published, entailing an average 3% cut in the TUR applicable as from 1 April 2016.
- On 30 September 2016, the DGPEM Ruling of 26 September 2016 was published, entailing an average 1.1% rise in the TUR applicable as from 1 October 2016.
- On 31 December 2016, the DGPEM Ruling of 29 December 2016 was published, entailing an average 3.5% rise in the TUR applicable as from 1 January 2017.

The supply of liquefied petroleum gas (LPG) is regulated by Law 34/1998 on the oil and gas industry.

The MINETAD establishes the selling rates for piped LPG for end consumers and the assignment prices of LPG at which it is purchased by piped LPG distributors, laying down the specific rates or a system for automatically calculating and updating them. These prices are published under monthly resolutions.

2.2. Regulation of the natural gas industry in Latin America

In Brazil, Colombia and Mexico there are stable regulatory and pricing frameworks that set out the procedures and processes needed for periodical rate and distribution margin reviews. The rate review is carried out every five years through the filing of the respective rate reports with the regulators.

The regulatory framework in Mexico is under review, to be brought into line with the Energy Reform decided on at the end of 2013. With respect to gas distribution, a simplification in the payment method is expected which is to favour distributors. Gas Natural Fenosa distributors in Mexico have rates approved for the five year period 2016 – 2020.

In Brazil, on 30 December 2013, the regulator for Río de Janeiro state approved the new tariffs, applicable from 1 January 2014 to the end of 2017. In aggregate terms, unit revenue from this activity is maintained.

In Brazil, the Sao Paulo state regulator is expected to approve new tariffs during 2017.

The tariff review process in Colombia is still under way. The distributors presented their applications for new tariffs in October 2015 in accordance with resolution CREG-202-2013, but on 15 July 2016 resolution CREG-93-2016 was published which revoked certain provisions of CREG-202 and shelved the cases filed by the distribution companies for the calculation of the new distribution tariffs. No resolution has yet been approved concerning the part of the methodology which was revoked by resolution CREG-202. However, the new distribution tariffs are expected to be approved in 2017.

In Argentina, The Ministry of Energy and Mining (MEM) published a resolution on 1 April 2016 establishing the new natural gas prices, instructing the Argentinian regulator to commence the tariff review process which should be completed by March 2017 and ordering the publication of a new transitional tariff list that would enable distributors to comply with the investment plan envisaged, meet O&M, administration and marketing expenses, and fulfil their obligations, which would remain in force until the end of the tariff review process.

The new transitional tariff list led to major increases in the final rate paid by consumers, which in turn led to complaints being filed with the courts. The MEM therefore decided to restrict the final figure to be paid by some consumers by means of arranging discounts in natural gas prices. During June, July and August legal judgements were handed down which annulled the transitional tariffs and ordered a public hearing to approve new tariffs. As a result, the distributors were temporarily unable to apply the tariffs and bill their customers.

In August 2016 the MEM issued a new resolution in order to enforce, inter alia, the retroactive application of the tariffs in force in 2015 to residential consumers for energy consumed by them as from 1 April 2016 and the establishment of a four-month period for consumers to pay the sums that had not been paid to distributors due to the judicial annulment of the transitional tariffs. The regulator was also instructed to convene a public hearing to approve the transitional tariffs.

Following the public hearing, in September 2016 the MEM issued a new resolution for the adaptation of the prevailing transitional tariffs that would allow gas distributors to meet their obligations, in order to ensure the continuity of the ordinary provision of the service until the definitive tariff lists were established as a result of the Comprehensive Tariff Review.

Additionally, in order to reduce the impact on distributors of the judicial annulment of the tariffs and their incapacity to issue invoices for a number of months, the distributors asked the Argentinian Government to provide them with temporary financial assistance, which was eventually granted on 30 December 2016 for a total of 3,450 million Argentinean pesos, to resolve the Mandatory Investment Plan and the repayment of debts to production companies, of which 594 million Argentinian pesos pertains to Gas Natural BAN, S.A.

In Chile, natural gas distribution regulations are limited to technical aspects. Tariffs are freely established by the distributor, which is also the supply company. The Law provides for the possibility of establishing mandatory tariffs for low-consumption customers should the

Competition Court (TDLC) demonstrate that there is a monopoly situation. This has not been the case to date.

During 2016 a Bill has been processed to amend the Law on gas services in order to cover certain regulatory lacunae existing under the current Law. The changes include the function of the TDLC, the function of which is now fulfilled by a committee of experts. The period to be considered in profitability analyses has also been extended from one to three years. The Bill was approved by the Congress and Senate, and is expected to be enacted in early 2017. These regulatory developments are not expected to affect management of this activity.

2.3. Regulation of the natural gas industry in Italy

In Italy, natural gas supply activity has been totally deregulated since 1 January 2003. However, residential customers (customers who do not exceed the threshold of 2 Gwh per year) that have not elected to use a new supplier, the price of the natural gas supplied is still set by the Autorità per Energia Elettrica e il Gas (the Italian National Energy Commission, AEEG). On the other hand, for residential customers that have opted for a new natural gas provider in the market, the AEEG has established, on the basis of effective service costs, reference tariffs that the supply companies, as part of their public service obligations, must include in their commercial offering.

In the region of Sicily, the liberalisation of the natural gas supply activities is being implemented, under different modalities and deadlines, and is expected to be completed by 1 January 2010, when all the consumers will be free to choose their supplier.

The supply of natural gas can only be made by companies that are not engaged in other activities in the natural gas sector, except import, export, production and wholesaling. There is also an obligatory legal separation of the operator from the distribution system, and limitations on the maximum percentages of supplies and retailing, in order to foster competition and the entry of new operators.

By means of Delibera number 573 of December 2013, the Italian Regulator published the rates for the period 2014-2019. There are no fundamental changes in the methodology.

At end-2016 the Regulator instigated a process of discussion with Agents for the modification of investments to be made in the future. This process is still under way.

2.4. Regulation of the Electricity sector in Spain

<u>Main characteristics of the electricity sector in Spain</u>

Electricity industry regulation in Spain was reformed during 2013 through Law 24/2013 on the Electricity Industry which adapted the existing Law (Ley 54/1997) to the situation both in the economy and in the Spanish electricity and energy sector.

The Ministry of Energy, Tourism and the Digital Agenda (MINETAD) is responsible for regulating the gas and electricity sectors, which the CNMC is the regulatory authority in charge of maintaining and ensuring competition and the transparent functioning of the Spanish energy industries. The Ministries belonging to the Regional Governments have competencies in legislative enactment and regulatory powers. The Nuclear Safety Council exercised specific competencies over the facilities using this technology.

Furthermore, the Technical Manager of the System, Red Eléctrica de España, S.A. (REE), has the main function of guaranteeing the continuity and safety of the electricity supply and the proper coordination of the production and transport system. It should be borne in mind that Law provides a strict legal separation between the system operator and the activities of generation or sale of electric power.

Generally, the electricity sector has the following main features:

- It is an industry in which regulated and de-regulated activities coexist. The regulated activities consist of transport and electricity distribution (as well as system and market operation). The non-regulated activities comprise generation and retailing of electricity.

  Following the directives of EU legislation (Directives 2009/72/CE), all Spanish consumers can freely choose their electricity provider. A system of regulated tariff applies to consumers with contracted capacity of less than or equal to 10kW. This regulated tariff has been referred to as the Small Consumer Voluntary Price (PVPC), and it also exists the last-resort tariff (TUR) having become the regulated price which is calculated from PVPC and applicable to consumers classed as vulnerable and to consumers that do not meet requirements to apply the PVPC but are temporarily without a supply company in the free market. The social tariff (TUR) for vulnerable consumers is funded by the social bond, thath will be financed by the holding group companies engaged in electricity supply activities or directly by the suppliers if they are not part of a group .

- The electricity consumed in Spain is mostly generated domestically, since the international connections with France and Portugal have a very limited capacity.

- The Iberian Electricity Market (MIBEL) has operated effectively between Spain and Portugal since 1 July 2007, the electricity systems of both countries having been integrated (although integration is still not perfect).

- During the period 2000-2013 the electricity system was not self-sufficient, generating an annual deficit that has been financed by the conventional electricity companies, among them Gas Natural Fenosa.

- With the aim of eliminating the sector deficit, a number of provisions introduced in recent years have brought in important measures and adjustments to electricity sector activities to correct departures caused by mismatches between costs and revenue, culminating in the regulatory package known as the July 2013 electricity reform and the approval in December 2013 of Electricity Sector Law 24/2013, which established the basic principle of the sector’s economic and financial sustainability.

Finally, on December 27, Law 24/2013 of December 26 on the electricity sector was published, the main developments being:

– With respect to the principle of the system's economic and financial sustainability:

  - The remuneration calculation parameters will have a six-year term and will be reviewed prior to the start of the regulatory period taking into account the economic cycle, demand for electricity and an adequate return from these activities.

- A distinction is made between transmission and distribution grid access tolls and the charges that are necessary to cover other costs of the relevant system activities, which will be determined using methodology to be established by the Government; in general, tolls and charges will be reviewed annually or in the event of circumstances that have a material impact on regulated costs or on the calculation parameters employed.

- Small consumer voluntary prices (PVPC) are regulated and will be applicable throughout Spain. In line with the prices previously referred to as last-resort tariffs, these prices are defined as the maximum prices that the reference supply companies may collect from consumers that avail themselves of the prices. The last-resort tariff (TUR) has become the regulated price applicable to consumers classed as vulnerable and to consumers that do not meet requirements to apply the voluntary price for small consumers but are temporarily without a supply company in the free market.

- Mismatches due to a shortfall in revenues are limited to the extent that they may not exceed 2% of revenues estimated for the period in question and cumulative liabilities due to mismatches may not exceed 5% of those revenues. Should these limits not be observed, the relevant tolls or charges will be reviewed. The portion of the mismatch that is not offset by a rise in tolls and charges shall be financed by the parties subject to the settlement system in proportion to their debt claims arising from the activities performed. The amounts contributed in this way will be reimbursed in the settlements for the following five years, plus applicable interest. Any surplus revenues generated will be used to offset prior-year mismatches; while there are outstanding prior-year liabilities, the access tolls or charges may not be reduced.

- For 2013, a revenue deficit in electricity system settlements is recognised in a maximum amount of Euros 3.6 Billion, which will give rise to debt claims consisting of the right to receive a part of the monthly billings for 15 successive years as from 1 January 2014, until the debts are settled.

- The obligation to keep separate accounting records is extended, applying not only to the separation of electricity activities from non-electricity activities, but also to the separation of regulated-remuneration activities from unregulated-remuneration activities in electricity generation. This obligation extends to all producers receiving regulated remuneration.

– Electricity generation:

  - The temporary closure of generation facilities is contemplated and will be subject to prior administrative authorisation.

  - Hydraulic resources necessary for electricity generation are regulated, as is the daily market supply system, one special provision being that all production units must offer to supply electricity to the market, including those operating under the former special regime.

  - Electricity demand and contracting, rights and obligation of electricity generators, and specific remuneration regime records are all regulated.

– System's economic and technical management:

  - System operator and market operator functions are regulated, as are the procedures for the certification of the system operator by the National Markets and Competition Commission, and for authorisation and designation as a transmission grid manager by the Ministry of Industry, Energy and Tourism, which must be notified to the European Commission, and certification relating to non-European Union countries.

- Grid access and connection is regulated, clearly defining the access right and connection right concepts, as well as access and connection permits, the related grant procedure and requirements, and parties responsible for granting permits subject to technical and economic criteria to be stipulated in enabling regulations.

– Electricity transmission:

  - A specific requirement is provided whereby remuneration for new facilities must be included in the planning phase.

  - The functions that must be performed by the transmission company are provided, having previously been included in different laws or enabling regulations.

– Electricity distribution:

  - A definition of distribution facilities is provided.

  - The obligations and functions of electricity distribution companies are stipulated, distinguishing between distribution performed as the owners of distribution grids and distribution performed as grid management companies.

– Regime for inspections, infringements and penalties:

  - The classification of infringements is revised and new infringements are included, certain conduct having been identified that had not been envisaged in Law 54/1997 (27 November) but has a negative impact on the electricity system's economic sustainability and functioning.

  - The amount of penalties is revised, existing incidental penalties are extended and powers to impose penalties are modified.

<u>The regulation of electricity activities in Spain</u>

Electricity activities are divided into: 1) regulated activities: electricity transport and distribution; and 2) non-regulated activities: electricity generation and retailing.

2.4.1. Regulated activities

The regulated activities are characterised by the fact that access to them is subject to government authorisation, and remuneration for them is established by law, and undertaking these activities is subject to a series of specific obligations.

- *Need for prior government authorisation:* The undertaking of regulated activities requires prior regulated administrative authorisation. In order to obtain this authorisation, the applicant must basically demonstrate its legal, technical and economic capacity to exercise this activity. The abovementioned authorisation grants a legal monopoly in a given territory, which does not imply an exclusive right of use because of the third-party network access obligation.

- *Remuneration established by legislation:* Royal Decree 1047/2013, December 27, and Royal Decree 1048/2013, December 27, brought in remuneration methods applicable to the transmission and distribution activities, so as to ensure adequate remuneration and network development. The remuneration to be received is updated annually by ministerial order. The financial yield on assets during the first regulatory period, to 31 December 2019, is linked to the yield on government bonds plus a spread of 200 basis points.

The regulatory framework for the electricity industry in Spain has a procedure for settlement compensation amongst companies in the sector for net invoicing of electricity acquisition and other costs, so that each company receives the appropriate remuneration for their regulated activities.

- *Subjection to specific obligations of third party access to the network and unbundling:* The carrying out of the regulated activities is subject to specific obligations to ensure the development of competition in retailing. The two main obligations in this respect consist of permitting access by third parties to transport and distribution and the obligation to keep regulated and unregulated activities separate.

  Royal Decree 1955/2000 regulates access by third parties to the grid, determining which persons will have access rights, how the application is made, the deadlines for the same, the grounds for rejection of access, as well as the rights and obligations of each person involved in the system. The owners of the transport and distribution grids have the right to receive tolls and levies in consideration for this access, which are revised annually under ministerial order.

The legislation establishes the duty of functional separation, which means not only accounting separation, in order to avoid cross-subsidization and increase the transparency of the calculation of rates, tolls and levies, and legal separation, through separate companies, but also the requirement of independent operation of the regulated subsidiary company in relation to the other companies in the group.

2.4.1.1. Transport

Electricity transport links the plants with the distribution networks and specific final customers. The network is owned mainly by REE, although other companies, including Gas Natural Fenosa's subsidiary Unión Fenosa Distribución, S.A., own a small interest on secondary transport network.

The current remuneration framework is determined by Electricity Sector Law 24/2013 and Royal Decree 1047/2013 (27 December), providing the new methodology for calculating electricity transmission remuneration, and Order IET/2659/2015 of 11th December which approved standard installations and unitary values of reference for investment, operation and maintenance by fixed asset, which will be used when calculating the remuneration to be paid to the owners of electricity transmission facilities.

Transmission remuneration is laid down annually by the Ministry, which recognises compensation for investment, operation and maintenance, calculated on the basis of the regulatory unitary values of investment, operation and maintenance plus an availability incentive.

2.4.1.2. Distribution

The distribution of electricity includes all activities that bring electricity from the high tension grid to the final consumer.

The current remuneration framework is determined by Electricity Sector Law 24/2013 and Royal Decree 1048/2013 (27 December), providing the methodology for calculating electricity transmission remuneration, and Order IET/2660/2015 of 11th December which approved standard installations and unitary values of reference for investment, operation and maintenance by fixed asset and the unitary remuneration figures for other regulated tasks which will be used when calculating the remuneration to be paid to electricity distribution companies, establishing the definitions for natural growth and relevant power increase and compensation for use and reservation of facilities.

The remuneration is calculated annually by the Ministry and recognises compensation for investment and operation and maintenance of the distribution facilities, as well as other regulated services calculated on the basis of the unitary values approve by regulation, including incentives to reduce network losses, detect fraud and improve service quality.

Ministerial Orders IET/980/2016 and IET/981/2016 were published in 17 June 2016, which lay down the remuneration for electricity distribution companies and for owners of the transmission facilities for 2016. The remuneration set in these Orders will be paid on account to the distribution and transport companies in 2017, until the remuneration for 2017 is approved by the Ministry.

2.4.2. Unregulated activities

2.4.2.1. Electricity generation

The new Electricity Sector Law 24/2013 (26 December) stipulates that electricity production must be carried on under a free competition regime, in the organised market, including both conventional generation and renewable energy facilities, which must market electricity on the same terms as the conventional plants; the main advantages maintained by renewable energy facilities are a specific remuneration scheme and dispatching priority, on equal economic terms.

The remuneration of the generation activity is based on electricity market prices of electric production. The electricity generated in the system is sold to the wholesale electricity generation market, regulated by Royal Decree 2019/1997, either in the organised spot market or electricity pool or though bilateral, financial and physical agreements, and forward contracts.

Order ITC/3127/2011 of 17 November 2011 regulates remuneration in respect of capacity payments, including the incentive for investment in long-term capacity and the medium-term availability service, modifying remuneration for the capacity investment incentive stipulated in Order ITC/2794/2007 of September 27 and regulating the medium-term availability service applicable to marginal technologies in the daily market, i.e. fuel oil plants, combined cycle plants and coal plants, also applicable to pure-pumping, mixed-pumping and reservoir hydraulic plants.

In 2013, Law 15/2012, of December 27 on fiscal measures for energy sustainability was published, the principal aspects referring to electricity generation are:

- The establishment of a tax on the value of the production of electrical energy, of a direct type and real nature, imposed on the performance of production activities and incorporation of electricity into the Spanish electricity system. The tax will be applied on the production by all the generation installations at a rate of 7%.

- Two new taxes are regulated: the tax on production of nuclear fuel spent and radioactive residue that are the result of the nuclear generation of electricity and the tax on the storage of nuclear fuel generated and radioactive residue in central installations, with the aim of compensating society for the charges that it must bear as a result of this generation.

- Additionally, the Law revises the tax treatment applicable to the various energy generating products employed in the production of electricity. For the activity of generation of electricity from fossil fuels, certain exemptions are abolished while the energy generating products employed for combined generation of heat and electricity are taxed. In the same way, to apply a similar treatment to energy production from fossil energy sources, the tax rate on coal is increased, and at the same time, specific tax rates are created for fuels and gas-oils employed in the production of electricity or in the cogeneration of electricity and usable heat.

- A new royalty is applied to public domain assets for the use or exploitation of continental waters for hydroelectric power generation, amounting to 22% of the economic value of hydro-electricity generated; related enabling regulations are included in Royal Decree 198/2015, which develops Article 112.ii) of the revised Water Act and regulates the royalty for the use of continental waters to produce electricity in interregional hydrographic basins.

Revenues from these taxes cover the regulated costs in the electricity system.

European Parliament and Council Directive 2010/75/EU of 2010 on industrial emissions (integrated pollution prevention and control) provides that Member States may draw up a transitional national plan, applicable during the period 1 January 2016 to 30 June 2020, addressing combustion plants that obtained their first permit before 27 November 2002 or whose owners filed an application for a permit before said date, provided that the facility was in operation at the latest on 27 November 2003, indicating the facilities to be included therein.

On 19 October 2013, Royal Decree 815/2013 of October 18 was published, approving the Enabling Regulations on industrial emissions and developing Law 16/2002 of 1 July on integrated pollution prevention and control. The publication of this Royal Decree completed the transposition of the Industrial Emissions Directive into Spanish law. Legislative Royal Decree 1/2016, which approved the revised Law on integrated prevention and control and brought together all the amendments made to Law 16/2002 since 2005 in a single law, was published on 31 December 2016.

The specific remuneration regime for generation using renewable energies, co-generation and waste was established by Royal Decree 413/2014 of June 6, the main aspects being:

- Facilities will be classed as standard types (based on technology, capacity, age, etc.), each facility obtaining specific remuneration in accordance with the parameters applicable to each standard type facility.

- Over their regulatory useful lives, the facilities will receive compensation for energy sales on the market calculated at market prices and a specific compensation comprising two terms: a term per unit of installed power which covers, where appropriate, the investment costs for each standard facility that cannot be recovered through sales of energy on the market, called investment remuneration; and a term for operations which covers, as appropriate, the difference between the operating costs and operating income of the standard facility concerned, called operation remuneration.

- The specific remuneration will be sufficient for each standard type facility to obtain an adequate return. This return, before tax, will be similar to the average yield in the secondary market on 10-year government bonds, applying an adequate spread (300 basis points for existing facilities).

- Market prices will generally be applied to future facilities. In exceptional cases, where there is an obligation to fulfil objectives or other exceptional circumstances, a competitive mechanism will be established.

In addition to the six-year review, the regulation on renewables provides for mid-period reviews after three years to examine the specific remuneration for cogeneration and energy-from-waste renewable facilities as a function of market prices. This review calculates the extent to which market prices have deviated from the assumptions at the beginning of the three-year period. It also reviews estimates of future revenues from the sale of electricity in the market and the parameters directly related to it for the next three-year period, which also has an impact on the specific remuneration for the standard facilities.
On 20 June 2014, Order IET/1045/2014, June 16, was published, approving remuneration parameters for facilities, rates applicable to certain facilities generating electricity from renewable sources, cogeneration and waste.

On 16 March 2015, the Constitutional Court judgement of 16 February 2015 was published, annulling certain articles of Extremadura Assembly Law 7/1997 (29 May) on tax measures applicable to power production and transmission affecting the environment, as they covered the same tax areas as the local tax on economic activities and did not have an environmental purpose.

On 21 January 2016 the Resolution of 18 January 2016 of the DGPEM was published, concerning the auction for the assignment of the specific remuneration system for new biomass-based electricity production facilities in the mainland electricity system and for wind technology facilities, under the provisions of Royal Decree 947/2015. The entire MW capacity for both wind and biomass plants was awarded, with the peculiarity that in both cases, the discount was 100% and therefore none of the awardees will receive any compensation for the investment costs.

In relation to self-consumption, on 10 October 2015, Royal Decree 900/2015 (9 October) was published, regulating administrative, technical and economic conditions for self-consumption and production with self-consumption electricity supplies. This RD includes the reduction in tolls for self-consumers of less than 10 kW published in Royal Decree-Law 9/2015.

On 1 August 2015, Royal Decree 738/2015 was published, regulating electricity production and the dispatching procedure in non-peninsular electricity systems.

On 22 September 2015, Law 34/2015 (21 September) was published, partially amending General Tax Act 58/2003, Final Provision Seven of which envisages the creation of a state tax on the provision of emergency response services by the Civil Guard inside nuclear power plants or other nuclear facilities.

In 2016 the settlement under the Royal Decree on Supply Guarantee that was in force in 2010 and 2014 and which was still outstanding, has been finally completed.

The SEE Resolution of 16 February 2016 was published on 22 February 2016, laying down the procedure for calculating the actual costs for making the definitive annual settlement of the electricity system for 2012 under Royal Decree 134/2010. Following this Resolution, the final settlement for 2012 can be performed.

Subsequently, the SEE Resolution of 2 August 2016 was published on 12 August 2016, laying down the procedure for calculating the actual costs for the performance of the definitive annual settlement for 2013 under Royal Decree 134/2010. Following this Resolution, the final settlement for 2013 can be performed.

Finally, the SEE Resolution of 19 September 2016 was published on 20 September 2016, laying down the procedure for calculating the actual costs for the performance of the definitive annual settlement for 2014 under Royal Decree 134/2010. Following this Resolution, the final settlement for 2014 can be performed.

The amounts due were collected in December 2016.

2.4.2.2. Commercialisation of electricity

The commercialisation is based on the principles of deregulated contracting and the customer's choice of provider. Commercialisation, as a deregulated activity, is remunerated at a price freely agreed by the parties.

As mentioned above, as from 1 July 2009 consumers purchasing more than 10 Kw must be supplied by a free market retailer, while those consuming power equal to or lower than 10 Kw have the option to continue buying electricity under the regulated price (last-resort tariff). As from the new Law 24/2013, this regulated tariff is referred to as the Small Consumer Voluntary Price (PVPC), the last-resort tariff (TUR) being the regulated price applicable to consumers classed as vulnerable and to consumers that do not meet requirements to apply the PVPC but are temporarily without a supply company in the free market.

The criteria for establishing the last-resort supply tariff have been regulated by means of successive provisions of law. Legislation stipulates that the PVPC must include all supply costs on an additive basis, including power generation costs, access tolls and supply costs.

On 29 March 2014, Royal Decree 216/2014, March 28, was published, providing the methodology for calculating small consumer voluntary prices (PVPC) and the related legal regime for contracting. It determines the structure of small consumer voluntary prices, which will apply to low-voltage consumers with a contracted capacity of up to 10 kW. The Royal Decree also stipulates the procedure for calculating the cost of power generation, which will include the small consumer voluntary price.

The cost of power generation will be calculated based on the daily market hourly price during the billing period. Billing will be performed by the reference supply company based on actual readings and taking into consideration consumption profiles, except for supplies using metering equipment capable of telemetering and telemanagement, effectively integrated into the relevant systems, in which billing will be effected using hourly consumption values.

Alternatively, a consumer may contract a fixed power price for one year with the reference supply company.

On 10 September 2016 Order IET/1451/2016 of 8 September was published, approving the percentages for the allocation of the amounts to be financed relating to the social bond for 2016. Under this Order, Gas Natural SDG, S.A. has been allocated 14.80 % of the total.

Section Three of the Supreme Court has handed down various judgements which, upholding the appeals lodged against Royal Decree 968/2014, have declared the non-applicability of the system for financing the social bond laid down in Article 45.4 of Law 24/2013, on the grounds that it is incompatible with European Parliament and Council Directive 2009/72/EC of 13 July 2009 on common rules for the internal electricity market, which revoked Directive 2003/54/CE. Articles 2 and 3 of Royal Decree 968/2014, which developed Article 45.4 of Law

24/2013, were also declared null and void and it was recognised that the appellants were entitled to the reimbursement of the contributions made in this respect.

As a result, a new regulation on the means of financing the social bond has been urgently issued. Royal Decree Law 7/2016 of 23rd December regulating the mechanism for financing the social bond and measures to protect vulnerable electricity consumers was published on 24 December 2016. It was also ruled that supply to severely vulnerable customers may not be interrupted due to non-payment with effect from 1 January 2017.

Royal Decree 469/2016 of 18th November, which amended Royal Decree 216/2014 of 28th March, laying down the method for calculating voluntary prices for small electricity consumers (PVPC) and the legal contracting scheme, was published on 25th November 2016. Subsequently, Order ETU/1948/2016 of 22nd December was published on 24 December 2016, which set certain values for supply costs of supply companies to be included in the calculation of the PVPC for 2014-2018 under the above Royal Decree

In relation to interruptibility offered by some consumers, on 1 November 2013 Order IET/2013/2013 was published, regulating the competitive allocation mechanism for the interruptibility demand management service. It establishes an auction procedure for the allocation of this service, which will be managed by the System Operator and supervised by the CNMC. This Order was subsequently amended various times, the latest being under Order ETU/1976/2016. The SEE Resolution of 5 August 2016 approved the rules for the competitive auctions for assigning the interruptibility demand management service and the model for adhering to the legal framework laid down for taking part in the auctions.

2.5. Regulation of the international electricity sector

2.5.1. Generation

Gas Natural Fenosa, through its subsidiary Global Power Generation (GPG), is present as a generator in Mexico, Panama, Costa Rica, the Dominican Republic, Kenya, Puerto Rico and recently in Chile, Brazil and Australia.

In Costa Rica, Kenya and Puerto Rico, the Group's generation operations are subject to the regime for Power Purchase Agreement (PPA) with the sector's domestic companies, Costa Rica Electricity Institute (ICE), Kenya Power and Lighting Company (KPLC) and Puerto Rico Electric Power Authority (PREPA), respectively; all three public corporations vertically integrated and exclusively responsible for transport, distribution and commercialisation.

Generation under the PPA regime also exists in Mexico, with energy being sold to the Federal Commission for Electricity (CFE) and to end-customers under bilateral contracts. Surplus energy is sold on the market created under the energy reform carried out in 2015 and 2016. Additionally, the Bii Hioxo wind farm became operational during 2014, selling the power generated under bilateral contracts to final customers.

In Panama and the Dominican Republic, electricity generated is sold under bilateral contracts with the distributors.

In Chile, GPG won a tender in August 2016 for generation under a long-term contract scheme (PPA) with distributors (20 years). To meet this commitment, GPG expects to carry out two project (wind and solar) which will enter service in 2021.

In Australia, GPG was awarded a wind generation project in 2016 through a 20-year contract, with regulated tariffs for energy injected into the system.

Finally, GPG is also present in Brazil through the acquisition of two renewable generation projects involving long-term contracts for the sale of reserve energy to the Chamber for Commercialising Electrical Energy (CCEE), which have already been signed, based on a successful bid in the energy auction held in 2015.

In all these countries, electricity sector regulations are well-established and stable; legislation is developed and administered by independent regulators.

2.5.2. Distribution

In the countries in which Gas Natural Fenosa is present as a distributor, Argentina, Chile, Colombia, Moldova and Panama, the distribution activity is regulated. The distributors have the function of transporting electricity from the transport network to the customer hook up points and also the function of supplying electricity at regulated rates, to regulated customers, who, based on their consumption volumes, cannot chose their supplier. As for the unregulated customers that choose to purchase electricity from another supplier, they must pay the regulated distribution toll for the use of the networks.

The tariffs are revised periodically to reflect the variations in energy purchase prices and the transport tariffs, as well as the variation in economic indicators.

There are regulatory and tariff frameworks in these countries that lay down the procedures and paperwork necessary for the periodical revision of tariffs and distribution margins. The tariff revision is carried out between four and five years by filing tariff revision applications with the respective regulators.

In Moldova, distribution and supply tariffs will be in force until March 2018. On 15 July 2016 the Regulator approved a Resolution containing the procedure for the recovery of deviations from energy prices that are not passed on to end customers as they should be, in a period of four years. The Resolution was published on 15 July 2016. On 25 October 2016 the last outstanding agreement was concluded with energy generation companies (with the state corporation Energocom), successfully bringing an end to the negotiations with the Moldovan government to recover the debt derived from the failure to reflect real energy purchase prices in electricity rates. All that remains is for ANRE (Agenţia Naţională pentru Reglementare în Energetică) to define, before March 2017, the amount to be applied in tariffs to recover the debt in accordance with the procedure published on 4 October.

The distribution and sub-transmission activity in Chile is regulated under a known and stable framework. Tariffs are updated regularly to reflect fluctuations in cost indices and purchase prices, and are revised every four years.

The review of the electricity distribution rates, the effects of which will be backdated to November 2016, is expected to be approved in early 2017. Law 20.936 was published on 20 July 2016, which amended some provisions concerning transmission activities under the Law on Electricity Services and set up an Independent Coordination Body for the National Electricity System. The same law approved a two-year extension for current sub-transmission rates into 2016 and 2017, and therefore the new sub-transmission rates will not enter force until January 2018.

In Panama, work on the tariff review will commence in 2017 and the new tariff list will come into effect in July 2018.

Note 3. Basis of presentation and accounting policies

3.1. Basis of presentation

The Consolidated annual accounts of Gas Natural Fenosa for 2015 were adopted by the General Meeting of Shareholders of 4 May 2016.

The Consolidated annual accounts for 2016, which were drawn up by the Gas Natural SDG, S.A. Board of Directors on 7 February 2017, will be submitted, along with those of the investee companies, to the approval of the respective General Meetings. It is expected that they will be adopted without modification.

The Consolidated annual accounts of Gas Natural Fenosa for 2016 have been prepared on the basis of the accounting records of Gas Natural SDG, S.A. and the other companies in the Group, in accordance with the provisions of International Financial Reporting Standards adopted by the European Union (hereinafter "IFRS-EU"), as per (EC) Regulation 1606/2002 of the European Parliament and Council.

In the preparation of these Consolidated annual accounts the Company has used the historical cost method, although modified by the restatement of the financial instruments which under the standard for financial instruments are recorded at fair value while taking into account the criteria for recording business combinations and defined benefit plans.

These Consolidated annual accounts fairly present the consolidated equity and consolidated financial situation of Gas Natural Fenosa at 31 December 2016, and the consolidated results of its operations, the Changes in the Consolidated Statement of Comprehensive Income, the Changes in Consolidated Net Equity and the Consolidated Cash Flows of Gas Natural Fenosa for the year then ended.

The aggregates set out in these Consolidated annual accounts are stated in million Euros, unless indicated otherwise.

3.2 New IFRS-EU and IFRIC interpretations

As a result of the adoption, publication and coming into force on 1 January 2016 the following changes in the standards were applied:

- Annual improvements to IFRS, Cycle 2010-2012;
- IAS 19 (Amendment), "Defined benefit plans: employee contributions".
- IFRS 11 (Amendment), "Accounting for acquisitions of interests in joint operations";
- IAS 16 and IAS 38 (Amendment), "Clarification of acceptable methods of depreciation and amortisation";
- Annual improvements to IFRS, Cycle 2012-2014;
- IAS 1 (Amendment), "Disclosure initiative";
- IAS 27 (Amendment), "Equity method in separate financial statements".
- IFRS 10, IFRS 12 and IAS 28 (Amendment), "Investment entities: exception to consolidation".

The application of the above standards, interpretations and amendments did not have a significant impact on the consolidated annual accounts.

Additionally, in 2016 the European Union adopted the following standards which come into force for periods commencing on or after 1 January 2018, which have not been adopted early:

- IFRS 15, “Revenue from contracts with customers”;
- IFRS 9 "Financial instruments";

Finally, the IASB has issued the following standards and amendments that will come into force on 1 January 2017, 2018 or 2019 and are pending adoption by the European Union:

- IFRS 16, “Leases”;
- IAS 12 (Amendment), “Recognition of deferred tax assets for unrealised losses”;
- IAS 7 (Amendment), “Disclosure initiative”;
- IFRS 15 (Clarifications), “Revenue from contracts with customers”;
- IFRS 2 (Amendment) , “Classification and measurement of share-based payments”;
- IFRS 4 (Amendment), “Application of IFRS 9 Financial Instruments with IFRS 4 Insurance contracts”.
- IAS 40 (Amendment), “Investment property”
- IFRIC 22, “Foreign Currency Transactions and Advance Consideration”
- Annual improvements to IFRS, Cycle 2014-2016;

Gas Natural Fenosa is assessing the impact of the application of these standards and amendments on the Consolidated Annual Accounts.

Based on the analysis conducted to date, Gas Natural Fenosa estimates that, of all these regulations and amendments, the only ones that might have an impact on the consolidated financial statements are IFRS 9 and IFRS 15, which are due to come into force on 1 January 2018, and IFRS 16, which is due to come into force on 1 January 2019.

With regard to IFRS 9, which is a new standard for the classification and measurement of financial assets and liabilities that also includes modelling on expected credit looses and on hedge accounting aligned with the economic management of the risk, Gas Natural Fenosa is reviewing the impact on its business practices of the new model for impairment of accounts receivable as a function of expected losses, and for hedge accounting.

With respect to IFRS 15, wich is a new standard by which revenues arising from contracts will be recognised based on the compliance of performance obligations towards customers, Gas Natural Fenosa is analysing the application of the internal revenue recognition policies currently in force for the various types of contract with customers and identifying the performance obligations, transaction prices and their allocation in order to identify differences with respect to the model established by the new standard.

IFRS 16 establishes that assets for the right-of-use and liabilities arising from operating lease contracts must be recognised in the consolidated balance sheet (except for short-term leases and those relating to low-value assets). In addition, there will be a change in the policy for recognising the lease expense, which will be recognised as a depreciation expense for the relevant asset and a financial expense due to discounting the lease liability. Gas Natural Fenosa is compiling the necessary data on its operating lease contracts in order to assess the impact. Nevertheless, considering that the total amount of the Group's lease contracts is not material (Note 35), Gas Natural Fenosa does not expect IFRS 16 to have a significant impact on the consolidated financial statements.

Consequently, given the complexity of applying IFRS 9, IFRS 15 and IFRS 16, the analyses referred to above will end in 2017 since a conclusion has not yet been reached about the first-time-adoption option to be adopted on the date of transitioning to these standards.

3.3. Accounting policies

The main accounting policies used in the preparation of these consolidated annual accounts have been as follows:

3.3.1 Consolidation

a) Subsidiaries

Subsidiaries are companies controlled by Gas Natural Fenosa. Gas Natural Fenosa controls an entity when, as a result of its involvement, it is exposed or entitled to variable returns and has the capacity to influence those returns through the power exercised in the entity.

Subsidiaries are fully consolidated as from the date on which control is transferred to Gas Natural Fenosa and are excluded from consolidation on the date on which this control ceases.

In order to account for the acquisition of subsidiaries the acquisition method is used. The cost of acquisition is the fair value of the assets delivered of the equity instruments issued and the liabilities incurred and borne on the date of the exchange, the fair value of any additional consideration that depends on future events (provided that they are likely to occur and can be reliably measured).

The intangible assets acquired through a business combination must be recognised separately from goodwill if they met the criteria for asset recognition, whether they are separable or they arise from legal or contractual rights and when their fair value can be reliably measured.

The identifiable assets acquired and the liabilities or contingent liabilities incurred or borne as a result of the transactions are initially stated at their fair value at the date of acquisition, irrespective of the percentage of the non-controlling interest.

For each business combination, Gas Natural Fenosa may opt to recognise any non-controlling interest in the target company at fair value or at the proportional part of the target's net identifiable assets pertaining to the non-controlling interest.

Acquisition costs are expensed in the year when they are incurred.

The surplus cost of the acquisition in relation to the fair value of the shareholding of Gas Natural Fenosa in the net identifiable assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the Consolidated Income Statement.

The measurement period for business combinations begins on the acquisition date and ends when Gas Natural Fenosa concludes that it cannot obtain further information on the events and circumstances that existed at the acquisition date. This period may not in any case exceed one year as from the acquisition date. During the measurement period, the business combination is deemed to be provisional and adjustments to the provisional amount will be recognised, if applicable, as if the business combination had been fully recognised on the acquisition date.

In a business combination achieved in stages, Gas Natural Fenosa values its prior interest in the target's equity at the fair value on the control date, recognising resulting gains or losses in the Consolidated Income Statement.

Inter-company transactions, balances and unrealized gains on transactions between Gas Natural Fenosa companies are eliminated in the consolidation process. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

The shareholding of the minority shareholders in the equity and profit or loss of the subsidiary companies is broken down under “Non-controlling interests” in the Consolidated Balance Sheet and “Net income attributable to non-controlling interests” in the Consolidated Income Statement.

In relation to the acquisitions or sale of shareholdings without loss of control, the difference between the price paid or received and their net carrying value, or as the case may be, the result of their sale, is booked as equity transactions and does not generate either goodwill or profits.

The sale options given to minority shareholders of subsidiary companies in relation to shareholdings in these companies are stated at the current value of the reimbursement, i.e., their exercise price and are carried under “Other liabilities”.

b) Joint Arrangements

Joint arrangements are understood as combinations in which there are contractual agreements by virtue of which two or more companies hold an interest in companies that undertake operations or hold assets in such a way that any financial or operating decision is subject to the unanimous consent of the partners.

A joint arrangement is classed as a joint operation if the parties hold rights to its assets and have obligations in respect of its liabilities or as a joint venture if the venturers hold rights only to the investee's net assets.

Interests in joint operations are accounted for by proportionate consolidation method and interests in joint arrangements are recorded under the equity method.

Under the equity consolidation method, interests in joint arrangements are initially recognised at cost and are later adjusted to recognise Gas Natural Fenosa's share of post-acquisition profits and losses and movements in other comprehensive income.

At each reporting date, Gas Natural Fenosa determines whether there is objective evidence of the impairment of its investment in a joint venture. If impairment is identified, Gas Natural Fenosa calculates the amount of the impairment loss as the difference between the joint venture's recoverable amount and carrying amount, recognising it in the item “Profit/(loss) from equity-consolidated companies” in the consolidated income statement.

The assets and liabilities assigned to joint operations are recorded on the Consolidated Balance Sheet in accordance with their nature and proportionally to Gas Natural Fenosa shareholding percentage. The income and expenses from joint operations are reflected in the Consolidated Income Statement in accordance with their nature and proportionally to Gas Natural Fenosa shareholding percentage.

c) Associates

Associates are all entities over which Gas Natural Fenosa has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights.

Investments in associates are accounted under the equity method.

d) Consolidation scope

Appendix I includes the investee companies directly and indirectly owned by Gas Natural Fenosa that have been included in the consolidation scope.

Appendix II lists the main consolidation scope changes in 2016 and 2015, the most relevant being as follows.

Year 2016

In 2016 the main consolidation scope changes relate to the sale by Unión Fenosa Gas of its interest in Gasifica, S.A and in Planta de Regasificación de Sagunto, S.A. (Note 7), the sale of the interest in GNL Quintero, S.A. (Note 7), the sale of Gasco S.A. along with the purchase of an additional 37.88% of Gas Natural Chile S.A. (Note 9), the purchase of Vayu Limited (Note 31) and the desconsolidation of the interest in Electricaribe after the loss of control (Note 8).

Year 2015

In 2015, the main consolidation scope changes related to the sale of a 44.9% interest in the electricity distribution company Barras Eléctricas Galaico Asturianas, S.A. in June 2015 (Note 28) and the acquisition of the 100% of the shares in the renewable energy company Gecal Renovables, S.A. in October 2015 (Note 31).

Although the transfer did not entail a loss of control and the subsidiary is still fully consolidated, the interest held by Global Power Generation S.A., the company that holds Gas Natural Fenosa's international generation assets, decreased from 100% to 75% (Note 13).

3.3.2 Transactions in foreign currency

Items included in the financial statements of each of Gas Natural Fenosa's entities are measured using the currency of the primary economic environment in which the entity operates. The Consolidated financial statements are presented in Euros, which is the Gas Natural Fenosa presentational currency.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at the year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

The results and financial position of all Gas Natural Fenosa entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentational currency are translated into the presentational currency as follows:

- Assets and liabilities for each Balance sheet presented are translated at the closing rate at the date of that balance sheet;

- Income and expenses for each Income statement are translated at monthly average exchange rates, unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions.

- All the currency translation differences are recognised in the Consolidated Statement of Comprehensive Income, and the cumulate amount under the caption Cumulative translation adjustments in net equity.

The adjustments to goodwill and the fair value arising from the acquisition of a foreign company are treated as its assets and liabilities and are translated at the closing exchange rate.

The exchange rates against the Euro (EUR) of the main currencies of the companies in Gas Natural Fenosa at Saturday, December 31, 2016 and 2015 have been:

	31 December 2016		31 December 2015	
	Closing Rate	Average Accumulated Rate	Closing Rate	Average Accumulated Rate
US Dollar (USD)	1.05	1.11	1.09	1.11
Argentinean Peso (ARS)	16.74	16.24	14.09	10.21
Brazilian Real (BRL)	3.44	3.86	4.25	3.70
Colombian Peso (COP)	3,163	3,376	3,329	3,046
Chilean Peso (CLP)	703.32	748.54	770.08	726.09
Mexican Peso (MXN)	21.78	20.66	18.88	17.61
Panamanian Balboa (PAB)	1.05	1.11	1.09	1.11
Moldovan Lei (MDL)	21.01	22.04	21.40	20.85

3.3.3 Intangible assets

a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of Gas Natural Fenosa's share of the net identifiable assets of the acquired subsidiary, joint arrangements or associates acquired, at the date of acquisition. Goodwill on acquisitions of subsidiaries or joint arrangements is included in Intangible assets while goodwill related to acquisitions of associates is recorded under Investments using the equity method.

Goodwill derived from acquisitions carried out before 1 January 2004 is recorded at the amount recognized as such in the 31 December 2003 consolidated financial statements prepared using Spanish GAAP.

Goodwill is not amortised and it is tested annually to analyse possible impairment losses. It is recognised in the consolidated balance sheet at cost value less cumulative impairment losses.

The impairment losses on goodwill cannot be reversed.

b) IFRIC 12 Concessions and other Concessions and the like

The concessions and the like relates to the cost of acquisition of concessions if they are acquired directly from a public entity or similar, or at the fair value attributed to the corresponding concession in the event of being acquired as part of a business combination. These amounts relate both to the concessions that are considered intangible assets, or construction and improvements of those infrastructures assigned to concessions in accordance with IFRIC 12 "Service concession Agreements".

The aforementioned assets related to the service concession agreements under IFRIC 12 are those that the licensor controls the services that Gas Natural Fenosa (operator) must provide and the significant residual stake in the infrastructure at the end of the agreement, are set forth in this section in accordance with the accounting model for intangible assets based on the nature of the economic profits to be received by the operator. The income and expenses on construction services or infrastructure improvements are recognized for their gross amount. Given that concession agreements do not specify remuneration for these concepts, it is assumed that fair value of income corresponds to incurred costs without margin.

The assets included in this accounts are amortised on a straight-line basis over the duration of each concession, except in the case of the Maghreb-Europe pipeline, which, in order to properly reflect the expected consumption scheme for the future economic profits, is based on the value of gas transported during the life of the right of use, which represents accumulated amortisation that is no less than what would be the result of using a straight-line amortisation method.

Furthermore, the concessions for the distribution and transmission of electricity in Spain and Chile, and the concessions for the gas distribution in Chile acquired, all of them, basically as part of a business combination has no legal or any other type of limit. Accordingly, since we are dealing with intangible assets with an undefined life, they are not amortised, although they are tested for possible impairment annually as per that set out in Note 3.3.5.

c) Computer software

Cost associated with the production of computer software programs that are likely to generate economic profits greater than the costs related to their production are recognized as intangible assets. The direct costs include the cost of the staff that has developed the computer programs.

Computer software development costs recognized as assets are amortised on a straight–line basis in four or five years as from the time the assets are prepared to be brought into use.

d) Research costs

Research activities are expensed in the Consolidated Income Statement as incurred.

e) Other intangible assets

Other intangible assets mainly include the following:

- The cost of acquisition of the exclusive re-gasification rights at the re-gasification plant in Peñuelas (Puerto Rico), which are amortised on a straight-line basis until the end of their term (2025).

- The licence costs for renewable farms, mainly acquired as part of a business combination, which will be amortized on a straight-line basis over their useful lives.

- Gas supply contracts and other contractual rights purchased as part of a business combination, which are valuated at fair value and amortised over the contract term that does not differ of expected consumption scheme.

There are no intangible assets with an undefined useful life apart from goodwill and the aforementioned concessions for electricity distribution and transmission and the concessions for gas distribution.

3.3.4 Property, plant and equipment

Property, plant and equipment are carried at cost less accumulated depreciation and any impairment provision.

a) *Cost*

All property, plant and equipment are presented at cost of acquisition or production, or the value attributed to the asset in the event that it was acquired as part of a business combination.

The financial cost for the technical installation projects until the asset is ready to be brought into use, form part of property, plant and equipment.

Costs of improvements are capitalized only when they represent an increase in capacity, productivity or an extension of their useful life.

Major maintenance expenditures (overhauls) are capitalized and depreciated over the estimated useful life of the asset (generally 2 to 6 years) while minor maintenance is expensed as incurred.

Own work capitalised under Property, plant and equipment relates to the direct cost of production.

The non-extractable gas necessary as a cushion for the exploitation of the underground storage units of natural gas is recorded as Property, plant and equipment (“cushion gas”), and depreciated over the useful life of the underground storage deposit.

Expenses arising from actions designed to protect and improve the environment are expensed in the year they are incurred.

They are capitalised when they represent asset additions to Property, plant and equipment, and when allocated to minimise environmental impact and protect and improve the environment.

The future costs to which Gas Natural Fenosa must meet in relation to the closure of certain facilities are included in the value of the assets at the restated value, including the respective provision (Note 3.3.16).

Gains and losses on disposals are determined by comparing proceeds with carrying amounts. These are included in the Consolidated Income Statement.

b) Depreciation

Assets are depreciated using the straight-line method, over their estimated useful life or, if lower, over the time of the concession agreement. Estimated useful lives are as follows:

	Years of estimated useful life
Buildings	33-50
Gas tankers	25-30
Technical installations (pipeline network and transport)	20-40
Technical installations (hydro-electric plants)	14-65
Technical installations (thermal energy plants)	25-40
Technical installations (combined cycle gas turbine: CCGT)	25
Technical installations (nuclear energy plants)	40
Technical installations (wind farms)	25
Technical installations (electricity transmission lines)	30-40
Technical installations (electricity distribution network)	18-40
Computer equipment	4
Vehicles	6
Other	3-20

The hydro-electric plants are subject to the temporary administrative concession regime. Upon termination of the terms established for the administrative concessions, the plants revert to the Government in proper condition, which is achieved by stringent maintenance programs.

The calculation of the depreciation charge for the hydro-electric plants differentiates between the different types of assets they have, distinguishing between the investments in civil works (which are depreciated on the basis of the concession period, or 100 years if there is no concession), electro-mechanical equipment (40 years) and the other fixed assets (14 years), taking into account, in any case, the use of the plant and the maximum term of the concessions (expiring between 2022 and 2063).

Gas Natural Fenosa depreciates its nuclear energy plants over a useful life of 40 years which corresponds to the theoretical useful life of its main components. Operating licences for these plants usually have 10-year terms, it not being possible to request their renewal until near to the end of each licence. Nonetheless, in view of the optimal performance of these facilities and related maintenance programmes, the permits are expected to be renewed at least until a 40-year useful life is reached.

In the third quarter of 2015, Gas Natural Fenosa completed technical studies on the estimation of the useful life of wind parks. The technical studies were conducted by internal engineers based on experience gained in operating assets in use for approximately 20 years that maintain the same availability levels, on the wind farm's excellent state of repair due to maintenance plans applied and on information supplied by the equipment manufacturers and the practices of the sector's main operators, which consider a 25-year useful life.

Consequently, as from 1 October 2015, Gas Natural Fenosa prospectively adjusted the useful life of its wind farms from the estimated 20 years to 25 years. The effect of this estimated useful life change on the item “Depreciation, amortisation and impairment losses” in the 2015 consolidated income statement was a reduction of Euros 6 million in the depreciation charge.

The assets’ residual values and useful lives are reviewed, and adjusted if appropriate, at each Balance sheet date.

An asset’s carrying amount is written down immediately to its recoverable amount if the asset’s carrying amount is greater than its estimated recoverable amount, i.e., when the asset is no longer useful such as due to a rerouting of the distribution pipeline (Note 3.3.5).

c) Exploration operations and production of gas

Operating costs, excluding drilling costs, are recognised in the income statement as they arise, using the successful-efforts method. If, as a result of test drilling, proven reserves are found that justify commercial development, costs are transferred to investments in zones with reserves; otherwise, they are charged to the income statement.

Costs of investments in zones with reserves are capitalised and depreciated over the estimated commercial life of the gas field, based on the relationship between annual production and proven reserves at the start of the depreciation period.

At the year end, or at any time when there is an indication that there may be asset impairment, the recoverable value is compared to their carrying value.

3.3.5 Impairment losses of assets

Assets are tested for possible impairment provided that an event or change in circumstances indicates that their carrying amount might not be recoverable. Additionally, goodwill and intangible assets not in use or with indefinite useful lives are tested at least annually for impairment.

When the recoverable amount is lower than the asset's carrying amount, an impairment loss is recognised in the consolidated income statement for the difference between both. Recoverable amount is calculated as the higher of fair value less costs to sell and value in use, using the future cash flow discounting method. Gas Natural Fenosa considers value in use as the recoverable amount, calculated as described below.

For the purposes of assessing impairment, assets are grouped at the lowest level for which separate cash inflows can be identified. Both assets and goodwill are assigned to these cash generating units (CGUs).

CGUs are defined using the following criteria:

- Gas distribution:

  - Gas distribution in Spain. The development, operation and maintenance of the gas distribution network is managed jointly.

  - Gas distribution in Latin America. A CGU is understood to exist for each country in which there are operations (Argentina, Brazil, Chile, Colombia, Mexico and Peru) since the businesses are subject to different regulatory frameworks.

  - Gas distribution Rest of Europe. This relates to the gas distribution assets in Italy, which are managed separately.

- Electricity distribution:

  - Electricity distribution in Spain. The development, operation and maintenance of the electricity distribution network is managed jointly.

  - Electricity distribution in Latin America. A CGU is understood to exist for each country in which there are operations (Argentina, Chile, Panama and Colombia) since the businesses are subject to different regulatory frameworks.

- Electricity distribution Rest of Europe. This relates to electricity distribution assets in Moldova.

- Gas. This includes the gas infrastructure and supply CGUs and the interest in Unión Fenosa Gas, which is tested for impairment separately.

- Electricity:

  - Electricity Spain. The power generation park in Spain is managed jointly and is centralised based on conditions of demand, where all power plants using different technologies play a major, complementary and necessary role in light of different market situations, providing the electricity required by customers at any given time. This model focuses, inter alia, on the existence of a single representative and settlement agent vis-á-vis the market, that operates through a single supply room, the entire generation and marketing business being under the same management. Therefore, a single CGU is understood to exist for the generation (including the different conventional and renewable generation technologies) and marketing of electricity in Spain, since they are managed and controlled globally on a centralised basis).

  - Global Power Generation (GPG). A CGU is understood to exist in each country in which there are operations since the businesses are subject to different regulatory frameworks and are managed independently. GPG's power generation park is located in Latin America (Costa Rica, Mexico, Panama, Dominican Republic and Puerto Rico, the latter being consolidated using the equity method and in Kenya and Australia).

- Rest. This includes basically the CGU connected with the coal mines in South Africa.

For those CGUs, requiring testing for impairment, cash flows have been based on the Strategic Plan approved by Gas Natural Fenosa, extrapolated for up to five years, on the basis of regulations and expectations regarding the development of the market based on available industry forecasts and historical experience of the performance of prices and output.

Cash flows subsequent to the projected period are extrapolated, taking into account the growth rates estimated by each CGU. These rates in no circumstances exceed the medium to long-term growth rates for the business and country in which the CGUs operate and which in no event are less than the growth rates for the period covered by the strategic plan. In order to estimate future cash flows in the calculation of residual values, all maintenance investments have been taken into account, and where appropriate, the investments for renewal needed to maintain CGU production capacity.

The nominal growth rates used for each CGU or group of CGUs are as follows:

	Growth 2016 (%)	Growth 2015 (%)
Gas distribution Spain	1.0	1.0
Gas distribution Rest of Europe	1.0	1.0
Gas distribution Latin America	2.6-3.0	1.0-2.8
Electricity distribution Spain	1.2	0.6
Electricity distribution Rest of Europe	1.8	1.8
Electricity distribution Latin America	1.6 -3.0	1.2 -3.0
Unión Fenosa Gas	1.8	1.4
Electricity Spain	2.2	1.8
GPG	1.0-4.6	1.0 - 4.9

The discount rates before tax used to calculate the recoverable value of each CGU or group of CGUs are as follows:

	Rates 2016 (%)	Rates 2015 (%)
Gas distribution Spain	6,2	6,5
Gas distribution Rest of Europe	5.9	6.3
Gas distribution Latin America	10.0-17.0	10.7-16.0
Electricity distribution Spain	5.2	5.6
Electricity distribution Rest of Europe	14.9	14.9
Electricity distribution Latin America	8.8-16.6	8.8-15.5
Unión Fenosa Gas	11.9	11.0
Electricity Spain	6.1	6.8
GPG	5.8-12.8	6.4-11.1

The parameters taken into account to determine the above discount rates are as follows:

- Risk-free bond: 10-year bond on the CGU's reference market.
- Market risk premium: Estimate based on equities in each country at 10 years.
- Unlevered beta: According to sector average in each case.
- Local currency interest rate swap: 10-year swap.
- Debt to equity ratio: Sector average.

Apart from these discount rates, the most sensitive parameters included in the projections used and which are based on sector forecasts and historical experience are as follows:

- Gas and electricity distribution Latin America and Other

  - Rate performance. Valuation of rates in each country, based on existing regulatory conditions and rate reviews, taking into account the experience gained from previous rate reviews in each country.
  - Energy cost. Estimated on the basis of predictive modelling based on an understanding of energy markets in each country.
  - Operation and maintenance costs. Estimated on the basis of the historical cost of the network managed.

- Investments. Taking into account the necessary investments to maintain the regular use of the network and quality of supply.

- Electricity distribution in Spain.

  - Regulated remuneration. Amount and increase in remuneration approved by the regulator, taking into account the regulatory impacts of Royal Decree-Law 9/2013 and Law 24/2013 (Note 2.4.1.2) and Royal Decree 1048/2013 (Note 2.4.1).

  - Order IET /2660/2015 of 11th December which approved standard installations and unitary values of reference for investment, operation and maintenance by fixed asset and the remuneration for other regulated activities that will be applied in the first regulatory period which will run from 1 January 2016 to 31 December 2019.

  - Operation and maintenance costs. Estimated on the basis of the historical cost of the network managed.

  - Investments. Taking into account the necessary investments to maintain the regular use of the network and supply quality.

- Unión Fenosa Gas:

  - Gas supply cost. In accordance with the prices of the long-term contracts entered into by Unión Fenosa Gas and expected price fluctuations in spot markets.

  - Gas volumes to be obtained from each supply source.

  - Selling price of natural gas. Valued using predictive modelling based on the forecast performance of price curves and experience in the markets where Union Fenosa Gas operates.

- Electricity Spain:

  - Electricity generated. The evolution of demand has been estimated by consensus with several international organisations. Market share has been estimated based on the market share of Gas Natural Fenosa in each technology and the expected performance of the share of each technology in the market as a whole. The regulatory impacts of Royal Decree-Law 2/2013, Royal Decree-Law 9/2013, Law 24/2013 and Royal Decree 413/2014 have been taken into account (Note 2.4 and 2.4.2.1).

  - Electricity price. Market electricity prices used have been calculated using models cross-checking expected demand against supply forecasts, taking into account the forecast performance of the generation park in Spain, based on sector forecasts.

  - Fuel costs. Estimated based on the long-term supply contracts entered into by Gas Natural Fenosa and the forecast performance of price curves and experience on the markets where it operates.

  - Operation and maintenance costs. Estimated based on the historical cost of the park managed.

  - Impact of taxes laid down in Law 15/2012 (Note 2.4.2.1).

- Global Power Generation (GPG):

  - International electricity generation is managed under energy sale-purchase contracts through stable business models and which are not subject to fluctuation risks on the basis of market variables.

As a result of the above process, in 2016 the recoverable values of the CGUs' assets, calculated using the methodology described, have been, except for the interest in Union Fenosa Gas where an impairment of the investment has been recognised (Note 7), higher than the carrying amounts recognised in these consolidated annual accounts.

In 2015 the impairment tests performed did not reveal the need to recognise additional impairment or reverse impairment recognised in the previous year.

Gas Natural Fenosa has carried out a sensitivity analysis of the unfavourable variations which, drawing on historical experience, may reasonably impact on the aforementioned sensitive parameters on which the recoverable amounts of CGUs have been determined. Specifically, the most significant sensitivity analyses performed were as follows:

	Increase	Decrease
Discount rate	50 basis points	-
Electricity generated	-	5%
Electricity price	-	5%
Fuel and gas supply costs	5%	-
Rate/ remuneration performance	-	5%
Operation and maintenance cost.	5%	-
Investments	5%	-

These sensitivity analyses performed for each basic assumption independently would not alter the conclusions obtained as regards the recoverable amount being higher than CGUs' carrying amount except in the case of Unión Fenosa Gas whose recoverable value is similar to its carrying amount.

3.3.6 Financial assets and liabilities

Financial investments

Purchases and sales of investments are recognized on trade-date, which is the date on which Gas Natural Fenosa commits to purchase or sell the asset, and are classified under the following categories:

a) Loans and financial receivables

These are non-derivative financial assets, with fixed or determinable pay outs, which are not listed in an active market, and for which there is no plan to trade in the short-term. They include current asset, except those maturing after twelve months as from the balance sheet date those are classified as non-current assets.

They are initially recorded at their fair value and then at their amortised cost using the effective interest rate method.

A provision is set up for impairment of receivables when there is objective proof that all the outstanding amounts will not be paid. The provision is the difference between the book value of the asset and the present value of the estimated future cash flows discounted at the effective interest rate.

b) Held-to-maturity financial assets

These are assets representing debt with fixed or determinable pay outs and fixed maturity which Gas Natural Fenosa plans to and can hold until maturity. The valuation criteria for these investments are the same as those for loans and financial receivables.

c) Fair value financial assets through profit or loss

These are assets acquired for short-term sale. Derivatives form part of this category unless they are designated as hedges. These financial assets are stated, both initially and in later valuations, at their fair value, and the changes in their value are taken to the Income Statement for the year.

d) Available for sale financial assets

Available-for-sale financial assets are non-derivative debt or equity instruments that are not designated in either category.

They are recognised at the fair value. Unrealized gains and losses arising from changes in fair value are recognized in net equity. When these assets are sold or suffer an impairment for a long period, the accumulated adjustments to the reserves due to valuation adjustments are included in the Income statement as gains and losses.

The fair values of listed investments are based on listed prices (Level 1). In the case of shareholdings in unlisted companies, fair value is determined using valuation techniques that include the use of recent transactions between willing and knowledgeable parties, references to other instruments that are substantially the same and the analysis of discounted future cash flows (Levels 2 and 3). If none of these techniques can be used to determine fair value, investments are carried at cost less any impairment loss.

Fair value measurements recognised in these consolidated annual accounts are classified using a fair value hierarchy that reflects the relevance of the variables employed to perform the measurement. This ranking has three levels:

- Level 1: Valuations based on the quotation price of identical instruments in an official market. The fair value is based on quoted market prices at the balance sheet date.

- Level 2: Valuations based on variables that are observable for the asset or liability. The fair value of financial assets included in this category is determined using valuation techniques. The valuation techniques maximize the use of observable market data when available and rely as little as possible on specific estimates done by Gas Natural Fenosa. If all significant inputs required to calculate the fair value are observable, the instrument is included in Level 2. If one or more of the significant inputs are not based on observable market data, the instrument is included in Level 3.

- Level 3: Valuations based on variables that are not based on observable market information.

The financial assets are written off when the contractual rights to the cash flows generated by the asset have matured or have been transferred, while the risks and rewards inherent in their ownership must be substantially transferred. The financial assets are not written off and a liability is recognised in an amount equal to the consideration received for the assignment of assets in which the income and profit inherent in them have been retained.

The account receivables assignment agreements are qualified as factoring without recourse always when they involve a transfer of the risks and rewards inherent in ownership of the financial assets assigned have been transferred.

Cash and cash equivalents

Cash and cash equivalents include cash at hand, time deposits with financial entities and other short-term investments noted for their great liquidity with a maturity of no longer than three months.

Borrowings

Borrowings are initially recognised at their fair value, net of the transaction costs that they may have incurred. Any difference between the amount received and the repayment value is recognised in the income statement during the period of repayment using the effective interest rate method.

Borrowings are classified as current liabilities unless they mature in more than twelve months as from the balance sheet date, or include tacit one-year prorogation clauses that can be exercised by Gas Natural Fenosa.

Trade and other payables

Trade and other current payables are financial liabilities that fall due in less than twelve months that are stated at their fair value and do not accrue explicit interest. They are accounted for at their nominal value. Those maturing in more than 12 months are considered non-current payables.

3.3.7 Derivatives and other financial instruments

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognizing the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the asset being hedged.

Gas Natural Fenosa documents at the inception of the transaction and periodically, the relationship between hedging instruments and hedged items, as well as its risk management objective. Additionally, the aims of risk management and hedging strategies are periodically reviewed.

A hedge is considered to be highly effective when the changes in the fair value or the cash flows of the assets hedged are offset by the change in the fair value or cash flows of the hedging instrument, with an effectiveness ranging from 80% to 125%.

The market value of the different financial instruments is calculated using the following procedures:

- Derivatives listed on an official market are calculated on the basis of their year-end quotation (Level 1).

- Derivatives that are not traded on official markets are calculated on the basis of the discounting of cash flows based on year end market conditions, based on market conditions as at Consolidated balance sheet date or, for some non-financial items, on best estimation on forward curves of said non-financial item (Level 2 and 3).

Fair values obtained in absence of risk are adjusted by the expected impact of the risk of counterparty credit observable in positive valuation scenarios and the impact of own credit risk in observable negative valuation scenarios.

Derivatives embedded in other financial instruments or in other host contracts are recorded separately as derivatives only when their financial characteristics and inherent risks are not strictly related to the instruments in which they are embedded and the whole item is not being carried at fair value through consolidated profit or loss.

For accounting purposes, the operations are classified as follows:

1. Derivatives qualifying for hedge accounting

a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualified as fair value hedges are recognized in the income statement together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

b) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualified as cash flow hedges are recognized in equity. The gain or loss relating to the ineffective portion is recognized immediately in the Consolidated Income Statement.

Amounts accumulated in net equity are reclassified to the income statement in the periods when the hedged item will affect the Consolidated Income Statement.

c) Hedges of net foreign investments

The accounting treatment is similar to cash flow hedges. The variations in value of the effective part of the hedging instrument are carried on the Consolidated Balance Sheet under "Cumulative translation differences". The gain or loss from the non-effective part is recognised immediately under "Exchange differences" on the Consolidated Income Statement. The accumulated amount of the valuation recorded under "Cumulative translation differences" is released to the Consolidated Income Statement as the foreign investment that gave rise to it is sold.

2. Derivatives that do not qualify for hedge accounting

Certain derivative instruments do not qualify for hedge accounting. Such derivatives are classified as at fair value through profit or loss, and changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognized immediately in the Consolidated Income Statement.

3. Energy purchase and sale agreements

During the normal course of its business Gas Natural Fenosa enters into energy purchase and sale agreements which in most cases include "take or pay" clauses. by virtue of which the buyer takes on the obligation to pay the value of the energy contracted irrespective of whether he receives it or not. These agreements are executed and maintained in order to meet the needs of receipt of physical delivery of energy projected by Gas Natural Fenosa in accordance with the energy purchase and sale estimates made periodically, which are monitored systematically and adjusted always may be by physical delivery. Consequently, these are negotiated contracts for “own use”, and accordingly, fall out with the scope of IAS 39.

3.3.8 Non-current assets held for sale and discontinued activities

Gas Natural Fenosa classifies as assets held for sale all the assets and related liabilities for which active measures have been taken in order to sell them and if it is estimated that the sale will take place within the following twelve months.

Additionally, Gas Natural Fenosa considers discontinued activities the components (cash generating units or groups of cash generating units) that make up a business line or geographic area of operations, which are significant and which can be considered separately from the rest, and which have been sold or disposed by other means or which meet the conditions to be classified as held-for-sale. Furthermore, discontinued activities also include entities acquired exclusively for resale.

These assets are stated at the lower of their carrying value or fair value after deducting the costs required for their sale and they are not subject to depreciation, as from the time in which they are classified as non-current assets held for sale.

Non-current assets held for sale are disclosed as follows on the consolidated balance sheet: the assets are carried under a single account “Non-current assets held for sale” and the liabilities are also carried under a single account called “Liabilities linked to non-current assets held for sale”. The profit or loss from discontinued activities is stated on a single line on the Consolidated income statement called “Net income for the year from discontinued operations net of tax”.

3.3.9 Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is determined using weighted average cost.

Costs of inventories include the cost of raw materials and those that are directly attributable to the acquisition and/or production, including the costs of transporting inventories to the current location.

The nuclear fuel is valued on the basis of the costs actually incurred in its acquisition and preparation. The consumption of nuclear fuel is charged to the income statement on the basis of the energy capacity consumed.

During 2016 the accounting policy for classifying greenhouse gas emission allowances as intangible fixed assets has been revised. Following the relevant analysis than considers those assets as inventories, based on the fact that they will not remain, generally, as an asset for a long period, and following the practice applied by the main industry operators, the carrying amount of the emission allowances recorded as intangible assets has been reclassified to inventories. emission allowances are stated at the lower of weighted average acquisition price and net realisable value. When the rights are delivered, they are derecognised against the provision recorded when the CO_2 emissions take place (Note 3.3.16).

Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. For raw materials, the Group assesses whether or not the net realisable value of finished goods is greater than their production cost.

3.3.10 Share capital

Share capital is made up of ordinary shares.

Incremental costs directly attributable to the issue of new shares or options, net of tax, are deducted from equity as a deduction from Reserves.

Dividends on ordinary shares are recognized as a deduction from equity in the year they are approved.

Acquisitions of treasury shares are recorded at acquisition cost, deducted from equity until disposal. The Gains and losses on disposal of treasury shares are recognized under "Reserves" in the consolidated balance sheet.

3.3.11 Earnings per share

Basic earnings per share are calculated as a quotient between Consolidated Net Income for the year attributable to equity holders of the company and the average weighted number of ordinary shares in circulation during this period, excluding the average number of shares of the parent Company held by the Group.

Diluted earnings per share are calculated as a quotient between Consolidated net income for the year attributable to the ordinary equity holders of the company adjusted by the effect attributable to the potential ordinary shares having a dilutive effect and the average weighted number of ordinary shares in circulation during this period, adjusted by the average weighted number of ordinary shares that would be issued if all the potential ordinary shares were converted into ordinary shares of the Company. Accordingly, the conversion is considered to take place at the beginning of the period or at the time of issue of the potential ordinary shares, if these have been placed in circulation during the period itself.

3.3.12 Borrowings and equity instruments

Borrowings and equity instruments issued by Gas Natural Fenosa are classified based on the nature of the issue.

Gas Natural Fenosa treats all contracts that represent a residual share in net assets as equity instruments.

Equity instrument issuance costs are presented as a deduction in equity.

3.3.13 Preference shares and subordinated perpetual debentures

The issues of preference shares and subordinated perpetual debentures are considered equity instruments if and only if:

- They do not include the contractual obligation for the issuer to repurchase them, under conditions involving certain amounts and at certain dates or determinable amounts and at determinable dates, or the right of the holder to demand their redemption.

- The payment of interest is at the discretion of the issuer.

In the case of issues of preference shares made by a subsidiary of the Group, which comply with the above conditions, the amount received is classified on the Consolidated Balance Sheet under “Non-controlling interest”.

3.3.14 Deferred income

This caption mainly includes:

- Capital grants relating basically to Agreements with the Regional Governments for the gasification of municipalities and other investments in gas infrastructure, for which Gas Natural Fenosa has met all the conditions established, are stated at the amount granted.

- Income received for the construction of connection facilities for the gas or electricity distribution network (connections), which are booked for the cash received, as well as assignments received for these facilities, which are booked, in accordance with IFRIC 18, at their fair value, since both the cash and the facilities are received in consideration for an ongoing service of providing access to the network during the life of the facilities.

- Income from the extension of the pipeline network that will be financed by third parties.

Amounts under Deferred income are recognised through the Consolidated Income Statement systematically on the basis of the useful life of the corresponding asset, thus offsetting the amortisation expense.

When the corresponding asset is replaced, the deferred income from the extension of the pipeline network financed by third parties is expensed at the carrying value of the assets replaced. The remaining amount of the deferred income is taken to profit and loss systematically over the useful life of the respective asset.

3.3.15 Provisions for employee obligations

a) Post-employment pension obligations and the like

- Defined contribution plans

Gas Natural SDG. S.A., together with other Group companies, is the promoter of a joint occupational pension plan, which is defined contribution plan for retirement and a defined benefit plan for the so-called risk contingencies, which are secured.

Additionally, there is a defined contribution plan for a group of executives, for which Gas Natural Fenosa undertakes to make certain contributions to an insurance policy. Gas Natural Fenosa guarantees this group a yield of 125% of the CPI of the contributions made to the insurance policy. All the risks have been transferred to the insurance company, since it insures the guarantee indicated above.

The contributions made have been recorded under “Personnel costs” on the Consolidated Income Statement.

- Defined benefit plans

For certain groups there are defined benefit liabilities relating to the payment of retirement pension, death and disability supplements, in accordance with the benefits agreed by the entity and which have been transferred out in Spain through single premium insurance policies under Royal Decree 1588/1999/15 October, which adopted the Regulations on the arrangement of company pension liabilities.

The liability recognised for the defined benefit pensions plans is the current value of the liability at the balance sheet date less the fair value of the plan-related assets. The defined benefit liabilities are calculated annually by independent actuaries using the projected credit unit method. The current value of the liability is determined by discounting the estimated future cash flows at bond interest rates denominated in the currency in which the benefits will be paid and using maturities similar to those of the respective liabilities.

Actuarial losses and gains arising from changes in actuarial assumptions or from differences between assumptions and reality are recognised directly in the equity item "Other comprehensive income", for the entire amount, in the period in which they arise.

Past-service costs are recognized immediately in Consolidated Income Statement under “Personnel costs”.

b) Other post-employment benefit obligations

Some of Gas Natural Fenosa’s companies provide post-employment benefits to their employers. The entitlement to these benefits is usually conditional on the employee remaining in service up to retirement age and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment using an accounting methodology similar to that used for defined benefit pension plans. Actuarial gains and losses arising from changes in actuarial assumptions are charged or credited, directly in equity, to “reserves”.

c) Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or when an employee accepts voluntary redundancy in exchange for these benefits. Gas Natural Fenosa terminates the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits. In the event that mutual agreement is required, the provision is only recorded in those situations in which Gas Natural Fenosa has decided to give its consent to voluntary redundancies once they have been requested by the employees.

3.3.16 Provisions

Provisions are recognized when Gas Natural Fenosa has a legal or implicit present obligation as a result of past events; it is more likely than an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognized for future operating losses.

Provisions are measured at the present value of the best estimate of expenditure required to settle the present obligation at the balance sheet date.

When it is expected that part of the disbursement needed to settle the provision is paid by a third party, the payment is recognised as a separate asset, provided that its receipt is practically assured.

Gas Natural Fenosa has the obligation to dismantle certain facilities at the end of their useful life, such as those related to nuclear power plants and mines, as well as carry out environmental restoration where these are located. To do so, it is recorded under Property.

plant and equipment the current value of the cost that these tasks would amount, which, in the case of nuclear plants, includes the time until ENRESA, the public entity takes charge of the dismantling and management of radioactive waste, with a counter-entry under provisions for liabilities and charges. This estimate is reviewed annually so that the provision reflects the current value of the future costs by increasing or decreasing the value of the asset. The variation in the provision arising from its financial restatement is recorded under “Financial expenses”.

In the contracts in which the obligations borne include inevitable costs greater than the economic profit expected to be received from them, the expenses and respective provision are recognised in the amount of the current value of the existing difference.

In order to cover the obligation concerning the delivery of CO_2 emission allowances for emissions made during the year, Current provisions record the CO_2 allowances to be delivered valued at acquisition cost for allowances purchased recorded under Inventories and, if not all necessary emission allowances are held, at fair value for allowances pending purchase.

3.3.17 Leases

1) Finance leases

The leases in which the lessee assumes substantially all the risks and the advantages derived from the ownership of the assets are classified as financial leases.

Gas Natural Fenosa acts as a lessee under a number of finance lease agreements. These leases are recognised at lease inception at the lower of the asset's fair value and the present value of lease payments, including the purchase option, if applicable. Each lease payment is allocated between the debt reduction and finance charge so as to achieve a constant rate of interest on the debt pending payment. The payment obligation arising from the lease, net of the finance charge, is recognised in liabilities in the consolidated balance sheet. The interest component of the finance charge is taken to the consolidated income statement over the term of the lease so as to produce a constant periodic rate of interest on the debt pending payment for each period. Property, plant and equipment acquired under finance leases is depreciated over the asset's useful life.

2) Operating leases

Leases where the lessor retains substantially all the risks and rewards of ownership are classified as operating leases.

Operating lease payments are charged to the consolidated income statement on a straight-line basis over the lease period.

3.3.18 Income tax

Income tax expense includes the deferred tax expense and the current tax expense which is the amount payable (or refundable) on the tax profit for the year.

Deferred taxes are recorded by comparing the temporary differences that arise between the taxable income on assets and liabilities and their respective accounting figures in the Consolidated annual accounts used the tax rates that are expected to be in force when the assets and liabilities are realised. No deferred tax liabilities are recognised for profits not distributed from the subsidiaries when Gas Natural Fenosa can control the reversal of the timing differences and it is likely that they will not reverse in the foreseeable future.

Deferred taxes arising from direct charges or credits to equity accounts are also charged or credited to equity.

Deferred income tax assets and credit taxes are recorded only when there are no doubts as to their future recoverability through the future tax profits that can be used to offset timing differences and make credit taxes effective.

Should tax rates change, deferred tax assets and liabilities are reestimated. These amounts are charged or credited to the consolidated income statement or to the item "Other comprehensive income for the year" in the consolidated statement of comprehensive income, depending on the account to which the original amount was charged or credited.

3.3.19 Revenue and expenses recognition and payments for regulated activities

a) General

The sales of goods are recognised when they have been delivered to the customer and the customer has accepted them, even if they have not been billed, or, if applicable, the services have been rendered and the collectability of the respective accounts receivable is reasonably assured. The sales figure for the year includes the estimate of the energy supplied that has yet to be invoiced.

The expenses are recognised on an accruals basis, immediately in the case of disbursements that are not going to generate future economic profits or when the requirements for recording them as assets are not met.

Sales are stated net of tax and discounts and the transactions between companies in the Gas Natural Fenosa are eliminated.

b) Revenues from the gas business and settlement for regulated activities

Note 2.1 describes the basic aspects of the applicable regulations to the gas sector.

The regulatory framework of the natural gas sector in Spain regulates a payment procedure for the redistribution amongst companies in the sector of the net turnover obtained, so that each company receives the remuneration recognised for its regulated activities.

The remuneration of the regulated gas distribution activity is fixed for each distribution company for all its facilities according to the clients connected to them and the volume of gas supplied.

The remuneration of the regulated gas transport is fixed in respect of availability and continuity of supply of the companies owning transmission assets.

The remuneration of the regulated gas transport is recorded as income in the amount assigned under the Ministerial Order that sets this amount each year.

At the date of preparation of these consolidated annual accounts, no final settlements from prior years are outstanding.

Order ETU/1977/2016 of 23rd December (Note 2.1.1.2) recognises the accumulated deficit in the gas system at 31 December 2014 which coincides with the amount approved in the final settlement in 2014. Companies subject to the settlement system, including Gas Natural Fenosa, will be entitled to recover this deficit in fifteen consecutive annual payments from

25 November 2016, through annual amounts that will be included in system costs and in which a provisional interest rate of 1.104% will be recognised. Order ETU/1977/2016 also recognises a temporary mismatch between income and costs for 2015, which coincides with that approved in the final settlement for 2015. Companies subject to the settlement system, including Gas Natural Fenosa, will be entitled to recover this amount in five consecutive annual payments from 25 November 2016, applying a provisional interest rate of 0.836%. Consequently, the financing for the gas system revenue deficit is recognised as a financial asset since, on the basis of this regulation, Gas Natural Fenosa is entitled to a reimbursement and there are no future contingent factors.

Revenue includes the amount of both last-resort gas sales and free market sales, since the last-resort supplier and the free-market supplier are deemed to be a principal agent and not a commission agent for the supply made.

The exchanges of gas that do not have a different value and do not include costs that causes differences in value are not classified as transactions that generate revenues and are not included, therefore, in the income figure.

c) Revenue from electricity business and settlement for regulated activities

Note 2.4 describes the basic aspects of the applicable regulations to the electricity sector.

The regulatory framework of the electricity sector in Spain regulates a payment procedure for the redistribution amongst companies in the sector of the net turnover obtained, so that each company receives the remuneration recognised for its regulated activities.

The remuneration of the regulated electricity distribution is recorded as income in the amount assigned under the Ministerial Order that sets this amount each year.

At the date of formulation of these Consolidated annual accounts the final payments for the period 2013-2015 have not been published, although it is not expected that the final payments will generate significant differences in relation to the estimates made.

In 2006 to 2013, given that the income collected by the companies in the Spanish electricity industry have not been sufficient to remunerate the different regulated activities and costs of the system, the companies themselves, including Gas Natural SDG. S.A., were forced to finance this income deficit, until its definitive funding through the electricity system securitisation fund. Following successive auctions and assignments of the outstanding debt claims, on 15 December 2014 the electricity system deficit securitisation process was completed.

Following the publication of Electricity Sector Law 24/2013, December 26 (Note 2.4), temporary mismatches between electricity system revenues and costs are funded by the companies subject to the settlement system, including Gas Natural Fenosa, generating the right to recover the relevant amount over the following five years, including interest at a market rate. Consequently, the financing for the electricity system revenue deficit is recognised as a financial asset since, on the basis of this regulation, Gas Natural Fenosa is entitled to a reimbursement and there are no future contingent factors. In 2014 to 2016 after new regulation implementation, there is no revenue shortfall in the sector, according to the provisional settlements data.

Revenue includes the amount of electricity sales in both the PVPC market and the free market, since the last-resort supplier and the free-market supplier are deemed to be a principal agent and not a commission agent for the supply made. Consequently, power purchases and sales are recognised for the total amount. Nonetheless, power purchases and sales from the pool made by the Group's generation and supply companies in the same time band are eliminated during the consolidation process.

d) Other income and expenses

Gas Natural Fenosa has power generation capacity assignment contracts with the Federal Electricity Commission for its combined-cycle plants in Mexico (CFE), for a 25-year term as from the start date of commercial operations. These contracts stipulate a pre-established collection schedule for the assignment of power supply capacity. As Gas Natural Fenosa has the capacity to operate and manage the plants, sells the power at market prices and retains the rewards and risks of operations, taking relevant decisions that will affect future cash flows, these contracts represent provisions of services and are thus recognised on a percentage-of-completion basis.

In accounting for revenues from the service provision agreements is used the percentage realisation method in which, when the income can be reliably estimated, it is recorded on the basis of the degree of progress in the completion of the contract at the year end, calculated as a proportion of the costs incurred at that date of the estimated costs required to fulfil the contract.

If the income from the contract cannot be estimated reliably, the costs (and respective income) are recorded in the period in which they are incurred, provided that the former can be recovered. The contract margin is not recorded until there is certainty of its materialisation, based on cost and income planning.

In the event that the total costs exceed the contract revenues, this loss is recognised immediately in the Consolidated Income Statement for the year.

Interest income and expenses are recognized using the effective interest method.

Dividend income is recognised when the right to collect the dividend is established.

3.3.20 Cash Flow Statements

The consolidated cash flow statements have been prepared using the indirect method and contain the use of the following expressions and their respective meanings:

a) Operating activities: activities that constitute ordinary Group revenues, as well as other activities that cannot be qualified as investing or financing.

b) Investing activities: acquisition, sale or disposal band other means of assets in the long-term and other investments not included in cash and cash equivalents.

c) Financing activities: activities that generate changes in the size and composition of equity and liabilities that do not form part of operating activities.

3.3.21 Significant accounting estimates and judgements

The preparation of the Consolidated annual accounts requires the use of estimates and assumptions. We set out below the measurement policies that require a greater use of estimates:

a) *Intangible assets and property, plant and equipment (Notes 3.3.3 and 3.3.4)*

The useful lives of intangible assets and property, plant and equipment are determined using estimates of the level of use of the assets and of expected technological advancement. Assumptions regarding level of use, technological framework and future development imply a significant degree of judgement, since the timing and nature of future events are difficult to foresee.

b) *Impairment of non-financial assets (Note 3.3.5)*

The estimated recoverable value of the CGU applied to the impairment tests has been determined using the discounted cash flows based on the budgets by Gas Natural Fenosa, which have historically been substantially met.

c) Derivatives and other financial instruments (Note 3.3.7)

The fair value of financial instruments traded in active markets is based on quoted market prices at the consolidated balance sheet date. The quoted market price used for financial assets held by the group is the current bid price.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. Gas Natural Fenosa uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The fair value of financial swaps is calculated as the present value of the estimated future cash flows. The fair value of forward foreign exchange contracts is determined using quoted forward exchange rates at the balance sheet date. The fair value of commodity prices derivatives is determined using quoted forward price curves at the balance sheet date.

The carrying value less impairment provision of trade receivables and payables is assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to Gas Natural Fenosa for similar financial instruments.

d) *Provisions for employee benefits (Note 3.3.15)*

The calculation of the pension expense, other post-employment benefit expenses or other post-employment liabilities, requires the application of various assumptions. Gas Natural Fenosa estimates at each year end the provision necessary to meet its pension liabilities and the like, in accordance with the advice from independent actuaries. The changes that affect these assumptions could give rise to different expenses and liabilities recorded. The most significant assumptions for the measurement of pension or post-retirement benefit liabilities are energy consumption by beneficiaries during retirement, retirement age, inflation and the discount rate employed. Moreover, the assumptions of social security coverage are essential in determining other post-employment benefits. The future changes in these assumptions will have an impact on the future pension expenses and liabilities.

e) *Provisions (Note 3.3.16)*

Gas Natural Fenosa makes an estimate of the amounts to be settled in the future, including amounts relating to, contractual obligations, outstanding litigation, future costs for dismantling and closure of certain facilities and restoration of land or other liabilities. These estimates are subject to the interpretation of current events and circumstances, projections of future events and estimates of their financial effects.

f) *Income tax (Note 3.3.18)*

The calculation of the income tax expense requires interpretations of tax legislation in the jurisdictions in which Gas Natural Fenosa operates. The determination of expected outcomes of outstanding disputes and litigation requires the preparation of significant estimates and judgment. Gas Natural Fenosa evaluates the recoverability of the deferred income tax assets based on estimates of future taxable income. The recoverability of the deferred tax assets depends ultimately on the capacity of Gas Natural Fenosa to generate sufficient tax profits during the periods in which these deferred taxes are deductible.

g) *Revenue recognition and settlement of regulated activities (Nota 3.3.19)*

Revenues from energy sales are recognized when the goods are delivered to the customer based on periodical meter readings and include the estimated accrual of the value of the goods consumed as from the date of the meter reading until the close of the period. Estimated daily consumption is based on historical customer profiles taking into account seasonal adjustments and other factors than can be measured and may affect consumption. Historically, no material adjustments have been made relating to the amounts booked as unbilled income and none are expected in the future.

Certain aggregates for the electricity and gas system, including those relating to other companies which allow for the estimate of the overall settlement of the electricity system that must materialise in the respective final payments, could affect the calculation of the deficit in the payments for the electricity and gas regulated business in Spain.

Note 4. Segment financial information

An operating segment is a component that carries on business activities from which it may obtain ordinary revenue and incur in costs, which operating results are reviewed regularly by the Gas Natural SDG, S.A. Board of Directors to determine the resources that must be allocated to the segment and to evaluate its performance, and in respect of which separate financial information is available.

Without there being any change in the definition of the segments in which Gas Natural Fenosa operates with respect to the previous year, CGE (Chile)'s business is presented within gas distribution Latin America and electricity distribution Latin America in line with internal management information information used by the Gas Natural Fenosa's management.

a) *Segment information*

The operating segments of Gas Natural Fenosa are:

- Gas distribution. This segment encompasses the regulated gas distribution business in Spain, Italy and Latin America.

  The gas distribution business in Spain includes the regulated gas distribution activity, the services for third-party access to the network, as well as the activities related to distribution. This also includes the liquefied petroleum gas (LPG) business.

  Gas distribution in Italy consists of regulated gas distribution.

  The gas distribution business in Latin America (Argentina, Brazil, Chile, Colombia, Mexico and Peru) includes the regulated gas distribution activity and sales to customers at regulated prices. In Chile the gas supply and commercialisation business is also included.

- Electricity distribution. This segment encompasses the regulated electricity distribution business in Spain, Moldova and Latin America.

  The electricity distribution business in Spain includes the regulated electricity distribution business and network services for customers, metering and other business related to third party access to the distribution network.

  The electricity distribution business in Moldova consists of the regulated distribution of electricity and commercialisation at tariff in the area of the country.

  The electricity distribution business in Latin America consists of the regulated electricity distribution activity in Argentina, Chile, Panama and Colombia (until 31 december 2016).

- Gas. Includes the activity arising from the gas Infrastructure, the supply activity and Unión Fenosa Gas.

  The infrastructure business includes operation of the Maghreb-Europe gas pipeline and the regassfication process, and gas exploration, production and storage.

  The commercialization business includes wholesale gas procurement and supply both in the Spanish liberalised market and in other countries, maritime transportation, retail supply of gas and other related products and services in the liberalised market in Spain and Italy, and supply of gas at the last-resort tariff (TUR) in Spain. Additionally includes maritime transportation activity, previously included in the infraestructure business, has been included, adapting 2015 comparative amounts.

  Unión Fenosa Gas' business (50%-owned by Gas Natural Fenosa and 50% by another shareholder, consolidated using the equity method) includes the Damietta (Egypt) liquefaction activities, sea transport and gas commercialisation activities.

- Electricity. It includes the electricity generation and commercialisation in Spain and the Global Power Generation activities.

  The Electricity business in Spain includes electricity production activity through combined cycle, coal, nuclear, hydro, co-generation and wind farm plants. and other special regime technologies, the supply of electricity to wholesale markets and the wholesaling and retailing of electricity in the de-regulated Spanish market.

  The Global Power Generation business mainly includes the Group's international generation activities in Latin America (Mexico, Costa Rica, Dominican Republic, Panama and Puerto Rico, the latter being consolidated using the equity method, through EcoEléctrica, L.P.), Rest (Kenya and Australia) and will incorporate Brasil and Chile when their activities start.

- Rest. This includes the exploitation of the coal field belonging to Kangra Coal (Proprietary), Ltd in South Africa, the corporation operational assets/liabilities and operation expenses along with its billing to the different business based on its utilisation as well as the other non-energy business.

Net financial income and income tax expense are not allocated to the operating segments, since both financing activities and the income tax effects are managed jointly.

Segment results and investments for the periods of reference are as follows:

Segment financial information – Income statement

016	Gas distribution Spain	Gas distribution Italy	Gas distribution Latin America	Gas distribution Total	Electricity distribution Spain	Electricity distribution Moldova	Electricity distribution Latin America	Electricity distribution Total	Gas Infrastruc-tures	Gas Supply	Gas UF GAS	Gas Total	Electricity Spain	Electricity Global Power Generation	Electricity Total	Rest	Eliminations	TOTAL
Sales consolidated	1,075	88	3,587	**4,750**	789	227	4,673	**5,689**	27	7,616	**-**	**7,643**	4,217	763	**4,980**	**122**	**-**	**23,184**
Sales intersegments	123	-	-	**123**	44	-	-	**44**	297	1,194	**-**	**1,491**	1,062	18	**1,080**	**242**	**-**	**2,980**
Sales segment	1,198	88	3,587	**4,873**	833	227	4,673	**5,733**	324	8,810	**-**	**9,134**	5,279	781	**6,060**	**364**	**(2,980)**	**23,184**
Segment supplies	(33)	(1)	(2,372)	**(2,406)**	-	(170)	(3,408)	**(3,578)**	(7)	(7,951)	**-**	**(7,958)**	(3,813)	(400)	**(4,213)**	**(94)**	**2,829**	**(15,420)**
Net personnel expenses	(68)	(11)	(124)	**(203)**	(85)	(6)	(216)	**(307)**	(5)	(72)	**-**	**(77)**	(138)	(40)	**(178)**	**(248)**	**-**	**(1,013)**
Other operating income/expenses	(208)	(14)	(312)	**(534)**	(145)	(9)	(360)	**(514)**	(14)	(240)	**-**	**(254)**	(613)	(84)	**(697)**	**67**	**151**	**(1,781)**
EBITDA	889	62	779	**1,730**	603	42	689	**1,334**	298	547	**-**	**845**	715	257	**972**	**89**	**-**	**4,970**
Other results	-	-	-	**-**	-	-	-	**-**	-	-	-	**-**	-	-	**-**	**122**	**-**	**122**
Depreciation, amortization and impairment expenses	(291)	(24)	(159)	**(474)**	(222)	(5)	(162)	**(389)**	(58)	(62)	**-**	**(120)**	(523)	(132)	**(655)**	**(121)**	**-**	**(1,759)**
Transfers to provisions	(2)	-	(23)	**(25)**	-	-	(215)	**(215)**	-	(44)	**-**	**(44)**	(38)	-	**(38)**	**(5)**	**-**	**(327)**
Operating income	596	38	597	**1,231**	381	37	312	**730**	240	441	**-**	**681**	154	125	**279**	**85**	**-**	**3,006**
Net financial income	-	-	-	**-**	-	-	-	**-**	-	-	-	**-**	-	-	**-**	**-**	**-**	**(825)**
Equity-method result	-	-	16	**16**	-	-	9	**9**	-	-	(176)	**(176)**	2	49	**51**	**2**	**-**	**(98)**
Income before tax	-	-	-	**-**	-	-	-	**-**	-	-	**-**	**-**	-	-	**-**	**-**	**-**	**2,083**
Income tax	-	-	-	**-**	-	-	-	**-**	-	-	**-**	**-**	-	-	**-**	**-**	**-**	**(416)**
Profit/(loss) for the year from continuing operations	-	-	-	**-**	-	-	-	**-**	-	-	**-**	**-**	-	-	**-**	**-**	**-**	**1,667**
Profit/(loss) for the year from discontinued operations	-	-	-	**-**	-	-	-	**-**	-	-	**-**	**-**	-	-	**-**	**-**	**-**	**44**
Net income for the period	-	-	-	**-**	-	-	-	**-**	-	-	**-**	**-**	-	-	**-**	**-**	**-**	**1,711**

2015	Gas distribution Spain	Gas distribution Italy	Gas distribution Latin America	Gas distribution Total	Electricity distribution Spain	Electricity distribution Moldova	Electricity distribution Latin America	Electricity distribution Total	Gas Infrastruc-tures	Gas Supply	Gas UF GAS	Gas Total	Electricity Spain	Electricity Global Power Generation	Electricity Total	Rest	Eliminations	TOTAL
Sales consolidated	1,056	92	4,018	**5,166**	792	260	4,582	**5,634**	21	9,468	**-**	**9,489**	4,695	779	**5,474**	**252**	**-**	**26,015**
Sales intersegments	135	-	-	**135**	46	-	-	**46**	296	1,292	**-**	**1,588**	1,084	27	**1,111**	**237**	**-**	**3,117**
Sales segment	1,191	92	4,018	**5,301**	838	260	4,582	**5,680**	317	10,760	**-**	**11,077**	5,779	806	**6,585**	**489**	**(3,117)**	**26,015**
Segment supplies	(16)	(1)	(2,779)	**(2,796)**	(1)	(205)	(3,359)	**(3,565)**	(6)	(9,676)	**-**	**(9,682)**	(4,338)	(420)	**(4,758)**	**(177)**	**2,981**	**(17,997)**
Net personnel expenses	(68)	(12)	(126)	**(206)**	(83)	(6)	(196)	**(285)**	(5)	(68)	**-**	**(73)**	(138)	(39)	**(177)**	**(232)**	**-**	**(973)**
Other operating income/expenses	(235)	(13)	(300)	**(548)**	(147)	(11)	(326)	**(484)**	(13)	(228)	**-**	**(241)**	(562)	(86)	**(648)**	**4**	**136**	**(1,781)**
EBITDA	872	66	813	**1,751**	607	38	701	**1,346**	293	788	**-**	**1,081**	741	261	**1,002**	**84**	**-**	**5,264**
Other results	-	-	-	**-**	-	-	-	**-**	-	-	-	**-**	-	-	**-**	**5**	**-**	**5**
Depreciation, amortization and impairment expenses	(289)	(24)	(170)	**(483)**	(217)	(6)	(159)	**(382)**	(65)	(54)	**-**	**(119)**	(523)	(134)	**(657)**	**(109)**	**-**	**(1,750)**
Transfers to provisions	(4)	-	(20)	**(24)**	(2)	-	(135)	**(137)**	-	(59)	**-**	**(59)**	(38)	-	**(38)**	**-**	**-**	**(258)**
Operating income	579	42	623	**1,244**	388	32	407	**827**	228	675	**-**	**903**	180	127	**307**	**(20)**	**-**	**3,261**
Net financial income	-	-	-	**-**	-	-	-	**-**	-	-	-	**-**	-	-	**-**	**-**	**-**	**(894)**
Equity-method result	-	-	1	**1**	2	-	24	**26**	-	-	(81)	**(81)**	4	40	**44**	**6**	**-**	**(4)**
Income before tax	-	-	-	**-**	-	-	-	**-**	-	-	**-**	**-**	-	-	**-**	**-**	**-**	**2,363**
Income tax	-	-	-	**-**	-	-	-	**-**	-	-	**-**	**-**	-	-	**-**	**-**	**-**	**(573)**
Profit/(loss) for the year from continuing operations	-	-	-	**-**	-	-	-	**-**	-	-	**-**	**-**	-	-	**-**	**-**	**-**	**1,790**
Profit/(loss) for the year from discontinued operations	-	-	-	**-**	-	-	-	**-**	-	-	**-**	**-**	-	-	**-**	**-**	**-**	**34**
Net income for the period	-	-	-	**-**	-	-	-	**-**	-	-	**-**	**-**	-	-	**-**	**-**	**-**	**1,824**

Segmental financial information – Assets, liabilities and investments

	Gas distribution				Electricity distribution				Gas				Electricity					
2016	**Spain**	**Italy**	**Latin America**	**Total**	**Spain**	**Moldova**	**Latin America**	**Total**	**Infrastruc-tures**	**Supply**	**UF GAS**	**Total**	**Spain**	**Global Power Generation**	**Total**	**Rest**	**Eliminations**	**TOTAL**
Operating assets (a)	4,113	528	5,031	**9,672**	4,939	149	5,223	**10,331**	520	3,247	-	**3,767**	8,761	1,979	**10,740**	1,115	(689)	**34,916**
Investments under equity method	-	-	10	**10**	6	-	54	**60**	-	-	1,034	**1,034**	94	344	**438**	33	-	**1,575**
Operating liabilities (a)	(768)	(42)	(796)	**(1,606)**	(900)	(32)	(804)	**(1,736)**	(10)	(1,404)	-	**(1,414)**	(1,035)	(145)	**(1,180)**	(984)	699	**(6,221)**
Investment in intangible assets (b)	20	30	136	**186**	30	-	44	**74**	4	6	-	**10**	5	3	**8**	124	-	**402**
Invest. in property, plant & equipment (c)	673	1	168	**842**	235	13	344	**592**	9	455	-	**464**	100	85	**185**	32	-	**2,115**
Business combinations (Note 31)	-	-	-	**-**	-	-	-	**-**	-	32	-	**32**	-	-	**-**	-	-	**32**

	Gas distribution				Electricity distribution				Gas				Electricity					
2015	**Spain**	**Italy**	**Latin America**	**Total**	**Spain**	**Moldova**	**Latin America**	**Total**	**Infrastruc-tures**	**Supply**	**UF GAS**	**Total**	**Spain**	**Global Power Generatio n**	**Total**	**Rest**	**Eliminations**	**TOTAL**
Operating assets (a)	3,697	518	4,497	**8,712**	5,178	208	5,769	**11,155**	543	2,773	-	**3,316**	9,192	1,983	**11,175**	1,238	(723)	**34,873**
Investments under equity method	-	-	10	**10**	6	-	73	**79**	-	-	1,209	**1,209**	90	309	**399**	33	-	**1,730**
Operating liabilities (a)	(764)	(40)	(639)	**(1,443)**	(994)	(42)	(1,148)	**(2,184)**	(15)	(1,352)	-	**(1,367)**	(1,055)	(102)	**(1,157)**	(966)	746	**(6,371)**
Investment in intangible assets (b)	27	24	149	**200**	29	-	19	**48**	-	4	-	**4**	1	1	**2**	112	-	**366**
Invest. in property, plant & equipment (c)	408	1	175	**584**	220	9	301	**530**	12	34	-	**46**	103	57	**160**	81	-	**1,401**
Business combinations (Note 31)	5	-	-	**5**	-	-	-	**-**	-	-	-	**-**	304	-	**304**	-	-	**309**

(A) There follows a breakdown of the reconciliation of “Operating assets” and “Operating liabilities” with consolidated “Total assets” and “Total liabilities”:

	2016	2015
Operating assets	**34,916**	**34,873**
Goodwill	5,036	4,962
Investments carried under the equity method	1,575	1,730
Non-current financial assets	1,907	1,387
Deferred tax assets	872	1,070
Non-current assets held for sale (Note 9)	-	955
Derivative financial instruments (Note 11)	46	5
Public administrations (Note 11)	144	197
Current tax assets	162	198
Other current financial assets	389	365
Cash and cash equivalents	2,067	2,390
Total assets	**47,144**	**48,132**

	2016	2015
Operating liabilities	**(6,221)**	**(6,371)**
Net equity	(19,005)	(18,518)
Non-current financial liabilities	(15,003)	(15,653)
Finance lease liability (Notes 18 and 20)	(1,067)	(646)
Deferred tax liabilities	(2,509)	(2,543)
Liabilities related to non-current assets held for sale (Note 9)	-	(585)
Current financial liabilities	(2,599)	(2,595)
Derivative financial instruments (Notes 18, 19 and 20)	(48)	(188)
Dividend payable (Note 20)	(37)	(421)
Public administrations (Note 19)	(519)	(477)
Current tax liabilities	(106)	(135)
Total liabilities	**(47,114)**	**(48,132)**

(b) Includes the investment in "Intangible assets" (Note 5), broken down by operating segment, except for the investment for emission allowances amounting to Euro100 million in 2015.
(c) Includes the investment in "Property, plant and equipment" (Note 6), broken down by operating segment.

b) Reporting by geographic area

Gas Natural Fenosa's net revenue by country of destination is analysed below:

	2016	2015
Spain	10,101	11,731
Rest of Europe	2,794	2,668
Latin American	9,504	10,271
Other	785	1,345
Total	**23,184**	**26,015**

The assets of Gas Natural Fenosa, which include operating assets, as described above, and the investments booked using the equity method, are assigned based on their location:

	At 12/31/16	At 12/31/15
Spain	21,706	21,863
Rest of Europe	1,162	1,069
Latin American	12,558	12,564
Other	1,065	1,107
Total	**36,491**	**36,603**

The investments in property, plant and equipment and other intangible assets of Gas Natural Fenosa, as described above, assigned according to location of the assets are as follows:

	At 12/31/16	At 12/31/15
Spain	1,672	967
Rest of Europe	50	36
Latin American	773	739
Other	22	25
Total	**2,517**	**1,767**

Note 5. Intangible assets

The movement in 2016 and 2015 in intangible assets is as follows:

	IFRIC 12 Concessions	Other concessions and the like	Computer software	Other intangible assets	Subtotal	Goodwill	Total
Gross cost	2,527	3,539	946	1,309	**8,321**	4,959	**13,280**
Amortisation and impairment expenses	(948)	(563)	(601)	(385)	**(2,497)**	-	**(2,497)**
Net carrying value at 1/1/15	**1,579**	**2,976**	**345**	**924**	**5,824**	**4,959**	**10,783**
Investment (Note 4)	153	4	196	113	**466**	-	**466**
Divestitures [(1)]	(1)	-	-	(47)	**(48)**	-	**(48)**
Assets and liabilities held for sale (Note 9)	-	(47)	-	(51)	(98)	(49)	(147)
Amortisation and impairment charge	(75)	(52)	(123)	(58)	**(308)**	-	**(308)**
Translation differences	(294)	(54)	(5)	(11)	**(364)**	38	**(326)**
Business combinations (Note 31)	-	2	-	87	**89**	14	**103**
Reclassifications and other	(11)	(8)	-	21	**2**	-	**2**
Net carrying value at 12/31/15	**1,351**	**2,821**	**413**	**978**	**5,563**	**4,962**	**10,525**
Gross cost	2,229	3,496	1,131	1,423	**8,279**	4,962	**13,241**
Amortisation and impairment expenses	(878)	(675)	(718)	(445)	**(2,716)**	-	**(2,716)**
Net carrying value at 1/1/16	**1,351**	**2,821**	**413**	**978**	**5,563**	**4,962**	**10,525**
Investment (Note 4)	151	13	215	23	**402**	-	**402**
Divestitures	-	-	(1)	-	**(1)**	-	**(1)**
Assets and liabilities held for sale (Note 9)	-	-	-	-	-	-	-
Amortisation and impairment charge	(78)	(41)	(133)	(76)	**(328)**	-	**(328)**
Translation differences	184	158	2	5	**349**	55	**404**
Business combinations (Note 31)	-	-	-	39	**39**	19	**58**
Reclassifications and other[(2)]	-	-	(5)	(135)	**(140)**	-	**(140)**
Net carrying value at 12/31/16	**1,608**	**2,951**	**491**	**834**	**5,884**	**5,036**	**10,920**
Gross cost	2,661	3,662	1,341	1,374	**9,038**	5,036	**14,074**
Amortisation and impairment expenses	(1,053)	(711)	(850)	(540)	**(3,154)**	-	**(3,154)**
Net carrying value at 12/31/16	**1,608**	**2,951**	**491**	**834**	**5,884**	**5,036**	**10,920**

(1) Mainly includes the transfer of CO_2 emission allowances as a result of the previous year's emissions.
(2) Mainly includes the reclassification of CO_2 emission allowances to Inventories for Euros 104 million (Note 3.3.9) and the derecognition of the balances of Electricaribe due to deconsolidation of that stake after the loss of control (Note 8).

Note 4 includes a breakdown of investments in intangible assets by segment.

In the heading "IFRIC 12 Concessions" are included the concessions that are considered intangible assets in accordance with IFRIC 12 "Service Concession Agreements" (Note 32).

The heading "Other concessions and the like" includes principally:

- The Maghreb-Europe pipeline concession (Note 32) amounting to Euros 212 million at 31 December 2016 (Euros 238 million at 31 December 2015).

- The electricity distribution concessions in Spain that have an indefinite useful life amounting to Euros 684 million (Euros 684 million at 31 December 2015).

- The Chilean power distribution concessions amounting to Euros 1,139 million (Euros 1,040 million at 31 December 2015) and gas distribution concessions in the amount of Euros 893 million (Euros 835 million at 31 December 2015), all having indefinite useful lives.

The heading “Other intangible assets” mainly includes:

- Licences to operate renewable farms totalling Euros 181 million at 31 December 2016 (Euros 182 million at 31 December 2015). In 2016 Euros 23 million have been included from Ibereólica Cabo Leones II S.A. business combination (Note 31)

- The exclusive regasification rights in the Peñuelas regasification plant (Puerto Rico) totalling Euros 24 million at 31 December 2016 (Euros 25 million at 31 December 2015).

- The CO_2 emission allowances acquired for Euros 104 million at 31 December 2015 that in 2016 have been reclassified to “Inventories” (Note 3.3.9).

- Value of gas supply contracts and other contractual rights acquired as a result of the CGE business combination in the amount of Euros 184 million at 31 December 2016 (Euros 193 million at 31 December 2015) and Unión Fenosa in the amount of Euros 389 million at 31 December 2016 (Euros 420 million at 31 December 2015) and Vayu Limited in the amount of Euros 14 million at 31 December 2016 (Note 31).

Set out below is a summary of goodwill assignment by CGU or CGU groups:

2016	**Gas distribution**	**Electricity distribution**	**Gas**	**Electricity**	**Other**	**Total**
Spain	-	1,070	-	2,708	-	3,778
Latin American	124	449	-	482	-	1,055
Rest	143	11	16	18	15	203
	267	**1,530**	**16**	**3,208**	**15**	**5,036**

2015	**Gas distribution**	**Electricity distribution**	**Gas**	**Electricity**	**Other**	**Total**
Spain	-	1,070	-	2,708	-	3,778
Latin American	116	418	-	463	-	997
Rest	143	11	-	18	15	187
	259	**1,499**	**-**	**3,189**	**15**	**4,962**

The impairment tests have been carried out at 31 December 2016 and 2015. On the basis of impairment analysis of the goodwill and indefinite useful life intangible assets the need of impairment was not shown (Note 3.3.5).

At 31 December 2016, Gas Natural Fenosa records investment commitments totalling Euros 2 million relating basically to the development of the gas distribution network with concessions regarded as intangible assets under IFRIC 12.

The intangible assets include, at 31 December 2016, fully amortised assets still in use totalling Euros 521 million (Euros 452 million at 31 December 2015).

Note 6. Property, plant and equipment

The movements in the accounts in 2016 and 2015 under property, plant and equipment and their respective accumulated depreciation and provisions have been as follows:

	Land and buildings	Gas installations	Electricity generation plants	Plant for electricity transmission and distribution	Gas tankers	Other Property, plant and equipment	PPE under construction	Total
Gross cost	965	10,353	11,924	8,479	693	1,067	883	34,364
Depreciation and impairment expenses	(144)	(4,853)	(3,237)	(1,261)	(186)	(416)	-	(10,097)
Net carrying value at 1/1/15	**821**	**5,500**	**8,687**	**7,218**	**507**	**651**	**883**	**24,267**
Investment (Note 4)	30	530	41	286	-	55	459	**1,401**
Divestitures	(10)	(6)	(1)	(4)	-	(5)	(8)	**(34)**
Assets and liabilities held for sale (Note 9)	(124)	(502)	-	-	-	(21)	(24)	**(671)**
Depreciation and impairment charge	(25)	(414)	(593)	(336)	(30)	(85)	-	**(1,483)**
Translation differences	(15)	(68)	120	(215)	-	(7)	(14)	**(199)**
Business combinations (Note 31)	1	27	349	-	-	6	4	**387**
Reclassifications and other	5	11	114	196	-	108	(409)	**25**
Net carrying value at 12/31/15	**683**	**5,078**	**8,717**	**7,145**	**477**	**702**	**891**	**23,693**
Gross cost	**817**	**10,194**	**12,484**	**8,670**	**693**	**1,140**	**891**	**34,889**
Depreciation and impairment expenses	**(134)**	**(5,116)**	**(3,767)**	**(1,525)**	**(216)**	**(438)**	**-**	**(11,196)**
Net carrying value at 1/1/16	**683**	**5,078**	**8,717**	**7,145**	**477**	**702**	**891**	**23,693**
Investment (Note 4)	26	781	50	316	425	63	454	**2,115**
Divestitures	(157)	(9)	(2)	-	-	(25)	(19)	**(212)**
Depreciation and Impairment charge	(23)	(379)	(591)	(339)	(29)	(70)	-	**(1,431)**
Translation differences	29	53	11	245	-	(1)	30	**367**
Business combinations (Note 31)	-	-	-	-	-	-	-	**-**
Reclassifications and other [(1)]	(13)	94	145	(723)	-	(44)	(364)	**(905)**
Net carrying value at 12/31/16	**545**	**5,618**	**8,330**	**6,644**	**873**	**625**	**992**	**23,627**
Gross cost	**668**	**10,972**	**12,666**	**8,269**	**1,118**	**1,042**	**992**	**35,727**
Depreciation and impairment expenses	**(123)**	**(5,354)**	**(4,336)**	**(1,625)**	**(245)**	**(417)**	**-**	**(12,100)**
Net carrying value at 12/31/16	**545**	**5,618**	**8,330**	**6,644**	**873**	**625**	**992**	**23,627**

(1) Apart from the reclassification of PPE under construction, includes mainly the derecognition of the balances of Electricaribe due to deconsolidation of that stake after the loss of control (Note 8).

Note 4 include a breakdown of investments in property, plant and equipment by segment.

In December 2016, Gas Natural Fenosa completed the sale of four properties located in Madrid (Avenida San Luis 77, Antonio Lopez 193, A Canto 11-13 and Avenida América 38) for Euros 206 million and creating a gain before income tax of Euros 51 million (Note 27). Additionally for each of those properties it signed 10-year operating lease contracts, without a purchase option, with the buyers that, except for the Avenida América 38 building, are renewable for five more years (Note 35). At the transaction date, the remaining useful life of all the sold properties was far higher than the maximum lease term.

The item "Electricity generation plants" includes the power islands at the Palos de la Frontera combined cycle plant and Sagunto combined cycle plant acquired under finance lease (Note 16).

The item "Gas tankers" at 31 December 2016 includes the present value at the acquisition date of committed payments to charter tankers under finance leases (Note 18), net of their depreciation. At 31 december 2016 Gas Natural Fenosa have six gas tankers chartered under finance leases after the adquisition in 2016 of two new gas tankers for Euros 425 million. On the other hand, here is a commitment to obtain two more gas tankers in 2017 (Note 34).

At 31 December 2016, the item “Other fixed assets” includes the carrying amount of investments in areas with reserves, totalling Euros 293 million (Euros 338 million at 31 December 2015), basically relating to the investments in the coalfield of the company Kangra Coal (Proprietary), Ltd. in South Africa and exploration and development costs of Euros 22 million (Euros 26 million at 31 December 2015).

Set out below is a breakdown of fixed assets in course of construction by business area:

	31.12.2016	**31.12.2015**
Gas distribution	109	144
Electricity distribution	528	388
Electricity	329	334
Rest	26	25
Total	**992**	**891**

At 31 December 2016, Gas Natural Fenosa had no significant real estate investments.

At 31 December 2016, property, plant and equipment include fully-depreciated assets still in use totalling Euros 2,011 million (Euros 1,854 million at 31 December 2015).

It is Gas Natural Fenosa's policy to take out insurance where deemed necessary to cover risks that could affect its property, plant and equipment.

At 31 December 2016, Gas Natural Fenosa records investment commitments totalling Euros 533 million relating basically to the construction of two gas tankers (Note 35) and the development of the gas and electricity distribution network.

The financial expenses capitalised in 2016 in fixed assets projects during their construction total Euros 12 million (Euros 14 million in 2015). The financial expenses capitalised in 2016 account for 1.3% of total financial costs on net borrowings (1.6% in 2015). The average capitalisation rate for 2016 and 2015 was 4.1% and 3.3%, respectively.

Note 7. Investments in companies

Associates and jointly-controlled entities

Set out below is a breakdown of equity-consolidated investments:

	At 31.12.16	At 31.12.15
Associates	46	45
Jointly-controlled entities	1,529	1,685
Total	**1,575**	**1,730**

Appendix I lists all the associates and jointly-controlled entities in which Gas Natural Fenosa holds an interest, stating their activity and the percentage of the shareholding and equity interest.

The most significant shareholdings are Unión Fenosa Gas and EcoEléctrica L.P. (Note 4).

Movements during 2016 and 2015 in equity-consolidated investments, including a breakdown of the most significant shareholdings, are as follows:

	Unión Fenosa Gas	EcoEléctrica, L.P.	Other jointly-controlled entities	Total jointly-controlled entities	Associates	Total
Value of shareholding at 1/1/2015	**1,295**	**286**	**408**	**1,989**	**45**	**2,034**
Investment	-	-	61	**61**	-	**61**
Divestitures (1)	-	-	(92)	**(92)**	-	**(92)**
Shares of profits/(losses)	(81)	40	32	**(9)**	5	**(4)**
Business combinations (Note 31)	-	-	6	**6**	-	**6**
Dividends received	(13)	(52)	(36)	**(101)**	-	**(101)**
Translation differences	11	32	(5)	**38**	-	**38**
Other comprehensive income	(1)	2	-	**1**	-	**1**
Reclassifications and other (2)	(2)	1	(207)	**(208)**	(5)	**(213)**
Value of shareholding at 12/31/2015	**1,209**	**309**	**167**	**1,685**	**45**	**1,730**
Investment	-	-	5	**5**	-	**5**
Divestitures (3)	-	-	(52)	**(52)**	-	**(52)**
Shares of profits/(losses)	(176)	49	27	**(100)**	2	**(98)**
Business combinations (Note 31)	-	-	-	**-**	-	**-**
Dividends received	(2)	(27)	(13)	**(42)**	(1)	**(43)**
Translation differences	1	13	4	**18**	-	**18**
Other comprehensive income	4	1	4	**9**	-	**9**
Reclassifications and other	(2)	(1)	9	**6**	-	**6**
Value of shareholding at 12/31/2016	**1,034**	**344**	**151**	**1,529**	**46**	**1,575**

(1) In July 2015, Gas Natural Fenosa sold its 44.9% stake in the electricity distribution company Barras Eléctricas Galaico Asturianas, S.A., entailing a divestment of Euros 92 million in companies carried under the equity method (Note 28).

(2) It Included the transfer of held-for-sale assets totalling Euros 5 million (Note 9) and the write-off of the spin off shares from Nueva Generadora del Sur, S.A. (Note 31).

(3) On 29 June 2016 Gas Natural Fenosa, through the company Aprovisionadora Global de Energía (AGESA), a subsidiary of Gas Natural Chile, S.A., concluded an agreement for the sale of 20.0% of the interest in GNL Quintero, S.A. (Chile) with Enagás for USD 200 million, which following the adjustments for dividends at the year end stood at USD 197 million (Euros 182 million). The operation was concluded in November 2016 and resulted in a capital gain before taxes and Non-controlling interests of Euros 128 million (Note 28).

In April 2016, Unión Fenosa Gas (consolidated by the equity method) sold its 21% holding in Regasificadora del Noroeste, S.A. (Reganosa), through Gasifica, S.A., to the Galicia regional government and to Grupo Tojeiro for an amount of Euros 28 million, generating an after-tax capital gain of Euros 1 million for Gas Natural Fenosa.

In June 2016 Unión Fenosa Gas reached an agreement with Enagás for the sale, through Infraestructuras de Gas S.A., of its 42.5% interest in Planta de regasificación de Sagunto, S.A. (Saggas) for Euros 106 million. This transaction took place in July 2016, generating an after-tax capital gain of Euros 21 million for Gas Natural Fenosa.

At 31 December 2015, the recoverable value of Unión Fenosa Gas was similar to its carrying value. In the previous year an impairment of the interest in Unión Fenosa Gas amounting to Euros 485 million had been recognised due to a substantial failure of the Egyptian supplier to comply with the agreements to re-establish supplies of gas to the Damietta (Egypt) liquefaction plant. The results posted by Unión Fenosa Gas in 2015 are similar to the amounts included in the projections used in the 2014 impairment analysis; as there were no new events, there was no need to recognise additional impairment or to reverse the impairment loss recognised in the previous year.

In 2016 an impairment of Euros 94 million was recognised with respect to the interest in Unión Fenosa Gas due to the need to update the assumptions concerning the supply cost in view of the forecast evolution of the energy scenario for Unión Fenosa Gas. Note 3.3.5 provides details of the assumptions relating to the discount and growth rates. The other assumptions have not been altered.

There follows a breakdown of assets, liabilities, revenue and results of Gas Natural Fenosa's main interests in jointly-controlled entities (by shareholding percentage):

	At 31/12/2016		At 31/12/2015	
	Unión Fenosa Gas	**EcoEléctrica, L.P.**	**Unión Fenosa Gas**	**EcoEléctrica, L.P.**
Non-current assets	1,537	313	1,772	313
Current assets	266	96	316	76
Cash and cash equivalents	100	18	123	3
Non-current liabilities	(623)	(32)	(700)	(54)
Non-current financial liabilities	(181)	(27)	(204)	(50)
Current liabilities	(146)	(33)	(179)	(26)
Current financial liabilities	(34)	(25)	(31)	(11)
Net assets	**1,034**	**344**	**1,209**	**309**
Net borrowings (1)	115	34	112	58

(1) Net borrowings: Non-current financial liabilities+Current financial liabilities-Cash and cash equivalents.

	2016		2015	
	Unión Fenosa Gas	**EcoEléctrica, L.P.**	**Unión Fenosa Gas**	**EcoEléctrica, L.P.**
Operating income	**(128)**	**56**	**(99)**	**46**
Sales	578	155	676	152
Operating expenses	(576)	(81)	(635)	(84)
Depreciation and amortisation charge	(130)	(18)	(140)	(22)
Share of profits	**(176)**	**49**	**(81)**	**40**
Profit/(loss) for the year from continuing operations	(82)	49	(81)	40
Impairment of shareholding	(94)	-	-	-

There are no contingent liabilities affecting interests in jointly-controlled entities. Contractual commitments relating to interests in jointly-controlled entities are commitments to purchase gas of Unión Fenosa Gas and EcoEléctrica L.P. in the amount of Euros 5,189 million at 31 December 2016 (Euros 5,223 million at 31 December 2015, commitments to sell gas of Unión Fenosa Gas in the amount of

Euros 1,859 million (Euros 2,643 million at 31 December 2015), commitments to provide power generation capacity assignment services of EcoEléctrica L.P. to the Puerto Rico Electricity Power Authority in the amount of Euros 232 million (Euros 265 million at 31 December 2015) and the operating costs associated with charter contracts for gas tankers of Unión Fenosa Gas in the amount of Euros 145 million at 31 December 2016 (Euros 148 million at 31 December 2015).

Certain investment projects related to interests in jointly-controlled entities have been financed by means of specific structures (project finance) which include pledges on the shares in the project companies. At 31 December 2016, the outstanding balance of this type of financing totals Euros 303 million (Euros 361 million at 31 December 2015).

Joint operations

Gas Natural Fenosa participates in different joint ventures that meet the conditions indicated in Note 3.3.1.b and which are described in Appendix I, section 3. The relevant interests in joint ventures at 31 December 2016 and 2015 are as follows:

	2016	**2015**
Comunidad de Bienes Central Nuclear de Almaraz	11.3%	11.3%
Comunidad de Bienes Central Nuclear de Trillo	34.5%	34.5%
Comunidad de Bienes Central Térmica de Aceca	50.0%	50.0%
Comunidad de Bienes Central Térmica de Anllares	66.7%	66.7%

The contribution from the joint operations to Gas Natural Fenosa's assets, liabilities, revenue and results is analysed below:

	At 31.12.16	**At 31.12.15**
Non-current assets	562	596
Current assets	120	185
Cash and cash equivalents	1	1
Non-current liabilities	(75)	(76)
Non-current financial liabilities	-	-
Current liabilities	(91)	(89)
Current financial liabilities	(13)	(11)
Net assets	**516**	**616**
Net borrowings (1)	12	10

(1) Net borrowings: Non-current financial liabilities+Current financial liabilities-Cash and cash equivalents.

	2016	**2015**
Operating income	**(23)**	**49**
Sales	226	254
Operating expenses	(192)	(146)
Depreciation and amortisation charge	(57)	(59)
Share of profits	**(17)**	**41**
Profit/(loss) for the year from continuing operations	(17)	41

Note 8. Financial assets

The breakdown of financial assets, excluding those carried under “Trade and other receivables” (Note 11) and “Cash and other cash equivalents” (Note 12), at 31 December 2016 and 2015, classified according to their nature and account, is as follows:

At 31 December 2016	Available for sale	Loans and other receivables	Investments held to maturity	Hedging derivatives	Fair value through profit or loss	Total
Equity instruments	619	-	-	-	-	**619**
Derivatives (Note 17)	-	-	-	111	-	**111**
Other financial assets	-	1,175	2	-	-	**1,177**
Non-current financial assets	**619**	**1,175**	**2**	**111**	**-**	**1,907**
Derivatives (Note 17)	-	-	-	1	-	**1**
Other financial assets	-	388	-	-	-	**388**
Current financial assets	**-**	**388**	**-**	**1**	**-**	**389**
Total	**619**	**1,563**	**2**	**112**	**-**	**2,296**

At 31 December 2015	Available for sale	Loans and other receivables	Investments held to maturity	Hedging derivatives	Fair value through profit or loss	Total
Equity instruments	141	-	-	-	-	141
Derivatives (Note 17)	-	-	-	208	-	208
Other financial assets	-	1,035	3	-	-	1,038
Non-current financial assets	**141**	**1,035**	**3**	**208**	**-**	**1,387**
Derivatives (Note 17)	-	-	-	2	-	2
Other financial assets	-	362	1	-	-	363
Current financial assets	**-**	**362**	**1**	**2**	**-**	**365**
Total	**141**	**1,397**	**4**	**210**	**-**	**1,752**

Financial assets recognised at fair value at 31 December 2016 and at 31 December 2015 are classified as follows:

	31 December 2016				**31 December 2015**			
Financial assets	**Level 1**	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Available for sale	-	-	619	**619**	-	-	141	**141**
Hedging derivatives	-	112	-	**112**	-	210	-	**210**
Fair value through profit or loss	-	-	-	**-**	-	-	-	**-**
Total	**-**	**112**	**619**	**731**	**-**	**210**	**141**	**351**

Available-for-sale financial assets

The movement of Available for sale financial assets in 2016 and 2015, according with the method applied for calculating their fair value is as follows:

	2016				**2015**			
	Level 1	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
At January 1	**-**	**-**	**141**	**141**	**-**	**-**	**145**	**145**
Increases	-	-	-	-	-	-	-	-
Translation differences	-	-	1	1	-	-	(7)	(7)
Transfers and other (1)	-	-	477	477	-	-	3	3
At 31 December	**-**	**-**	**619**	**619**	**-**	**-**	**141**	**141**

(1) Includes mainly the derecognition of the balances of Electricaribe due to deconsolidation of that stake after the loss of control (Note 8).

Basically, it includes a 14.9% interest in the Medgaz, S.A., the company that operates the submarine gas pipeline between Algeria and Spain, in the amount of Euros 90 million (Euros 87 million at 31 December 2015) and the interest in Electrificadora del Caribe, S.A. ESP and their dependent companies (Electricaribe).

Electricaribe, a company in which Gas Natural Fenosa owns an interest of 85.38%, experienced major cash difficulties during the year due to the acts and omissions of the Republic of Colombia in relation to the non-payment of a considerable number of customer invoices, mostly with obligatory supply arrangements, as well as significant consumer fraud.

As a result, within the framework of the Treaty for the reciprocal protection of investments between Spain and Colombia, on 12 July 2016 Gas Natural Fenosa commenced discussions to seek a negotiated solution to the extremely difficult situation in which Electricaribe finds itself. In the event of an expropriation or similar event, the treaty demands that the indemnity be equivalent to the fair market value of the investment prior to the expropriation.

On 14 November 2016, the Superintendence for Residential Public Services of the Republic of Colombia (“the Superintendence”) ordered, as a necessary measure to ensure the provision of electrical energy services, the seizure of the goods, assets and businesses of Electricaribe.

The Superintendence also ordered the separation of the members of the governing body and the general manager, and their replacement by a special agent appointed by the Superintendence. In the fulfilment of his functions, this agent has replaced the executive personnel appointed by Gas Natural Fenosa and has centralised decision-making on the information to be supplied to Gas Natural Fenosa. Therefore, at 31 December 2016 Gas Natural Fenosa had lost control and any significant influence over Electricaribe as it does not take part in, and has no direct information about, material business activities or decisions.

Subsequently, on 11 January 2017, the Superintendence agreed to extend this government take-over until 14 March 2017, in order to analyse the reports issued by the agent and other entities on Electricaribe's situation. The action plan to be implemented in the company will be based on the diagnosis that eventually emerges from the government intervention in accordance with Colombian regulations applicable to such situations, although Gas Natural Fenosa will exercise its rights to recover control of, and continue to manage, the company.

In the light of the above facts and in accordance with IFRS 10, on 31 December 2016 Electricaribe ceased to be consolidated on the consolidated balance sheet of Gas Natural Fenosa. Its assets, liabilities and non-controlling interests have been derecognised for a net amount of Euros 475 million and the relevant negative exchange differences amounting to Euros 38 million have been transferred to the income statement (Note 28). In addition, the investment in Electricaribe has been recorded at fair value as defined by IAS 39 (Euros 475 million) under “Available-for-sale financial assets”. As the investment in Electricaribe involves unlisted equity instruments and, therefore, no quoted share price is available, it has been valued on Level 3 and a prudent approach has been applied in the valuation due to the uncertainty surrounding the current situation, as described above, obtaining an amount which does not differ from the net book value. The assumptions used in the valuation are similar to those described in Note 3.3.5. However, Gas Natural Fenosa believes that the final amount that may reasonably be expected to be recognised by the agencies and courts that may decide on the applicable price or indemnity based on fair market value will be higher than the figure mentioned above.

The detail of assets, liabilities and non-controlling interests of Electricaaribe recorded in the Gas Natural Fenosa consolidated Balance Sheet that have been written off at 31 december 2016 are as follows:

	At 31/12/2016
Intangible assets	6
Property, plant and equipment	929
Non-current financial assets	63
Deferred income tax assets	157
NON-CURRENT ASSETS	**1.155**
Trade and other receivables	633
Other current financial assets	20
Cash and cash equivalents	42
CURRENT ASSETS	**695**
TOTAL ASSETS	**1.850**
NON-CONTROLLING INTERESTS	**70**
Non-current provisions	265
Non-current financial liabilities	85
Deferred income tax liability	4
NON-CURRENT LIABILITIES	**354**
Current financial liabilities	493
Trade and other payables	450
Other current liabilities	8
CURRENT LIABILITIES	**951**
TOTAL NON-CONTROLLING INTERESTS and LIABILITIES	**1.375**

By the other hand the Profit and loss account generated by Electricaribe to the consolidated profit and loss account during 2016 is as follows:

	2016
Sales	1.453
Procurements	(984)
Other operating income	3
Personnel costs	(53)
Other operating expenses	(360)
Depreciation, amortisation and impairment expenses	(40)
OPERATING INCOME	**19**
Financial income	5
Finance expense	(65)
Net exchange gains/losses	(1)
NET FINANCIAL INCOME	**(61)**
PROFIT/(LOSS) BEFORE TAXES	**(42)**
Income tax expense	(10)
NET INCOME FOR THE YEAR	**(52)**
Attributable to:	
Equity holders of the parent company	(44)
Non-controlling interests	(8)

The 2016 Electricaribe statutory Financial Statements prepared as the Colombian legislation have not been yet audited

Loans and other receivables

The breakdown at 31 December 2016 and 2015 is as follows:

	At 31.12.16	At 31.12.15
Commercial loans	56	129
Gas system income deficit financing	357	199
Deposits and guarantees deposits	138	121
Debtors for levelling of capacity service income	74	88
Other loans	550	498
Loans and other receivables non-current	**1,175**	**1,035**
Commercial loans	62	65
Electricity system income deficit financing	106	68
Gas system income deficit financing	144	102
Dividend receivable	8	14
Other loans	68	113
Loans and other receivables current	**388**	**362**
Total	**1,563**	**1,397**

The breakdown by maturities at December 2016 and 2015 is as follows:

Maturities	At 31.12.16	At 31.12.15
No later than 1 year	388	362
Between 1 year and 5 years	500	284
More than 5 years	675	751
Total	**1,563**	**1,397**

The fair values and carrying amounts of these assets do not differ significantly.

“Commercial loans” mainly include the credits for the sale of gas and electricity installations. The respective interest rates (between 5% and 11% for loans from 1 to 5 years) are adjusted to market interest rates for this type of loans and duration.

The item “Electricity system income deficit financing” relates to temporary mismatches between electricity system income and costs, funded by Gas Natural Fenosa pursuant to Law 24/2013, December 26 (Note 2.4), generating a recovery right over the following five years and interest at a market rate. The amount of this financing has been entirely recognised as a short-term item on the understanding that it is a temporary mismatch that will be recovered through system settlements within one year.

The item “Gas system revenue deficit financing” relates to temporary mismatches between gas system revenues and costs accumulated in 2014, 2015 and 2016 funded by Gas Natural Fenosa pursuant to the Law 18/2014, October 17 (Note 2.1.1.2), generating a recovery right, over the following 15 years, to the amount that is deemed to be the definitive 2014 deficit, and in the following five years for the remainder of the financing, recognising a market interest rate. The amount of this financing has been recognised in long term and short term items based on the estimated recovery period through system settlements.

The item “Deposits and guarantees deposits” basically include amounts deposited with the competent Public Administrations, under applicable legislation, in respect of guarantees and deposits received from customers when contracts are concluded to secure the supply of electricity and natural gas (Note 18).

The item “Capacity service income debtors” relates to revenue yet to be billed in respect of the levelling of the term of the service contracts for electricity generation capacity assignment with the Mexican Federal Electricity Commission (Note 3.3.19.d).

“Other loans” includes, basically:

- A loan of Euros 192 million (Euros 211 million at 31 December 2015) for financing ContourGlobal La Rioja. S.L. for the sale of the Arrúbal combined cycle plant (La Rioja), which took place on 28 July 2011, of which Euros 15 million is classified under current assets (Euros 14 million in 2015). The loan, which is secured by the shares of this company and by other assets, bears annual interest at a market rate and matures in 2021.

- the value of generation concessions in Costa Rica that are deemed to be credits, pursuant to IFRIC 12 “Service concession arrangements” (Note 3.3.3.b and Note 31), in the amount of Euros 276 million (Euros 277 million at 31 December 2015), of which Euros 12 million is classified in current assets (Euros 14 million in 2015). These credits are classified in the item “Loans and receivables” as they represent an unconditional right to receive cash in fixed or determinable amounts.

Hedging derivatives

The variables upon which the valuation of the hedging derivatives reflected under this heading are based and observable in an active market (Level 2).

Note 17 shows the details of the derivative financial instruments.

Note 9. Non-current assets and disposal groups of assets held for sale and discontinued operations

On 18 December 2015 Gas Natural Fenosa, which owned a controlling interest through the Chilean company CGE of 56.62% of Gasco, S.A., entered into an agreement with a group of shareholders with an interest of 22.4% in Gasco S.A., named "Familia Perez Cruz", to split Gasco, S.A. into two companies, one devoted to the natural gas business which would remain under the control of Gas Natural Fenosa and the other to the liquefied petroleum gas business (GLP) which would be controlled by the Perez Cruz Family. This split was approved at an extraordinary meeting of the shareholders of Gasco, S.A. on 30 March 2016.

Following completion of the split, on 6 July 2016 each party launched a public share offering in order to obtain a 100% interest in its company in order to carry out its own independent project. On 8 August 2016 Gas Natural Fenosa reported the sale of the shares in Gasco S.A. held by it through its subsidiaries totalling 160,197 million Chilean pesos (Euros 220 million), generating a net capital gain of Euros 4 million, in addition to the success of the takeover bid for Gas Natural Chile, S.A. which entailed the acquisition of an additional 37.88% of the capital of Gas Natural Chile, S.A. for a total of 223,404 million Chilean pesos (Euros 306 million).

Since Gas Natural Fenosa has a commitment to sell those assets that were clearly identified, the process was ongoing and it was expected to conclude in 2016, the sale was assumed to be highly likely and, consequently, on 31 December 2015 the account balances of these assets and liabilities were transferred to "Non-current assets held for sale" and "Liabilities related to non-current assets held for sale" in accordance with IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations".

In addition, it was considered a discontinued operation since it was a component classified as held for sale which represented a significant line of business, separate from the rest. Therefore, all income and expenses pertaining to the LPG business for

2015 and 2016 are presented under "Profit/loss for the year from discontinued operations, net of taxes".

At 31 December 2015, the detail by nature of assets classified as held for sale and the associated liabilities was as follows:

	2015
Intangible assets	147
Property, plant and equipment	671
Non-current financial assets	9
Deferred tax assets	14
NON-CURRENT ASSETS	**841**
Inventories	49
Trade and other receivables	42
Cash and cash equivalents	23
CURRENT ASSETS	**114**
TOTAL ASSETS	**955**
Non-current provisions	12
Non-current financial liabilities	285
Deferred tax liabilities	134
Other non-current liabilities	38
NON-CURRENT LIABILITIES	**469**
Current financial liabilities	53
Trade and other payables	57
Other current liabilities	6
CURRENT LIABILITIES	**116**
TOTAL LIABILITIES	**585**

Total comprehensive income on this activity in the years ended 31 December 2016 and 2015 breaks down as follows:

	2016 (1)	2015
Consolidated profit/(loss) for the year	44	34
Income and expenses recognised directly in net equity:	21	(16)
Translation differences	21	(16)
Cash-flow hedges	-	-
Total comprehensive income for the year	**65**	**18**

(1) Relates to the period1 January 2016 to 8 August 2016 (date on which the shares were sold).

The breakdown by nature of "Profit/(loss) for the year from discontinued operations net of taxes" on the consolidated income statement relating to the LPG business in Chile at 8 August 2016, date on which the shares were sold, and 31 december 2015 is as follows:

	2016 (1)	**2015**
Sales	391	547
Procurements	(263)	(329)
Other operating income	2	4
Personnel costs	(26)	(45)
Other operating expenses	(36)	(66)
Depreciation, amortisation and impairment expenses	-	(41)
Other results	4	-
OPERATING INCOME	**72**	**70**
Financial income	1	4
Financial expenses	(15)	(28)
Net exchange gains/losses	(1)	-
NET FINANCIAL INCOME	**(15)**	**(24)**
Profit/(loss) on equity method companies	1	1
PROFIT/(LOSS) BEFORE TAXES	**58**	**47**
Income tax	(14)	(13)
NET INCOME FOR THE YEAR FROM DISCONTINUED OPERATIONS	**44**	**34**
Attributable to:		
Equity holders of the parent company	22	11
Non-controlling interests	22	23

(1) Relates to the period 1 January 2016 to 8 August 2016 (date on which the shares were sold).

The cash flows from discontinued operations included in the consolidated cash flow statements are:

	2016 (1)	**2015**
Cash flow generated from operating activities	46	75
Cash flow received from investing activities	(17)	(35)
Cash flow received from financing activities	(32)	(46)

(1) Relates to the period1 January 2016 to 8 August 2016 (date on which the shares were sold).

Transactions between the companies making up the discontinued LPG business with other group companies are not significant. Therefore, intragroup cash flows with the discontinued business are not significant.

Note 10. Inventories

The breakdown of Inventories is as follows:

	At 31.12.16	**At 31.12.15**
Natural gas and liquefied gas	421	522
Coal and fuel oil	76	130
Nuclear fuel	65	63
CO_2 emission allowances (1)	60	-
Raw materials and other inventories	136	111
Total	**758**	**826**

(1) Relates to the reclassification of CO_2 emission allowances from intangible assets amounting to Euros 104 million (Note 3.3.9), the delivery of CO_2 emission allowances due to emissions in the preceding year amounting to Euros 103 million and the acquisition of emission allowances totalling Euros 59 million.

Gas inventories basically include the inventories of gas deposited in underground storage units, sea transport, plants and pipelines.

Note 11. Trade and other receivables

The breakdown of this account is as follows:

	At 31.12.16	At 31.12.15
Trade receivables	4,939	5,248
Receivables with related companies (Note 33)	85	163
Provision for depreciation of receivables	(676)	(890)
Trade receivables for sales and provisions of services	4,348	4,521
Public Administration	144	197
Prepayments	70	83
Derivative financial instruments (see Note 17)	46	5
Sundry receivables	229	187
Other receivables	489	472
Current income tax assets	162	198
Total	**4,999**	**5,191**

The fair values and carrying amounts of these assets do not differ significantly.

In general, the outstanding invoices do not accrue interest as they fall due in an average period of 19 days.

The movement in the impairment of receivables is as follows:

	2016	2015
At January 1	**(890)**	**(940)**
Net charge for the year (Note 26)	(327)	(258)
Write offs	336	254
Translation adjustments	(21)	54
Transfers and other (1)	226	-
At December 31	**(676)**	**(890)**

(1) Includes mainly the derecognition of the balances of Electricaribe due to deconsolidation of that stake after the loss of control (Note 8).

Note 12. Cash and cash equivalents

Cash and cash equivalents comprise the following:

	At 31.12.16	At 31.12.15
Cash at bank and in hand	985	1,467
Short term investments (Spain and rest of Europe)	618	751
Short term investments (International)	464	172
Total	**2,067**	**2,390**

The investments in cash equivalents mature in less than three months and bear a weighted effective interest rate 0.4% at 31 December 2016 (0.5% at 31 December 2015).

Note 13. Equity

The main elements of Equity are broke down as follows:

Share capital and share premium

The variations in 2016 and 2015 in the number of shares and share capital and share premium accounts have been as follows:

	Number of shares	Share capital	Share premium	Total
At 31 December 2014	**1,000,689,341**	**1,001**	**3,808**	**4,809**
Variation	-	-	-	-
A 31 December 2015	**1,000,689,341**	**1,001**	**3,808**	**4,809**
Variation	-	-	-	-
A 31 December 2016	**1,000,689,341**	**1,001**	**3,808**	**4,809**

All the shares issued are fully paid and have the same economic and voting rights.

The Spanish Capital Companies Act specifically allows the use of the "Share premium" balance to increase capital and imposes no specific restrictions on its use.

The most representative holdings in the share capital of Gas Natural SDG, S.A. at 31 December 2016, in accordance with the public information available or the communication issued by the Company itself, are as follows:

	Interest in share capital %	
	2016	**2015**
- Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona,“la Caixa”(1)	24.4	34.4
- Repsol, S.A.	20.1	30.0
- Global Infraestructure Partners III (2)	20.0	-
- Sonatrach	4.0	4.0

(1) Through Criteria Caixa S.A.U. and Caixabank, S.A. In 2015 additionally through VidaCaixa S.A. de Seguros and Reaseguros.

(2) Global Infraestructure Partners III, whose investment manager is Global Infraestructure Management LLC, owns its stake indirectly through GIP III Canary 1, S.à.r.l.

On 21 September 2016 the shareholders of Gas Natural Fenosa, Criteria Caixa, S.A.U. (la Caixa) and Repsol, S.A. (Repsol) reported the sale to GIP III Canary 1, S.à.r.l. (GIP) of shares representing 20% (10% Criteria and 10% Repsol) of the capital of Gas Natural SDG, S.A. in accordance with the sale and purchase agreement concluded on 12 September 2016. As a result of this sale, the agreement between ‘‘la Caixa” and Repsol concerning Gas Natural of 11 January 2000, amended on 16 May 2002, 16 December 2002 and 20 June 2003, has been terminated and the composition of the Board of Directors and Board committees of Gas Natural Fenosa has changed; in addition, the Regulations of its Board of Directors envisages a majority of two thirds of Board members for the approval of certain reserved matters.

All the shares of Gas Natural SDG, S.A. are traded on the four official Spanish Stock Exchanges and the “Mercado continuo” and form part of Spain’s Ibex 35 stock index.

The share price at the end of 2016 of Gas Natural SDG, S.A. is Euros 17.91 (Euros 18.82 at 31 December 2015).

Reserves

"Reserves" includes the following reserves:

	2016	2015
Legal reserve	200	200
Statutory reserve	100	100
Revaluation Reserve Royal Decree-Law 7/96	225	225
Goodwill reserve	496	496
Voluntary reserves	6,603	6,580
Other reserves	1,925	1,476
	9,549	**9,077**

Legal reserve

Appropriations to the legal reserve are made in compliance with the Spanish Capital Companies Act, which stipulates that 10% of the profits must be transferred to this reserve until it represents at least 20% of share capital. The legal reserve can be used to increase capital in the part that exceeds 10% of the capital increased.

Except for the use mentioned above, and as long as it does not exceed 20% of share capital, the legal reserve can only be used to offset losses in the event of no other reserves being available.

Statutory reserve

Under the articles of association of Gas Natural SDG, S.A., 2% of net income for the year must be allocated to the statutory reserves until it reaches at least 10% of share capital.

Revaluation reserve

The revaluation reserve can be used to offset accounting losses, increase share capital, or can be allocated to freely distributable reserves, provided that all the monetary gain has been realised. The part of the gain that will be considered realised is the part relating to the amortisation recorded or when the revaluated assets have been transferred or written off the accounting books.

Goodwill reserve

Law 22/2015 on Auditing has eliminated the requirement to record annually the restricted reserve for at least 5% of the goodwill figuring under assets on the balance sheet, stipulating that in periods commencing as from 1 January 2016, the goodwill reserve is to be reclassified to voluntary reserves and will be available in the amount that exceeds the goodwill recognised under assets on the balance sheet.

Treasury shares

Movements during 2016 and 2015 involving the treasury shares of Gas Natural SDG, S.A. are as follows:

	Number of shares	In million euro	% Capital
At 1 January 2015	-	-	-
Acquisitions	2,899,180	58	0.3%
Disposals	(2,899,180)	(58)	(0.3%)
A 31 December 2015	**-**	**-**	**-**
Acquisitions	3,049,189	53	0.3%
Disposals	(2,298,644)	(40)	(0.2%)
At 31 December 2016	**750,545**	**13**	**0.1%**

On 14 May 2015, the shareholders in General Meeting authorised the Board of Directors to purchase, within five years, in one or more operations, a maximum of 10% of share capital or the maximum figure applicable under legislation prevailing at the time of acquisition. The relevant Company shares must be fully paid in and the nominal value of the shares directly or indirectly acquired, added to those already held by the Company and its subsidiaries, may not exceed 10% of share capital or any other limit established by law.

The minimum and maximum acquisition price will be the share price on the continuous market of the Spanish stock exchanges, within an upper or lower fluctuation of 5%.

In 2016, Gas Natural Fenosa obtained a profit of Euros 0.4 million in transactions involving treasury shares, which was recorded in “Other reserves” (a profit of Euros 2 million in the exercise 2015).

Movements during 2016 and 2015 involving the treasury shares of Compañía General de Electricidad, S.A. have been as follows:

	Number of shares	In million euro	% Capital
At 1 January 2015	-	-	-
Acquisitions	-	-	-
Disposals	-	-	-
A 31 December 2015	**-**	**-**	**-**
Acquisitions	1,879,034	8	0.1%
Disposals	-	-	-
At 31 December 2016	**1,879,034**	**8**	**0.1%**

On 9 august 2016 Gas Natural Fenosa Chile S.A. (today Compañía General de Electricidad S.A.) Extraordinary Shareholder’s Meeting was celebrated where the merger by incorporation of Compañía General de Electricidad S.A. in Gas Natural Fenosa Chile S.A. was approved. As a consequence of the operation, shareholder’s of both companies had a retirement right, by which they had the opportunity to sell their shares to the company. This rigth was exercised by 44 shareholders owners of 1,879,034 shares of Compañía General de Electricidad, S.A. equivalent to the 0.4% of the capital.

Earnings per share

The earnings per share are calculated by dividing the net income attributable to the equity holders of the parent Company by the average weighted number of ordinary shares in circulation during the year.

	At 31.12.16	A 31.12.2015
Net income attributable to equity holders of the parent company [(1)]	1,347	1,571
Weighted average number of ordinary shares in issue	1,001,468,342	1,001,689,341
Earnings per share from continuing activities (in Euros):		
- Basic	1.33	1.56
- Diluted	1.33	1.56
Earnings per share from discontinued activities (in Euros):		
- Basic	0.02	0.01
- Diluted	0.02	0.01

(1) Pursuant to IAS 33, profit attributable to the parent company's equity holders at 31 December 2015 was adjusted for the excess carrying amount of the preferred shares over the amount paid to buy them back, net of the tax effect (see "Non-controlling interests" section of this note).

The weighted average number of ordinary shares in issue used to calculate the Earnings per share of 2016 is as follows:

	2016
Weighted average number of ordinary shares	1,001,689,341
Weighted average number of treasury shares	(220,999)
Weighted average number of ordinary shares in issue	1,001,468,342

The Parent Company has no financial instruments that could dilute the earnings per share.

Dividends

The breakdown of the payments of dividends made in 2016 and 2015 is as follows:

	31.12.16			31.12.15		
	% of par value	Euros per share	Amount	% of par value	Euros per share	Amount
Ordinary shares	133%	1.330	1,331	91%	0.908	909
Remaining shares (no vote. redeemable. etc.)	-	-	-	-	-	-
Total dividends paid	**133%**	**1.330**	**1,331**	**91%**	**0.908**	**909**
a) Dividends charged to income statement	133%	1.330	1,331	91%	0.908	909
b) Dividends charged to reserves or share premium	-	-	-	-	-	-
c) Dividends in kind	-	-	-	-	-	-

Additionally, dividends paid to non-controlling shareholders in 2016 amounted to Euros 195 million (Euros 161 million in 2015). See "Non-controlling interest" section of this note.

Year 2016

Includes the payment of an interim dividend of Euros 0.408 per share out of 2015 profits, for a total amount of Euros 408 million, agreed on 30 October 2015 and paid out on 8 January 2016.

The General Shareholders Meeting held on 4 May 2016 approved a complementary dividend of Euros 0.592 per share for a total of Euros 593 million, paid on 30 June 2016.

On 22 July 2016 the Board of Directors approved the payment of an interim dividend out of 2016 profits of Euros 0.330 per share, for a total of Euros 330 million, paid on 27 September 2016.

The Parent company had sufficient liquidity to pay out the interim dividend at the approval date, pursuant to the Spanish Companies Act 2010. The Parent company's provisional liquidity statement drawn up by the Directors at 31 July 2016 is as follows:

Net income		721
Reserves to be allocated		-
Maximum amount available for distribution		721
Forecast of interim dividend payment		330
Treasury liquidity	1,434	
Debt issue and undrawn credit facilities	6,906	
Total liquidity		8,340

On 7 February 2017, the Board of Directors approved the following proposal for the distribution of Gas Natural SDG, S.A.'s net profit for 2016, for submission to the Annual General Meeting:

Available for distribution	
Profit/(loss)	1,067
Distribution	
To Voluntary reserve	66
To Dividend	1,001

This proposal for the distribution of profits prepared by the Board for approval by the Annual General Meeting includes the payment of a supplementary dividend of Euros 0.67 per qualifying share outstanding on the proposed payment date, 27 June 2017.

The economic rights inherent to treasury shares, with the exception of the right to free allocation of new shares, will be allocated proportionally to the rest of the shares.

Year 2015

It Included the payment of an interim dividend of Euros 0.397 per share out of 2014 profits, for a total amount of Euros 397 million, agreed on 28 November 2014 and paid out on 8 January 2015.

Additionally, the proposal for the distribution of 2014 profits approved by the Annual General Meeting held on 14 May 2015 included the payment of a supplementary dividend of Euros 0.511 per share, for a total amount of Euros 512 million, paid on 1 July 2015.

Adjustments for changes in value

Adjustments for changes in value movements are presented in the Consolidated statement of comprehensive income for each concept showing a breakdown of the tax effect.

The item “Currency translation differences" includes the exchange differences described in Note 3.3.2 as a result of the euro's fluctuation against the main currencies of Gas Natural Fenosa's foreign companies.

Non-controlling interests

	Non-controlling interests
Balance at 1/1/2015	**3,879**
Total comprehensive income for the year	295
Distribution of dividends	(188)
Issue of perpetual subordinated debentures	493
Repurchase of preference shares	(640)
Capital increase in Global Power Generation	496
Payments return on other equity instruments	(41)
Other changes	(143)
Balance at 31/12/2015	**4,151**
Total comprehensive income for the year	470
Distribution of dividends	(214)
Sale of Gasco, S.A.	(196)
Purchase of 37.88% Gas Natural Chile	(314)
Payments return on other equity instruments	(58)
Loss of control in Electricaribe (Note 8)	(70)
Business combinations (Note 31)	8
Other changes	3
Balance at 12/31/2016	**3,780**

The most significant movements for 2016 relate to:

- On 8 August 2016 the liquefied petroleum gas (LPG) business in Chile was sold through the sale of the interest in Gasco, S.A. (Euros 220 million, generating a net capital gain of Euros 4 million and a reduction in “Non-controlling interests” of Euros 196 million (Note 9).

- On the other hand, on the same date, following the successful takeover bid for Gas Natural Chile, S.A. an additional 37.88% of its capital was acquired for Euros 306 million. As this is an acquisition of non-controlling interests, it has been recognised as an equity transaction, entailing a decrease in "Non-controlling interests" of Euros 314 million and an increase in "Reserves" of Euros 8 million.

- Other changes:

  In December 2016, an additional 6.9% of Gas Galicia, S.A. was acquired for Euros 6 million, taking the controlling interest to 68.5%. As this is an acquisition of non-controlling interests, it has been recognised as an equity transaction, entailing a decrease in "Non-controlling interests" of Euros 3 million and a decrease in "Reserves" of Euros 3 million.

  In 31 desember 2015 it also included the acquisition of other additional investments in subsidiaries of Euros 6 million.

The most significant movements in 2015 are described below:

- Issue of perpetual subordinated debentures

  On 21 April 2015 Gas Natural Fenosa Finance, B.V. closed an issue of perpetual subordinated debentures secured by Gas Natural SDG, S.A. amounting to Euros

500 million. The issue rate was set at 98.65% of nominal value, resulting in a net issue of Euros 493 million. The debentures accrued interest was defined as a reference interest rate plus a mark-up. The reference interest rate is the swap rate at 9 years (initially equivalent to 0.421%) which may be reviewed every 9 years. The initial spread is 3,079% and will be maintained for the first 10 years, followed by 3.329% from 2025 to 2044 and subsequently 4.079%. The effective interest rate was therefore 3.375%.

Interest accrued on these debentures is not payable but rather cumulative. Nonetheless, Gas Natural Fenosa should pay it if dividends are paid out or the decision to exercise the early cancellation option is taken.

Although no contractual maturity has been established for these debentures, Gas Natural Fenosa Finance, B.V. have the option to redeem them early in certain circumstances envisaged in the terms and conditions on 24 April 2024 and subsequently, on every interest payment date.

After analysing the terms and conditions of this issue, and in accordance with IAS 32, Gas Natural Fenosa accounted for the cash received by crediting “Non-controlling interests” included in equity on the consolidated balance sheet at 31 December 2015 on the understanding that the issue did not meet the conditions to be considered as a financial liability, because Gas Natural Fenosa Finance B.V. did not have the contractual commitment to hand over cash or another financial asset and also it did not have an obligation to exchange financial assets or liabilities, being at the discretion of Gas Natural Fenosa Finance, B.V the fully circumstances.

- Repurchase of preference shares

In 2005 Union Fenosa Preferentes, S.A. carried out a preference share issue for a nominal amount of Euros 750 million, which was recognised under Non-controlling interests. The main characteristics are:

a) Dividend: variable non-accumulative; from the date of payment until 30 June 2015 it will be Euribor at three months plus a spread of 0.65%; as from that date, it will be Euribor at three months plus a spread of 1.65%.

b) Dividend payment: will be paid by calendar quarters in arrears, depending on the existence of distributable profit of Gas Natural Fenosa, considering as such the lesser of the net profit declared by the Gas Natural Fenosa and the net profit of Gas Natural SDG, S.A. as guarantor.

c) Term: perpetual, with the option for the issuer of reducing all or part of the shareholdings after 30 June 2015. Any redemptions will be made at par value.

d) Remuneration: the dividend payment will be preferential and not accumulative and depends on whether distributable profit is reported by Gas Natural SDG, S.A. and the payment of a dividend to its ordinary shareholders. The issuer will have the option but not the obligation to pay the shareholders remuneration in kind by increasing the nominal value of the preference shares.

e) Voting rights: none

In May 2015 Gas Natural Fenosa offered to buy back in cash the preference shares issued by Union Fenosa Preferentes S.A.U. in 2005 at 85% of their nominal value. After the acceptance period, the aggregate nominal amount with respect to which the pertinent acceptance was issued totalled Euros 640 million (85.3% of the issue), which represented a cash amount of Euros 544 million. The rest has remained outstanding.

The excess of the carrying amount of the preference shares over the amount paid to buy them back totalled Euros 69 million and was recognised as an equity transaction, entailing an increase in "Reserves" under “Other movements" in the consolidated Statement of changes in equity.

- Capital increase in Global Power Generation

  In March 2015 Gas Natural Fenosa and Kuwait Investment Authority (KIA) entered into an agreement through which KIA committed to increasing capital by $550 million (Euros 493 million) to become a 25% shareholder of Global Power Generation S.A. (GPG), the parent of the subgroup holding that included the international generation assets of Gas Natural Fenosa. Following the obtainment of the pertinent authorisations, this operation was completed in October 2015. In accordance with the terms and conditions of the agreement reached, Gas Natural Fenosa retains control of GPG. Therefore, from an accounting viewpoint, it is an equity transaction, entailing an increase in “Non-controlling interests” amounting to Euros 496 million, relating to the carrying amount of the interest transferred, and a decrease in “Reserves” amounting to Euros 3 million.

- Other changes.

  In 2015 Gas Natural Fenosa Chile, SpA acquired an additional interest of 0.65% in Compañía General de Electricidad, S.A. (CGE) for Euros 18 million, its controlling interest amounting to 97.37%. As this is an acquisition of non-controlling interests, it was recognised as an equity transaction, entailing a decrease in "Non-controlling interests" of Euros 16 million and a decrease in "Reserves" of Euros 2 million.

  In June 2015 Gasco, S.A. (a subsidiary of Gas Natural Fenosa) acquired an additional interest of 12.75% in Gasmar, S.A. (a subsidiary of Gas Natural Fenosa) for Euros 34 million, its controlling interest amounting to 63.8%. As this is an acquisition of non-controlling interests, it was recognised as an equity transaction, entailing a decrease in "Non-controlling interests" of Euros 32 million and a decrease in "Reserves" of Euros 2 million.

  In October 2015 Gas Natural Fenosa Chile, SpA acquired an additional interest of 8.33% in Metrogas, S.A. (a subsidiary of Gas Natural Fenosa) for Euros 116 million, its controlling interest amounting to 60.17%. As this is an acquisition of non-controlling interests, it was been recognised as an equity transaction, entailing a decrease in "Non-controlling interests" of Euros 110 million and a decrease in "Reserves" of Euros 6 million.

  In 31 desember 2015 it also included the acquisition of other additional investments in subsidiaries of Euros 4 million.

Set out below is a breakdown of the most significant non-controlling interests:

Company	2016			2015		
	Attributed equity	Consolidated profit/(loss) for the year	Dividends received and other remunerations	Attributed equity	Consolidated profit/(loss) for the year	Dividends received and other remunerations
Metrogas, S.A.	605	46	13	860	44	25
Companhia Distribuidora de Gás do Río de Janeiro, S.A.	205	35	12	150	38	20
Global Power Generation, S.A. (1)	114	(2)	19	140	-	-
Gasco GLP, S.A.	-	7	7	98	11	22
Fuerza y Energía de Tuxpan (1)	115	10	-	106	2	-
Electrificadora del Caribe, S.A. ESP	-	-	-	89	7	-
Empresa de Distribución Eléctrica Metro Oeste, S.A.	101	11	-	85	13	22
Ecoelectrica L.P. (1)	83	14	14	77	1	-
Kangra Coal (Proprietary), Ltd	75	(6)	-	75	(6)	-
Europe Maghreb Pipeline, Ltd.	63	40	42	62	55	52
Gasmar, S.A.	-	9	4	57	14	13
Gas Natural Mexico, S.A. de CV	61	7	3	55	8	-
Gas Natural, S.A. ESP	49	29	28	45	31	4
Ceg Río, S.A.	46	6	3	35	10	7
Aprovisionadora global de energía, S.A.	39	65	32	-	-	-
Other companies (2)	612	34	36	605	38	20
Subtotal	**2,168**	**305**	**213**	**2,539**	**266**	**185**
Preferred shares	110	1	1	110	3	3
Subordinated perpetual debentures	1,502	58	58	1,502	53	41
Other equity instruments	**1,612**	**59**	**59**	**1,612**	**56**	**44**
Total	**3,780**	**364**	**272**	**4,151**	**322**	**229**

(1) Included in 2015 due to the effect of the GPG capital increase paid up by KIA, as described in this note.

(2) 2016 profits include the impact on non-controlling interests of the capital gain on the sale of GNL Quintero S.A. (Note 7) for Euros 39 million.

Dividends paid to non-controlling interests in 2016 amounted to Euros 195 million (Euros 161 million in 2015).

Set out below are financial highlights for the most significant non-controlling shareholdings (amounts at 100%):

Company	31 December 2016			31 December 2015		
	Total assets	Non-current liabilities	Current liabilities	Total assets	Non-current liabilities	Current liabilities
Metrogas, S.A.	2,216	(759)	(88)	2,190	(764)	(63)
Companhia Distribuidora de Gás do Río de Janeiro, S.A.	909	(205)	(239)	703	(172)	(188)
Global Power Generation, S.A.	542	(5)	(86)	583	(1)	(2)
Gasco GLP, S.A.	-	-	-	409	(125)	(66)
Fuerza y Energía de Tuxpan	1,151	(174)	(33)	1,070	(161)	(16)
Electrificadora del Caribe, S.A. ESP	-	-	-	1,538	(480)	(454)
Empresa de Distribución Eléctrica Metro Oeste, S.A.	920	(218)	(350)	731	(152)	(258)
Ecoelectrica L.P.	409	(32)	(33)	389	(54)	(26)
Kangra Coal (Proprietary), Ltd	377	(101)	(8)	433	(114)	(6)
Europe Maghreb Pipeline, Ltd.	292	(1)	(15)	276	(1)	(4)
Gasmar, S.A.	-	-	-	163	(46)	(30)
Gas Natural Mexico, S.A. de CV	809	(314)	(90)	721	(241)	(55)
Gas Natural, S.A. ESP	334	(68)	(145)	379	(92)	(99)
Ceg Río, S.A.	277	(85)	(74)	253	(51)	(110)
Aprovisionadora global de energía, S.A.	181	(18)	(72)	-	-	-

Appendix I contains a breakdown of Gas Natural Fenosa's investee companies, stating their activity and the percentage of the shareholding and equity interest.

The analysis performed to determine that Gas Natural Fenosa exercises control over the consolidated entities identified no cases requiring a complex judgement, since

Gas Natural Fenosa is entitled to variable returns from its involvement in the investee and has the capacity to influence those returns through its power in the investee, based on Gas Natural Fenosa's representatives on the Board of Directors and its participation in significant decisions. Additionally, in general terms, there are no significant restrictions, such as protective rights, on Gas Natural Fenosa's capacity to access or utilise assets, or to settle liabilities.

Note 14. Deferred income

The breakdown and the movements under this heading in 2016 and 2015 have been as follows:

	Grants	Revenues from pipeline networks and branch lines	Income from extension of pipelines charged to third parties	Other	Total
At 1.01.15	**156**	**567**	**99**	**10**	**832**
Amount received	16	50	3	-	69
Release to income	(19)	(29)	(15)	(1)	(64)
Translation differences	3	-	(1)	(2)	-
Transfers and other	12	-	4	-	16
At 31.12.15	**168**	**588**	**90**	**7**	**853**
Amount received	6	38	5	-	49
Release to income	(9)	(25)	(9)	-	(43)
Translation differences	1	(1)	(1)	(1)	(2)
Transfers and other	(10)	(2)	(3)	-	(15)
At 31.12.16	**156**	**598**	**82**	**6**	**842**

Note 15. Provisions

The breakdown of provisions at 31 December 2016 and 2015 is as follows:

	At 31.12.16	At 31.12.15
Provisions for employee obligations	489	659
Other provisions	759	829
Non-current provisions	**1,248**	**1,488**
Current provisions	158	193
Total	**1,406**	**1,681**

Provisions for employee obligations

A breakdown of the provisions related to employee obligations is as follows:

	2016			2015		
	Pensions and other similar obligations	Other obligations with personnel	Total	Pensions and other similar obligations	Other obligations with personnel	Total
At January 1	**650**	**9**	**659**	**731**	**9**	**740**
Contributions charged to profits	42	10	52	42	9	51
Payments during the year	(44)	-	(44)	(60)	-	(60)
Translation differences	25	-	25	(43)	-	(43)
Changes recognised directly in equity	51	-	51	(7)	-	(7)
Business combinations (Note 31)	-	-	-	-	-	-
Transfers and other applications (1)	(245)	(9)	(254)	(13)	(9)	(22)
At 31 December	**479**	**10**	**489**	**650**	**9**	**659**

(1) Includes mainly the derecognition of the balances of Electricaribe due to deconsolidation of that stake after the loss of control (Note 8).

Pensions and other similar obligations

The breakdown of the provisions for post-employment pension obligations by country is as follows:

Breakdown by country	At 31.12.16	At 31.12.15	At 1.01.15
Spain (1)	368	362	374
Colombia (2)	-	196	238
Brazil (3)	40	25	36
Chile (4)	54	48	67
Mexico (5)	11	14	10
Rest	6	5	6
Total	**479**	**650**	**731**

1) Pension plans and other post-employment benefits in Spain

Most of the post-employment obligations of Gas Natural Fenosa in Spain consist of the contribution of defined amount to occupational pension plan systems. Nevertheless, at 31 December 2016 and 31 December 2015, Gas Natural Fenosa held the following defined benefit obligations for certain groups of workers:

- Pensioners (retired workers, the disabled, widows and orphans).
- Defined benefit supplement obligations with retired personnel of the legacy Unión Fenosa Group who retired before November 2002 and a residual part of current personnel.
- Coverage of retirement and death for certain employees.
- Gas subsidy for current and retired personnel.
- Electricity for current and retired personnel.
- Liabilities with employees that took early retirement until they reach official retirement age and early retirement plans.
- Salary supplements and contributions to social security for a group of employees taking early retirement until they can access ordinary retirement.
- Health care and other benefits.

2) Pension plans and other post-employment benefits in Colombia

At 31 December 2015 there were following obligations with certain employees of the Colombian company Electrificadora del Caribe, S.A. E.S.P:

- Pension liabilities for retired personnel.
- Electricity for current and retired personnel.
- Healthcare and other post-retirement aid.

3) Pension Plans and Other post-employment benefits in Brazil

At 31 December 2016 and at 31 December 2015, Gas Natural Fenosa has the following benefits for certain employees in Brazil:

- Defined post-employment benefits plan, covering retirement, death on the job and disability pensions and overall amounts.
- Post-employment healthcare plan.
- Other defined post-employment benefit plans that guarantee temporary pensions, life-time pensions and overall amounts depending on seniority.

4) Pension plans and Other post-employment benefits in Chile

At 31 December 2016 and 2015, as a result of the acquisition of the CGE Group, Gas Natural Fenosa has the following benefits in force for certain employees in Chile:

- Termination benefits for employees due to retirement, dismissal or death, calculated based on length of service.
- Pension supplements for employees hired prior to 1992 in some electricity distribution companies.
- Length-of-service awards payable at 5, 10, 15, 20, 25 and 30 years of service.

5) Pension Plans and Other post-employment benefits in Mexico

At 31 December 2016 and at 31 December 2015, Gas Natural Fenosa has the following benefits for certain employees in Mexico:

- Length-of-service award payable after 15 years of service
- Severance indemnity for employees without the service requirement, payable in the event of death at work, incapacity or redundancy.
- Severance indemnity equivalent to three months' salary plus 20 days' salary per year of service.
- Additional compensation only in the event of retirement equal to 1% of the base salary per year of service.

The breakdown of the provisions for pensions and liabilities, by country, recognised in the consolidated balance sheet and the fair value of the plan-related assets is as follows:

	2016					2015				
	Spain	**Colombia**	**Brazil**	**Chile**	**Mexico**	**Spain**	**Colombia**	**Brazil**	**Chile**	**Mexico**
Present value of obligations										
At 1 January	**1,173**	**196**	**96**	**48**	**14**	**1,240**	**238**	**138**	**67**	**10**
Service cost for the year	5	-	-	4	-	6	-	-	4	2
Interest cost	23	17	15	3	1	24	17	13	2	-
Changes recognised in equity	77	35	22	-	-	(19)	2	(11)	(1)	-
Benefits paid	(75)	(22)	(11)	(5)	-	(78)	(25)	(11)	(11)	-
Translation differences	-	17	24	4	(3)	-	(36)	(33)	(1)	2
Business combinations (Note 31)	-	-	-	-	-	-	-	-	-	-
Transfers and other (1)	-	(243)	-	-	-	-	-	-	(12)	-
At 31 December	**1,203**	**-**	**146**	**54**	**12**	**1,173**	**196**	**96**	**48**	**14**
Fair value of plan assets										
At 1 January	**811**	**-**	**71**	**-**	**-**	**866**	**-**	**102**	**-**	**-**
Expected yield	15	-	12	-	-	16	-	10	-	-
Contributions	(2)	-	4	-	-	1	-	6	-	-
Changes recognised in equity	71	-	13	-	-	(11)	-	(11)	-	-
Benefits paid	(60)	-	(11)	-	-	(61)	-	(11)	-	-
Translation differences	-	-	17	-	-	-	-	(25)	-	-
Transfers and other	-	-	-	-	1	-	-	-	-	-
At 31 December	**835**	**-**	**106**	**-**	**1**	**811**	**-**	**71**	**-**	**-**
Provisions for pensions and similar obligations	**368**	**-**	**40**	**54**	**11**	**362**	**196**	**25**	**48**	**14**

(1) Includes mainly the derecognition of the balances of Electricaribe due to deconsolidation of that stake after the loss of control (Note 8).

The amounts recognized in the Consolidated Income Statement for the above-mentioned pension plans are as follows:

	2016					2015				
	Spain	**Colombia**	**Brazil**	**Chile**	**Mexico**	**Spain**	**Colombia**	**Brazil**	**Chile**	**Mexico**
Cost of service for the year	5	-	-	4	-	6	-	-	4	2
Past service cost	-	-	-	-	-	-	-	-	-	-
Interest cost	23	17	15	3	1	24	17	13	2	-
Expected return on plan assets	(15)	-	(12)	-	-	(16)	-	(10)	-	-
Total income statement charge	**13**	**17**	**3**	**7**	**1**	**14**	**17**	**3**	**6**	**2**

Benefits payable in coming years as a result of the above-mentioned commitments are as follows:

	2016					2015				
	Spain	**Colombia**	**Brazil**	**Chile**	**Mexico**	**Spain**	**Colombia**	**Brazil**	**Chile**	**Mexico**
Between 1 to 5 years	5	-	-	-	-	8	-	-	13	-
Between 5 to 10 years	37	-	2	29	2	31	196	25	12	3
More than 10 years	326	-	38	25	9	323	-	-	23	11
Provisions for pensions and similar obligations	**368**	**-**	**40**	**54**	**11**	**362**	**196**	**25**	**48**	**14**

The weighted average term of defined benefit commitments is as follows:

	2016					2015				
Years	**Spain**	**Colombia**	**Brazil**	**Chile**	**Mexico**	**Spain**	**Colombia**	**Brazil**	**Chile**	**Mexico**
Weighted average term of pension commitments	11.33	-	9.84	10.26	19.45	11.49	7.41	8.90	10.50	11.49

Movements in the liability recognised in the Consolidated Balance Sheet are as follows:

	2016					2015				
	Spain	Colombia	Brazil	Chile	Mexico	Spain	Colombia	Brazil	Chile	Mexico
At 1 January	**362**	**196**	**25**	**48**	**14**	**374**	**238**	**36**	**67**	**10**
Charge against the income statement	13	17	3	7	1	14	17	3	6	2
Contributions paid	(13)	(22)	(4)	(5)	-	(18)	(25)	(6)	(11)	-
Changes recognised in equity	6	35	9	-	-	(8)	2	-	(1)	-
Transfers (1)	-	(243)	-	-	(1)	-	-	-	(12)	-
Translation differences	-	17	7	4	(3)	-	(36)	(8)	(1)	2
Business Combinations	-	-	-	-	-	-	-	-	-	-
Discontinued operations	-	-	-	-	-	-	-	-	-	-
At 31 December	**368**	**-**	**40**	**54**	**11**	**362**	**196**	**25**	**48**	**14**

(1) Includes mainly the derecognition of the balances of Electricaribe due to deconsolidation of that stake after the loss of control (Note 8).

Cumulative actuarial gains and losses recognised directly in equity are negative in the amount of Euros 107 million in 2016 (Spain: negative in the amount of Euros 55 million, Brazil: negative in the amount of Euros 42 million, Chile: negative in the amount of Euros 5 million and Mexico: negative in the amount of Euros 5 million). In 2015, the cumulative amount was negative by Euros 188 million (Spain: negative in the amount of Euros 49 million, Colombia: negative in the amount of Euros 100 million, Brazil: negative in the amount of Euros 33 million, Chile: negative in the amount of Euros 5 million and Other: negative in the amount of Euros 1 million).

The change recognised in equity relates to actuarial losses and gains derived basically from adjustments to:

	2016					2015				
	Spain	Colombia	Brazil	Chile	Mexico	Spain	Colombia	Brazil	Chile	Mexico
Financial assumptions	39	21	3	-	-	6	(7)	(6)	-	-
Demographic assumptions	-	-	-	-	-	-	-	-	-	-
Experience	(33)	14	6	-	-	(13)	9	4	(1)	-
Limits on assets	-	-	-	-	-	(1)	-	2	-	-
At 31 December	**6**	**35**	**9**	**-**	**-**	**(8)**	**2**	**-**	**(1)**	**-**

The main categories of assets, expressed as a percentage of the total fair value of the assets are as:

	2016					2015				
% over total	**Spain**	**Colombia**	**Brazil**	**Chile**	**Mexico**	**Spain**	**Colombia**	**Brazil**	**Chile**	**Mexico**
Shares	-	-	16%	-	-	-	-	13%	-	-
Bonds	100%	-	76%	-	-	100%	-	77%	-	-
Real estate and other assets	-	-	8%	-	-	-	-	10%	-	-

Real yields on the plan-related assets in 2016, relating basically to Spain and Brazil, have been Euros 27 million (Euros 26 million in 2015).

The main annual actuarial assumptions used were as follows:

	At 31.12.16					At 31.12.15				
	Spain	Colombia	Brazil	Chile	Mexico	Spain	Colombia	Brazil	Chile	Mexico
Discount rate (1)	0 to 1.8%	7.5%	11.9%	1.7%	7.0%	0.2 to 2.6%	8.7%	13.31%	1.7%	7.0%
Expected return on plan assets (1)	0 to 1.8%	-	11.9%	-	7.0%	0.2 to 2.6%	-	13.31%	-	7.0%
Future salary increases (1)	2.0%	4.5%	6.6%	2.0%	5.5%	2.0%	4.5%	7.7%	1.9%	5.5%
Future pension increases (1)	2.0%	3.5%	5.5%	NA	3.4%	2.0%	3.5%	5.5%	NA	3.4%
Inflation rate (1)	2.0%	3.5%	5.5%	3.0%	4.0%	2.0%	3.5%	5.5%	NA	4.0%
Mortality table	PERMF 2000	RV08	AT-2000	RV-2009	EMSSA 2009	PERMF 2000	RV08	AT-2000	RV-2009	EMSSA 2009
Life expectancy:										
Men										
Retired in the current year	22.5	18.45	20.45	19.58	22.56	22.5	18.45	20.45	19.58	22.5
Retired in 20 years	42.5	36.69	37.94	20.47	39.53	42.5	36.69	37.94	20.47	39.42
Women										
Retired in the current year	27.0	22.18	23.02	29.07	25.04	27.0	22.18	23.02	29.07	24.99
Retired in 20 years	48.4	40.39	41.44	29.75	44.81	48.4	40.39	41.44	29.75	44.75

(1) Annual

These assumptions are applicable to all the obligations homogeneously irrespective of the origin of their collective bargaining agreements.

The interest rates employed to discount the post-employment liabilities are applied based upon the period of each commitment and the reference curve is calculated as the average of the curves of corporate bonds with a high level credit rating (AA), issued in the Eurozone.

Benefits payable and estimated contributions to be made for 2017 in million euros are as follows:

	Benefits					Contributions				
	Spain	Colombia	Brazil	Chile	Mexico	Spain	Colombia	Brazil	Chile	Mexico
Post-employment	63	-	9	-	-	12	21	1	4	-
Post-employment medical	-	-	-	-	-	3	3	2	-	-
Long term	-	-	-	-	-	-	-	-	-	-
At 31 December	**63**	**-**	**9**	**-**	**-**	**15**	**24**	**3**	**4**	**-**

The following table includes the effect of a 1% variation in the inflation rate, a 1% change in the discount rate and a 1% change in the cost of healthcare over the provisions and actuarial costs:

	Inflation + 1%	Discount +1%	Healthcare +1%
Present value of obligations	117	(148)	17
Fair value of plan assets	-	(76)	-
Provision for pensions	117	(72)	17
Cost of service for the year	2	(2)	-
Interest cost	2	9	1
Expected return on plan assets	-	(7)	-

Other obligations with personnel

Gas Natural Fenosa operates a variable multi-annual remuneration system aimed at strengthening the commitment of the management to achieving the economic objectives of the Group directly related to those established in the current Strategic Plans, approved by the Board of Directors and communicated to the financial markets and the achievement of which, along with their permanence in the Group, grants the right to receive a variable remuneration in cash in the first quarter of the year after its termination.

At 31 December 2016 a provision has been booked corresponding to the remuneration, 2014-2016, 2015-2018 and 2016-2019 amounting to Euros 18 million (Euros 18 million at 31 December 2015), of which Euros 9 million are classified as non-current in 2016 (Euros 9 million 2015).

Other current and non-current provisions

Movements in current and non-current provisions are as follows:

	Non-current provisions			Current provisions	Total
	Due to facility closure costs	Other provisions	Total		
At 1.01.15	**403**	**417**	**820**	**128**	**948**
Appropriations/reversals charged to income statement:					
– Appropriations due to financial update	10	4	14	-	**14**
– Appropriations charged to other results	-	34	34	103	**137**
– Reversals	-	(22)	(22)	-	**(22)**
Appropriations/reversals charged to fixed assets:	18	-	18	-	**18**
Payments	(2)	(37)	(39)	(43)	**(82)**
Business combinations (Note 31)	2	5	7	-	**7**
Translation differences	(3)	(8)	(11)	5	**(6)**
Transfers and other	-	8	8	-	**8**
At 31.12.15	**428**	**401**	**829**	**193**	**1,022**
Appropriations/reversals charged to income statement:					
– Appropriations due to financial update	10	1	11	-	**11**
– Appropriations charged to other results	-	15	15	56	**71**
– Reversals	-	(24)	(24)	(1)	**(25)**
Appropriations/reversals charged to fixed assets:	(1)	-	(1)	-	**(1)**
Payments	(4)	(30)	(34)	(112)	**(146)**
Business combinations (Note 31)	-	-	-	-	**-**
Translation differences	4	3	7	2	**9**
Transfers and other	(23)	(21)	(44)	20	**(24)**
At 31.12.16	**414**	**345**	**759**	**158**	**917**

(1) Includes mainly the derecognition of the balances of Electricaribe due to deconsolidation of that stake after the loss of control (Note 8).

The item "provisions due to facility closure costs" includes provisions for obligations arising from decommissioning, restoration and other costs related basically to electricity generation facilities.

The item "Other provisions" mainly includes provisions posted to cover obligations derived principally from tax claims (Note 21), lawsuits and arbitration, insurance and other liabilities. Note 35 "Commitments and contingent liabilities" includes further information on contingent liabilities.

The item "Current provisions" relates mainly to CO_2 emissions estimated for the year in the amount of Euros 56 million at 31 December 2016 (Euros 103 million in 2015).

No provision for onerous contracts was deemed necessary at 31 December 2016 or 2015.

The estimated payment periods for the obligations provisioned in this item are Euros 306 million in between one and five years (Euros 331 million at 31 December 2015), Euros 86 million in between five and ten years (Euros 102 million at 31 December 2015), and Euros 367 million after more than 10 years (Euros 396 million at 31 December 2015).

Note 16. Borrowings

The breakdown of borrowings at 31 December 2016 and 2015 is as follows:

	At 31.12.16	At 31.12.15
Issuing of debentures and other negotiable obligations	10,098	10,632
Loans from financial institutions	4,837	4,802
Derivative financial instruments	62	165
Other financial liabilities	6	54
Non-current borrowings	**15,003**	**15,653**
Issuing of debentures and other negotiable obligations	1,563	1,691
Loans from financial institutions	856	741
Derivative financial instruments	18	14
Other financial liabilities	162	149
Current borrowings	**2,599**	**2,595**
Total	**17,602**	**18,248**

Financial liabilities recognised at fair value at 31 December 2016 and at 31 December 2015 are classified as follows:

	31 December 2016				31 December 2015			
Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Fair value through profit or loss	-	-	-	**-**	-	-	-	**-**
Hedging derivatives	-	80	-	**80**	-	179	-	**179**
Total	**-**	**80**	**-**	**80**	**-**	**179**	**-**	**179**

The carrying amounts and fair value of the non-current borrowings are as follows:

	Carrying amount		Fair value	
	At 31.12.16	**At 31.12.15**	**At 31.12.16**	**At 31.12.15**
Issuing of debentures and other negotiable securities	10,098	10,632	11,389	11,961
Loans from financial institutions and others	4,843	4,856	4,874	4,882

The fair value of the listed bond issues is estimated on the basis of their market price (Level 1). The fair value of loans with fixed interest rates is estimated on the basis of the discounted cash flows over the remaining terms of such debt. The discount rates were determined based on market rates available at 31 December 2016 and 31 December 2015 on borrowings with similar credit and maturity characteristics. These valuations are based on the quotation price of similar financial instruments in an official market or on observable information in an official market (Level 2).

The movement in borrowings is as follows:

	2016	2015
At 1 January	**18,248**	**20,544**
Business combinations (Note 31)	-	165
Increase in borrowings	7,826	5,943
Decrease in borrowings	(8,069)	(8,043)
Translation differences	264	(285)
Assets and liabilities held for sale (Note 9)	-	(338)
Transfers and other (1)	(667)	262
At 31 December	**17,602**	**18,248**

(1) Includes mainly the derecognition of the balances of Electricaribe due to deconsolidation of that stake after the loss of control (Note 8).

The following tables describe consolidated gross borrowings by instrument at 31 December 2016 and 31 December 2015 and their maturity profile, taking into account the impact of the derivative hedges.

	2017	2018	2019	2020	2021	2022 and after	Total
At 31 December 2016							
Issuing of debentures and other negotiable securities							
Fixed	1,429	1,568	1,241	1,659	1,553	3,992	11,442
Floating	133	23	63	-	-	-	219
Institutional Banks and other financial companies							
Fixed	229	163	127	127	84	93	823
Floating	138	108	82	78	121	624	1,151
Commercial Banks and other financial liabilities							
Fixed	134	30	484	146	125	5	924
Floating	536	791	881	385	390	60	3,043
Total Fixed	1,792	1,761	1,852	1,932	1,762	4,090	13,189
Total Floating	807	922	1,026	463	511	684	4,413
Total	**2,599**	**2,683**	**2,878**	**2,395**	**2,273**	**4,774**	**17,602**

	2016	2017	2018	2019	2020	2021 and after	Total
At 31 December 2015:							
Issuing of debentures and other negotiable securities							
Fixed	1,296	1,405	1,567	1,235	1,660	4,588	11,751
Floating	390	29	26	58	-	69	572
Institutional Banks and other financial companies							
Fixed	167	234	190	177	177	255	1,200
Floating	53	68	79	53	50	88	391
Commercial Banks and other financial liabilities							
Fixed	172	168	78	491	30	10	949
Floating	517	582	581	774	579	352	3,385
Total Fixed	1,635	1,807	1,835	1,903	1,867	4,853	13,900
Total Floating	960	679	686	885	629	509	4,348
Total	**2,595**	**2,486**	**2,521**	**2,788**	**2,496**	**5,362**	**18,248**

Had the impact of the derivatives on borrowings been excluded, the financial debt at fixed rate would amount to Euros 11,636 million at 31 December 2016 (Euros 11,104 million at 31 December 2015) and, at floating rates, Euros 5,886 million at 31 December 2016 (Euros 6,965 million in 2015).

The following table describes consolidated gross financial debt denominated by currency at 31 December 2016 and 31 December 2015 and its maturity profile, taking into account the impact of the derivative hedges:

	2017	2018	2019	2020	2021	2022 and after	Total
At 31 December 2016							
Euro Debt	1,944	1,923	1,951	2,113	2,086	3,961	13,978
Foreign Currency Debt:							
US Dollar	288	20	502	1	106	5	922
Chilean peso	133	408	167	281	81	751	1,821
Mexican peso	3	136	102	-	-	57	298
Brazilian real	159	179	74	-	-	-	412
Colombian peso	61	9	75	-	-	-	145
Argentinian peso	11	8	7	-	-	-	26
Rest	-	-	-	-	-	-	-
Total	**2,599**	**2,683**	**2,878**	**2,395**	**2,273**	**4,774**	**17,602**

	2016	2017	2018	2019	2020	2021 and after	Total
At 31 December 2015:							
Euro Debt	1,940	1,879	1,800	2,123	2,218	4,593	14,553
Foreign Currency Debt:							
US Dollar	229	86	20	486	1	6	828
Chilean peso	161	183	412	16	256	696	1,724
Mexican peso	4	-	157	66	-	67	294
Brazilian real	104	107	84	-	-	-	295
Colombian peso	143	225	47	97	21	-	533
Argentinian peso	10	6	1	-	-	-	17
Rest	4	-	-	-	-	-	4
Total	**2,595**	**2,486**	**2,521**	**2,788**	**2,496**	**5,362**	**18,248**

Borrowings in euros have borne an effective average interest rate of 3.57% at 31 December 2016 (3.81% at 31 December 2015) while borrowings in foreign currency have borne an effective average interest rate of 7.13% in 2016 (7.91% at 31 December 2015) including derivative instruments assigned to each transaction.

At 31 December 2016, Gas Natural Fenosa has credit facilities totalling Euros 8,192 million (Euros 8,003 million at 31 December 2015), of which Euros 7,642 million has not been drawn down (Euros 7,558 million at 31 December 2015).

Bank borrowings totalling Euros 2,308 million (Euros 1,505 million at 31 December 2015) are subject to the fulfilment of certain financial ratios.

At the formulation date of these Consolidated annual accounts, Gas Natural Fenosa is not in breach of its financial obligations or of any type of obligation that could give rise to the early maturity of its financial commitments.

Certain investment projects have been financed by means of specific structures (project finance) which include pledges on the shares in the project companies. At 31 December 2016, the outstanding balance of this type of financing totals Euros 13 million (Euros 19 million at 31 December 2015).

The most relevant financing instruments are described below:

Issuing of debentures and other negotiable securities

In 2016 and 2015 the evolution of the issues of debt securities has been as follows:

	At 1.1.2016.	Issuances	Buy-backs or redemptions	Adjustments, exch. rates & other	At 31.12.2016.
Issued in a member state of the European Union which required the filing of a prospectus	**10,857**	5,125	(5,725)	5	**10,262**
Issued in a member state of the European Union which did not required the filing of a prospectus	**-**	-	-	-	
Issued outside a member state of the European Union	**1,466**	-	(116)	49	**1,399**
Total	**12,323**	**5,125**	**(5,841)**	**54**	**11,661**

	At 1.1.2015.	Issuances	Buy-backs or redemptions	Adjustments, exch. rates & other	At 31.12.2015
Issued in a member state of the European Union which required the filing of a prospectus	11,246	2,859	(3,263)	15	10,857
Issued in a member state of the European Union which did not required the filing of a prospectus	-	-	-	-	-
Issued outside a member state of the European Union	2,004	194	(583)	(149)	1,466
Total	**13,250**	**3,053**	**(3,846)**	**(134)**	**12,323**

ECP Program

On 23 March 2010 a Euro Commercial Paper program (ECP) was contracted totalling Euros 1,000 million, the issuer being the subsidiary Gas Natural Fenosa Finance BV (former Unión Fenosa Finance BV). During 2016, further issues were completed under that Programme for a total amount of Euros 4,225 million (Euros 2,359 million at December 2015). At 31 December 2016, the amount of Euros 100 million had been drawn down on the Programme (Euros 300 million at December 2015) and the sum of Euros 900 million was available (Euros 700 million at December 2015).

EMTN Program

Gas Natural Fenosa, though the subsidiary companies Gas Natural Capital Markets, S.A. and Gas Natural Fenosa Finance BV (former Unión Fenosa Finance BV), maintains a European Medium Term Notes (EMTN) Program in the medium term. This Program was established in 1999 of which a total principal of up to Euros 2.000 million could be issued. Following a number of extensions, the latest in December 2016, the Programme limit is Euros 14,000 million (Euros 14,000 million at 31 December 2015). At 31 December 2016, principal drawn down totalled Euros 10,205 million (Euros 10,605 million at 31 December 2015) and the amount of Euros 3,795 million was available. In April 2016 a private placement of Euros 300 million was performed to refinance another bond which maturity was April 2017 with an annual coupon of 2.31%.

The breakdown of the nominal issue balance is as follows:

Issue	Nominal	Maturity	Coupon %
July 2009	500	2019	6.375
November 2009	750	2021	5.125
January 2010	850	2020	4.500
January 2010	700	2018	4.125
February 2011	600	2017	5.625
May 2011	500	2019	5.375
February 2012	750	2018	5.000
September 2012	800	2020	6.000
October 2012	500	2017	4.125
January 2013	600	2023	3.875
January 2013 (1)	204	2019	2.125
April 2013	750	2022	3.875
July 2013 (2)	101	2023	3.974
October 2013	500	2021	3.500
March 2014	500	2024	2.875
May 2014	200	2023	2.625
January 2015	500	2025	1.375
April 2016	600	2026	1.250
April 2016	300	2021	0.515
Total	**10,205**		

(1) CHF 250 million as nominal value.
(2) NOK 800 million as nominal value

Preference shares

In May 2003, the subsidiary Unión Fenosa Financial Services USA, L.L.C., issued preference shares for a nominal amount of Euros 609 million with the following characteristics:

- Dividend: variable, non-accumulative, until 20 May 2013, was Euribor at three months plus a spread of 0.25% capped at 7% and a minimum of 4.25%; as from that date, Euribor at three months plus a spread of 4%.
- Term: perpetual, with the option for the issuer of reducing in advance all or part of the shareholding after 20 May 2013. Any redemptions will be made at par value.
- Remuneration: the dividend payment will be preferential and not accumulative and depends on whether distributable consolidation profit is reported or the payment of a dividend to its ordinary shareholders.
- Voting rights: none

On 16 April 2013, Gas Natural Fenosa's Board of Directors approved a bid for the preferred shares. A cash bid was made to purchase the shares at 93% of their nominal amount; on 16 May 2013, once the acceptance period had ended, the aggregate nominal amount of the acceptances confirmed was Euros 539 million. 88.56% of the issue's nominal amount.

On 22 February 2016, all said outstanding preference shares were redeemed at par value. The balance totalled Euros 69 million and accrued interest at a rate of 3.849%.

Negotiable bonds and Certificates Programme

In May 2010, in Panama, the subsidiary Empresa de Distribución Eléctrica Metro-Oeste, S.A. launched a programme to issue up to USD 50 million (Euros 47 million) in Negotiable Commercial Paper (VCNs). At 31 December 2016 no issuance under said programme had been utilised, remaining available in its entirety (Euros 46 million at December 2015).

In turn, on 3 May 2011 Gas Natural Fenosa, through its subsidiary Gas Natural México S.A. de C.V., registered a Stock Market Certificate Programme in the Mexican Stock Exchange for the sum of Mexican Pesos 10 billion (Euros 530 million), secured by Gas Natural SDG, S.A. Under this Programme, on 20 May 2011 debt was issued for a period of seven years amounting to 1,460 million Mexican pesos (Euros 67 million). Debt was also issued at four years, which has now expired. On 14 July 2015 a debt issue was completed for periods of three and ten years and an aggregate amount of Mexican Pesos 2.8 billion (Euros 129 million). At 31 December 2016, the drawn-down balance is 4,260 Mexican pesos, Euros 196 million (Euros 225 million at 31 December 2015). The balance available under this programme at 31 December 2016 was Mexican Pesos 5,740 million, Euros 263 million (Euros 305 million at 31 December 2015).

During the year 2012, the dependent company Gas Natural S.A. ESP, located in Colombia, signed an Ordinary Bonds program for Columbian Pesos 500,000 million (Euros 158 million) on the local capital market; in the month of October it placed under this program two issues amounting to Columbian Pesos 100,000 million (Euros 32 million) and Columbian Pesos 200,000 million (Euros 63 million) with maturity at 5 and 7 years, respectively. The balance available at 31 December 2016 under this program is Columbian Pesos 200,000 million (Euros 63 million) (Euros 58 million at 31 December 2015).

Following the CGE Group acquisition, capital market debt under a Chilean programme was consolidated. At 31 December 2016, a balance of CLP 563,599 million (Euros 801 million) (Euros 730 million at 31 December 2015) had been utilised and CLP 1,067,663 million (Euros 1,518 million) was drawable.

Loans from financial institutions

European bank loans (commercial / institutional banks)

At 31 December 2016, bank borrowings include bank loans of Euros 1,520 million (Euros 1,662 million at 31 December 2015) and credit lines drawn in the amount of Euros 233 million (Euros 237 million at 31 December 2015). On 16 February 2015, a tranche of the Club Deal loan obtained in 2013 was repaid in advance in the amount of Euros 750 million and a credit line tranche of that loan was refinanced in the amount of Euros 1,500 million to obtain a new credit line of Euros 1,750 million thaht was not utilised at 31 December 2016 and 2015. Additionally, borrowings from the Official Credit Institute (ICO) total Euros 112 million, maturing in 2018 at maximum (Euros 192 million at 31 December 2015).

The European Investment Bank (EIB) has granted financing to Gas Natural Fenosa in the amount of Euros 1,835 million (Euros 1,358 million at 31 December 2015) with Euros 300 million remaining available. In September 2016 the Euros 600 million loan granted by the EIB to finance investments in the gas distribution business in Spain was drawn down.

Loans from Latin American banks (commercial / institutional banks)

At 31 December 2016 borrowings from various Latin American banks totalled Euros 1,978 million (Euros 2,069 million at 31 December 2015). The geographic breakdown of these loans is as follows:

Country	**2016**	**2015**
Chile	998	1,002
Colombia	48	445
Brazil	412	295
Panama	409	222
Mexico	106	80
Other	5	25
	1,978	**2,069**

Of the total bank borrowings in Latin America at 31 December 2016, 99% relates to commercial banks and the remaining 1% to institutional banks.

Bank loans in other countries (commercial/institutional banks)

At 31 December 2016, borrowings from credit institutions in other countries stand at Euros 16 million (Euros 25 million at 31 December 2015), relating basically to Moldova and Kenya.

Other financial liabilities

At 31 December 2016, the item "Other financial liabilities" basically includes the 10-year finance lease entered into in 2007 with financial institutions for the power islands at the Sagunto combined cycle plant (Note 6).

The breakdown of the minimum payments for the finance leases are as follows:

	At 31.12.16			**At 31.12.15**		
	Nominal value	**Discount**	**Present value**	**Nominal value**	**Discount**	**Present value**
Less than 1 year	52	(2)	**50**	37	(3)	**34**
Between 1 and 5 years	-	-	**-**	51	(2)	**49**
Total	**52**	**(2)**	**50**	**88**	**(5)**	**83**

Note 17. Risk management and derivative financial instruments

Risk management

Gas Natural Fenosa has a series of standards, procedures and systems for identifying, measuring and managing different types of risk which are made up of the following basic action principles:

- Guaranteeing that the most relevant risks are correctly identified, evaluated and managed.

- Segregation at the operating level of the risk management functions.

- Assuring that the level of its risk exposure for Gas Natural Fenosa in its business is in line with the objective risk profile and achievement of its annual, strategic objectives.

- Ensuring the appropriate determination and review of the risk profile by the Risk Committee, proposing global limits by risk category, and assigning them to the Business Units.

On 23 June 2016, voters in the United Kingdom supported their country's exit from the European Union ("Brexit"). Although the United Kingdom's exit will be accompanied by a negotiation process that will last for a period of time that is currently undefined, the first consequences have already been observed in both capital and currency markets. However, Gas Natural Fenosa's exposure to the risk of the so-called "Brexit" is virtually zero, so the conclusions stated above on risks and uncertainties are not affected.

Interest rate risk

The fluctuations in interest rates modify the fair value of the assets and liabilities that accrue a fixed interest rate and the cash flows from assets and liabilities pegged to a floating interest rate, and accordingly, affect equity and profit, respectively.

The purpose of interest rate risk management is to balance floating and fixed borrowings in order to reduce financial debt costs within the established risk parameters.

Gas Natural Fenosa employs financial swaps to manage exposure to interest rate fluctuations, swapping floating rates for fixed rates.

The debt structure at 31 December 2016 and 2015 (Note 16), after taking into account the hedges structured through derivatives, is as follows:

	At 31.12.16	**At 31.12.15**
Fixed interest rate	13,189	13,900
Floating interest rate	4,413	4,348
Total	**17,602**	**18,248**

The floating interest rate is mainly subject to the fluctuations of the EURIBOR, the LIBOR and the indexed rates of Mexico, Brazil, Colombia, Argentina and Chile.

The sensitivity of profit and equity ("Adjustments for changes in value") to the fluctuation in interest rates is as follows:

	Increase/decrease in interest rates (basis points)	Effect on profit before tax	Effect on equity before tax
2016	+50	(22)	83
	-50	22	(83)
2015	+50	(22)	27
	-50	22	(27)

Exchange rate risk

The variations in the exchange rates can affect the fair value of:

- Counter value of cash flows related to the sale and purchase of gas and other raw materials denominated in currencies other than local or functional currencies.
- Debt denominated in currencies other than local or functional currencies.
- Operations and investments in non-Euro currencies, and, accordingly, the counter value of equity contributed and results.

In order to mitigate these risks Gas Natural Fenosa finances, to the extent possible, its investments in local currency. Furthermore, it tries to make, whenever possible, costs and revenues indexed in the same currency, as well as amounts and maturities of assets and liabilities arising from operations denominated in non-Euro currencies.

For open positions, the risks in investments in non-functional currencies are managed through financial swaps and foreign exchange fluctuation insurance within the limits approved for hedging instruments.

The non-Euro currency with which Gas Natural Fenosa operates the most is the US Dollar. The sensitivity of results and consolidated equity ("Adjustments for changes in value") of Gas Natural Fenosa to a 5% variation (increase or decrease) in the US Dollar / Euro exchange rate is as follows:

		Effect on profit before tax	Effect on equity before tax
2016	+5%	-	12
	-5%	-	(10)
2015	+5%	-	24
	-5%	-	(23)

Additionally, net assets of foreign companies that have a non-euro functional currency are subject to foreign exchange risk when their financial statements are translated to euros during the consolidation process. Exposure to risk countries where there is more than one exchange rate is immaterial. At 31 December 2016 Gas Natural Fenosa's equity denominated in Argentinian pesos totals Euros 47 million (Euros 39 million at 31 december 2015), representing a pre-tax impact on equity of Euros 2 million (Euros 2 million at 31 december 2015) at 5% sensitivity.

Commodities price risk

A large portion of Gas Natural Fenosa's operating expenses are linked to gas purchased to supply customers or generate electricity at combined cycle plants. Therefore, Gas Natural Fenosa is exposed to gas price fluctuation risk, whose determination is basically subject to the prices of crude oil and its by-products. Additionally, in the electricity generation business Gas Natural Fenosa is exposed to CO_2 emission allowances fluctuation risk and electricity prices variations.

The exposure to these risks is managed and mitigated through the monitoring of its position regarding these commodities, trying to balance purchase and supply obligations and diversification and management of supply contracts. When it is not possible to achieve a natural hedge the position is managed, within reasonable risk parameters, through derivatives to reduce exposure to price risk, generally through hedging instruments.

The risk involved in the electricity ad CO_2 emission allowances trading operations carried out by Gas Natural Fenosa is not significant, due to the low volume of these operations and the limits established, both in terms of amount and maturity.

The sensitivity of profit and equity (Value adjustments) to the variation in the fair value of derivative contracts to hedge commodity prices is as follows:

	Increase / decrease in the purchase price of gas	Effect on profit before tax	Effect on equity before tax
2016	+10%	-	44
	-10%	-	(44)
2015	+10%	-	67
	-10%	-	(67)

	Increase / decrease in the electricity sale price	Effect on profit before tax	Effect on equity before tax
2016	+10%	-	27
	-10%	-	(27)
2015	+10%	1	1
	-10%	(1)	(1)

As regards exposure to low commodity prices, Gas Natural Fenosa has no relevant investments in upstream businesses or commodities production, so that fluctuations in commodity prices have no significant impact on asset values.

Business segment sensitivity to the prices of oil, gas, coal and electricity is explained below:

- Gas and electricity distribution It is a regulated activity with revenue and profit margins are linked to distribution infrastructure management services rendered, irrespective of the prices of the commodities distributed. In any event, a fall in the price of gas could increase consumption, having a favourable impact on revenue and thus contributing to the stability of Gas Natural Fenosa's results.

- Gas and electricity. Profit margins on gas and electricity commercialisation activities are directly affected by commodity prices. In this regard, Gas Natural Fenosa has a risk policy that stipulates the tolerance range of the company, based on applicable risk limits, among other aspects. Measures employed to keep the risk within the stipulated limits include active supply management, balanced acquisitions and sales formulae, and specific hedging so as to maximise the risk-profit binomial.

Credit risk

The credit risk arising from the default of a counterparty is controlled through policies that assure that wholesale sales of products are made to customers with an appropriate credit history, for which the respective solvency studies are established and based on which the respective credit limits are assigned.

In order to do so various credits quality measuring models have been designed. Based on these models, the probability of customer default on payment can be measured, and the expected commercial loss can be kept under control.

The main guarantees that are negotiated are guarantees, guarantee deposits and deposits. At 31 December 2016, Gas Natural Fenosa had received guarantees totalling Euros 155 million to cover the risk of large industrial customers (Euros 51 million at 31 December 2015). In 2016, bank guarantees amounting to Euros 1 million were enforced (Euros 1 million at 31 December 2015).

Furthermore, the debt claims are stated on the Consolidated balance sheet net of provisions for bad debts (Note 11), estimated by Gas Natural Fenosa on the basis of the ageing of the debt and past experience in accordance with the prior segregation of customer portfolios and the current economic environment.

At 31 December 2016 and 2015 Gas Natural Fenosa does not have significant concentrations of credit risk.

In order to mitigate credit risk arising from financial positions, Gas Natural Fenosa enters into derivatives and places treasury surpluses in banks and financial entities that are highly solvent and rated by Moody's and S&P.

Likewise, most of the accounts receivable neither due nor provided for have a high credit rating, according to the valuations of Gas Natural Fenosa, based on the solvency analysis and payment habits of each customer.

The breakdown of the age of financial receivables overdue but not considered bad debts at 31 December 2016 and 2015 is as follows:

	At 31.12.16	**At 31.12.15**
Less than 90 days	326	450
90 – 180 days	89	142
More than 180	14	7
Total	**429**	**599**

The impaired financial assets are broken down in Note 11.

Liquidity risk

Gas Natural Fenosa has liquidity policies that ensure compliance with its payment commitments, diversifying the coverage of financing needs and debt maturities. A prudent management of the liquidity risk includes maintaining sufficient cash and realisable assets and the availability of funds sufficient to cover credit obligations.

Available cash resources at 31 December 2016 are analysed below:

Liquidity source	Availability 2016
Undrawn credit facilities (Note 16)	7,642
Undrawn loans	352
Cash and cash equivalents (Note 12)	2,067
Total	**10,061**

There is also additional capacity to issue debt in the capital markets unused for Euros 6,586 million, as explained previously (Note 16).

The breakdown of the maturities of the financial liabilities at 31 December 2016 and 2015 is as follows:

	2017	2018	2019	2020	2021	2022 and after	Total
At 31.12.16							
Trade and other payables	(4,072)	-	-	-	-	-	(4,072)
Loans and other financial payables	(3,327)	(3,371)	(3,499)	(2,914)	(2,678)	(5,709)	(21,498)
Financial derivatives	(16)	31	23	-	(11)	7	34
Other liabilities	(104)	(97)	(165)	(87)	(81)	(615)	(1,149)
Total (1)	**(7,519)**	**(3,437)**	**(3,641)**	**(3,001)**	**(2,770)**	**(6,317)**	**(26,685)**

	2016	2017	2018	2019	2020	2021 and after	Total
At 31 December 2015							
Trade and other payables	(4,008)	-	-	-	-	-	(4,008)
Loans and other financial payables	(3,165)	(3,247)	(3,220)	(3,420)	(3,017)	(6,210)	(22,279)
Financial derivatives	(1)	(16)	(1)	73	-	(15)	40
Other liabilities	(65)	(60)	(59)	(125)	(51)	(366)	(726)
Total (1)	**(7,239)**	**(3,323)**	**(3,280)**	**(3,472)**	**(3,068)**	**(6,591)**	**(26,973)**

(1) The amounts are undiscounted contractual cash flows and, accordingly, differ from the amounts included in the balance sheet and in Note 16.

Capital management

The main purpose of capital management of Gas Natural Fenosa is to ensure a financial structure that can optimise capital cost and maintain a solid financial position, in order to combine value creation for the shareholder with the access to the financial markets at a competitive cost to cover financing needs.

Gas Natural Fenosa considers the following to be indicators of the objectives set for capital management: maintaining, after the acquisition of Unión Fenosa, a long-term leverage ratio of approximately 50%.

The long-term credit rating of Gas Natural Fenosa is as follows:

	2016	2015
Moody's	Baa2	Baa2
Standard & Poor's	BBB	BBB
Fitch	BBB+	BBB+

Its leverage rating is as follows:

	2016	2015
Net borrowings:	**15,423**	**15,648**
Non-current borrowings (Note 16)	15,003	15,653
Current borrowings (Note 16)	2,599	2,595
Cash and cash equivalents (Note 12)	(2,067)	(2,390)
Derivatives (Note 17)	(112)	(210)
Net equity:	**19,005**	**18,518**
Equity holders of the Company (Note 13)	15,225	14,367
Non-controlling interests (Note 13)	3,780	4,151
Leverage (Net borrowings / (Net borrowings + Net equity))	**44.8%**	**45.8%**

Derivative financial instruments

The breakdown of derivative financial instruments by category and maturity is as follows:

	At 31.12.16		At 31.12.15	
	Assets	Liabilities	Assets	Liabilities
Derivatives qualifying for hedge accounting	**111**	**62**	**208**	**167**
Cash flow hedges				
- Interest rate	85	22	25	41
- Commodity prices	-	-	-	2
Fair value hedges				
- Interest rate and exchange rate	26	40	183	124
Other financial instruments	**-**	**-**	**-**	**-**
Derivative financial instruments – non current	**111**	**62**	**208**	**167**
Derivatives qualifying for hedge accounting	**46**	**61**	**5**	**190**
Cash flow hedges				
- Interest rate	1	6	-	1
- Exchange rate	9	-	1	1
- Commodity prices	36	42	1	174
Fair value hedges				
- Interest rate and exchange rate	-	-	-	-
- Exchange rate	-	13	3	14
Other financial instruments	**1**	**5**	**2**	**10**
- Commodity prices	1	5	2	9
- Exchange rate	-	-	-	1
Derivative financial instruments – current	**47**	**66**	**7**	**200**
Total	**158**	**128**	**215**	**367**

The fair value of derivatives is determined based on observable variables in an active market (Level 2).

“Other financial instruments” includes the derivatives not qualifying for hedge accounting.

The impact on the Consolidated Income Statement of derivative financial instruments is as follows:

	2016		2015	
	Operating profit/(loss)	**Net financial income/(expense)**	**Operating profit/(loss)**	**Net financial income/(expense)**
Cash flow hedges	(81)	(25)	61	(15)
Fair value hedges	(10)	(28)	(18)	(36)
Other financial instruments	(25)	(1)	(2)	15
Total	**(116)**	**(54)**	**41**	**(36)**

The breakdown of the derivative financial instruments at 31 December 2016 and 2015, their fair value and the breakdown by maturity of their notional values are as follows:

	Fair value	**31 December 2016 Notional amount**						
		2017	**2018**	**2019**	**2020**	**2021**	**after**	**Total**
INTEREST RATE HEDGES:								
Cash flow hedges:								
Financial swaps (EUR)	23	684	-	-	-	-	1,500	2,184
Financial swaps (USD)	(2)	223	259	-	-	-	-	482
Financial swaps (MXN)	32	57	200	-	-	-	-	257
Financial swaps (CHF)	26	-	-	204	-	-	-	204
Financial swaps (NOK)	(21)	-	-	-	-	-	101	101
Financial swaps (COP)	-	-	-	-	-	-	-	-
FOREIGN EXCHANGE HEDGES:								
Cash flow hedges:								
Foreign exchange insurance (USD)	9	213	-	-	-	-	-	213
Foreign exchange insurance (GBP)	-	13	-	-	-	-	-	13
Fair value hedges:								
Financial swaps (CLP)	(14)	-	-	60	-	160	-	220
Financial swaps (MXN)	-	-	-	-	-	-	-	-
Foreign exchange insurance (BRL)	-	-	-	-	-	-	-	-
Foreign exchange insurance (USD)	(13)	374	-	-	-	-	-	374
Foreign exchange insurance (DHN)	-	7	-	-	-	-	-	7
COMMODITIES HEDGES:								
Cash flow hedges:								
Commodities price derivatives (EUR)	23	309	54	4	-	-	-	367
Commodities price derivatives (USD)	(29)	281	139	131	-	-	-	551
OTHER:								
Commodities price derivatives (EUR)	(4)	13	-	-	-	-	-	13
Foreign exchange derivatives (USD)	-	-	-	-	-	-	-	-
TOTAL	**30**	**2,174**	**652**	**399**	**-**	**160**	**1,601**	**4,986**

	Fair value	31 December 2015 Notional amount						
		2016	**2017**	**2018**	**2019**	**2020**	**after**	**Total**
INTEREST RATE HEDGES:								
Cash flow hedges:								
Financial swaps (EUR)	(13)	255	684	-	-	-	-	939
Financial swaps (USD)	(5)	3	216	251	-	-	-	470
Financial swaps (MXN)	0	-	53	-	-	-	-	53
Financial swaps (CHF)	24	-	-	-	204	-	-	204
Financial swaps (NOK)	(24)	-	-	-	-	-	101	101
Financial swaps (COP)	1	23	120	-	-	-	-	143
FOREIGN EXCHANGE HEDGES:								
Cash flow hedges:								
Foreign exchange insurance (USD)	-	482	-	-	-	-	-	482
Foreign exchange insurance (GBP)	-	1	-	-	-	-	-	1
Fair value hedges:								
Financial swaps (CLP)	60	-	-	-	722	-	160	882
Financial swaps (MXN)	(1)	-	-	222	-	-	-	222
Foreign exchange insurance (BRL)	-	13	-	-	-	-	-	13
Foreign exchange insurance (USD)	(11)	833	-	-	-	-	-	833
Foreign exchange insurance (DHN)	-	6	-	-	-	-	-	6
COMMODITIES HEDGES:								
Cash flow hedges:								
Commodities price derivatives (EUR)	(20)	219	40	-	-	-	-	259
Commodities price derivatives (USD)	(155)	215	228	120	123	-	-	686
OTHER:								
Commodities price derivatives (EUR)	(7)	103	27	-	-	-	-	130
Foreign exchange derivatives (USD)	(1)	1	-	-	-	-	-	1
TOTAL	**(152)**	**2,154**	**1,368**	**593**	**1,049**	**-**	**261**	**5,425**

Note 18. Other non-current liabilities

The breakdown of this heading at 31 December 2016 and 2015 is as follows:

	At 31.12.16	At 31.12.15
Finance lease liabilities (1)	965	582
Deposits and guarantees deposits (2)	221	215
Derivative financial instruments (see Note 17)	-	2
Other liabilities (3)	145	145
Total	**1,331**	**944**

There are no significant differences between the carrying values and the fair values of the items in the account “Other non-current liabilities”.

(1) Finance lease liabilities

The main finance lease liabilities recognised in this item at 31 December are as follows:

- In 2003 Gas Natural Fenosa acquired two gas transport tankers to transport liquefied natural gas with a capacity of 276,000 m^3 through finance lease agreements. The duration of the contracts is 20 years, maturing in 2023.

- In 2007 and 2009 two 138,000 m^3 tankers were acquired, together with Repsol, under 25-year time-charter agreements, extendable for consecutive 5-year periods. In 2014, Gas Natural Fenosa and Shell entered into an agreement, as part of the sale of the Repsol Group's liquefied natural gas business, to obtain exclusive use of each of the two tankers, Gas Natural Fenosa using the tanker acquired in 2009 under a time charter expiring in 2029 and extendable for consecutive five-year periods.

- In March 2014, Gas Natural Fenosa acquired a 173,000 m^3 tanker to carry liquefied natural gas under an 18-year finance lease expiring in 2032.

- In September and November 2016, Gas Natural Fenosa acquired two 176,300 m^3 tankers to carry liquefied natural gas under an 20-year finance leases expiring in 2036.

Minimum lease payments are as follows:

	At 31.12.16			At 31.12.15		
	Nominal value	Discount	Present value	Nominal value	Discount	Present value
Less than 1 year	110	(7)	**103**	68	(4)	**64**
Between 1 and 5 years	439	(86)	**353**	271	(51)	**220**
More than 5 years	1,190	(578)	**612**	640	(278)	**362**
Total	**1,739**	**(671)**	**1,067**	**979**	**(333)**	**646**

The effective average interest rate on the liabilities for finance lease agreements at 31 December 2016 is 6.5% (6.5% at 31 December 2015).

(2) Deposits and guarantees deposits

The item “deposits and guarantees deposits” basically includes amounts received from customers under contracts for the supply of electricity and natural gas, deposited with the competent Public Administrations (Note 8) as stipulated by law, and amounts received from customers to secure supplies of liquefied natural gas.

(3) Other liabilities

This includes the purchase commitment (without a premium) made to Sinca Inbursa, S.A. de C.V. (Inbursa) on 22 September 2008 covering 14.125% of Gas Natural México, S.A. de C.V. and 14% of Sistemas de Administración, S.A. de C.V. The maturity date of this commitment is May 2019, when Ibursa will be able to offer all shares held at that time to Gas Natural Fenosa, which will be obligated to purchase them. The acquisition price will be the market value of each share, based on the investees' results. As a result of the commitment, this sale is recognized as a deferred payment and the repurchase commitment percentage is still allocated to the Parent company. The liability recognised in this item at 31 December 2016 totals Euros 74 million, representing the present value of the amount repayable (Euros 72 million at 31 December 2015).

Note 19. Trade and other payables

The breakdown at 31 December 2016 and 2015 is as follows:

	At 31.12.16	At 31.12.15
Trade payables	3,204	3,049
Trade payables with related parties (Note 33)	51	43
Amounts due to associates	19	4
Trade payables	3,274	3,096
Public Administration	519	477
Derivative financial instruments (see Note 17)	48	183
Amounts due to employees	96	95
Other creditors	29	22
Other creditors	692	777
Current tax liabilities	106	135
Total	**4,072**	**4,008**

The fair value and carrying value of these liabilities do not differ significantly.

Disclosure of deferrals of payment to suppliers Additional Provision 3 “Duty of disclosure” of Law 15/2010 of July 5

The total amount of payments made during the year, with details of periods of payments, according to the maximum legal limit under Law 15/2010 of July 5, which laid down measures against slow payers, is as follows:

	2016	2015
	Amount	**Amount**
Total payments	11,533	14,647
Total payments outstanding	417	464
Average supplier payment period (days) (1)	28	29
Transactions paid ratio (days) (2)	27	29
Transactions pending payment ratio (days) (3)	30	30

(1) Calculated taking into account paid amounts and pending payment amounts.
(2) Supplier payment period in the operations paid in the exercise
(3) Average age of supplier pending payment amounts

Note 20. Other current liabilities

The breakdown at 31 December 2016 and 2015 is as follows:

	At 31.12.16	At 31.12.15
Dividend payable	37	421
Expenses accrued pending payment	174	233
Finance lease liabilities (Note 18)	103	64
Derivative financial instruments (Note 17)	-	3
Other liabilities	33	31
Total	**347**	**752**

Note 21. Tax situation

Gas Natural SDG, S.A. is the parent of Tax Consolidated Group 59/93, which includes all the companies resident in Spain that are at least 75% directly or indirectly owned by the parent company and that fulfil certain requirements, entailing the overall calculation of the group's taxable income, deductions and tax credits. The Tax Consolidated Group for 2016 is indicated in Appendix III.

The rest of the Gas Natural Fenosa companies file individual tax returns under their respective regimes, barring a number of Italian subsidiaries that form their own tax consolidated group.

Set out below is the reconciliation between “Income tax” recognised and the amount that would be obtained by applying the nominal tax rate in force in the parent company's country (Spain) to “Profit/(loss) before taxes" for 2016 and 2015:

	2016	%	2015	%
Income before taxes	**2,083**		**2,363**	
Statutory tax	**521**	**25.0**	**662**	**28.0**
Effect of net results under equity method	25	1.2	1	-
Application of tax rates of foreign entities	(20)	(1.5)	(45)	(1.9)
Tax credits	(13)	(0.1)	(39)	(1.7)
Reversal deferred tax on Transnet merger	(128)	(6.1)	-	-
Remeasurement deferred taxes Colombia	21	1.0	-	-
Other items	10	0.5	(6)	(0.2)
Income tax	**416**	**20.0**	**573**	**24.2**

Breakdown of current/deferred expense:

	2016	2015
Current income tax	474	662
Deferred income tax	(58)	(89)
Income tax	**416**	**573**

On 27 November 2014, Corporate Income Tax Law 27/2014 was approved, stipulating a general tax rate cut from 30% to 28% for 2015 and to 25% as from 2016. This tax rate reduction from 28% to 25% in Spain was partially mitigated by a rise in the tax rate in Chile from 22.5% to 24%.

As part of a business reorganisation process in Chile and corporate structure simplifcation, on 14 December 2016, Compañía General de Electricidad, S.A. carried out a vertical merger with its subsidiary Transnet. The resulting goodwill has been allocated to the value for tax purposes of the non-monetary assets received from the absorbed company (electricity transmission networks), subject to the limit of its market value, equivalent to its carrying amount at the date of the operation, generating a decrease in deferred tax liabilities of Euros 128 million with exchange to the heading "Income tax expense" of the Consolidated income statement.

On 29 December 2016, Colombia published Act no. 1819 on Structural Tax Reform, which establishes a progressive reduction in the income tax rate in 2017, 2018 and 2019. As a result, deferred taxes were re-measured using the projected reversal rate, resulting in an amount of Euros 21 million of additional corporate income tax expenses being recognised in the consolidated income statement.

Royal Decree-Act 3/2016, adopting tax-related measures to strengthen public finances, was enacted on 3 December 2016; it made significant amendments to the law on corporate income tax. Those amendments include: the obligation, from 1 January 2016, to reverse, within at most five years, any impairment recognised on holdings that were deductible prior to 2013; limitation of tax loss carryforwards for large companies to 25% of the preceding taxable base; and limitation of the application of the earned or unused internal or international double-taxation tax credit to 50% of the pre-existing gross tax payable. Additionally, with effects from 1 January 2017, the transmissions losses of participations will not be deducted. In 2016 these measures had a non-material impact in the financial statements of Gas Natural Fenosa.

Income qualifying for the tax credit for reinvestment of extraordinary profits provided by Article 42 of the revised Corporate Income Tax Act introduced under Royal Decree-Law 4/2004 of March 5 (TRLIS) and the resulting investments made in previous periods are explained in the annual accounts for the relevant years. Set out below is a breakdown:

Year of sale	Amount obtained on the sale	Amount reinvested	Income qualifying for deduction	Year of reinvestment
2011	4	4	2	2011
2012	1	1	-	2012
2013	1	1	1	2013
2014	414	414	210	2014
Total	**420**	**420**	**213**	

The reinvestment was made in fixed assets used in business activities and was carried out by both the parent company the other companies included in the Consolidated Tax Group. by virtue of the provisions of article 75 of the Corporate Income Tax Act.

Income qualifying for the tax scheme for transfers of assets made in compliance with competition law (Additional Provision 4 of the revised CIT Act) and the investments in which it was used in prior years are explained below:

Year of sale	Amount obtained on the sale	Amount reinvested	Capital gain	Capital gain included in tax base	Capital gain pending inclusion in tax base
2002	917	917	462	18	444
2003	39	39	20	-	20
2004	292	292	177	9	168
2005	432	432	300	1	299
2006	309	309	226	-	226
2009	161	161	87	-	87
2010	799	799	560	-	560
2011	450	450	394	-	394
2012	38	38	32	-	32
TOTAL	**3,437**	**3,437**	**2,258**	**28**	**2,230**

The reinvestment was made in fixed assets related to economic activities carried out by the transferring Company or any other company included in the Consolidated Tax Group. by virtue of the provisions of article 75 of the Corporate Income Tax Act.

The breakdown of the tax effect relating to each component of "Other comprehensive income" of the Consolidated Statement of Comprehensive Income for the year is as follows:

	At 31.12.16			At 31.12.15		
	Gross	Tax effect	Net	Gros s	Tax effect	Net
Measurement of available-for-sale financial assets	4	(1)	3	5	(1)	4
Cash flow hedges	228	(61)	167	(164)	39	(125)
Translation differences	428	-	428	(320)	-	(320)
Actuarial gains and loss (Note 15)	(51)	13	(38)	7	(2)	5
Total	**609**	**(49)**	**560**	**(472)**	**36**	**(436)**

Set out below is an analysis of and movements in deferred taxes:

Deferred tax assets	Provisions for employee benefit obligations	Provision of depreciation of receivables and other provisions	Tax- loss carry-forwards (1)	Depreciation differences	Financial instruments and asset valuation	Other	Total
At 1.01.15	**204**	**236**	**106**	**416**	**43**	**129**	**1,134**
Charged/(credited) to income statement (2)	(11)	42	(7)	(79)	38	16	(1)
Business combinations (Note 31)	-	-	6	1	-	2	9
Movements related to equity adjustments	(2)	-	-	-	1	-	(1)
Translation differences	(10)	(28)	(2)	(8)	(12)	(2)	(62)
Assets and liabilities held for sale (Note 9)	(1)	(1)	(10)	(2)	-	-	(14)
Transfers and other	(1)	9	-	-	(3)	-	5
At 31.12.15	**179**	**258**	**93**	**328**	**67**	**145**	**1,070**
Charged/(credited) to income statement	(7)	(10)	(16)	(14)	(39)	(5)	(91)
Business combinations (Note 31)	-	-	-	-	-	-	-
Movements related to equity adjustments	17	-	-	-	(4)	-	13
Translation differences	5	13	5	2	(6)	(1)	18
Assets and liabilities held for sale (Note 9)	-	-	-	-	-	-	-
Transfers and other (3)	(33)	(96)	(15)	(9)	21	(6)	(138)
At 31.12.16	**161**	**165**	**67**	**307**	**39**	**133**	**872**

(1) At 31 December 2016 and 2015, the tax credits relate mainly to tax loss carryforwards in the CGE Group generated basically as a result of taking accelerated depreciation for tax purposes. The recovery of the tax credits is reasonably assured since there is no expiration date and they relate to companies that have historically posted recurring profits.

(2) The reversal of the application of the temporary 30% limit on the tax deduction of depreciation charges stipulated in Law 16/2012 was included in 2015.

(3) Includes mainly the derecognition of the balances of Electricaribe due to deconsolidation of that stake after the loss of control (Note 8).

Deferred tax liabilities	Depreciation differences	Deferred capital gains	Business combination valuation (1)	Financial instruments and asset valuation	Other	Total
At 1.01.15	**1,043**	**210**	**1,448**	**6**	**91**	**2,798**
Charged/(credited) to income statement	(2)	(1)	(66)	(5)	(16)	(90)
Business combinations (Note 31)	1	-	15	-	-	16
Movements related to equity adjustments	(1)	-	-	(2)	-	(3)
Translation differences	(39)	1	(9)	-	3	(44)
Assets and liabilities held for sale (Note 9)	(111)	-	(20)	-	(3)	(134)
Transfers and other	2	(1)	-	(1)	-	-
At 31.12.15	**893**	**209**	**1,368**	**(2)**	**75**	**2,543**
Charged/(credited) to income statement (2)	(119)	-	(51)	1	20	(149)
Business combinations (Note 31)	-	-	8	-	-	8
Movements related to equity adjustments	-	-	-	20	-	20
Translation differences	61	-	6	-	4	71
Assets and liabilities held for sale (Note 9)	-	-	-	-	-	-
Transfers and other (3)	-	-	(9)	25	-	16
At 31.12.16	**835**	**209**	**1,322**	**44**	**99**	**2,509**

(1) The item "Business combination valuation" includes the tax effect of the portion of the merger difference resulting from the absorption of Unión Fenosa, S.A. by Gas Natural SDG, S.A. in 2009, allocated to net assets acquired, which is not expected to have tax effects. It also includes the tax effect of the allocation of the acquisition price of CGE by Gas Natural Fenosa carried out in 2014 and of various prior acquisitions completed by CGE.

(2) The item "Depreciation differences" includes the decrease in deferred tax liabilities of Euros 128 million resulting from the Transnet merger mentioned above.

(3) Includes mainly the derecognition of the balances of Electricaribe due to deconsolidation of that stake after the loss of control (Note 8).

At 31 December 2016 the tax credits that have not been recorded totalled Euros 30 million (Euros 27 million at 31 December 2015).

In October 2015, the tax inspection of Gas Natural SDG, S.A. and Gas Natural Distribución Latinoamérica, S.A. (formerly Gas Natural Internacional SDG, S.A.) for corporate income tax (2009 and 2010) and value added tax (2010) came to an end, no relevant matters having been identified and without any significant impacts on the consolidated income statement.

Gas Natural SDG, S.A.'s tax group is open to inspection for 2011 and subsequent periods and the taxes to which it is subject.

In general, the other Gas Natural Fenosa companies are open to inspection for the following periods:

Country	Period
Argentina	2010-2016
Brazil	2011-2016
Colombia	2014-2016
Chile	2013-2016
Italy	2012-2016
Mexico	2011-2016
Panama	2010-2016

As a result, among other things, of the different interpretations to which current tax legislation lends itself, additional liabilities could arise as a result of an inspection. In any case, Gas Natural Fenosa considers that any such liabilities will not have a significant effect on these annual accounts.

Gas Natural Fenosa has recorded provisions for obligations deriving from a number of tax claims. At 31 December 2016, the main tax litigation affecting the Group relates to the tax credit for export activities. As a result of the inspection proceedings on tax periods 2003 to 2008, the Inspectorate has questioned the admissibility of the tax credit for export activities applied by Gas Natural SDG, S.A.; the tax assessments have been contested and appeals have been lodged at the Tax and Treasury Court and the Supreme Court. At 31 December 2016, the assessments, including interest, amounted to Euros 93 million and are fully provisioned (Note 15).

Note 22. Sales

The breakdown of this heading for 2016 and 2015 is as follows:

	2016	2015
Sales of gas and connections to distribution networks	11,531	13,904
Sales of electricity and access to distribution networks	10,106	10,575
Rental of facilities, maintenance and other services	1,472	1,445
Other sales	75	91
Total	**23,184**	**26,015**

Note 23. Procurements

The breakdown of this heading for 2016 and 2015 is as follows:

	2016	2015
Energy purchases	12,782	15,075
Access to transmission networks	2,152	2,176
Other purchases and Stock variation	486	746
Total	**15,420**	**17,997**

Note 24. Other operating income

The breakdown of this heading for 2016 and 2015 is as follows:

	2016	2015
Other management income	261	252
Operating grants	4	5
Total	**265**	**257**

The item "Other management income" includes income from services relating to the construction or improvement of concession infrastructures under IFRIC 12 in the amount of Euros 141 million (Euros 143 million in 2015); whose fair value is estimated by reference to the expenses incurred (Note 26), with no margin.

Note 25. Personnel costs

The breakdown of this heading for 2016 and 2015 is as follows:

	2016	2015
Wages and salaries	857	820
Social security costs	136	134
Defined contribution plans	44	41
Defined benefit plans (Note 15)	9	10
Own work capitalised	(116)	(113)
Other	83	81
Total	**1,013**	**973**

The average number of employees of Gas Natural Fenosa in 2016 was 19,661 and 21,542 in 2015 and its breakdown by category is as folows:

	2016	2015
Executives	1,477	1,500
Middle management	3,098	3,631
Specialized technicians	5,281	5,769
Workers	9,805	10,642
Total	**19,661**	**21,542**

The average number of employees in the year with a disability equal to or greater than 33% is as follows, by category:

	2016	2015
Executives	7	6
Middle management	25	23
Specialized technicians	64	60
Workers	164	174
Total	**260**	**263**

The number of employees of Gas Natural Fenosa at the end of 2016 and 2015 broken down by category, gender and geographical area, is as follows:

	2016		2015	
	Male	**Female**	**Male**	**Female**
Executives	1,091	371	1,087	360
Middle management	2,297	607	2,402	648
Specialized technicians	3,479	1,757	3,611	1,702
Workers	5,515	2,112	7,386	2,743
Total	**12,382**	**4,847**	**14,486**	**5,453**

	2016	2015
Spain	7,452	7,560
Rest of Europe	1,252	1,210
Latin American	7,612	10,213
Rest	913	956
Total	**17,229**	**19,939**

At the end of 2016, the number of employees, which is not included as a consequence of the loose of control (Note 8), was 1,478 persons.

The calculation of the average number of employees does not take into account the average number of employees of equity-consolidated companies, which amounts to 920 persons (1,104 persons at 31 December 2015). It also did not consider the number of employees of those companies at the year end, amounting to 848 persons at 31 December 2016 (1,151 persons at 31 December 2015).

Note 26. Other operating expenses

The breakdown of this heading for 2016 and 2015 is as follows:

	2016	2015
Taxes	483	484
Operation and maintenance	372	361
Commercial services and advertising	357	353
Bad debt provision (Note 11)	327	258
Professional services and insurance	200	193
Construction or improvements services of IFRIC 12 Concessions (Note 24)	141	143
Supplies	113	121
Services to customers	86	70
Operating leases (1)	57	61
Other	331	316
Total	**2,467**	**2,360**

(1) In Note 35 are detail of the minium payments that can not be cancelled of the operating leases.

Note 27. Gain/(loss) on disposals of tangible fixed assets

It includes the gain of Euros 51 million from the sale of four buildings in Madrid for Euros 206 million (Note 6).

Note 28. Other income

In 2016, this item relates to the pre-tax gain of Euros 128 million from the sale of the interest in GNL Quintero, S.A. (Chile) for Euros 182 million (Note 7).

Also included is the transfer of translation differences accumulated in net equity on the Electricaribe stake up to the point that Gas Natural Fenosa lost control (Note 8), with a negative impact of Euros 38 million.

In 2015, this item related to the pre-tax gain of Euros 5 million from the sale of the 44.9% stake in the company Barras Eléctricas Galaico Asturianas, S.A. to the Viesgo Group for Euros 97 million (Note 7).

Note 29. Net financial income

The breakdown of this heading for 2016 and 2015 is as follows:

	2016	2015
Dividends	14	12
Interest income	32	22
Other	85	106
Total financial income	**131**	**140**
Financial expense from borrowings	(779)	(845)
Interest expenses of pension plans and other post-employment benefits	(32)	(30)
Other financial expenses	(143)	(157)
Total financial expenses	**(954)**	**(1,032)**
Variations in the fair value of derivate financial instruments (Note 17)	(2)	(1)
Net exchange gains/losses	-	(1)
Net financial income	**(825)**	**(894)**

Note 30. Cash generated from operating activities

The breakdown of cash generated from operations in 2016 and 2015 is as follows:

	2016	2015
Income before tax	**2,083**	**2,363**
Adjustments to net income:	**2,495**	**2,599**
Depreciation, amortisation and impairment expenses (Note 5, 6 and 9)	1,759	1,791
Other adjustments to net income:	736	808
Net financial income (Note 9 and 29)	825	918
Profit of entities recorded by equity method (Note 7 and 9)	98	3
Transfer of deferred income (Note 14)	(43)	(64)
Other results (Note 28)	(122)	(5)
Net variation in Provisions	(76)	(91)
Pre-tax profit/(loss) from discontinued activities (Note 9)	54	47
Changes in working capital (excluding the effects of adjustments in consolidation scope and exchange differences):	**5**	**(75)**
Inventories	135	251
Trade and other receivables	(316)	228
Trade and other payables	186	(554)
Other cash flows from operating activities:	**(1,208)**	**(1,387)**
Interest paid	(793)	(898)
Interest collected	31	24
Dividends collected	79	82
Income tax payments	(525)	(595)
CASH FLOWS GENERATED FROM OPERATING ACTIVITIES	**3,375**	**3,500**

Note 31. Business combinations

Year 2016

Vayu Limited

On 29 July 2016 Gas Natural Fenosa completed the purchase of 100% of the Irish gas and electricity supply company Vayu Limited (Vayu) under the new strategic plan which envisages growth in the energy supply business in Europe. This transaction will complement the Group's position in the European markets in which it is already present (France, Italy, Belgium, Netherlands, Portugal, Germany and Luxembourg) will permit to achive the saving synergies arising from the integration and facilitates the development of GNL's trading and operations activity. Vayu's share in the supply of gas in Ireland to major industrial and commercial customers is 15%, while its share of electricity sales is around 6%. The total cost of the business combination amounts to Euros 32 million. Goodwill has been calculated at Euros 16 million as the difference between the acquisition cost and interest in the fair value of the identifiable assets and liabilities existing at the transaction date.

The net assets acquired at 30 September 2016 and goodwill break down as follows:

Acquisition cost	32
Fair value of the net assets	16
Goodwill (Note 5)	**16**

	Fair value	**Carrying amount**
Intangible assets (Note 5)	14	-
Other current assets	12	12
Cash and cash equivalents	10	10
TOTAL ASSETS	**36**	**22**
Deferred tax liabilities (Note 21)	2	-
Other current liabilities	18	18
TOTAL LIABILITIES	**20**	**18**
Net assets acquired	**16**	**4**
Fair value of the net assets acquired	**16**	
Acquisition price	32	
Cash and cash equivalents in subsidiary acquired	10	
Net acquisition cost	**22**	

If the operation had taken place on 1 January 2016, the impact of the operation on revenue and consolidated profit would not have been significant.

During the process for the assignment of the purchase price, assets were identified subject to restatement on the basis of the balance sheet of Vayu Limited at 31 July 2016. Vayu Limited 's net assets have basically been measured using the following methodology:

- The business was measured following the revenue approach and in particular, through the discounted cash flow method, based on Level 3 inputs as the data were not observable on the market.
- The main parameters used in the measurement were a discount rate of 12.1% and a growth rate of 0%.
- The most sensitive assumptions included in the projections and which are based on sector forecasts and the analysis of historical information relate to the evolution of electricity and gas margins.

As a result of the assignment process, an intangible asset restatement has been recognised with respect to the value of the gas and electricity customer portfolio and the value of agreements to acquire energy. The deferred tax liabilities relating to revaluations were also recognised.

At the acquisition date, no contingent liabilities have been identified and therefore no provisions have been recognised in addition to the amounts included in the carrying amount.

Provisional goodwill resulting from this business combination is attributable to the high profitability of the acquired business described above, to the benefits and synergies that are expected to arise from the aforementioned integration, and from the fact that Vayu has a workforce with considerable experience in the energy markets.

Ibereólica Cabo Leones II S.A.

At 15 December 2015, Gas Natural Fenosa reached an agreement to acquire 15% of Ibereólica Cabo Leones II S.A. through its subsidiary Global Power Generation Chile S.p.A. This business combination was recognised definitively in 2016 since that was the year in which key information required for such recognition was obtained and in which the 12-month period from the acquisition data as established in IFRS 3 expired.

Cabo Leones II is a 204 MW wind farm which, in the 2016 power auctions, was awarded a contract to supply 555 GWh per year to the Chilean distribution system starting in 2020.

With this acquisition, Gas Natural Fenosa fulfilled its commitment to enter the Chilean power generation market.

The total cost of the business combination amounts to Euros 11 million. Goodwill has been calculated at Euros 3 million as the difference between the acquisition cost and the interest in the fair value of the identifiable assets and liabilities existing at the transaction date.

The net assets acquired at 1 January 2016 and goodwill break down as follows:

Acquisition cost	11
Fair value of the net assets	8
Goodwill (Note 5)	**3**

	Fair value	Carrying amount
Intangible assets (Note 5)	23	1
TOTAL ASSETS	**23**	**1**
Deferred tax liabilities (Note 21)	6	-
Trade and other payables	1	1
TOTAL LIABILITIES	**7**	**1**
Net assets acquired	**16**	**-**
Non-controlling interests (Note 13)	**8**	
Fair value of the net assets acquired	**8**	
Acquisition price	11	
Cash and cash equivalents in subsidiary acquired	-	
Net acquisition cost	**11**	

During the process for the assignment of the purchase price, assets qualifying for revaluation were identified on the basis of the balance sheet of Ibereólica Cabo Leones II S.A. at 1 January 2016, corresponding to intangible assets consisting of the necessary permits to operate the wind farm. The deferred tax liabilities relating to revaluations were also recognised.

Those net assets of Ibereólica Cabo Leones II S.A. were measured basically as follows:

– The business was measured following the revenue approach and in particular, through the discounted cash flow method, based on Level 3 inputs as the data were not observable on the market.

– The main parameters used in the measurement were a discount rate of 9.2% and a growth rate of 0%.

The most sensitive assumptions included in the projections, which are based on sector forecasts and the analysis of historical information, relate to the evolution of electricity prices in the Chilean market and the estimated hours of wind during the facility's useful life.

Other acquisitions

In December 2016, Gas Natural Fenosa acquired, through GPG, 100% of the companies Inca de Varas I, S.A. and Inca de Varas II, S.A. for an initial amount of Euros 1 million corresponding basically to intangible assets. These companies are initiating the development of a photovoltaic solar generation facility in Chile with a capacity of 120 MW.

On the other hand, in December 2016, Gas Natural Fenosa acquired, through GPG, 85% of the companies Sobral I Solar Energia SPE Ltda. and Sertao I Solar Energia SPE Ltda., for a joint amount of Euros 1 million corresponding basically to intangible assets. No goodwill arose on the operation. These companies are commencing the development of two photovoltaic solar generation facilities in Brazil with a joint capacity of 60 MW.

Had these operations taked place on 1 January 2016, the impact on revenue and consolidated profit would not have been significant.

All these business combinations have been accounted for provisionally, as the 12-month period from the acquisition date established under IFRS 3 has still not terminated.

During 2016, payments on investments in companies, net of cash and equivalents acquired amounted to Euros 331 million, mainly due to the acquisitions of Gas Natural Chile, S.A. (Nota 9) and Vayu Limited.

Year 2015

Gecal Renovables, S.A.

In June 2015 Gas Natural Fenosa entered into an agreement to acquire 100% of Gecal Renovables, S.A. (Gecalsa). The transaction was completed on 13 October 2015 although for accounting purposes, the business combination date was considered to be 30 September 2015 on the understanding that the difference between both dates was insignificant. The total cost of the business combination amounts to Euros 104 million. Goodwill was calculated at Euros 14 million as the difference between the acquisition cost and interest in the fair value of the identifiable assets and liabilities existing at the transaction date.

The net assets acquired at 30 September 2015 and goodwill break down as follows:

Acquisition cost	104
Fair value of the net assets	90
Goodwill (Note 5)	**14**

	Fair value	**Carrying amount**
Intangible assets (Note 5)	89	2
Property, plant and equipment (Note 6)	160	160
Investments carried under the equity method (note 7)	6	2
Non-current financial assets	2	2
Deferred tax assets (Note 21)	9	9
Other current assets	13	13
Cash and cash equivalents	12	12
TOTAL ASSETS	**291**	**200**
Non-controlling interests (Note 13)	5	-
Non-current financial liabilities (Note 16)	56	56
No-current provisions (Note 15)	3	3
Other non-current liabilities	2	2
Deferred tax liabilities (Note 21)	16	2
Current financial liabilities (Note 16)	109	109
Other current liabilities	10	10
TOTAL LIABILITIES	**201**	**182**
Net assets acquired	**90**	**18**
Fair value of the net assets acquired	**90**	
Acquisition price	104	
Cash and cash equivalents in subsidiary acquired	12	
Net acquisition cost	**92**	

The consolidated net profit for the period contributed since the acquisition date amounted to Euros 1 million. If the acquisition had taken place on 1 January 2015, consolidated revenue and EBITDA for the period would have increased by Euros 28 million and Euros 19 million respectively, and the impact on consolidated profit attributable to the parent company's shareholders would not have been significant.

Gecalsa operates 10 wind farms and a photovoltaic plant in Spain, which together have a net installed capacity of 222 MW.

During the process for the assignment of the purchase price, assets were identified subject to restatement on the basis of the balance sheet of Gecalsa at 30 September 2015. The measurement of Gecalsa's net assets was basically performed using the following methodology:

– The business was measured following the revenue approach and in particular, through the discounted cash flow method, based on Level 3 inputs as the data were not observable on the market.

– The main parameters used in the measurement were a discount rate of 10.3% and a growth rate of 0%.

– The most sensitive assumptions included in the projections and which were based on sector forecasts and the analysis of historical information, relate to the evolution of electricity price, and the operation and maintenance costs.

As a result of the assignment process, an intangible asset restatement was recognised with respect to the value of the necessary authorisations to operate the wind farms while deferred tax liabilities were been recognised on the restatements with no tax effect. In December 2015 the merger by absorption of Gecal Renovables, S.A and several subsidiaries by Gas Natural Fenosa Renovables S.L.U was initiated.

<u>Gas Directo, S.A.</u>

In July 2015 Gas Natural Fenosa acquired from Union Fenosa Gas, S.A. and Cepsa, S.A, their respective interests of 60% and 40% in the gas distribution company, Gas Directo, S.A., amounting to Euros 5 million. This operation did not trigger any goodwill. Before the operation Gas Natural Fenosa owned an indirect interest of 30% through its interest in Union Fenosa Gas, S.A. Therefore, the operation was treated as a business combination in stages, although the restatement for the different between the carrying amount of the interest and its fair value was not significant.
If the operation had taken place on 1 January 2015, the impact of the operation on revenue and consolidated profit would not have been significant.

<u>Genroque, S.L.</u>

In October 2015 Nueva Generadora del Sur, S.A., a company 50% owned jointly with another shareholder, that operated the 800 MW combined cycle plant in Gibraltar, spun off each of its two groups of 400 MW generators, along with the corresponding material and human resources in favour of two companies Genroque, S.L. and Puente Mayorga Generación, S.L., wholly owned respectively by Gas Natural Fenosa and the other shareholder, following the sale-purchase of 50 remaining. Therefore, for accounting purposes, the operation was considered a swap. Given that the net amount of the interest in Nueva Generadora del Sur, S.A. amounting to Euros 200 million was carried at fair value and that this agreed with the fair value of the business acquired (Genroque, S.L.), the operation did not generate profit or goodwill. On 30 December 2015 the Extraordinary General Shareholders' Meeting of Gas Natural Fenosa Generación, S.L.U. approved the merger by absorption of Genroque, S.L.U, in order to fully integrate the group attributed in the generation park of Gas Natural Fenosa.

If the operation had taken place on 1 January 2015, the impact of the operation on consolidated revenue and profit would not have been significant.

All the business combinations described in this note have been definitely recognised in 2016,without changes of the provisional accounting of 2015.

During 2015, payments on investments in companies, net of cash and equivalents acquired amounted to Euros 99 million, mainly due to Gecalsa and Gas Directo, S.A. acquisitions.

Note 32. Service concession arrangements

Gas Natural Fenosa manages a number of concessions containing provisions for the construction, operation and maintenance of facilities, as well as connection and power supply obligations during the concession period, in accordance with applicable regulations (Note 2). There follow details of the concession period and the period remaining to the expiration of concessions that are not indefinite:

Company	Activity	Country	Concession period	Initial remaining period
Gas Natural BAN, S.A.	Gas distribution	Argentina	35 (extendable 10)	11
Energía San Juan S.A.	Electricity distribution (CGE)	Argentina	60	40
Companhia Distribuidora de Gás do Río de Janeiro, S.A, Ceg Rio, S.A. and Gas Natural Sao Paulo Sul, S.A.	Gas distribution	Brazil	30 (extendable 20/30)	11-14
Gas Natural, S.A. ESP, Gas Natural del Oriente S.A. ESP, Gas Natural Cundiboyacense S.A. ESP and Gas Natural del Cesar S.A. ESP.	Gas distribution	Colombia	15-50 (extendable 20)	31
Unión Fenosa Generadora La Joya, S.A. and Unión Fenosa Generadora Torito, S.A.	Electricity generation	Costa Rica	20	6-14
Gas Natural Fenosa Generación S.L.U., S.A. and Gas Natural Fenosa Renovables, S.L.	Hydraulic power generation	Spain	14-65	6-47
Gas Natural Distribuzione SpA, Cetraro Distribuzione Gas, S.R.L., Favellato Reti Gas, S.R.L. and Cilento Reti Gas, S.R.L.	Gas distribution	Italy	11-30	22
Gas Natural México S.A. de C.V. and Comercializadora Metrogas S.A. de C.V.	Gas distribution	Mexico	30 (extendable 15)	11-22
Europe Maghreb Pipeline Ltd	Gas transportation	Morocco	25 (extendable)	5
Red Unión Fenosa, S.A.	Electricity distribution	Moldova	25 (extendable)	9
Empresa Distribuidora de Electricidad Metro Oeste, S.A. and Empresa Distribuidora de Electricidad Chiriqui, S.A.	Electricity distribution	Panama	15	12
Gas Natural Perú, S.A.	Gas distribution	Peru	20-year extendable	18

As indicated in Note 3.3.3.b, Gas Natural Fenosa applies IFRIC 12 “Service concession arrangements”, the intangible asset model being applicable basically to the gas distribution activities in Argentina, Brazil Italy and Peru, and to the electricity distribution activity in Argentina, while the financial asset model applies to the electricity generation business in Costa Rica.

The hydraulic power plant concessions in Spain (Note 3.3.4.b) fall out with the scope of IFRIC 12, due among other reasons to the fact that power selling prices are set in the market. The other international concessions fall out with the scope of IFRIC 12 because the grantor does not control a significant residual interest in the infrastructure at the concession end date and simultaneously determines the service price. Concession assets are still recognised in “Property, plant and equipment”.

Note 33. Related-party disclosures

Related parties are as follows:

- Significant shareholders of Gas Natural Fenosa. i.e. those directly or indirectly owning 5% or more, and those who, though not significant, have exercised the power to appoint a member of the Board of Directors.

  Based on this definition, the significant shareholders of Gas Natural Fenosa are Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona ("la Caixa"), Repsol, S.A. (Repsol) and Global Infrastructure Partners III (GIP) and subsidiaries.

- Directors and executives of the company, and their immediate families. The term "director" means a member of the Board of Directors; "executive" means a member of the Management Committee of Gas Natural Fenosa and the Internal Audit Director. The operations with directors and executives are disclosed in Note 34.

- Transactions between Group companies form part of ordinary activities and are effected at arm's length. Group company balances include the amount that reflects Gas Natural Fenosa's share of the balances and transactions with companies recorded under equity method.

The main aggregates for operations with significant shareholders are as follows:

	2016				2015		
	Significant shareholders			Group companies	Significant shareholders		Group companies
Expense and Income (thousand euros)	**"la Caixa"**	**Repsol**	**GIP (*)**		**"la Caixa"**	**Repsol**	
Financial expenses	2,799	-	-	100	3,532	-	336
Leases	-	-	-	5	-	-	2
Services received	15,160	8,853	-	25,954	14,009	5,148	32,229
Goods purchased	-	236,845	-	300,478	-	292,762	391,294
Other expenses (1)	24,541	-	-	-	28,705	-	-
Total expenses	**42,500**	**245,698**	**-**	**326,537**	**46,246**	**297,910**	**423,861**
Financial income	247	-	-	415	2,040	-	984
Leases	-	-	-	-	-	-	-
Services provided	462	1,363	-	22,079	561	374	24,619
Goods sold (finished or in progress)	1,243	694,196	-	44,240	-	878,022	62,196
Other income	-	-	-	2,007	-	-	2,007
Total income	**1,952**	**695,559**	**-**	**68,741**	**2,601**	**878,396**	**89,806**

	2016				2015		
	Significant shareholders			Group companies	Significant shareholders		Group companies
Other transactions (thousand euros)	**"la Caixa"**	**Repsol**	**GIP (*)**		**"la Caixa"**	**Repsol**	
Acquisition of property, plant and equipment, intangible assets or other assets (2)	-	424,651	-	-	-	74,209	-
Financing agreements: loans and capital contributions (lender) (3)	513,062	-	-	11,211	779,317	-	12,533
Sale of property, plant and equipment, intangibles or other assets (4)	274,528	-	-	-	458,355	-	-
Financing agreements: loans and capital contributions (borrower) (5)	123,316	-	-	-	205,384	-	-
Collateral and bank guarantees received	100,000	-	-	-	201,667	-	-
Dividends and other profits distributed	424,923	367,291	66,045	-	311,716	273,873	-
Other operations (6)	480,720	-	-	-	1,053,762	-	-

	2016				2015		
	Significant shareholders			Group companies	Significant shareholders		Group companies
Trade debtors and creditors (thousand euros)	**"la Caixa"**	**Repsol**	**GIP (*)**		**"la Caixa"**	**Repsol**	
Trade and other receivables	-	77,381	-	8,099	-	138,049	24,585
Trade and other payables	-	20,828	-	30,351	-	11,916	31,519

(*) Since 21 September 2016.

(1) Includes contributions to pension plans, group insurance policies, life insurance and other expenditure.

(2) Basically includes the purchase of LNG supply points under the agreement with Repsol Butano dated 30 September 2015, located in the area of influence of its existing distribution zones and it is being completed as the relevant administrative authorisations are obtained.

(3) Includes treasury and financial investments.

(4) Includes basically the assignment of debt claims (factoring without recourse) with “la Caixa” each of the years.

(5) At 31 December 2016, credit lines contracted with ”la Caixa” amounted to Euros 569,000 thousand (Euros 569,000 thousand at 31 December 2015), of which no amounts having been utilised. ”la Caixa” also has shares of other loans totalling Euros 123,316 thousand. At 31 December 2015, its shares in other loans amounted to Euros 205,384 thousand.

(6) At 31 December 2016, the item “Other transactions” with ”la Caixa” includes the amount of Euros 348,962 thousand in respect of foreign exchange hedges (Euros 771,746 thousand at 31 December 2015) and Euros 131,758 thousand in respect of interest rate hedges (Euros 282,016 thousand at 31 December 2015).

Note 34. Disclosures regarding members of the Board of Directors and the Executive personnel

Remuneration of the members of the Board of Directors

In accordance with the By-laws and the General Meeting resolution of 14 May 2015, the Company may earmark a maximum of Euros 5 million for Board directors' remuneration each year.

The amount accrued to the members the Board of Directors of Gas Natural SDG, S.A. as members of the Board of Directors, Executive Committee (EC), Audit Committee (AC) and Appointments and Remuneration Committee (A&RC) totalled Euros 4,573 thousand (Euros 4,205 thousand in 2015), broken down as follows in Euros:

	Office	Board	EC	AC	A&RC	Total
Mr. Isidro Fainé Casas [1]	Chairman	280,500	200,000	-	-	480,500
Mr. Salvador Gabarró Serra [2]	Chairman	400,000	400,000	-	-	800,000
Mr. Josu Jon Imaz San Miguel [3]	First Deputy Chairman	46,000	46,000	-	-	92,000
Mr. Antonio Brufau Niubó [4]	Deputy Chairman	92,000	-	-	18,182	110,182
Mr. William Alan Woodburn [3]	Second Deputy Chairman	46,000	46,000	-	9,091	101,091
Mr. Rafael Villaseca Marco	Chief Executive Officer	126,500	126,500	-	-	253,000
Mr. Ramón Adell Ramón	Director	126,500	126,500	40,000	-	293,000
Mr. Enrique Alcántara-García Irazoqui	Director	126,500	92,000	14,545	-	233,045
Mr. Xabier Añoveros Trías de Bes	Director	126,500	-	14,545	-	141,045
Mr. Marcelino Armenter Vidal [3]	Director	46,000	46,000	-	-	92,000
Mr. Mario Armero Montes [3]	Director	46,000	-	-	-	46,000
Mr. Francisco Belil Creixell	Director	126,500	46,000	29,091	9,091	210,682
Mr. Demetrio Carceller Arce [4]	Director	92,000	92,000	-	-	184,000
Ms. Benita María Ferrero-Waldner	Director	126,500	80,500	-	-	207,000
Mr. Alejandro García-Bragado Dalmau [3]	Director	46,000	-	-	9,091	55,091
Ms. Cristina Garmendia Mendizábal	Director	126,500	-	14,545	25,000	166,045
Ms. Helena Herrero Starkie [5]	Director	80,500	-	14,545	-	95,045
Mr. Emiliano López Achurra [6]	Director	46,000	46,000	-	-	92,000
Mr. Miguel Martínez San Martín	Director	126,500	126,500	-	9,091	262,091
Mr. Heribert Padrol Munté [4]	Director	92,000	-	-	-	92,000
Mr. Rajaram Rao [3]	Director	46,000	46,000	14,545	-	106,545
Mr. Juan Rosell Lastortras [4]	Director	92,000	92,000	-	-	184,000
Mr. Luis Suárez de Lezo Mantilla	Director	126,500	-	40,000	-	166,500
Mr. Miguel Valls Maseda [4]	Director	92,000	-	-	18,182	110,182
		2,681,500	**1,612,000**	**181,816**	**97,728**	**4,573,044**

[1] Since 21 September 2016, previously a Member of the Board of Directors.
[2] Until 21 September 2016. Appointed Honorary President, unremunerated, on 30 September 2016.
[3] Since 21 September 2016.
[4] Until 21 September 2016.
[5] Since 4 May 2016.
[6] Until 4 May 2016.

In 2016, as in 2015, no amounts were received for other items.

In 2016, the Chief Executive Officer received Euros 57 thousand (Euros 85 thousand in 2015) as a Board member of the investee company CGE. These amounts are deducted from the Chief Executive Officer's annual variable remuneration.

The amounts accrued to the Chief Executive Officer for executive functions in respect of fixed remuneration, annual variable remuneration, multi-year variable remuneration and other items totalled Euros 1,212 thousand, Euros 1,002 thousand, Euros 860 thousand and Euros 8 thousand, respectively, in 2016 (Euros 1,142 thousand, Euros 1,054 thousand, Euros 883 thousand and Euros 8 thousand in 2015).

Contributions to pension plans and group insurance policies, together with life insurance premiums paid, totalled Euros 328 thousand in 2016 (Euros 315 thousand in 2015). Funds accumulated due to these contributions amount to Euros 3,241 thousand at 31 December 2016 (Euros 2,930 thousand at 31 December 2015).

The members of the Board of Directors of the Company have not received remuneration from profit sharing, bonuses or indemnities, and have not been given loans or advances. Neither have they received shares or share options during the year, nor have they exercised options or have options to be exercised.

The members of the Board of Directors are covered with the same liability policy that insures all managers and directors of Gas Natural Fenosa. In 2016, the premium paid by Gas Natural SDG, S.A. for the entire policy amounted to 101 thousand euros.

The Chief Executive Officer's contract was amended in October 2016 to remove the clause under which the contract would be terminated in the event of a material change in the Company's shareholders and its duration was extended to cover the entire term of his current appointment as a Company director.

It contains an agreement whereby six months' prior notice must be provided by the Chief Executive Officer, except in the event of force majeure, an exclusivity pact for the period during which he is to fulfil his functions and a confidentiality agreement for both the duration of the contract and post-termination.

The Chief Executive Officer's contract provides for an indemnity of three yearly payments of his full emoluments at the date of contractual amendment for certain termination events: at the company's decision, except in the event of a serious and culpable breach of his professional obligations causing serious harm to the interests of Gas Natural SDG, S.A., at the Chief Executive Officer's decision, or due to the finalisation of the contract. In addition, as consideration for a post-contractual no-competition agreement with a duration of one year, an indemnity equivalent to one year's full remuneration is provided for.

The contract requires the Company to arrange third-party liability insurance.

Transactions with Directors

The Directors have the obligation to avoid conflicts of interest as established by Regulation of the Board of Gas Natural SDG, S.A. and Articles 228 and 229 of the Capital Companies Law. Additionally, these articles require that conflicts of interest incurred by the board shall be reported in the annual accounts.

The Directors of Gas Natural SDG, S.A. have not reported any conflict of interest that has to be informed.

In the operations with related parties (significant shareholders) that have been submitted for approval by the Board, subject to a favourable report of the Appointments and Remuneration Committee or Audit Committee, the Directors representing the related party involved have abstained.

During the years 2016 and 2015, the members of the Board have not carried out related transactions outside the ordinary course or transactions that are not conducted under normal market conditions with the company or Group companies.

Remuneration of Executive personnel

For the sole purposes of the information contained in this section, "executives" refers to the members of the Management Committee, excluding the CEO, whose remuneration has been included in the previous section, and the Internal Audit Director.

During 2016 a total of 11 persons formed part of the Management Committee. One person left the committee in April.

Amounts accrued to executives in respect of fixed remuneration, annual variable remuneration, multi-year variable remuneration and other items totalled Euros 4,827 thousand, Euros 2,553 thousand, Euros 1,945 thousand and Euros 120 thousand, respectively, in 2016 (Euros 4,962 thousand, Euros 2,528 thousand, Euros 1,982 thousand and Euros 112 thousand, respectively, in 2015).

Contributions to pension plans and group insurance policies, together with life insurance premiums paid, totalled Euros 2,389 thousand in 2016 (Euros 2,428 thousand in 2015). Funds accumulated due to these contributions amount to Euros 22,121 thousand at 31 December 2016 (Euros 24,955 thousand at 31 December 2015).

The executives have received no remuneration in respect of profit sharing or bonuses and no loans have been granted to them. Advances to management personnel at 31 December 2016 amounted to Euros 175 thousand. At 31 December 2015 no advances to management personnel were granted. No indemnities were received during 2016 or 2015.

The contracts of the executives contain a clause that stipulates a minimum indemnity of two years pay in certain cases of termination of contract and an indemnity equivalent to one year's fixed remuneration for the post-employment no-competition clause for a period of two years.

Note 35. Commitments and contingent liabilities

Guarantees

At 31 December 2016 Gas Natural Fenosa has given guarantees to third parties for activities totalling Euros 1,332 million (Euros 1,368 million at 31 December 2015).

Financial guarantees have also been given totalling Euros 607 million (Euros 348 million at 31 December 2015), of which Euros 126 million relate to the guarantee for compliance with the obligations on the loan received by investee companies (Euros 138 million at 31 December 2015).

Gas Natural Fenosa estimates that the liabilities not foreseen at 31 December 2016, if any, that could arise from guarantees furnished, would not be significant.

Contractual commitments

The following tables present the contractual commitments for purchases and sales at 31 December 2016:

	At 31.12.16						
Acquisition	**Total**	**2017**	**2018**	**2019**	**2020**	**2021**	**and after**
Energy purchases (1)	81,094	7,474	7,191	7,285	7,174	5,818	46,152
Energy transmission (2)	4,176	439	458	389	391	364	2,135
Investment (3)	536	532	1	2	-	1	-
Operating leases (4)	217	86	22	17	15	15	62
Nuclear fuel purchases	34	15	19	-	-	-	-
Total contractual obligations	**86,057**	**8,546**	**7,691**	**7,693**	**7,580**	**6,198**	**48,349**

		At 31 December 2016					
Sale	**Total**	**2017**	**2018**	**2019**	**2020**	**2021**	**and after**
Energy sales (5)	18,768	3,345	3,096	1,638	1,570	1,472	7,647
Provision of capacity assignment services (6)	4,115	285	265	283	333	299	2,650
Total contractual obligations	**22,883**	**3,630**	**3,361**	**1,921**	**1,903**	**1,771**	**10,297**

1) Basically reflects the long-term commitments for natural gas purchases under gas supply contracts with take or pay clauses negotiated and held for "own use" (Note

3.3.7.3). Normally, these contracts are for 20-25 years, a minimum amount of gas to be purchased and revision mechanisms for prices indexed to international natural gas prices and regulated prices of natural gas in the countries of origin. The commitments according to these contracts have been calculated on the basis of natural gas prices at 31 December 2016.

This also includes long-term commitments to buy electricity, calculated based on prices at 31 December 2016.

2) Reflects the long-term commitments (20 to 25 years) for gas transport and electricity transmission calculated on the basis of prices at 31 December 2016. Additionally, reflects operating costs associated with charter contracts for gas tankers under finance leases, including the six operational tankers (Note 18) and the two tankers under construction (Note 6), which are expected to become operational in 2017.

3) Basically reflects the investment commitments for the construction of two gas tankers expected to enter services in 2017 (Note 6), the construction of new power generation facilities and the development of the electricity distribution network.

4) Mainly reflects the gas tankers operating lease commitments, which end in 2017, as well as buildings leases commitments.

   It includes the rent of the “Torre del Gas” building owned by Torre Marenostrum, S.L., for which Gas Natural Fenosa has an operating lease without a purchase option for a period of ten years as from March 2016, extended at market value during 2016 as the contract is extendible at market value for successive periods of three years, on a discretionary basis for Gas Natural Fenosa and an obligatory basis for Torre Marenostrum S.L.

   It also includes operating leases without a purchase option that were written down in December 2016 of four buildings in Madrid (Avenida San Luís 77, Antonio López 193, Acanto 11-13 and Avenida América 38), for a term of ten years, except for Avenida América 38, extendable for five years more (Note 6).

5) It basically reflects long-term commitments to sell natural gas under gas sale contracts, containing take-or-pay clauses, negotiated and held for “own use” (Note 3.3.7.3). The commitments have been calculated based on natural gas prices at 31 December 2016.

6) It reflects service provision commitments under power generation capacity assignment contracts in Mexico (Note 3.3.19). The commitments made in these contracts have been calculated based on prices at 31 December 2016.

Contingent liabilities

At the preparation date of these consolidated annual accounts, the main contingent liabilities relate to the following litigation:

Claims for PIS and COFINS taxes in Brazil

In September 2005, the Río de Janeiro Tax Administration rendered ineffective the recognition that it had previously issued, in April 2003, for the offset of receivables in respect of PIS and COFINS sales taxes paid by the Group company Companhia Distribuidora de Gás do Rio de Janeiro - CEG, 54.2% subsidiary owned by Gas Natural Fenosa. The administrative court confirmed that ruling in March 2007 and the company filed an appeal at a contentious-administrative court (Justicia Federal do Rio de Janeiro). Subsequently, notification of a public civil action against CEG relating to the same events was received on 26 January 2009. The total amount of tax payable in dispute with interest included, was BRL 386 million (Euros 111 million). In November 2015, the above-mentioned first-instance court issued a judgement partially allowing CEG's appeal and reducing the total amount to BRL 260 million (Euros 75 million). This reduction in the amount of the contingency will not be definitive until the scope for appeals has been exhausted, estimated tentatively at another four years. Gas Natural Fenosa has appealed the judgement, taking the view, together with the company's legal advisors, that there is no basis even for the reduced amount.

Claim against Edemet - Edechi (Panama)

In April 2012, notification was received of a second-instance judgement rendering void the first-instance judgement that ordered Empresa Distribuidora de Electricidad Metro Oeste S.A. and Empresa Distribuidora de Electricidad Chiriquí S.A., a 51.0% subsidiaries owned by Gas Natural Fenosa, to pay damages to the claimant in the amount that was to be determined by experts, subject to a maximum of USD 84 million. Both the claimant and the defendants (Edemet and Edechi) appealed that judgement. The alleged damages relate to a tender for the en bloc purchase of electricity called by the Public Services Authority and awarded to the claimant, which was not finally capable of fulfilling the contract due to the failure to furnish the guarantees required by the bidding specifications. In March 2015, the Supreme Court resolved the appeal, ordering Edemet and Edechi to pay USD 21 million (Euros 19 million). In March 2016 the First Civil Chamber of the Supreme Court of Justice of Panama communicated the corresponding ruling, reducing the amount payable to USD 2.5 million (Euros 2 million). The plaintiffs have filed an appeal for review against this new quantification of damages.

Qatar Gas arbitration

In May 2015, Gas Natural Fenosa commenced an arbitration procedure against Qatar Liquefied Gas Company Limited in order, among other matters, to set the prices for gas supplies that it receives from said company. Gas Natural Fenosa has requested a price reduction and the supplier has requested an increase. The parties submitted their pleadings during 2016.

Unión Fenosa Gas

In 2014, Egyptian state-owned company, Egyptian Natural Gas Holding (EGAS), ceased supplying gas to Unión Fenosa Gas a 50.0% subsidiary owned by Gas Natural Fenosa, and ceased paying the fee for use of the Damietta liquefaction plant. As a result, Unión Fenosa Gas initiated arbitration proceedings against that company and against Egypt, and also reduced its supplies to its main customer, Gas Natural Fenosa Generación, S.L.U., a wholly-owned subsidiary of Gas Natural Fenosa, resulting in a number of proceedings being undertaken between this company and Unión Fenosa Gas.

Gas Natural Fenosa considers that no significant liabilities will arise as a consecuence of the risks described in this Note.

Note 36. Auditors' fees

The fees accrued in thousand Euros by the different companies trading under the PwC brand are as follows:

	Thousand Euros	
	2016	**2015**
Auditing services	3,846	3,854
Assurance services and services related to the audit	888	877
Other services	233	22
Total fees	**4,967**	**4,753**

Additionally, other audit firms have rendered the following services to Group companies:

	Thousand Euros	
	2016	**2015**
Auditing services	2,307	1,686
Assurance services and services related to the audit	-	32
Other services	336	96
Total fees	**2,643**	**1,814**

Note 37. Environment

Main environmental actions

Gas Natural Fenosa’s main activities related to the company's environmental strategy so as to assure compliance with environmental legislation, reduce environmental impacts, mitigate climate change, preserve biodiversity, optimise consumption of natural resources such as water, prevent pollution and promote continuous improvement, going beyond the stipulations of applicable laws.

Measures continued to make energy development compatible with environmental protection. General activities included the promotion of continuous improvement by updating and extending environmental management, involving our suppliers and encouraging our customers to use energy responsibly.

This is achieved through environmental management based on the ISO 14001 model, the correct functioning of which is verified periodically, providing the tools required to assure environmental management. In 2016, certification has been obtained for the environmental management system applied to electricity distribution in Chile. Along similar lines, progress has been made in the process to adapt environmental management of rest of the Chilean activities to ensure consistency with the rest of the company.

Gas Natural Fenosa's positioning in relation to climate change is based on its contribution to climate change mitigation by using low-carbon and renewable energies, promoting energy saving and efficiency, applying new technologies and capturing carbon in the Group's projects. During 2016 there have been significant reductions in direct CO2 emissions with respect to 2015, as a result of lower production in coal generation in Spain which has been replaced by cleaner generation options. As a result, specific emission per unit of energy generated has been significantly reduced compared with 2015. There has been also a reduction in emissions of other substances due to lower thermal generation in Spain.

In 2016, Gas Natural Fenosa undertook numerous actions to promote the conservation of biodiversity, some in response to requirements implemented by environmental authorities and others voluntarily. During this period, the initial steps have been taken to implement biodiversity action plans and highly significant progress has been made in the creation of tools to support the company's biodiversity strategy.

Gas Natural Fenosa is aware of the essential role played by water in the production process; as part of its ongoing commitment to the environment and to the efficient management of natural resources, in 2016 progress has been made in its water strategy by determining management indicators and lines of action to optimise water use in the most significant production processes. Within the commitment towards the environment and the efficient management of natural resources, during 2016 Gas Natural Fenosa has started work on bringing together, in 2017, the lines of action in the circular economy area on which it has been working for some time.

All these environmental activities undertaken in 2016 amounted to Euros 91 million (Euros 95 million in 2015), of which Euros 21 million related to environmental investments and Euros 70 million relate to environmental management expenditure. Among these actions we should note those relating to improving safety at nuclear power plants and combustion systems in thermal power stations, improving hydraulic generation facilities and improving the gas distribution network to reduce emissions of natural gas into the atmosphere.

Any contingencies, indemnities and other environmental risks that could be incurred by Gas Natural Fenosa are adequately covered by third-party liability insurance.

Emissions

In 2016, total consolidated CO_2 emissions from Gas Natural Fenosa' coal thermal and combined cycle plants subject to regulations governing the greenhouse gas emission trade regime totalled 10.4 million tonnes of CO_2 (13.6 million tonnes of CO_2 in 2015).

Gas Natural Fenosa devises a strategy each year for managing its CO_2 emission allowance coverage portfolio, acquiring them through its active participation both in both the primary and secondary markets. In addition, it has a committed investment of approximately Euros 1 million in primary projects and carbon funds, for the provision of emission credits.

In 2014 the Group launched the COmpensa2 initiative in which emissions associated with buildings, corporate trips, vehicles and events are voluntarily offset every year. Gas Natural Fenosa also offers its customers the opportunity to neutralise emissions equivalent to their consumption, offering CO_2 management as a value-added product.

Note 38. Events after the balance sheet date

On 11 January 2017 Gas Natural Fenosa, through its Euro Medium Term Notes (EMTN) programme, carried out a bond issue amounting to Euros 1,000 million, maturing in January 2027 with an annual coupon of 1.375%.

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APPENDIX I Gas Natural Fenosa companies

1. Subsidiaries

Company	Country	Activity	Method of Consolidation (1)	Total % interest	
				% Controlling interest (2)	% Equity interest
Gas Natural BAN, S.A.	Argentina	Gas distribution	F.C.	70.0	70.0
Ceg Río, S.A.	Brazil	Gas distribution	F.C.	59.6	59.6
Companhia Distribuidora de Gás do Río de Janeiro, S.A.	Brazil	Gas distribution	F.C.	54.2	54.2
Gas Natural Sao Paulo Sul, S.A.	Brazil	Gas distribution	F.C.	100.0	100.0
Gas Natural Cundiboyacense, S.A. ESP	Colombia	Gas distribution	F.C.	77.5	45.7
Gas Natural del Cesar, S.A. ESP	Colombia	Gas distribution	F.C.	62.2	21.7
Gas Natural del Oriente, S.A. ESP	Colombia	Gas distribution	F.C.	54.5	32.2
Gas Natural, S.A. ESP	Colombia	Gas distribution	F.C.	59.1	59.1
Gas Galicia SDG, S.A.	Spain	Gas distribution	F.C.	68.5	68.5
Gas Natural Andalucía, S.A.	Spain	Gas distribution	F.C.	100.0	100.0
Gas Natural Aragon SDG, S.A.	Spain	Gas distribution	F.C.	100.0	100.0
Gas Natural Balears, S.A.	Spain	Gas distribution	F.C.	100.0	100.0
Gas Natural Castilla La-Mancha, S.A.	Spain	Gas distribution	F.C.	95.0	95.0
Gas Natural Castilla y León, S.A.	Spain	Gas distribution	F.C.	90.1	90.1
Gas Natural Catalunya SDG, S.A.	Spain	Gas distribution	F.C.	100.0	100.0
Gas Natural Cegas, S.A.	Spain	Gas distribution	F.C.	99.7	99.7
Gas Natural Redes de Distribución de Gas, SDG, S.A.	Spain	Gas distribution	F.C.	100.0	100.0
Gas Natural Madrid SDG, S.A.	Spain	Gas distribution	F.C.	100.0	100.0
Gas Natural Redes GLP, S.A.	Spain	Gas distribution	F.C.	100.0	100.0
Gas Natural Rioja, S.A.	Spain	Gas distribution	F.C.	87.5	87.5
Gas Natural Transporte SDG, S.L.	Spain	Gas distribution	F.C.	100.0	100.0
Gas Navarra, S.A.	Spain	Gas distribution	F.C.	100.0	100.0
Nedgia, S.P.A.	Italy	Gas distribution	F.C.	100.0	100.0
Comercializadora Metrogas, S.A. de CV (3)	Mexico	Gas distribution	F.C.	100.0	85.0
Gas Natural México, S.A. de CV (3)	Mexico	Gas distribution	F.C.	85.0	85.0
Gas Natural Fenosa Perú, S.A.	Peru	Gas distribution	F.C.	100.0	100.0
Unión Fenosa Distribución, S.A.	Spain	Electricity distribution	F.C.	100.0	100.0
Gas Natural Fenosa Furnizare Energie, S.R.L.	Moldova	Electricity distribution	F.C.	100.0	100.0
Red Unión Fenosa, S.A.	Moldova	Electricity distribution	F.C.	100.0	100.0

Empresa de Distribución Electrica Chiriqui, S.A.	Panama	Electricity distribution	F.C.	51.0	51.0
Empresa de Distribución Electrica Metro Oeste, S.A.	Panama	Electricity distribution	F.C.	51.0	51.0
Gas Natural Almacenamientos Andalucía, S.A.	Spain	Gas infrastructures	F.C.	100.0	100.0
Gas Natural Exploración, S.L.	Spain	Gas infrastructures	F.C.	100.0	100.0
Palencia 3 Investigación Desarrollo y Explotación, S.L.	Spain	Gas infrastructures	F.C.	63.9	63.9
Petroleum Oil & Gas España, S.A.	Spain	Gas infrastructures	F.C.	100.0	100.0
Gas Natural Rigassificazione Italia, S.P.A.	Italy	Gas infrastructures	F.C.	100.0	100.0
Metragaz, S.A.	Morocco	Gas infrastructures	F.C.	76.7	76.7
Europe Maghreb Pipeline, Ltd.	United Kingdom	Gas infrastructures	F.C.	77.2	77.2
Natural Energy, S.A.	Argentina	Gas commercialisation	F.C.	100.0	100.0
Gas Natural Serviços, S.A.	Brazil	Gas supply	F.C.	100.0	100.0
Serviconfort Colombia, S.A.S.	Colombia	Gas supply	F.C.	100.0	100.0
Gas Natural Servicios, S.A. de C.V. (3)	Mexico	Gas supply	F.C.	100.0	85.0
Gas Natural Aprovisionamientos SDG, S.A.	Spain	Gas supply	F.C.	100.0	100.0
Gas Natural Fenosa LNG, S.L.	Spain	Gas supply	F.C.	100.0	100.0
Sagane, S.A.	Spain	Gas supply	F.C.	100.0	100.0
Gas Natural Europe, S.A.S.	France	Gas supply	F.C.	100.0	100.0
Gas Natural Fenosa LNG GOM Limited	Ireland	Gas supply	F.C.	100.0	100.0
Natural Fenosa LNG Internacional Ltd	Ireland	Gas supply	F.C.	100.0	100.0
Gas Natural Fenosa LNG Marketing Ltd	Ireland	Gas supply	F.C.	100.0	100.0
Gas Natural Vendita Italia, S.P.A.	Italy	Gas supply	F.C.	100.0	100.0
Gas Natural Puerto Rico, Inc	Puerto Rico	Gas supply	F.C.	100.0	100.0
Gas Natural Comercializadora, S.A.	Spain	Gas and electricity supply	F.C.	100.0	100.0
Gas Natural S.U.R. SDG, S.A.	Spain	Gas and electricity supply	F.C.	100.0	100.0
Gas Natural Servicios SDG, S.A.	Spain	Gas and electricity supply	F.C.	100.0	100.0
Mataró Energía Sostenible, S.A.	Spain	Gas and electricity supply	F.C.	51.1	51.1
Vayu Energy B.V.	Holland	Gas and electricity supply	F.C.	100.0	100.0
Vayu Energy, Ltd	Ireland	Gas and electricity supply	F.C.	100.0	100.0
Vayu Ltd	Ireland	Gas and electricity supply	F.C.	100.0	100.0

Vayu Energy, Ltd (UK)	United Kingdom	Gas and electricity supply	F.C.	100.0	100.0
Berrybank Development Pty, Ltd	Australia	Electricity generation	F.C.	100.0	72.7
Crookwell Development Pty, Ltd	Australia	Electricity generation	F.C.	100.0	72.7
Ryan Corner Development Pty, Ltd	Australia	Electricity generation	F.C.	100.0	72.7
Sertao i Solar Energía, SPE, Ltda	Brazil	Electricity generation	F.C.	85.0	63.8
Sobral i Solar Energía, SPE, Ltda	Brazil	Electricity generation	F.C.	85.0	63.8
Iberéolica Cabo Leones II, S.A.	Chile	Electricity generation	F.C.	51.0	38.3
Inca de Varas I	Chile	Electricity generation	F.C.	100.0	75.0
Inca de Varas II	Chile	Electricity generation	F.C.	100.0	75.0
Hidroeléctrica Rio San Juan S.A.S. ESP	Colombia	Electricity generation	F.C.	100.0	75.0
Almar Ccs, S.A.	Costa Rica	Electricity generation	F.C.	100.0	75.0
P.H. La Perla, S.A.	Costa Rica	Electricity generation	F.C.	100.0	100.0
Unión Fenosa Generadora La Joya, S.A.	Costa Rica	Electricity generation	F.C.	65.0	48.8
Unión Fenosa Generadora Torito, S.A.	Costa Rica	Electricity generation	F.C.	65.0	48.8
Boreas Eólica 2, S.A.	Spain	Electricity generation	F.C.	89.6	89.6
Corporación Eólica de Zaragoza, S.L	Spain	Electricity generation	F.C.	68.0	68.0
Energías Ambientales de Somozas, S.A.	Spain	Electricity generation	F.C.	97.0	97.0
Energías Especiales Alcoholeras, S.A., En Liquidación	Spain	Electricity generation	F.C.	82.3	82.3
Explotaciones Eólicas Sierra de Utrera, S.L.	Spain	Electricity generation	F.C.	75.0	75.0
Fenosa Wind, S.L.U.	Spain	Electricity generation	F.C.	100.0	100.0
Fenosa, S.L.U.	Spain	Electricity generation	F.C.	100.0	100.0
Gas Natural Fenosa Generación Nuclear, S.L.U.	Spain	Electricity generation	F.C.	100.0	100.0
Gas Natural Fenosa Generación, S.L.U.	Spain	Electricity generation	F.C.	100.0	100.0
Gas Natural Fenosa Renovables Ruralia, S.L.U.	Spain	Electricity generation	F.C.	51.0	51.0
Gas Natural Fenosa Renovables, S.L.U.	Spain	Electricity generation	F.C.	100.0	100.0
Gas Natural Wind 4, S.L.U.	Spain	Electricity generation	F.C.	100.0	100.0
Global Power Generation, S.A.	Spain	Electricity generation	F.C.	75.0	75.0
J.G.C. Cogeneración Daimiel, S.L.	Spain	Electricity generation	F.C.	97.6	97.6
P.E. El Hierro, S.L.	Spain	Electricity generation	F.C.	95.0	95.0
P.E. Montamarta, S.L.	Spain	Electricity generation	F.C.	95.0	95.0
P.E. Nerea, S.L.	Spain	Electricity generation	F.C.	95.0	95.0
P.E. Peñarroldana, S.L.	Spain	Electricity generation	F.C.	95.0	95.0
Sociedad de Tratamiento Hornillos, S.L., en liquidación	Spain	Electricity generation	F.C.	94.4	94.4
Sociedad de Tratamiento La Andaya, S.L., en liquidación	Spain	Electricity generation	F.C.	60.0	60.0
Sociedad Parque Eólico Mouriños, S.L.U.	Spain	Electricity generation	F.C.	100.0	100.0
Societat Eòlica de l´Enderrocada, S.A.	Spain	Electricity generation	F.C.	80.0	80.0

Tratamiento Cinca Medio, S.L. en liquidación	Spain	Electricity generation	F.C.	80.0	80.0
Tratamiento de Almazán, S.L., en liquidación	Spain	Electricity generation	F.C.	90.0	90.0
Iberáfrica Power Ltd.	Kenya	Electricity generation	F.C.	100.0	75.0
Fuerza y Energía Bii Hioxo, S.A. de C.V.	Mexico	Electricity generation	F.C.	100.0	75.0
Fuerza y Energía de Hermosillo, S.A. de C.V.	Mexico	Electricity generation	F.C.	100.0	75.0
Fuerza y Energía de Naco Nogales, S.A. de C.V.	Mexico	Electricity generation	F.C.	100.0	75.0
Fuerza y Energía de Norte Durango, S.A de C.V	Mexico	Electricity generation	F.C.	100.0	75.0
Fuerza y Energía de Tuxpan, S.A. de C.V.	Mexico	Electricity generation	F.C.	100.0	75.0
Energía y Servicios de Panamá, S.A.	Panama	Electricity generation	F.C.	51.0	38.3
Generadora Palamara La Vega, S.A.	Dominican Rep.	Electricity generation	F.C.	100.0	75.0
Lignitos de Meirama, S.A.	Spain	Mining	F.C.	100.0	100.0
Kangra Coal (Proprietary), Ltd.	South Africa	Mining	F.C.	70.0	70.0
Welgedacht Exploration Company, Ltd	South Africa	Mining	F.C.	100.0	70.0
Gas Natural Informática, S.A.	Spain	IT services	F.C.	100.0	100.0
United Saudi Spanish Power and Gas Services, LLC	Saudi Arabia	Engineering services	F.C.	100.0	78.8
Gas Natural Fenosa Engineering Brasil , S.A.	Brazil	Engineering services	F.C.	100.0	100.0
Gas Natural Fenosa Engineering, S.A.S.	Colombia	Engineering services	F.C.	100.0	100.0
Gas Natural Fenosa Ingeniería y Desarrollo de Gen., S.A.S.	Colombia	Engineering services	F.C.	100.0	75.0
Gas Natural Fenosa Ingeniería y Desarrollo de Gen., S.A.	Costa Rica	Engineering services	F.C.	100.0	75.0
Operación y Mantenimiento Energy Costa Rica, S.A.	Costa Rica	Engineering services	F.C.	100.0	75.0
Soluziona Technical Services, Llc. En Liquidación	Egypt	Engineering services	F.C.	100.0	100.0
Gas Natural Fenosa Engineering, S.L.	Spain	Engineering services	F.C.	100.0	100.0
Gas Natural Fenosa Ingeniería y Desarrollo de Gen., S.L.	Spain	Engineering services	F.C.	100.0	75.0
Operación y Mantenimiento Energy, S.A.	Spain	Engineering services	F.C.	100.0	75.0
Gas Natural Fenosa Ingeniería y Desarrollo de Gen., S.A.	Guatemala	Engineering services	F.C.	100.0	75.0
Spanish Israeli Operation and Maintenance Company, Ltd.	Israel	Engineering services	F.C.	100.0	100.0
Gas Natural Fenosa Ingenieria México, S.A. de C.V.	Mexico	Engineering services	F.C.	100.0	100.0
Gas Natural Fenosa Ingenieria y Desarrollo de Gen. México, S.A. de C.V.	Mexico	Engineering services	F.C.	100.0	75.0
GPG Energía México, S.A. de C.V.	Mexico	Engineering services	F.C.	100.0	75.0
Operación y Mantenimiento Energy Mexico, S.A. de C.V.	Mexico	Engineering services	F.C.	100.0	75.0
Unión Fenosa Operación México S.A. de C.V.	Mexico	Engineering services	F.C.	100.0	75.0
Gas Natural Fenosa Engineering Panamá, S.A.	Panama	Engineering services	F.C.	100.0	100.0
Gas Natural Fenosa Technology INC	Puerto Rico	Engineering services	F.C.	100.0	75.0
Operations & Maintenance Energy Uganda Ltd	Uganda	Engineering services	F.C.	100.0	75.0
Natural Re, S.A.	Luxembourg	Insurance	F.C.	100.0	100.0
Gas Natural Capital Markets, S.A.	Spain	Financial services	F.C.	100.0	100.0
Unión Fenosa Financiación, S.A.	Spain	Financial services	F.C.	100.0	100.0

Unión Fenosa Preferentes, S.A.U.	Spain	Financial services	F.C.	100.0	100.0
Gas Natural Fenosa Finance B.V.	Holland	Financial services	F.C.	100.0	100.0
Clover Financial and Treasury Services, DAC.	Ireland	Financial services	F.C.	100.0	100.0
Natural Servicios, S.A.	Argentina	Services	F.C.	100.0	100.0
Gas Natural do Brasil, S.A.	Brazil	Services	F.C.	100.0	100.0
Gas Natural Servicios Económicos, S.A.S.	Colombia	Services	F.C.	100.0	100.0
Gas Natural Servicios Integrales, S.A.S.	Colombia	Services	F.C.	100.0	100.0
Gas Natural Servicios, S.A.S.	Colombia	Services	F.C.	100.0	59.0
Arte Contemporáneo y Energía, A.I.E.	Spain	Services	F.C.	100.0	100.0
Compañía Española de Industrias Electroquímicas, S.A.	Spain	Services	F.C.	98.5	98.5
General de Edificios y Solares, S.L.	Spain	Services	F.C.	100.0	100.0
Gas Natural Italia S.P.A.	Italy	Services	F.C.	100.0	100.0
Administración y Servicios ECAP, S.A. de C.V.	Mexico	Services	F.C.	100.0	100.0
Administradora de Servicios de Energía México, S.A. de CV (3)	Mexico	Services	F.C.	100.0	85.0
Energía y Confort Administración de Personal, S.A. de C.V. (3)	Mexico	Services	F.C.	100.0	85.3
Sistemas de Administración y Servicios, S.A. de C.V. (3)	Mexico	Services	F.C.	85.0	85.0
Gas Natural Fenosa Servicios Panamá, S.A.	Panama	Services	F.C.	100.0	100.0
Inversiones Hermill, S.A.	Dominican Rep.	Services	F.C.	100.0	100.0
Gas Natural SDG Argentina, S.A.	Argentina	Holding company	F.C.	100.0	100.0
Invergás, S.A.	Argentina	Holding company	F.C.	100.0	100.0
Union Fenosa Wind Australia Pty, Ltd.	Australia	Holding company	F.C.	97.0	72.7
Global Power Generation Chile, S.p.A.	Chile	Holding company	F.C.	100.0	75.0
Gas Natural Distribución Latinoamerica, S.A.	Spain	Holding company	F.C.	100.0	100.0
Gas Natural Fenosa Electricidad Colombia, S.L.	Spain	Holding company	F.C.	100.0	100.0
Gas Natural Fenosa Internacional, S.A.	Spain	Holding company	F.C.	100.0	100.0
Holding Negocios Regulados Gas Natural, S.A.	Spain	Holding company	F.C.	100.0	100.0
La Energía, S.A.	Spain	Holding company	F.C.	100.0	100.0
La Propagadora del Gas Latam, S.L.U.	Spain	Holding company	F.C.	100.0	100.0
La Propagadora del Gas, S.A.	Spain	Holding company	F.C.	100.0	100.0
Unión Fenosa Minería, S.A.	Spain	Holding company	F.C.	100.0	100.0
Gas Natural Fenosa Minería, B.V.	Holland	Holding company	F.C.	100.0	100.0
GPG México Wind, B.V.	Holland	Holding company	F.C.	100.0	75.0
GPG México, B.V.	Holland	Holding company	F.C.	100.0	75.0
Buenergía Gas & Power, Ltd.	Cayman Islands	Holding company	F.C.	95.0	71.3

First Independent Power (Kenya), Ltd.	Kenya	Holding company	F.C.	100.0	75.0
Unión Fenosa México, S.A. de C.V.	Mexico	Holding company	F.C.	100.0	75.0
Distribuidora Eléctrica de Caribe, S.A.	Panama	Holding company	F.C.	100.0	100.0
Generación Eléctrica del Caribe , S.A.	Panama	Holding company	F.C.	100.0	75.0
Unión Fenosa South Africa Coal (Proprietary), Ltd	South Africa	Holding company	F.C.	100.0	100.0
CGE Group:					
Compañía General de Electricidad, S.A.	Chile	Electricity distribution	F.C.	97.2	97.2
Agua Negra S.A.	Argentina	Electricity distribution	F.C.	100.0	97.2
Energía San Juan S.A.	Argentina	Electricity distribution	F.C.	100.0	97.2
International Financial Investments S.A.	Argentina	Electricity distribution	F.C.	100.0	97.2
Los Andes Huarpes S.A.	Argentina	Electricity distribution	F.C.	98.0	95.3
CGE Argentina S.A.	Chile	Electricity distribution	F.C.	100.0	97.2
CGE Distribución S.A.	Chile	Electricity distribution	F.C.	99.3	96.6
CGE Magallanes S.A.	Chile	Electricity distribution	F.C.	99.9	97.1
Compañía Nacional de Fuerza Eléctrica S.A.	Chile	Electricity distribution	F.C.	99.3	96.6
Emel Norte S.A.	Chile	Electricity distribution	F.C.	98.2	95.5
Emelat Inversiones S.A.	Chile	Electricity distribution	F.C.	98.4	94.0
Empresa de Transmisión Eléctrica Transemel S.A.	Chile	Electricity distribution	F.C.	100.0	93.0
Empresa Eléctrica de Antofagasta S.A.	Chile	Electricity distribution	F.C.	92.7	86.3
Empresa Eléctrica de Arica S.A.	Chile	Electricity distribution	F.C.	94.2	86.9
Empresa Eléctrica de Atacama S.A.	Chile	Electricity distribution	F.C.	98.4	95.0
Empresa Eléctrica de Iquique S.A.	Chile	Electricity distribution	F.C.	88.6	84.2
Empresa Eléctrica de Magallanes S.A.	Chile	Electricity distribution	F.C.	55.2	53.6
Comercial & Logística General S.A.	Chile	Services	F.C.	100.0	97.2
Energy Sur Ingeniería, S.A.	Chile	Services	F.C.	55.0	53.5
Inversiones San Sebastian S.A.	Chile	Services	F.C.	100.0	53.6
Inversiones y Gestión S.A.	Chile	Services	F.C.	100.0	97.2
Novanet S.A.	Chile	Services	F.C.	100.0	97.2
Sociedad de Computación Binaria S.A.	Chile	Services	F.C.	100.0	97.2
Transformadores Tusan S.A.	Chile	Services	F.C.	100.0	97.2
TV Red S.A.	Chile	Services	F.C.	90.0	48.3
CGE Gas Natural, S.A.	Chile	Holding company	F.C.	97.4	97.4
Aprovisionadora Global de Energía, S.A.	Chile	Gas distribution	F.C.	60.2	55.8
Gas Sur S.A.	Chile	Gas distribution	F.C.	100.0	92.0

Innergy Holdings S.A.	Chile	Gas distribution	F.C.	60.0	55.2
Innergy Soluciones Energéticas S.A.	Chile	Gas distribution	F.C.	100.0	55.2
Innergy Transportes S.A.	Chile	Gas distribution	F.C.	100.0	55.2
Metrogas S.A.	Chile	Gas distribution	F.C.	60.2	55.8
Gasoducto del Pacífico (Argentina) S.A.	Argentina	Gas infrastructures	F.C.	56.7	52.2
Gasoducto del Pacífico S.A.	Chile	Gas infrastructures	F.C.	60.0	52.2
Gasoducto del Pacífico (Cayman) Ltd.	Cayman Islands	Gas infrastructures	F.C.	56.7	52.2
Centrogas S.A.	Chile	Services	F.C.	100.0	55.8
Empresa Chilena de Gas Natural S.A.	Chile	Services	F.C.	100.0	55.8
Financiamiento Doméstico S.A.	Chile	Services	F.C.	99.9	55.8
GN Holding Argentina Comercializadora, S.A.	Argentina	Holding company	F.C.	100.0	92.0
Gas Natural Chile, S.A.	Chile	Holding company	F.C.	94.5	92.0
GN Holding Argentina, S.A.	Chile	Holding company	F.C.	100.0	92.0
Sociedad Inversiones Atlántico S.A.	Chile	Holding company	F.C.	100.0	92.0
CGE Servicios, S.A.	Chile	Services	F.C.	100.0	100.0

(1) Consolidation method: F.C. Full Consolidation, P.C. Proportionate Consolidation, E.M. Equity Method
(2) Parent company's interest in the subsidiary.
(3) The shareholding percentage relating to legally owned shares and to the share buy-back commitment at the percentages stated in Note 18, which are also allocated to the Parent company.

2. Joint ventures

Company	Country	Activity	Method of Consolidation (1)	Total % interest: % Controlling interest (2)	% Equity interest
Grupo UF Gas:					
Unión Fenosa Gas, S.A.	Spain	Gas supply	E.M.	50.0	50.0
Segas Services, S.A.E.	Egypt	Gas infrastructures	E.M.	100.0	40.7
Spanish Egyptian Gas Company S.A.E.	Egypt	Gas infrastructures	E.M.	80.0	40.0
Nueva Electricidad del Gas, S.A.U, En Liquidación	Spain	Gas infrastructures	E.M.	100.0	50.0
Unión Fenosa Gas Exploración y Producción, S.A.U.	Spain	Gas infrastructures	E.M.	100.0	50.0
Unión Fenosa Gas Comercializadora, S.A.	Spain	Gas supply	E.M.	100.0	50.0
Unión Fenosa Gas Infraestructures B.V.	Holland	Holding company	E.M.	100.0	50.0
Gas Natural Vehicular del Norte Asociación en Participación (3)	Mexico	Gas distribution	E.M.	51.3	43.6
Eléctrica Conquense, S.A.	Spain	Electricity distribution	E.M.	46.4	46.4
Eléctrica Conquense de Distribución, S.A.	Spain	Electricity distribution	E.M.	100.0	46.4
CH4 Energía S.A. de C.V. (3)	Mexico	Gas supply	E.M.	50.0	42.5
ENER RENOVA, S.A.	Chile	Electricity generation	E.M.	40.0	40.0
Línea de Trasmisión Cabo Leones, S.A.	Chile	Electricity generation	E.M.	50.0	19.1
Castrios, S.A.	Spain	Electricity generation	E.M.	33.3	33.3
Cogeneración del Noroeste, S.L.	Spain	Electricity generation	E.M.	40.0	40.0
Desarrollo de Energías Renovables de la Rioja, S.A.	Spain	Electricity generation	E.M.	36.3	36.3
Desarrollo de Energías Renovables de Navarra, S.A.	Spain	Electricity generation	E.M.	50.0	50.0
ENER Renova España, S.L.	Spain	Electricity generation	E.M.	40.0	40.0
Energías Eólicas de Fuerteventura, S.L.	Spain	Electricity generation	E.M.	50.0	50.0
Infraestructuras Eléctricas La Mudarra, S.L	Spain	Electricity generation	E.M.	39.6	33.8
Molinos de la Rioja, S.A.	Spain	Electricity generation	E.M.	33.3	33.3
Molinos del Cidacos, S.A.	Spain	Electricity generation	E.M.	50.0	50.0
Montouto 2000, S.A.	Spain	Electricity generation	E.M.	49.0	49.0
Nueva Generadora del Sur, S.A.	Spain	Electricity generation	E.M.	50.0	50.0
P.E. Cinseiro, S.L.	Spain	Electricity generation	E.M.	50.0	50.0
Sociedad Gestora de Parques Eólicos Andalucía, S.A.	Spain	Electricity generation	E.M.	21.0	21.0
Toledo PV, A.E.I.E	Spain	Electricity generation	E.M.	33.3	33.3
Ghesa Ingeniería y Tecnología, S.A.	Spain	Engineering services	E.M.	41.2	41.2

EcoEléctrica Holding, LLC.	Puerto Rico	Holding company	E.M.	50.0	35.6
EcoEléctrica, L.P.	Puerto Rico	Electricity generation	E.M.	100.0	35.6
EcoEléctrica LLC	Puerto Rico	Holding company	E.M.	100.0	35.6
CGE Group:					
Gascart S.A.	Argentina	Gas distribution	E.M.	50.0	46.0
Gasnor S.A.	Argentina	Gas distribution	E.M.	97.4	46.0
Gasmarket S.A.	Argentina	Gas distribution	E.M.	50.0	46.0
Empresa de Distribución Eléctrica de Tucumán S.A.	Argentina	Electricity distribution	E.M.	80.5	48.6
Compañía Eléctrica de Inversiones S.A.	Argentina	Electricity distribution	E.M.	90.0	48.6
Empresa Jujeña de Energía S.A.	Argentina	Electricity distribution	E.M.	90.0	43.8
Empresa Jujeña de Sistemas Energéticos Dispersos S.A.	Argentina	Electricity distribution	E.M.	90.0	43.8
Norelec S.A.	Argentina	Electricity distribution	E.M.	50.0	48.6
Dimater, S.A.	Argentina	Electricity distribution	E.M.	100.0	48.6
Empresa de Construcción y Servicios , S.A.	Argentina	Electricity distribution	E.M.	100.0	48.6
Noanet, S.A.	Argentina	Electricity distribution	E.M.	100.0	48.6
Gasoductos GasAndes, S.A. (Argentina)	Argentina	Gas infrastructures	E.M.	47.0	26.2
Andes Operaciones y Servicios S.A.	Chile	Gas infrastructures	E.M.	50.0	27.9
Gas Natural Producción, S.A.	Chile	Gas infrastructures	E.M.	36.2	33.3
Gasoductos GasAndes, S.A. (Chile)	Chile	Gas infrastructures	E.M.	47.0	26.2
GNL Chile S.A.	Chile	Gas infrastructures	E.M.	33.3	18.6
Inmobiliaria Parque Nuevo S.A.	Chile	Services	E.M.	50.0	48.6

(1) Consolidation method: F.C. Full Consolidation, P.C. Proportionate Consolidation, E.M. Equity Method
(2) Parent company's interest in the subsidiary

3. Jointly-controlled assets and operations

Company	Country	Activity	Method of Consolidation (1)	Total % interest: % Controlling interest (2)	Total % interest: % Equity interest
Cilento Reti Gas, S.R.L.	Italy	Gas distribution	P.C.	60.0	60.0
Bezana / Beguenzo	Spain	Gas infrastructures	P.C.	55.6	55.6
Boquerón	Spain	Gas infrastructures	P.C.	4.5	4.5
Casablanca	Spain	Gas infrastructures	P.C.	9.5	9.5
Chipirón	Spain	Gas infrastructures	P.C.	2.0	2.0
Gas Natural West África, S.L.	Spain	Gas infrastructures	P.C.	40.0	40.0
Montanazo	Spain	Gas infrastructures	P.C.	17.7	17.7
Rodaballo	Spain	Gas infrastructures	P.C.	4.0	4.0
Tánger Larache	Morocco	Gas infrastructures	P.C.	24.0	24.0
Central Térmica de Anllares, A.I.E.	Spain	Electricity generation	P.C.	66.7	66.7
Centrales Nucleares Almaraz-Trillo, A.I.E	Spain	Electricity generation	P.C.	19.1	19.1
Comunidad de bienes Central Nuclear de Almaraz (Grupo I y II)	Spain	Electricity generation	P.C.	11.3	11.3
Comunidad de bienes Central Nuclear de Trillo (Grupo I)	Spain	Electricity generation	P.C.	34.5	34.5
Comunidad de bienes Central Térmica de Aceca	Spain	Electricity generation	P.C.	50.0	50.0
Comunidad de bienes Central Térmica de Anllares	Spain	Electricity generation	P.C.	66.7	66.7
Eólica Tramuntana 21, S.L.	Spain	Electricity generation	P.C.	60.0	60.0
Eólica Tramuntana 22, S.L.	Spain	Electricity generation	P.C.	60.0	60.0
Eólica Tramuntana 23, S.L.	Spain	Electricity generation	P.C.	60.0	60.0
Eólica Tramuntana 71, S.L.	Spain	Electricity generation	P.C.	60.0	60.0
Eólica Tramuntana 72, S.L.	Spain	Electricity generation	P.C.	60.0	60.0
Eólica Tramuntana 73, S.L.	Spain	Electricity generation	P.C.	60.0	60.0
Eólica Tramuntana, S.L.	Spain	Electricity generation	P.C.	60.0	60.0
UTE ESE Clece - Gas Natural	Spain	Services	P.C.	50.0	50.0

(1) Consolidation method: F.C. Full Consolidation, P.C. Proportionate Consolidation, E.M. Equity Method

4. Associates

Company	Country	Activity	Method of Consolidation (1)	Total % interest % Controlling interest (2)	% Equity interest
Qalhat LNG S.A.O.C.	Oman	Gas infrastructures	E.M.	7.4	3.7
Sistemas Energéticos La Muela, S.A.	Spain	Electricity generation	E.M.	20.0	20.0
Sistemas Energéticos Mas Garullo, S.A.	Spain	Electricity generation	E.M.	18.0	18.0
Sociedade Galega do Medio Ambiente, S.A.	Spain	Electricity generation	E.M.	49.0	49.0
Bluemobility System, S.L. En Liquidación	Spain	Services	E.M.	20.0	20.0
Kromschroeder, S.A.	Spain	Services	E.M.	44.5	44.5
Torre Marenostrum, S.L.	Spain	Services	E.M.	45.0	45.0
CER's Commercial Corp	Panama	Services	E.M.	25.0	18.8

(1) Consolidation method: F.C. Full Consolidation, P.C. Proportionate Consolidation, E.M. Equity Method
(2) Parent company's interest in the subsidiary

APPENDIX II Variations in consolidation scope

The main changes in the consolidation scope in 2016 have been as follows:

Registered name of the entity	Operation category	Effective date of operation	Voting rights acquired /eliminated (%)	Voting rights after operation (%)	Consolidation method after operation
Renovables Aragón, S.L.U	Acquisition	1 March	100.0	100.0	Full
Alas Capital Gas Natural, S.A.	Disposal	11 March	40.0	-	-
Gas Natural Chile, S.A.	Incorporation	30 March	56.6	56.6	Full
Sociedad Inversiones Atlántico, S.A.	Incorporation	31 March	55.1	55.1	Full
Energías Especiales de Extremadura, S.L.	Liquidation	25 April	99.0	-	-
Regasificadora del Noroeste, S.A.	Disposal	28 April	11.6	-	-
Leo-Ras, S.L.	Acquisition	15 May	100.0	100.0	Full
Aprovisionadora Global de Energía, S.A.	Incorporation	1 June	36.9	36.9	Full
Unión Fenosa Financial Services USA, Llc	Liquidation	29 June	100.0	-	-
Union Fenosa Wind Australia Pty, Ltd.	Acquisition	20 July	0.2	96.7	Full
Gas Natural Redes GLP, S.A.	Incorporation	21 July	100.0	100.0	Full
Enervent, S.A.	Disposal	28 July	26.0	-	-
Infraestructuras de Gas, S.A.	Disposal	29 July	85.0	-	
Planta de Regasificación de Sagunto, S.A.	Disposal	31 July	50.0	-	-
Vayu Ltd	Acquisition	2 August	100.0	100.0	Full
Vayu Energy, Ltd	Acquisition	2 August	100.0	100.0	Full
Vayu Energy, Ltd (UK)	Acquisition	2 August	100.0	100.0	Full
Vayu Energy B.V.	Acquisition	2 August	100.0	100.0	Full
LNG GOM Limited	Acquisition	2 August	100.0	100.0	Full
LNG International Resources Ltd	Acquisition	2 August	100.0	100.0	Full
LNG Marketing Ltd	Acquisition	2 August	100.0	100.0	Full
Gas Natural Wind 6, S.L.	Liquidation	2 August	60.0	-	-
Gas Natural Chile, S.A.	Acquisition	8 August	37.9	94.5	Full
Gasco S.A.	Disposal	8 August	55.1	-	-
Gasco GLP S.A.	Disposal	8 August	55.1	-	-
Gasmar S.A.	Disposal	8 August	35.2	-	-
Hualpén Gas S.A.	Disposal	8 August	17.6	-	-
Autogasco S.A.	Disposal	8 August	55.1	-	-
Transportes e Inversiones Magallanes S.A.	Disposal	8 August	46.9	-	-
Automotive Gas Systems S.A.	Disposal	8 August	55.1	-	-
Inversiones Invergas S.A.	Disposal	8 August	55.1	-	-
Inversiones Atlántico S.A.	Disposal	8 August	55.1	-	-
Campanario Generación S.A.	Disposal	8 August	11.0	-	-
Inversiones GLP S.A.S. E.S.P.	Disposal	8 August	38.6	-	-
JGB Inversiones S.A.S. E.S.P.	Disposal	8 August	38.6	-	-
Unigas Colombia S.A. E.S.P.	Disposal	8 August	27.0	-	-
Montagas S.A. E.S.P.	Disposal	8 August	12.9	-	-
Energas S.A. E.S.P.	Disposal	8 August	10.9	-	-
Tecnet, S.A.	Disposal	9 August	100.0	-	-
Infraestructuras Eléctricas La Mudarra, S.L.	Incorporation	31 August	39.6	39.6	Equity
CGE Gas Natural, S.A.	Incorporation	14 October	100.0	100.0	Full
GNL Quintero, S.A.	Disposal	8 November	20.0	-	-
Union Fenosa Wind Australia Pty, Ltd.	Acquisition	15 December	0.2	97.0	Full
Hormigones del Norte, S.A.	Disposal	16 December	100.0	-	-
Sobral i Solar Energía SPE, Ltda	Acquisition	19 December	85.0	85.0	Full
Sertao i Solar Energía SPE, Ltda	Acquisition	19 December	85.0	85.0	Full
Inca de Varas I	Acquisition	20 December	100.0	100.0	Full
Inca de Varas II	Acquisition	20 December	100.0	100.0	Full
Gasifica, S.A.	Liquidation	27 December	100.0	-	-
Gas Galicia SDG, S.A.	Acquisition	29 December	6.9	68.5	Full
Electrificadora del Caribe S.A, E.S.P.	Loss of control	31 December	85,4	-	-
Energía Empresarial de la Costa, S.A., E.S.P.	Loss of control	31 December	85,4	-	-
Energía Social de la Costa S.A. E.S.P.	Loss of control	31 December	85,4	-	-

The main changes in the consolidation scope in 2015 were as follows:

Registered name of the entity	Operation category	Effective date of operation	Voting rights acquired /eliminated (%)	Voting rights after operation (%)	Consolidation method after operation
Oficina de cambios de suministrador, S.A.	Liquidation	2 January	20.0	-	-
Gas Natural Fenosa Furnizare Energie, S.R.L.	Incorporation	31 January	100.0	100.0	Full
Compañía General de Electricidad, S.A.- CGE	Acquisition	31 January	0.2	96.9	Full
	Acquisition	28 February	0.4	97.3	Full
	Acquisition	31 March	0.1	97.4	Full
Mataró Energía Sostenible, S.A.	Acquisition	24 March	51.1	51.1	Full
Palencia 3 Investigación y Desarrollo y Exp. S.L.	Acquisition	9 April	24.9	63.93	Full
Genroque, S.L.	Incorporation	10 April	50.0	50.0	Equity
Puente Mayorga Generación, S.L.	Incorporation	10 April	50.0	50.0	Equity
First Independent Power, Ltd.	Acquisition	14 April	10.4	100.0	Full
Iberáfrica Power Ltd.	Acquisition	14 April	10.4	100.0	Full
Gas Natural Aragón SDG, S.A.	Incorporation	18 June	100.0	100.0	Full
Gas Natural Infraestructuras Distribución Gas SDG, S.A.	Incorporation	18 June	100.0	100.0	Full
Gasmar, S.A.	Acquisition	25 June	12.8	63.8	Full
Gas Directo, S.A.	Acquisition	10 July	70.0	100.0	Full
Barras Eléctricas Galaico Asturianas, S.A.	Disposal	28 July	44.9	-	Equity
Banteay Srei, S.L.	Acquisition	16 September	100.0	100.0	Full
Lanzagorta Comunicaciones, S.L.	Acquisition	16 September	100.0	100.0	Full
Union Fenosa Wind Australia Pty, Ltd.	Acquisition	2 September	0.4	96.5	Full
Berrybank development Pty, Ltd	Acquisition	2 September	0.4	96.5	Full
Crookwell development Pty, Ltd	Acquisition	2 September	0.4	96.5	Full
Ryan Corner development Pty, Ltd	Acquisition	2 September	0.4	96.5	Full
Global Power Generation, S.A.	Capital increase	5 October	25.0	75.0	Full
Metrogas, S.A.	Acquisition	10 October	8.3	60.2	Full
Gecal Renovables, S.A.	Acquisition	13 October	100.0	100.0	Full
Estela Eólica, S.L.U.	Acquisition	13 October	100.0	100.0	Full
P.E. Nerea, S.L.	Acquisition	13 October	85.5	85.5	Full
P.E. Los Pedreros, S.L.	Acquisition	13 October	100.0	100.0	Full
P.E. Peñarroldana, S.L.	Acquisition	13 October	95.0	95.0	Full
P.E. El Hierro, S.L.	Acquisition	13 October	95.0	95.0	Full
P.E. Montamarta, S.L.	Acquisition	13 October	95.0	95.0	Full
P.E. La Rabia, S.L.U.	Acquisition	13 October	100.0	100.0	Full
P.E. Cova da serpe, S.L.U.	Acquisition	13 October	100.0	100.0	Full
Eólica La Vega I, S.L.U.	Acquisition	13 October	100.0	100.0	Full
Eólica La Vega II, S.L.U.	Acquisition	13 October	100.0	100.0	Full
Ampliación de Nerea, S.L.U.	Acquisition	13 October	100.0	100.0	Full
P.E. Las Claras, S.L.U.	Acquisition	13 October	100.0	100.0	Full
Arañuelo Solar, S.L.	Acquisition	13 October	60.0	60.0	Full
P.E. Cinseiro, S.L.	Acquisition	13 October	50.0	50.0	Equity
Sociedad Gestora de Parques Eólicos Andalucía, S.A.	Acquisition	13 October	21.0	21.0	Equity
Ener Renova España, S.L.	Acquisition	13 October	40.0	40.0	Equity
Ener Renova , S.A.	Acquisition	13 October	40.0	40.0	Equity
Puente Mayorga, S.L.	Disposal	28 October	50.0	-	-
Genroque, S.L.	Acquisition	28 October	50.0	100.0	Full
Palawan Sulu Sea Gas, INC	Liquidation	30 November	50.0	-	-
Parque Eólico Sierra del Merengue S.L en Liq.	Liquidation	30 November	50.0	-	-
Gas Natural Balears, S.A.	Incorporation	30 November	100.0	100.0	Full
Global Power Generation Chile, S.p.A.	Incorporation	4 December	100.0	100.0	Full
Ibereólica Cabo Leones II S.A.	Acquisition	15 December	51.0	51.0	Full
Línea de Trasmisión Cabo Leones, S.A.	Acquisition	15 December	50.0	50.0	Equity
P.E. Nerea, S.L.	Acquisition	17 December	9.5	95.0	Full
3G Holdings Limited	Liquidation	30 December	10.0	-	-
Gasco Gran Cayman Ltd. (Chilean company)	Liquidation	31 December	55.1	-	-
Arañuelo Solar, S.L.	Liquidation	31 December	60.0	60.0	-

APPENDIX III Gas Natural tax group companies

The companies belonging to the Gas Natural tax group are as follows:

Gas Natural SDG, S.A.	Gas Natural Redes Distribución Gas SDG, S.A.
Ampliación de Nerea, S.L.U.	Gas Natural Redes GLP, S.A.
Banteay Srei, S.L.U.	Gas Natural Rioja, S.A.
Boreas Eólica 2, S.A.	Gas Natural S.U.R. SDG, S.A.
Compañía Española de Industrias Electroquímicas, S.A.	Gas Natural Servicios SDG, S.A.
Energías Ambientales de Somozas, S.A.	Gas Natural Transporte SDG, S.L.
Energías Especiales Alcoholeras, S.A.	Gas Natural Wind 4, S.L.U.
Energías Especiales de Extremadura, S.L.	Gas Navarra, S.A.
Eólica la Vega I, S.L.U.	Gecal Renovables, S.A.
Eólica la Vega II, S.L.U.	General de Edificios y Solares, S.L.
Estela Eólica, S.L.U.	Genroque, S.L.U.
Europe Mahgreb Pipeline Limited	Global Power Generation, S.A.
Explotaciones Eólicas Sierra de Utrera, S.L.	Holding Negocios Regulados Gas Natural, S.A.
Fenosa Wind, S.L.	JGC Cogeneración Daimiel, S.L.
Fenosa, S.L.U.	La Energía, S.A.
Gas Directo, S.A.U.	La Propagadora del Gas Latam, S.L.U.
Gas Natural Almacenamientos Andalucía, S.A.	La Propagadora del Gas, S.A.
Gas Natural Andalucía, S.A.	Lanzagorta Comunicaciones, S.L.
Gas Natural Aprovisionamientos SDG, S.A.	Lignitos de Meirama, S.A.
Gas Natural Aragón SDG, S.A.	Operación y Mantenimiento Energy, S.A.
Gas Natural Balears, S.A.	Parque Eólico Cova da Serpe, S.L.U.
Gas Natural Capital Markets, S.A.	Parque Eólico el Hierro, S.L.
Gas Natural Castilla y León, S.A.	Parque Eólico la Rabia, S.L.U.
Gas Natural Castilla-La Mancha, S.A.	Parque Eólico las Claras, S.L.U.
Gas Natural Catalunya SDG, S.A.	Parque Eólico los Pedreros, S.L.
Gas Natural Cegas, S.A.	Parque Eólico Montamarta, S.L.
Gas Natural Comercializadora, S.A.	Parque Eólico Nerea, S.L.
Gas Natural Distribución Latinoamérica, S.A.	Parque Eólico Peñarroldana, S.L.
Gas Natural Exploración, S.L.	Petroleum, Oil&Gas España, S.A.
Gas Natural Fenosa Electricidad Colombia, S.L.	Sagane, S.A.
Gas Natural Fenosa Engineering, S.L.	Sociedad de Tratamiento Hornillos, S.L.
Gas Natural Fenosa Generación Nuclear, S.L.	Societat Eòlica de l'Enderrocada, S.A.
Gas Natural Fenosa Generación, S.L.U.	Tratamiento Cinca Medio, S.L.
Gas Natural Fenosa Ingeniería y Desarrollo de Generación, S.L.U.	Tratamiento de Almazán, S.L.
Gas Natural Fenosa Internacional, S.A.	Unión Fenosa Distribución, S.A.
Gas Natural Fenosa LNG, S.L.	Unión Fenosa Financiación, S.A.
Gas Natural Fenosa Renovables, S.L.U.	Unión Fenosa Minería, S.A.
Gas Natural Informática, S.A.	Unión Fenosa Preferentes, S.A.U.
Gas Natural Madrid SDG, S.A.	

Gas Natural Fenosa
2016 Annual Report

Consolidated Directors' Report

Consolidated Directors' Report for the financial year ended 31 December 2016

Contents

1. Company situation

Gas Natural Fenosa's business model is characterised by responsible and sustainable management of all resources. Our commitment to sustainability and value creation over time is reflected specifically in our corporate responsibility policy, approved by the Board of Directors and implemented across all the Company's business processes; it comprises seven corporate responsibility commitments to stakeholders, which guide our activities: commitment to results, customer orientation, environmental protection, concern for people, health and safety, commitment to society and integrity.

Gas Natural Fenosa is an integrated energy company that supplies gas and electricity to almost 22 million customers. Its main purpose is to supply energy to society so as to maximise development and welfare, using innovation, energy efficiency and sustainability as the fundamental pillars of the business model. It is a leading energy company and a pioneer in the integration of gas and electricity. The business focuses on the full gas life cycle and on electricity generation, distribution and supply. There are other business lines, such as energy services, that favour diversification of activities and revenues, anticipating new market trends, meeting specific customer needs and providing an integrated service not focused only on selling energy.

Gas Natural Fenosa's business model is implemented through a large number of companies, basically in Spain, the rest of Europe, Latin America and Africa; there are four major business areas:

- **Gas distribution (Spain, rest of Europe and Latin America)**

  Gas Natural Fenosa has a leading position in the markets in which it operates, allowing organic growth opportunities to be leveraged both by winning new customers in municipalities to which gas is supplied and by expanding networks into zones without a gas supply. It is the leader in Spain and has a solid presence in Italy. It is also the leader in Latin America, with a presence in Mexico, Chile, Colombia, Brazil, Argentina and Peru.

- **Electricity distribution (Spain, rest of Europe and Latin America)**

  Gas Natural Fenosa is one of the most efficient operators in terms of operating and maintenance costs in electricity distribution. It is the third-ranked operator in the Spanish market and the leader in Moldova. In Latin America, it operates in Chile, Argentina, Panama and Colombia.

- **Gas (Infrastructures, Supply and Unión Fenosa Gas)**

  Gas Natural Fenosa has a unique, integrated gas infrastructure that provides considerable business stability, operational flexibility and the capacity to transport gas towards the best business opportunities.

  For Gas Natural Fenosa, our suppliers play a critical role in the optimal functioning of the value chain; accordingly, long-term contracts are concluded, a commitment to society is assumed and environmental impacts are minimised so as to guarantee supply.

  Gas Natural Fenosa responds with value-added services to customers' demands for speed, guarantees, quality and energy efficiency.

- **Electricity (Spain and International)**

  Gas Natural Fenosa has broad knowledge of all power generation technologies and an infrastructure that can be tailored to the needs of any energy model and each country's circumstances. A competitive, flexible gas supply allows the Company to achieve better margins than its competitors when managing combined cycle plants.

  Our leading position in the combined retailing of natural gas and electricity brings major advantages, such as a lower service cost, integrated customer service and lower acquisition costs, as well as greater proximity to customers.

  In the international market, Gas Natural Fenosa, through Global Power Generation, is established in Mexico, Puerto Rico, the Dominican Republic, Costa Rica, Panama, Kenya, Australia and, most recently, Chile and Brazil.

Our operations throughout the gas value chain provide Gas Natural Fenosa with a competitive advantage and a leading position in the sector. Our electricity management capacity and experience, combined with a unique integrated position in the gas and electricity markets, make the company a benchmark in this sector. International presence guarantees a privileged position to achieve growth in new regions that are in the process of economic development, making the Company one of the world's leading operators.

Appendix I to the Consolidated Annual Accounts contains a list of Gas Natural Fenosa's investees.

1.1. Corporate governance

Gas Natural Fenosa develops and continuously updates its corporate governance rules, which are formed by:

- Company By-laws.
- General Shareholders' Meeting Regulations.
- Board of Directors and Board Committee Regulations.
- Internal Code of Conduct with regard to the Securities Markets.
- Code of Ethics.
- Corporate Responsibility Policy.

Gas Natural Fenosa has continued to enhance its commitment to transparency and good practices, with the participation of the General Shareholders' Meeting, the Board of Directors and the Board committees: Executive Committee, Appointments and Remuneration Committee, and Audit Committee. The Management Committee also plays a significant role. In 2015, Gas Natural Fenosa adapted its corporate governance rules to the requirements of Act 31/2014, 3 December, which amended the Spanish Companies Act 2010 to improve corporate governance, and to the new the recommendations of the corporate governance code for listed companies of February 2015.

The accompanying 2016 Annual Corporate Governance Report contains a more detailed description.

The Board of Directors represents the Company and is Gas Natural Fenosa's ultimate decision-taking body, except for decisions reserved for the General Meeting. In particular, the Board is responsible for the following matters:

- Determining strategy and economic objectives.
- Supervising and verifying that the top executives fulfil the strategies and objectives.
- Assuring the company's future viability and competitiveness.
- Approving codes of conduct.

The Executive Committee is the Board committee responsible for continuous monitoring of Company management.

The Appointments and Remuneration Committee proposes Board remuneration criteria and general management remuneration policies. It also reviews the Board's structure and composition, supervising the appointment of new members and establishing guidelines for the appointment of directors.

The Audit Committee supervises internal control and risk management systems and evaluates their effectiveness, and also oversees the preparation of financial information and internal audit services.

The Management Committee coordinates business and corporate areas. Its main functions include studying and proposing Objectives, the Strategic Plan and the Annual Budget, as well as assessing, for the main Governing Bodies, action proposals that could affect the fulfilment of the Company's Strategic Plan. All the Management Committee members participate in the preparation of the Corporate Risk Map through work meetings in which they express opinions on the main uncertainties and potential impacts on the businesses.

2. Business evolution and results

2.1. Main milestones in 2016

Net profit amounted to Euros 1,347 million in 2016, 10.3% less than in 2015.

EBITDA amounted to Euros 4,970 million in 2016, 5.6% less than in 2015, after discontinuation of the liquefied petroleum gas business in Chile; these results were affected by a very demanding macroeconomic and energy situation. This situation had a particular impact on the contribution by the gas supply business, while the depreciation of Latin American currencies on translation to euro impacted EBITDA in the amount of Euros 112 million, mainly attributable to the Colombian peso and the Mexican peso.

As of 31 December 2016, the indebtedness ratio was 44.8%, i.e. lower than at 2015 year-end (45.8%), and the net financial debt/EBITDA ratio was 3.1, compared with 3.0 at the end of 2015, despite bringing forward the 2016 interim dividend.

The sale of a 20.0% stake in GNL Quintero, S.A. (Chile) to Enagas for Euros 182 million by Aprovisionadora Global de Energía, S.A. (AGESA), a subsidiary of Gas Natural Chile, S.A., was completed in November 2016, providing Euros 128 million in capital gains before taxes and non-controlling interests (Euros 50 million net capital gains).

On 14 November 2016, the Superintendence for Residential Public Services of the Republic of Colombia (“the Superintendence”) ordered, as a necessary measure to ensure the provision of electrical energy services, the seizure of the goods, assets and businesses of Electricaribe. The Superintendence also ordered the removal of the members of the governing body and the general manager, and their replacement by a special agent appointed by the Superintendence. In the fulfilment of his functions, this agent has replaced the executive personnel appointed by Gas Natural Fenosa and has centralised decision-making on the information to be supplied to Gas Natural Fenosa. Therefore, at 31 December 2016, Gas Natural Fenosa had lost control and any significant influence over Electricaribe as it does not take part in, and has no direct information about, material business activities or decisions. Subsequently, on 11 January 2017, the Superintendence extended this government take-over until 14 March 2017. In the light of the above facts and in accordance with IFRS 10, on 31 December 2016, Electricaribe ceased to be consolidated on the consolidated balance sheet of Gas Natural Fenosa, and its assets, liabilities and non-controlling interests have been derecognised for a net amount of Euros 475 million. In addition, the investment in Electricaribe has been recorded at fair value as defined by IAS 39 (Euros 475 million) under Available-for-sale financial assets.

Gas Natural Fenosa confirms its guidance for net profit for 2017 to be between Euros 1,300 and 1,400 million, as well as the continuity of its dividend policy in accordance with the Strategic Vision 2016-2020.

The Board of Directors will propose to the Ordinary Shareholders' Meeting that it allocate Euros 1,001 million out of 2016 income to dividends, i.e. the same as in the previous year, in line with the new dividend policy for 2016-18, which was approved in March 2016. The interim dividend of Euros 0.330 per share was paid in full in cash on 27 September 2016, and the supplementary dividend amounting to Euros 0.670 per share will also be paid in cash in June 2017, representing a payout of 74.3%.

2.2. Main aggregates

Gas Natural Fenosa's financial information contains magnitudes and measurements prepared in accordance with the International Financial Reporting Standards (IFRS), as well as others prepared in accordance with the Group's own reporting model, referred to as Alternative Performance Metrics (APM), which are considered to be adjusted magnitudes with respect to those presented in accordance with IFRS. In the last chapter of the Consolidated Directors' Report there is a glossary of terms and the definitions of the APMs.

Financial main aggregates

	2016	2015	%
Net sales	23,184	26,015	(10.9)
EBITDA	4,970	5,264	(5.6)
Operating income	3,006	3,261	(7.8)
Net income attributable to equity holders of the Company	1,347	1,502	(10.3)
Cash flows from operating activities	3,375	3,500	(3.6)
Investments	2,225	1,422	56.5
Net equity (at 31/12)	19,005	18,518	2.6
Attributed net equity (at 31/12)	15,225	14,367	6.0
Net borrowings (at 31/12)	15,423	15,648	(1.4)

Main financial ratios

	2016	2015
Leverage	44.8%	45.8%
EBITDA / Net financial expenses	6.7x	6.4x
Net borrowings / EBITDA	3.1x	3.0x
Liquidity ratio	1.1x	1.2x
Solvency ratio	1.0x	1.0x
Return on equity (ROE)	8.8%	10.5%
Return on assets (ROA)	2.9%	3.1%

Main stock market ratios and shareholder remuneration

	2016	2015
Average number of shares (thousand)	1,000,468	1,000,689
Share price at 31/12 (euro)	17.91	18.82
Stock market capitalisation at 31/12 (million euro)	17,922	18,828
Earnings per share (euro)[1]	1.35	1.57
Attributable equity per share (euro)	15.21	14.36
Price-earnings ratio (P/E)	13.3	12.5
EV/EBITDA	6.7	6.5

[1] Profit at 31 December 2015 adjusted in accordance with IAS 33 due to the carrying amount of the preference shares exceeding the amount paid to redeem them, net of the tax effect.

Main physical aggregates

	2016	2015	%
Gas distribution:			
Sales - TPA[1]:	458,265	473,831	(3.3)
Europe	188,197	181,212	3.9
Latin America	270,068	292,619	(7.7)
Gas distribution connections points (thousand) (at 31/12):	13,546	13,172	2.8
Europe	5,773	5,724	0.9
Latin America	7,773	7,448	4.4
Electricity distribution:			
Sales - TPA[1]:	68,258	68,731	(0.7)
Europe	34,697	34,676	0.1
Latin America*	33,561	34,055	(1.5)
Electricity distribution connections (thousand) (at 31/12):	8,202	10,622	(22.8)
Europe	4,580	4,550	0.7
Latin America	3,622	6,072	(40.3)
ICEIT [2] (minutes)	43	44	(2.3)
Gas:			
Gas supply (MW):	325,384	316,268	2.9
Spain	178,916	185,851	(3.7)
Rest of Europe	77,136	54,787	40.8
LNG International	69,332	75,630	(8.3)
Gas transportation – EMPL (MW)	111,720	112,861	(1.0)

* Figures for Colombia are as of 30/11/2016 since the December data are not available.

[1] Third-Party Access (energy distributed)
[2] Installed capacity equivalent interruption time in Spain

	2016	2015	%
Electricity:			
Electricity generated (GWh):	46,552	49,548	(6.0)
Spain:	28,504	31,568	(9.7)
Hydroelectric	3,933	2,457	60.1
Nuclear	4,463	4,544	(1.8)
Coal	5,687	7,973	(28.7)
CCGTs	11,963	14,494	(17.5)
Renewables and Cogeneration	2,458	2,100	17.0
Global Power Generation:	18,048	17,980	0.4
Hydroelectric	496	481	3.1
CCGTs	15,648	15,519	0.8
Oil – gas	1,111	1,130	(1.7)
Wind	793	850	(6.7)
Installed capacity (MW):	15,418	15,471	(0.3)
Spain:	12,716	12,769	(0.4)
Hydroelectric	1,954	1,954	-
Nuclear	604	604	-
Coal	2,010	2,065	(2.7)
CCGTs	7,001	7,001	-
Renewables and Cogeneration	1,147	1,145	0.2
Global Power Generation:	2,702	2,702	-
Hydroelectric	123	123	-
CCGTs	2,035	2,035	-
Oil – gas	310	310	-
Wind	234	234	-
Electricity supply (GWh)	36,384	35,241	3.2

2.3. Analysis of consolidated results

Sales

	2016	% of total	2015	% of total	% 2016/2015
Gas distribution	4,873	21.1	5,301	20.4	(8.1)
Spain	1,198	5.2	1,191	4.6	0.6
Italy	88	0.4	92	0.4	(4.3)
Latin America	3,587	15.5	4,018	15.4	(10.7)
Electricity distribution	5,733	24.7	5,680	21.8	0.9
Spain	833	3.6	838	3.2	(0.6)
Moldova	227	1.0	260	1.0	(12.7)
Latin America	4,673	20.1	4,582	17.6	2.0
Gas	9,134	39.4	11,077	42.6	(17.5)
Infrastructures	324	1.4	317	1.2	2.2
Supply	8,810	38.0	10,760	41.4	(18.1)
Electricity	6,060	26.1	6,585	25.3	(8.0)
Spain	5,279	22.7	5,779	22.2	(8.7)
Global Power Generation	781	3.4	806	3.1	(3.1)
Rest	364	1.6	489	1.9	(25.6)
Consolidation adjustments	(2,980)	(12.9)	(3,117)	(12.0)	(4.4)
Total	**23,184**	**100.0**	**26,015**	**100.0**	**(10.9)**

Net sales totalled Euros 23,184 million in 2016, a 10.9% decline with respect to 2015, due broadly to the decline in commodity prices year-on-year.

EBITDA

	2016	% of total	2015	% of total	% 2016/2015
Gas distribution	1,730	34.8	1,751	33.3	(1.2)
Spain	889	17.9	872	16.6	1.9
Italy	62	1.2	66	1.3	(6.1)
Latin America	779	15.7	813	15.4	(4.2)
Electricity distribution	1,334	26.8	1,346	25.6	(0.9)
Spain	603	12.1	607	11.5	(0.7)
Moldova	42	0.8	38	0.7	10.5
Latin America	689	13.9	701	13.4	(1.7)
Gas	845	17.0	1,081	20.5	(21.8)
Infrastructures	298	6.0	293	5.6	1.7
Supply	547	11.0	788	14.9	(30.6)
Electricity	972	19.6	1,002	19.0	(3.0)
Spain	715	14.4	741	14.0	(3.5)
Global Power Generation	257	5.2	261	5.0	(1.5)
Rest	89	1.8	84	1.6	6.0
Total	**4,970**	**100.0**	**5,264**	**100.0**	**(5.6)**

Consolidated EBITDA declined by Euros 294 million in 2016 to Euros 4,970 million, 5.6% less than in 2015, after discontinuation of the liquefied petroleum gas business in Chile.

Translation of foreign currencies in the consolidation process had a negative impact on EBITDA of Euros 112 million in 2016 compared with 2015, basically because of depreciation of the Colombian peso and Mexican peso.

EBITDA from Gas Natural Fenosa's international activities declined by 12.1% to account for 44.5% of the consolidated total, compared with 47.8% in 2015. EBITDA from operations in Spain increased by 0.4% and increased as a share of the consolidated total to 55.5%.

Under Rest caption there is a capital gain of €51 million (net capital gain is €35 million) on the sale of four buildings in Madrid for €206 million.

Operating income

	2016	% of total	2015	% of total	% 2016/2015
Gas distribution	1,231	41.0	1,244	38.1	(1.0)
Spain	596	19.8	579	17.8	2.9
Italy	38	1.3	42	1.3	(9.5)
Latin America	597	19.9	623	19.0	(4.2)
Electricity distribution	730	24.3	827	25.4	(11.7)
Spain	381	12.7	388	11.9	(1.8)
Moldova	37	1.2	32	1.0	15.6
Latin America	312	10.4	407	12.5	(23.3)
Gas	681	22.7	903	27.7	(24.6)
Infrastructures	240	8.0	228	7.0	5.3
Supply	441	14.7	675	20.7	(34.7)
Electricity	279	9.2	307	9.4	(9.1)
Spain	154	5.1	180	5.5	(14.4)
Global Power Generation	125	4.1	127	3.9	(1.6)
Rest	85	2.8	(20)	(0.6)	(525.0)
Total	**3,006**	**100.0**	**3,261**	**100.0**	**(7.8)**

Depreciation and amortisation charges and impairment losses in 2016 amounted to Euros 1,759 million, a 0.5% increase year-on-year, basically as a result of exchange rate trends.

Provisions for bad debts amounted to Euros 327 million, compared with Euros 258 million in 2015, a 26.7% increase.

EBIT in 2016 declined by Euros 255 million (7.8%) year-on-year to Euros 3,006 million.

Net financial income

Net financial expenses amounted to Euros 825 million in 2016, 7.7% less than in 2015 (Euros 894 million).

The breakdown of net financial income is as follows:

	2016	2015	%
Cost of net financial debt	(747)	(823)	(9.2)
Other financial expenses/revenues	(94)	(86)	9.3
Financial revenues Costa Rica[1]	16	15	6.7
Net financial income	**(825)**	**(894)**	**(7.7)**

[1] Generation concessions in Costa Rica are recorded as financial assets following IFRIC 12.

The cost of net borrowings in 2016 was Euros 747 million, i.e. lower than in 2015 due to the sharp reduction in the average volume of debt and in the margins and reference interest rates.

The average cost of net borrowings is 4.3%, and 75% of the debt is at fixed rates.

Profit/(loss) of entities recorded by equity method

Equity-accounted affiliates provided a loss of Euros -98 million in 2016, compared with Euros -4 million in 2015. The main components of this item were as follows: Ecoeléctrica provided a positive contribution of Euros 49 million, and the Unión Fenosa Gas sub-group contributed Euros -176 million, including the Euros 21 million capital gain on the Sagunto, S.A. (Saggas) regasification plant and Euros 94 million of impairment recognised as a result of the need to update the procurement cost assumptions contained in Unión Fenosa Gas's energy scenario projections.

Corporate income tax

On 27 November 2014, Act 27/2014, on Corporate Income Tax was approved, reducing the general tax rate in Spain from 30% to 28% for 2015 and to 25% from 2016 onwards.

The tax rate resulting from the consolidated corporate income tax recorded in 2016 was 20.0%, compared with 24.3% in 2015, as a result of the aforementioned reduction in the tax rate in Spain from 28% to 25%, which was partly offset by an increase in the tax rate in Chile from 22.5% to 24% and the accounting of the following non-recurring items:

- As part of a reorganisation of the business in Chile and a corporate structure simplification, Transnet was merged into Compañía General de Electricidad, S.A., its parent company, on 14 December 2016. The resulting goodwill was allocated to the value for tax purposes of the non-monetary assets received from the acquired company which was equivalent to their carrying amount on the transaction date, resulting in a reduction in deferred tax liabilities in the amount of Euros 128 million, with the corresponding positive impact in the ”Corporate income tax” recorded.

- On 29 December 2016, Colombia published Act no. 1819 on Structural Tax Reform, which establishes a progressive reduction in the income tax rate in 2017, 2018 and 2019. As a result, deferred taxes were re-measured using the projected reversal rate, resulting in an amount of €21 million of additional corporate income tax expenses being recognised in the consolidated income statement.

Non-controlling interests

The main items in this account are the non-controlling interests in EMPL, GPG, gas distribution companies in Brazil, Chile, Colombia and Mexico, and electricity generation and distribution companies in Chile, Panama and Colombia, as well as accrued interest on perpetual subordinated notes.

Income attributed to non-controlling interests amounted to Euros -364 million in 2016, compared with Euros -322 million in 2015, basically as a result of KIA acquiring a 25% stake in GPG and of the capital gain on the sale of GNL Quintero that is attributable to non-controlling interests.

Net income

Net income amounted to Euros 1,347 million, a reduction of 10.3% with respect to 2015.

2.4. Analysis of the consolidated balance sheet

Investments

The breakdown of investments by nature is as follows:

	2016	2015	%
Investments in property, plant and equipment and intangible assets	2,517	1,767	42.4
Financial investments	384	315	21.9
Total gross investments	**2,901**	**2,082**	**39.3**
Disposals and others	-676	-660	2.4
Total investments	**2,225**	**1,422**	**56.5**

Investments in property, plant and equipment and intangible assets amounted to Euros 2,517 million in 2016, a 42.4% increase with respect to 2015, due basically to the acquisition of new gas tankers in September and December 2016.

Excluding the Euros 425 million investment in the gas carriers, which were acquired under finance lease, investments in property, plant and equipment and intangible assets amounted to Euros 2,092 million, an 18.4% increase, due basically to greater investment in gas distribution in Spain as a result of completion of the acquisition of LPG distribution points from Repsol that had been agreed in 2015.

Financial assets added in 2016 correspond basically to the acquisition of an additional 37.88% of Gas Natural Chile (Euros 306 million) and the acquisition of a number of investees, including notably Vayu (Irlanda).

Disposals and others in 2016 refer basically to the sale of the shares of Gasco, S.A. that Gas Natural Fenosa held through subsidiaries, for a total of Euros 220 million, the sale of GNL Quintero for Euros 182 million, and the sale of buildings in Madrid for Euros 206 million.

The breakdown of investment in property, plant and equipment and intangible assets, by line of business, is as follows:

	2016	2015	% 2016/2015
Gas distribution	1,028	784	31.1
Spain	693	435	59.3
Italy	31	25	24.0
Latin America	304	324	(6.2)
Electricity distribution	666	578	15.2
Spain	265	249	6.4
Moldova	13	9	44.4
Latin America	388	320	21.3
Gas	474	50	-
Infrastructures	13	12	8.3
Supply	461	38	-
Electricity	193	162	19.1
Spain	105	104	1.0
Global Power Generation	88	58	51.7
Rest	156	193	(19.2)
Total	**2,517**	**1,767**	**42.4**

The gas distribution business accounted for 27.5% of total consolidated investment and was the largest single area of investment, in line with 2015. Excluding investment in gas supply, which increased because of the acquisition of two new gas carriers under finance lease in September and December 2016, the fastest-growing area of investment was gas distribution in Spain (+59.3%) due to the acquisition of LPG supply points from Repsol agreed in 2015.

Capital expenditure in Spain increased by 73.1% to account for 66.4% of the total, up from 54.7% the previous year, as a result of the acquisition of two new gas carriers under finance lease in September and December 2016. Excluding that effect, capital expenditure in Spain would have increased by 29.1% to 59.6% of the total.

Capital expenditure in other countries was stable year-on-year and accounted for 33.6% of the total (40.4% excluding the new gas carriers), compared with 49.6% in 2015.

Equity and shareholder remuneration

At 31 December 2016, Gas Natural Fenosa's shareholders' equity totalled Euros 19,005 million. Of that total, Euros 15,225 million is attributable to Gas Natural Fenosa.

At 31 December 2016, there were 1,000,689,341 ordinary shares represented by book entries, with a par value of one euro per share. All issued shares are fully paid up and carry equal voting and dividend rights.

At 31 December 2016, based on publicly available information, the main shareholders of Gas Natural Fenosa were as follows:

	Interest in share capital %
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona, "la Caixa" (1)	24.4
Repsol, S.A.	20.1
Global Infrastructure Partners III (2)	20.0
Sonatrach	4.0

(1) Held through Criteria Caixa S.A.U. and Caixabank, S.A.
(2) Global Infrastructure Partners III, whose investment manager is Global Infrastructure Management LLC, owns its stake indirectly through GIP III Canary 1, S.à.r.l.

See Note 13 of the Consolidated Annual Accounts for further details.

Year 2016

The Board of Directors will propose to the Ordinary Shareholders' Meeting that it allocate Euros 1,001 million out of 2016 income to dividends. That represents a dividend of Euros 1 per share and a pay-out of 74.3%, i.e. a dividend yield of 5.6% based on the share price at 31 December 2016 (Euros 17.91).

The 2016 interim dividend of Euros 0.330 per share was paid entirely in cash on 27 September 2016.

Year 2015

The distribution of 2015 income approved by the Shareholders' Meeting on 4 May 2016 entails allocating Euros 1,001 million to dividends, 10.1% more than in 2015. That represents a dividend of Euros 1 per share and a pay-out of 66.6%, i.e. a dividend yield of 5.3% based on the share price at 31 December 2015 (Euros 18.82).

<u>Debt and finances</u>

Evolution of net borrowings (million euros)

	31.12.16	31.12.15	%
Net borrowings	15,423	15,648	(1.4)

At 31 December 2016, net borrowings amounted to Euros 15,423 million and leverage was 44.8% (Euros 15,648 million and 45.8% as at 31 December 2015).

The net debt/EBITDA ratio was 3.1 and the EBITDA/net interest ratio was 6.7 at 31 December 2016, evidencing that the company continued to enhance its credit fundamentals in the period.

The detail of net borrowings is as follows:

	31.12.16	31.12.15
Non-current borrowings	15,003	15,653
Current borrowings	2,599	2,595
Cash and cash equivalents	(2,067)	(2,390)
Derivatives	(112)	(210)
Net borrowings	**15,423**	**15,648**

Net debt maturities (Euros million)

	2017	2018	2019	2020	2021	2022 and thereafter
Net debt maturities	833	2,276	2,872	2,395	2,273	4,774

The above table shows Gas Natural Fenosa's net debt maturities at 31 December 2016.

A total of 79.8% of the net borrowings at 31 December 2016 matures in or after 2019. The average term of the debt is 5.2 years.

Of the net financial debt, 5.4% is short term and 94.6% is long term.

Main financial transactions

Continuing with the financial policy of strengthening the liquidity position and managing the debt maturity profile, during 2016 Euros 600 million of 10-year notes were issued under the EMTN programme and a private placement of Euros 300 million in 5-year notes was performed.

With the same goal, bilateral bank loans were renegotiated with the banks and new loans were arranged.

In September 2016, the company drew a Euros 600 million loan granted by the EIB to finance investments in the gas distribution business in Spain.

The breakdown of the net borrowings by currency at 31 December 2016, in absolute and relative terms, is as follows:

(Euros million)	31.12.2016	%
EUR	12,318	79.9
CLP	1,452	9.4
USD	923	6.0
COP	100	0.6
BRL	339	2.2
MXN	287	1.9
Others	4	-
Total net borrowings	**15,423**	**100.0**

Credit rating

The credit ratings of Gas Natural Fenosa's short-term and long-term debt are as follows:

Agency	Short term	Long term
Fitch	F2	BBB+
Moody’s	P-2	Baa2
Standard & Poor’s	A-2	BBB

Liquidity and capital funds

At 31 December 2016, cash and cash equivalents together with available bank finance totalled Euros 10,061 million, providing the company with sufficient liquidity to cover its debt maturities for more than 24 months, with the following breakdown:

Liquidity source	Limit	Drawn	Available
Committed credit lines	7,485	(365)	7,120
Uncommitted credit lines	707	(185)	522
Undrawn loans	352	-	352
Cash and cash equivalents	2,067	-	2,067
Total	**10,611**	**(550)**	**10,061**

Additionally, at 31 December 2016 the company had Euros 6,586 million available in the form of shelf registrations for financial instruments, including Euros 3,795 million in the Euro Medium Term Notes (EMTN) programme; Euros 900 million in the Euro Commercial Paper (ECP) programme; and a combined Euros 1,891 million in the stock market certificates programmes on the Mexico Stock Exchange, the commercial paper programme on the Panama Exchange, the straight bonds programme in Colombia and the bond lines in Chile.

Set out below is a breakdown of working capital at 31 December:

(million euros)	2016	2015
Current operating assets[1]	5,595	5,819
Current operating liabilities[2]	(4,276)	(4,204)
	1,319	**1,615**

[1] Includes Inventories, Trade receivables for sales and provision of services, and Other receivables.
[2] Includes Trade payables, Other payables and Other current liabilities, excluding the dividend payable.

The average payment period for Gas Natural Fenosa suppliers is 28 days.

Analysis of contractual obligations and off-balance-sheet transactions

Note 35 to the consolidated annual accounts provides a breakdown of Gas Natural Fenosa's contractual obligations, off-balance-sheet transactions and contingent liabilities.

2.5. Analysis of results by activity

Gas distribution

2.5.1 Gas distribution Spain

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

Results

	2016	2015	%
Net sales	1,198	1,191	0.6
Procurement	(33)	(16)	106.3
Net personnel expenses	(68)	(68)	-
Other expenses/revenues	(208)	(235)	(11.5)
EBITDA	**889**	**872**	**1.9**
Depreciation, amortisation and impairment expenses	(291)	(289)	0.7
Change in operating provisions	(2)	(4)	(50.0)
Operating income	**596**	**579**	**2.9**

Net sales in the gas distribution business totalled Euros 1,198 million, Euros 7 million more than in 2015, due to growth in the liquefied petroleum gas business as a result of the acquisition of supply points that was completed in the fourth quarter of 2016. This effect offset the reduction in revenues from the regulatory inspection business caused by the lower volume of inspections scheduled in the year. The change in the regulatory inspection frequency (from every four years to every five years) resulted in 2016 being a trough year with a lower volume of inspections.

The higher volume of business in LPG business resulted in an increase in procurements to meet the higher demand.

This effect, coupled with efficiencies in operating expenses, resulted in a 1.9% increase in EBITDA.

Main aggregates

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

	2016	2015	%
Sales – TPA (GWh)	184,619	177,391	4.1
LPG sales (ton)	57,175	4,072	-
Distribution network (km)	51,956	51,016	1.8
Increase in connection points (thousand)	47	40	17.5
Connection points (thousand) (at 31/12)	5,313	5,266	0.9

Regulated gas sales increased by 4.1% (+7,228 GWh).

Residential demand accelerated in the fourth quarter, to +3% (+1,432 GWh), mainly as a result of higher consumption in that period (a colder winter in 2016 compared with 2015).

Industrial demand under 60 bar is recovering steadily, having increased by 3% (+2,939 GWh). Demand for transportation and industrial consumption over 60 bar increased by 6% (+2,857 GWh).

The distribution network expanded by 940 km in the last 12 months, adding 47 thousand new connection points, a 0.9% increase, to total 5.313 million connections.

On 30 September 2015, Gas Natural Distribución signed an agreement to acquire piped gas assets from Repsol Butano; as a result, in the fourth quarter of 2016, the company purchased approximately 230,000 supply connection points in its current distribution territories, enabling them to be connected to the natural gas distribution grid. These assets will accelerate growth and expansion in Gas Natural Fenosa's regulated natural gas business in the coming years.

2.5.2 Gas distribution Italy

The business in Italy includes regulated distribution of gas.

Results

	2016	2015	%
Net sales	88	92	(4.3)
Procurement	(1)	(1)	-
Net personnel expenses	(11)	(12)	(8.3)
Other expenses/revenues	(14)	(13)	7.7
EBITDA	**62**	**66**	**(6.1)**
Depreciation, amortisation and impairment expenses	(24)	(24)	-
Change in operating provisions	-	-	-
Operating income	**38**	**42**	**(9.5)**

EBITDA amounted to Euros 62 million, a 6.1% decrease year-on-year. The reduction was due basically to lower remuneration caused by updating the WACC recognised by the Italian regulator as a result of the decline in the risk-free rate.

Main aggregates

	2016	2015	%
Sales – TPA (GWh)	3,578	3,821	(6.4)
Distribution network (km)	7,265	7,167	1.4
Connection points (thousand) (at 31/12)	460	458	0.4

A total of 3,578 GWh of gas were distributed, i.e. 6.4% less than in 2015, due to less favourable weather.

The distribution grid expanded by 98 km in 2016, to 7,265 km at 31 December 2016.

Gas Natural Fenosa has 459,713 gas distribution connection points in Italy, a slight increase with respect to the previous year.

2.5.3 Gas distribution Latin America

This division involves regulated gas distribution in Argentina, Brazil, Chile, Colombia, Mexico and Peru. In Chile, it also includes the gas procurement and supply business.

Results

	2016	2015	%
Net sales	3,587	4,018	(10.7)
Procurement	(2,372)	(2,779)	(14.6)
Net personnel expenses	(124)	(126)	(1.6)
Other expenses/revenues	(312)	(300)	4.0
EBITDA	**779**	**813**	**(4.2)**
Depreciation, amortisation and impairment expenses	(159)	(170)	(6.5)
Change in operating provisions	(23)	(20)	15.0
Operating income	**597**	**623**	**(4.2)**

Revenues declined by 10.7% to Euros 3,587 million due to depreciation of the main Latin American currencies.

EBITDA amounted to Euros 779 million, a decline of 4.2% with respect to 2015, impacted by currency performance in Argentina (-37.2%), Mexico (-14.1%), Colombia (-10.2%), Brazil (-4.0%) and Chile (-2.6%). Excluding the effect of currency fluctuations, EBITDA would have increased by 4.8%.

Brazil contributed 30.8% of EBITDA, i.e. less than in 2015, mainly because of the currency effect; adjusting for that effect, EBITDA would have declined by 4.6%.

The sharp economic deceleration in Brazil resulted in lower sales to the industrial market; also, power generation dispatching and TPA for power plants were much lower as abundant rainfall raised reservoir levels. Offsetting this, residential-commercial sales were 6.2% higher than in 2015.

Mexico accounted for 20.8% of total EBITDA in this business. Excluding the exchange rate effect, Mexico's EBITDA increased by 13.5% on 3.2% growth in revenues, with volumes and margins increasing in all markets.

EBITDA in Colombia increased by 7.2% year-on-year (excluding the exchange rate effect), to account for 20.8% of the total. This growth was due mainly to the higher supply margin in the secondary market, which was the result of higher sale prices and volumes in this market. This positive performance in the secondary market was attributable to the effects of El Niño, which caused a sharp decline in hydroelectric generation during the first quarter.

EBITDA in Colombia was also impacted by other effects on energy margins, mainly from higher tariff update indices.

Chile contributed Euros 174 million in EBITDA (+1.7% at constant exchange rates), i.e. 22.3% of total EBITDA from Latin America. That was Euros 3 million more than in 2015, excluding the currency effect.

Adjusting for the negative exchange rate effect, EBITDA in Argentina increased by 29.8% due to the entry into force on 7 October 2016 of a new table of tariffs for all markets and to the receipt in December of Euros 35 million in Economic Assistance from the State to compensate for the delay in applying the initial tariffs (1 April 2016). Sales in the residential/commercial segment increased by 11.7% in 2016 as a result of lower temperatures in comparison with the previous year.

Main aggregates

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

	2016	2015	%
Gas activity sales (GWh):	270,068	292,619	(7.7)
Gas sales at the tariff	158,608	174,378	(9.0)
TPA	111,460	118,241	(5.7)
Distribution network (km)	82,966	80,036	3.7
Increase in connection points (thousand)	325	314	3.5
Connection points (thousand) (at 31/12)	7,773	7,448	4.4

The main physical aggregates by country in 2016 are as follows:

	Argentina	Brazil	Chile	Colombia	Mexico	Total
Gas activity sales (GWh):	71,526	72,015	47,154	28,177	51,196	270,068
Increase v. 31/12/2015 (%)	4.1	(30.4)	7.0	5.0	3.2	(7.7)
Distribution network (km)	25,663	7,446	6,966	21,839	21,052	82,966
Increase vs. 31/12/2015 (km)	1,007	299	116	370	1,138	2,930
Connection points (thousand) (at 31/12)	1,632	1,037	584	2,862	1,658	7,773
Increase vs. 31/12/2015 (thousand)	20	51	22	118	114	325

At 31 December 2016, there were a total of 7,772,830 gas distribution customers. Customer numbers increased by 325 thousand year-on-year, notably in Colombia and Mexico.

Sales in the gas activity in Latin America, which includes both gas sales and TPA (third-party access) services, totalled 270,068 GWh, i.e. less than the 2015 figure due to lower sales for power generation in Brazil.

The gas distribution grid expanded by 2,930 km (+3.7%) in the last 12 months, to 82,966 km at the end of December 2016. This sizeable expansion is attributable most notably to Mexico, which added 1,138 km, and Colombia, which added 370 km.

Highlights of this area in 2016:

- On 1 April 2016, new gas tariffs were approved in Argentina, effective from that same date, including full-rate tariffs, tariffs for customers who saved over 15% with respect to the previous year, and a social tariff. The Ministry of Energy and Mining instructed ENARGAS to carry out a comprehensive tariff review (RTI) within a year. This tariff increase commenced the process of normalising the company's revenues.

  Although the initial reaction was not excessively adverse, abnormally cold weather in May resulted in a sharp increase in bills and led the government to suspend application of the tariffs nationwide. The reason given was that the new tariffs had not been submitted for public consultation, which is a necessary requirement but whose result is not binding.

  In August, a court declared the 1 April 2016 tariffs to be null and void for residential customers. On 16 September 2016, a public consultation was announced as a first step towards the publication of new tariffs.

  On 7 October 2016, the Argentine government officially published a new table of tariffs that is applicable to all customers from that date. At the same time, an application was filed with the government for monetary compensation for the delay in applying the original tariffs (1 April 2016).

  On 28 December 2016, a resolution of the Ministry of Energy and Mining approved Transitional Economic Assistance (AET) for the gas distribution network licence-holders. The amount approved for Gas Natural BAN was ARP 594 million.

  The company also continues its efforts to contain costs in a context of high inflation (estimated at 38% per year).

- In Brazil, residential-commercial customer numbers increased by 10.5% year-on-year, especially new buildings, due to commercial efforts being brought forward because of the Olympics. Sales declined by 30.4%; the economic crisis affected sales to industrial customers (-11.9%), while sales for power generation and TPA declined by -41% due to lower dispatching of thermal power plants as reservoir levels were higher than in 2015 (33.7%) and also to lower electricity demand. In contrast, sales to the residential and commercial markets, which provide the highest margins, increased by 6.2%, while sales of natural gas as fuel for vehicles increased by 4.8% as it was more competitive than liquid fuels.

- In Colombia, gas sales and TPA expanded by 5.0% year-on-year, due mainly to growth in industrial consumption (+10.7%), caused by higher sales in the secondary market. Residential-commercial customer numbers increased by 117,856 net in 2016, i.e. 8.3% year-on-year growth, due mainly to the increase in connections of new buildings and to horizontal saturation.

  The unregulated businesses in Colombia performed better than in 2015, with the margin rising by 26.1%, particularly in the area of energy solutions, where the number of live contracts increased by 34.2%. Appliance sales in the residential and SME market increased by 23.9%.

- The acceleration plan continues to be implemented in Mexico. Gas sales increased in all markets, including 4.8% growth in the residential-commercial market, 7.1% in the industrial market and 0.5% in TPA.

  On 26 February 2016, Mexico's energy regulator (Comisión Reguladora de Energía — CRE) notified Gas Natural Fenosa of the resolutions determining the list of maximum tariffs for the fourth five-year period (2016-2020) of permits for natural gas distribution granted for the distribution territories of Nuevo Laredo, Bajío, Toluca, Saltillo, Monterrey and Mexico City, which came into force in mid-March 2016 in all areas.

The gas distribution licence for the Cuautitlán-Texcoco-Hidalgo area was granted in December.

- The number of supply connections in Chile increased by 21,954, including growth of 3.9% in the residential-commercial segment and 2.4% in the industrial segment with respect to 2015. As for gas sales and TPA, the strongest year-on-year growth was observed in the power generation (19.2%) and industrial (16.6%) segments, followed by the residential-commercial (5.0%) and TPA (3.5%) segments.

- In Peru, the company continues development work with a view to initiating commercial operations early in May 2017.

  As a result of the concession awarded in July 2013, Gas Natural Fenosa will supply energy to an area in south-west Peru that is not yet connected to the gas grid and expects to supply natural gas to over 80,000 households.

Electricity distribution

2.5.4 Electricity distribution 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.

Results

	2016	2015	%
Net sales	833	838	(0.6)
Procurement	-	(1)	-
Net personnel expenses	(85)	(83)	2.4
Other expenses/revenues	(145)	(147)	(1.4)
EBITDA	**603**	**607**	**(0.7)**
Depreciation, amortisation and impairment expenses	(222)	(217)	2.3
Change in operating provisions	-	(2)	(100.0)
Operating income	**381**	**388**	**(1.8)**

The Ministerial Orders on remuneration for distribution (IET/980/2016) and transmission (IET/981/2016) for 2016, which were issued in June, set the remuneration for distribution and transmission by Gas Natural Fenosa's electricity distribution company and the other players. That remuneration reflects the amendments made by the Electricity Sector Act (Act 24/2013, of 26 December) and the new methodology for calculating the remuneration for distribution and transmission, set out in Royal Decrees 1048/2013 and 1047/2013, of 27 December.

EBITDA amounted to Euros 603 million in 2016, a 0.7% decline with respect to 2015. Net sales amounted to Euros 833 million, i.e. 0.6% less than in 2015, due to application of the aforementioned Royal Decrees and to the accrual of investments that were brought into operation. Net personnel expenses increased by 2.4% due to efficiency measures implemented in the year that are expected to have a positive impact in subsequent years.

Main aggregates

	2016	2015	%
Electricity sales (GWh): TPA	32,025	31,992	0.1
Connection points (thousand) (at 31/12)	3,702	3,683	0.5
ICEIT (minutes)	43	44	(2.3)

Energy supply increased slightly in the fourth quarter. December ended with 0.1% growth, a slightly poorer performance than distribution demand nationwide, which was 246,691 GWh, i.e. 0.5% growth, according to figures from Red Eléctrica de España (REE).

The number of distribution connections increased in 2016, by 19,006 net year-on-year.

The ICEIT outage indicator also improved in the fourth quarter due to the lack of notable incidents. The ICEIT outage indicator was lower than in 2015 despite the impact of strong gales and rainstorms in January and the first half of February in Galicia, where the terrain is less favourable.

2.5.5 Electricity distribution in 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. Gas Natural Fenosa is responsible for 70% of electricity distribution in Moldova.

Results

	2016	2015	%
Net sales	227	260	(12.7)
Procurement	(170)	(205)	(17.1)
Net personnel expenses	(6)	(6)	-
Other expenses/revenues	(9)	(11)	(18.2)
EBITDA	**42**	**38**	**10.5**
Depreciation, amortisation and impairment expenses	(5)	(6)	(16.7)
Change in operating provisions	-	-	-
Operating income	**37**	**32**	**15.6**

Net sales reflect the pass-through effect of procurement costs together with the capital expenditure and operation and maintenance work performed in accordance with the country's current regulations.

The increase in EBITDA in 2016 was due to higher remuneration for the capital base following the annual tariff update, to a reduction in grid losses, and also to the MDL/USD exchange rate.

Main aggregates

	2016	2015	%
Electricity sales (GWh) – tariff sales	2,672	2,684	(0.4)
Connection points (thousand) (at 31/12)	878	867	1.3

In 2016, the company continued to implement its plan to improve operations in Moldova, focusing on processes to control power flows in the distribution networks, operating processes associated with the entire customer management cycle, and optimisation of facility O&M, being the most relevant aspects:

- Electricity supplied declined by 0.4% in 2016 because of milder weather compared with 2015 and of slower economic growth.
- The number of supply connections totalled 878,491, i.e. an increase of 1.3% in the last twelve months, primarily as a result of growth in the real estate sector.

2.5.6 Electricity distribution Latin America

This division involves regulated electricity distribution in Argentina, Chile, Colombia and Panama, and electricity transmission in Chile.

Results

	2016	2015	%
Net sales	4,673	4,582	2.0
Procurement	(3,408)	(3,359)	1.5
Net personnel expenses	(216)	(196)	10.2
Other expenses/revenues	(360)	(326)	10.4
EBITDA	**689**	**701**	**(1.7)**
Depreciation, amortisation and impairment expenses	(162)	(159)	1.9
Change in operating provisions	(215)	(135)	59.3
Operating income	**312**	**407**	**(23.3)**

EBITDA from electricity distribution in Latin America totalled Euros 689 million, a 1.7% decline compared with 2015.

Excluding the effect of currency fluctuations, EBITDA would have increased by 3.0%.

The distribution business in Colombia contributed Euros 253 million to EBITDA, i.e. a 7.8% increase excluding the currency effect. This growth was basically due to higher supply charge revenues and to the fact that tariffs were updated at higher rates.

Excluding the exchange rate effect, provisions in Colombia increased by Euros 75 million, mainly due to the growth in customer receivables caused by the increase in supply charge revenues from May 2015 and in energy prices because of the El Niño phenomenon, a trend not matched by an increase in receipts, which have deteriorated in the last year.

EBITDA in Panama amounted to Euros 118 million in 2016, a 1.7% reduction at constant exchange rates. This variation was due mainly to higher power losses.

EBITDA in Chile and Argentina (CGE) amounted to Euros 318 million, a Euros 3 million increase at constant exchange rates. This increase arose in the power distribution business in Chile mainly because of growth in physical sales, increased services to third parties and the reduction of operating expenses through efficiency plans, along with higher demand for power in the transmission segment.

Main aggregates

	2016*	**2015**	**%**
Electricity sales (GWh):	33,561	34,055	(1.5)
Tariff electricity sales	31,441	32,131	(2.1)
TPA	2,120	1,924	10.2
Connection points (thousand) (at 31/12)	3,622	6,072	(40.3)

[*] Figures for Colombia are at 30/11/2016 since the December data are not available.

Electricity sales amounted to 33,561 GWh, down 1.5% due basically to a decline in demand in Colombia.

Demand in Panama continues its positive growth, having increased by 3.0% in 2016.

The main physical aggregates by country in 2016 are as follows:

	Argentina	**Chile**	**Colombia[*]**	**Panama**	**Total**
Electricity sales (GWh):	1,946	14,319	12,306	4,990	33,561
Increase v. 2015 (%)	5.0	2.3	(7.9)	3.0	(1.5)
Connection points (thousand)	221	2,786	-	615	3,622
Increase vs. 31/12/2015 (thousand)	5	74	-	37	150

[*] Figures for Colombia are at 30/11/2016 since the December data are not available.

The increase in sales and connection points reflects the sustained growth in the electricity distribution business in Latin America.

Electricity transmission in Chile

	2016	**2015**	**%**
Electricity transmitted (GWh)	14,484	14,497	(0.1)
Transmission network (km)	3,528	3,495	0.9

Power transmission in Chile decreased by 0.1% year-on-year, mainly because of lower activity in the fourth quarter. The transmission network reached 3,528 km, 33 km more than at the end of 2015.

Gas

2.5.7 Infrastructure

This area includes operation of the Maghreb-Europe gas pipeline and the exploration, production, storage and regasification of gas.

Results

	2016	2015	%
Net sales	324	317	2.2
Procurement	(7)	(6)	16.7
Net personnel expenses	(5)	(5)	-
Other expenses/revenues	(14)	(13)	7.7
EBITDA	**298**	**293**	**1.7**
Depreciation, amortisation and impairment expenses	(58)	(65)	(10.8)
Change in operating provisions	-	-	-
Operating income	**240**	**228**	**5.3**

Net sales in the infrastructure business totalled Euros 324 million in 2016, a 2.2% increase.

EBITDA increased by 1.7% year-on-year to Euros 298 million, mainly as a result of the 3% increase in the international shipping tariff on the Maghreb-Europe pipeline.

Main aggregates

The main aggregates in international gas transportation are as follows:

	2016	2015	%
Gas transport-EMPL (GWh):	111,720	112,861	(1.0)
Portugal-Morocco	41,295	36,971	11.7
Spain (Gas Natural Fenosa)	70,425	75,890	(7.2)

The gas transportation activity conducted in Morocco through companies EMPL and Metragaz represented a total volume of 111,720 GWh, 1.0% more than in the same period last year. Of that figure, 70,425 GWh were shipped for Gas Natural Fenosa through Sagane and 41,295 GWh for Portugal and Morocco.

Gas Natural Fenosa owns 14.9% of Medgaz, the company that owns and operates the Algeria-Europe subsea gas pipeline connecting Beni Saf with the Almería coast (capacity: 8 bcm/year). The corresponding capacity is associated with a new supply contract amounting to 0.8 bcm/year. A total of 8,614 GWh were shipped via the Medgaz pipeline for Gas Natural Fenosa in 2016.

The company currently has 916 GWh of company-owned gas storage capacity. In December 2016, work (replacement of a gas pipeline and preliminary wells) was performed on one of the exploration, production and storage projects that Gas Natural Fenosa plans for the Guadalquivir Valley in the coming years. This project is expected to be completed in late 2017. The other four projects are at various stages of the permit process.

2.5.8 <u>Supply</u>

This area includes wholesale gas procurement and supply both in the Spanish liberalised market and in other countries, maritime transportation, retail supply of gas and other related products and services in the liberalised market in Spain and Italy, and supply of gas at the last-resort tariff (TUR) in Spain.

Results

	2016	**2015**	**%**
Net sales	8,810	10,760	(18.1)
Procurement	(7,951)	(9,676)	(17.8)
Net personnel expenses	(72)	(68)	5.9
Other expenses/revenues	(240)	(228)	5.3
EBITDA	**547**	**788**	**(30.6)**
Depreciation, amortisation and impairment expenses	(62)	(54)	14.8
Change in operating provisions	(44)	(59)	(25.4)
Operating income	**441**	**675**	**(34.7)**

Net sales amounted to Euros 8,810 million, 18.1% less than in 2015. EBITDA amounted to Euros 547 million, a 30.6% decrease that was in line with the adjustment in energy prices in the period.

Market context

Spanish gas market demand reached 319,838 GWh in 2016 (313,233 GWh in 2015), of which 51,892 GWh relate to the residential market (50,194 GWh in 2015), 208,546 GWh to the industrial market and third-party supplies (202,040 GWh in 2015) and 59,400 GWh to the electricity market (61,000 GWh in 2015).

Evolution of the main gas market price indices is set out below:

	2016	**2015**	**%**
Brent (USD/bbl)	43.7	52.5	(16.8)
Henry Hub (USD/MBtu)	2.4	2.8	(14.3)
NBP (USD/MBtu)	4.7	6.5	(27.7)
TTF (€/MWh)	13.9	20.3	(31.5)

Main aggregates

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

	2016	2015	%
Gas supply (GWh):	325,384	316,268	2.9
Spain:	178,916	185,851	(3.7)
Gas Natural Fenosa supply	140,877	144,568	(2.6)
Residential	27,053	27,658	(2.2)
Industrial	96,421	96,831	(0.4)
Electricity	17,403	20,079	(13.3)
Supplies to third parties	38,039	41,283	(7.9)
International:	146,468	130,417	12.3
Europe wholesale	74,102	51,677	43.4
Europe retail	3,034	3,110	(2.4)
LNG International	69,332	75,630	(8.3)
Energy services contracts (thousand) (at 31/12)	2,853	2,859	(0.2)
Share of supply market in Spain	44.0%	46.2%	(4.8)
Maritime transportation capacity (m3)	1,387,344	951,318	45.8

Gas supply

Wholesale supply by Gas Natural Fenosa totalled 295,297 GWh, a 3.4% increase, basically due to international business (+12.7%).

In a situation of weak demand due to weather conditions, Gas Natural Fenosa supplied 178,916 GWh to end customers in Spain, i.e. 3.7% less than in the previous year.

International gas supply continued the trend of previous quarters and reached 146,468 GWh in 2016, a 12.3% increase year-on-year, driven particularly by supply to end customers in other European countries.

The organised market in gas through MIBGAS continued to expand trading in DA (day-ahead: next-day delivery) and WD (within day) contracts and there was an increase in liquidity as a result of actions proposed by the System Operator (GTS) to achieve equilibrium in the gas balance; Gas Natural Comercializadora is one of the few active participants in this market.

In 2016, Gas Natural Europe strengthened its position in natural gas supply in Europe, with a presence in France, Belgium, Luxembourg, the Netherlands and Germany. It is also an active trader in these countries' liquid markets, enabling Gas Natural Fenosa to optimise its position and seize opportunities in European markets.

Sales in France in 2016 amounted to 49.2 TWh, to customers in numerous segments such as industry, local government and the public sector. Sales in Belgium, Luxembourg, the Netherlands and Germany amounted to 11.9 TWh in the same period.

Gas Natural Fenosa is also active in the wholesale market in Italy, where it sold 6.8 TWh in the year, and in the wholesale market in Ireland, through the supply company it acquired in July 2016, which contributed a volume of 0.6 TWh in 2016.

Gas Natural Fenosa is still Portugal's second-largest operator, with a 15% market share; it is the largest foreign operator there, with a sales volume of 5.6 TWh. Its activities are focused in the industrial market, where it has a share of over 17%.

The company continues to diversify into international markets, having sold gas in the Americas and Asia. This strengthens the Group's presence in the main international LNG markets, providing it with a medium-term position in countries with growth potential and in new markets.

In the retail market, Gas Natural Fenosa focuses on meeting its customers' energy needs. With a range of quality products and services, it has 12.3 million active gas, electricity and maintenance contracts, of which 575,000 are in Italy.

In the Italian retail market, Gas Natural Fenosa has a portfolio of 434,500 gas supply contracts and 50,000 electricity supply contracts, with an overlap of 25,000 between the two. Additionally, 90,500 customers have a maintenance contract.

Gas Natural Fenosa provides a comprehensive service by integrating the supply of both energies (gas and electricity) with maintenance services to achieve efficiencies and enhance customer satisfaction; it supplies both energies to over 1.5 million homes, a large percentage of which have a maintenance contract in place.

With a strong focus on continued growth in the retail business, the company sells products and services throughout Spain, having obtained 1,536,000 new contracts in 2016.

In the domestic gas segment, GNF updates its product portfolio with a view to offering electricity and natural gas tariffs that are tailored to each customer's profile. New products meet needs as a function of customers' energy usage, preferred form of payment, usage patterns over time and their interest in consuming renewable energy.

Gas Natural Fenosa remains committed to innovation to meet and even anticipate its customers' expectations by adding new functionalities in all digital channels, such as the ability to buy services and receive customer care online; its online platform receives 6 million queries per year.

The broad, diversified offering of services for residential customers and SMEs has enabled the company to increase the number of active contracts to 2.7 million, managed through the group's own operating platform with 118 associated firms connected via an online system, through which it provides an excellent service and satisfies even the most demanding customers. As a result of this performance, the portfolio of energy and services contracts in the retail segment increased in value.

The number of gas and electricity maintenance contracts in the SME market continues to grow, having attained 23,000.

Gas Natural Fenosa continues to develop its own network of natural gas service stations that are open to the public; at the end of 2016, it had a total of 48 service stations (both compressed and liquefied natural gas), of which 27 are open to the general public and 21 are private.

The integrated energy services solutions business continues to expand. A survey conducted by DBK identified Gas Natural Servicios as market leader in energy services to business.

Unión Fenosa Gas

Gas supplied in Spain by Unión Fenosa Gas (equity method, main aggregates at 100%) amounted to 35,741 GWh in 2016, compared with 33,389 GWh in 2015. Additionally, a total of 22,500 GWh of energy was traded in international markets, compared with 21,782 GWh in 2015.

Electricity

2.5.9 Electricity in Spain

The electricity business in Spain includes electricity generation in Spain, electricity wholesale and retail in Spain's liberalised market, and electricity supply at the “Small Consumer Voluntary Price” (PVPC).

Results

	2016	2015	%
Net sales	5,279	5,779	(8.7)
Procurement	(3,813)	(4,338)	(12.1)
Net personnel expenses	(138)	(138)	-
Other expenses/revenues	(613)	(562)	9.1
EBITDA	**715**	**741**	**(3.5)**
Depreciation, amortisation and impairment expenses	(523)	(523)	-
Change in operating provisions	(38)	(38)	-
Operating income	**154**	**180**	**(14.4)**

Net sales in the electricity business in Spain amounted to Euros 5,279 million, 8.7% less than in 2015, while EBITDA amounted to Euros 715 million, in line with 2015.

Market context

Electricity demand in mainland Spain amounted to 250,132 GWh in 2016, a 0.7% increase year-on-year. Correcting for the temperature and calendar effects, demand was flat year-on-year.

There was a net importation of electricity (7,663 GWh) via international physical exchanges in 2016, contrasting with 133 GWh exported in 2015; this was due to the entry into commercial operation of the new interconnector with France in October 2015 and to market prices in Spain being higher than in the rest of Europe (a phenomenon not seen since 2003).

Consumption for pumped storage amounted to 4,810 GWh in 2016, i.e. 6.4% more than in 2015, due to low market prices in comparison with last year.

Net domestic generation fell by 2.3% in 2016 with respect to 2015.

Renewable output (including hydroelectric) increased by 7.9% in 2016 and covered 39.9% of demand, 2.6 points more than in 2015.

Wind power output declined by 0.8%. Wind covered 18.9% of total demand, 0.3 points less than in 2015.

Other renewable output increased by 17.1% in 2016, while there was a decline in output by all technologies except hydroelectric and renewable thermal.

In terms of hydroelectric energy capability, 2016 ceased to be classified as a very wet year, since its exceedance probability was ultimately 29% when compared with the historical average; i.e. statistically, 29 out of every 100 years would be wetter than 2016.

Non-renewable output declined by 8.1% in 2016 and the thermal gap went from 30.7% in 2015 to 24.4% in 2016.

Nuclear output increased by 2.4%.

Coal-fired production declined by 30.9%. Utilisation of the former capacity guarantee units was 35%, compared with 46% for the other coal-fired units.

CCGT output increased by 2.3%. They covered 10.3% of total demand, 0.1 points more than in 2015.

Other non-renewable thermal output (cogeneration and energy-from-waste) increased by 1.7% in 2016.

Movements in the main electricity and related market price indices (in addition to the indices mentioned in point 2.5.8.) are set out below:

	2016	**2015**	**%**
Weighted average daily market price (€/MWh)	40.8	51.8	(21.2)
Coal API 2 CIF (USD/t)	59.8	56.8	5.3
CO_2 EUA (€/ton)	5.4	7.7	(29.8)

Main aggregates

The main aggregates in Gas Natural Fenosa's electricity business in Spain were as follows:

	2016	2015	%
Installed capacity (MW):	12,716	12,769	(0.4)
Generation:	11,569	11,624	(0.5)
Hydroelectric	1,954	1,954	-
Nuclear	604	604	-
Coal	2,010	2,065	(2.7)
CCGTs	7,001	7,001	-
Renewable and cogeneration output:	1,147	1,145	0.2
Wind	979	977	0.2
Small hydroelectric	110	110	-
Cogeneration and other	58	58	-
Electricity generated (GWh):	28,504	31,568	(9.7)
Generation:	26,046	29,468	(11.6)
Hydroelectric	3,933	2,457	60.1
Nuclear	4,463	4,544	(1.8)
Coal	5,687	7,973	(28.7)
CCGTs	11,963	14,494	(17.5)
Renewable and cogeneration output:	2,458	2,100	17.0
Wind	1,844	1,601	15.2
Small hydroelectric	562	448	25.4
Cogeneration and other	52	51	2.0
Power generation availability factor (%)	92.1	90.1	2.0 p.p.
Electricity sales (GWh):	36,384	35,241	3.2
Liberalised market	31,167	29,720	4.9
PVPC/Regulated	5,217	5,521	(5.5)
Market share of generation	17.0	18.4	-1.4 p.p.

On 17 May 2016, the market operator definitively decommissioned unit 1 of Narcea thermal power plant; this did not have an impact on the income statement because the plant was fully depreciated and a provision had been recognised for decommissioning it.

Gas Natural Fenosa generated 28,504 GWh of electricity in mainland Spain in 2016, i.e. 9.7% less than in 2015, basically due to conventional generation (-11.6%).

Conventional hydroelectric output increased by 60.1% with respect to 2015.

In the watersheds where Gas Natural Fenosa operates, 2016 was officially classified as an average year, with an exceedance probability of 51%; the year had two distinct parts: it was average-wet until June, and extremely dry for the remainder of the year.

Reservoirs in the Gas Natural Fenosa watersheds were at 23% of capacity, one point lower than at 2015 year-end (24.2%). Annual reservoir stocks stand at 34%, five points less than in 2015, while hyper-annual stocks are 9%, almost double the figure at 2015 year-end (5%).

Nuclear output declined by 1.8% in 2016 with respect to 2015, although the figures are affected by changes in the dates of scheduled shut-downs.

Coal-fired output decreased by 28.7% in 2016 with respect to 2015, and capacity utilisation stood at 34%.

CCGT output was 17.5% lower than in 2015; however, utilisation of this technology by Gas Natural Fenosa was 20%, almost double that of the industry as a whole (12%).

Emissions of CO_2 (greenhouse gases) in 2016 from Gas Natural Fenosa's coal-fired plants and CCGTs totalled 10.4 million tons in 2016 (3.1 million tons less than in 2015).

Under its commitments, during April 2016 Gas Natural Fenosa supplied the European Union's Union Registry with the rights equivalent to the CO_2 emissions certified at its coal-fired and CCGT plants in 2015, a total of 13.5 million tons of CO_2.

Gas Natural Fenosa's share of power generation was 17.0% in 2016, i.e. 1.4 points less than in 2015.

Sales in the electricity supply business amounted to 36,384 GWh, 3.2% more than in 2015. The electricity supply portfolio is in line with Gas Natural Fenosa's strategy of optimising margins and market share and hedging against price variations in the electricity market.

In November 2016, Gas Natural Fenosa Renovables commenced construction of 5 of the 13 wind farms that it registered within the maximum quota of 450 MW authorised by the Canary Islands Regional Government Ministry of Industry, Energy and Tourism. This quota qualifies for a special remuneration regime; the farms are expected to be commissioned by 31 December 2018. Work continues in order to obtain the necessary permits to commence construction of the other eight wind farms in the first half of 2017.

At 31 December 2016, Gas Natural Fenosa Renovables (GNF Renovables) had a consolidable total operational capacity of 1,104 MW, of which 979 MW are wind, 110 MW are small hydroelectric and 15 MW are cogeneration and photovoltaic. These figures do not include the cogeneration plants that are currently in liquidation (43MW); the company is awaiting the enactment of the new parameters for this technology in order to make a decision to partly or wholly re-open this capacity, which is currently dormant.

2.5.10 <u>Global Power Generation</u>

GPG encompasses all of the Group's international power generation assets and holdings in Mexico, Puerto Rico, the Dominican Republic, Panama, Costa Rica, Kenya and Australia (wind projects), and the assets operated for third parties via O&M Energy.

Results

	2016	2015	%
Net sales	781	806	(3.1)
Procurements	(400)	(420)	(4.8)
Net personnel expenses	(40)	(39)	2.6
Other expenses/revenues	(84)	(86)	(2.3)
EBITDA	**257**	**261**	**(1.5)**
Depreciation, amortisation and impairment expenses	(132)	(134)	(1.5)
Change in operating provisions	-	-	-
Operating income	**125**	**127**	**(1.6)**

Global Power Generation's EBITDA in 2016 amounted to Euros 257 million, down 1.5% compared with 2015, due mainly to lower EBITDA in Mexico and the Dominican Republic, partly offset by lower operating expenses at GPG Holding.

There was a 3.6% decline in EBITDA in Mexico basically because of the exchange rate effect and of higher maintenance expenses due to changes in the shutdown calendar. These negative effects were offset by a higher contribution margin attributable to better plant availability, despite adverse performance by the contractual benchmark indices. Bii Hioxo improved results due to more efficient management of the commercial mix.

EBITDA in the Dominican Republic declined by 31.4% due to the effect on margins of lower output and lower spot market prices after expiration of the PPA with the distribution companies.

EBITDA in Panama increased by 16.7% due to higher precipitation in the areas where the plants are located. This also resulted in the need to purchase electricity in the market to meet contractual commitments.

In Kenya, EBITDA increased by 12.5% year-on-year. This increase was due mainly to higher output as the plants were dispatched to a greater extent, and also to the receipt of insurance indemnities and a reduction in maintenance expenses.

Main aggregates

The main aggregates are as follows:

	2016	2015	%
Installed capacity (MW):	2,702	2,702	-
Mexico (CCGT)	2,035	2,035	-
Mexico (wind)	234	234	-
Costa Rica (hydroelectric)	101	101	-
Panama (hydroelectric)	22	22	-
Dominican Republic (oil-fired)	198	198	-
Kenya (oil-fired)	112	112	-
Electricity generated (GWh):	18,048	17,980	0.4
Mexico (CCGT)	15,648	15,519	0.8
Mexico (wind)	793	850	(6.7)
Costa Rica (hydroelectric)	398	408	(2.5)
Panama (hydroelectric)	98	73	34.2
Dominican Republic (oil-fired)	920	1,012	(9.1)
Kenya (oil-fired)	191	118	61.9
Availability factor (%)			
Mexico (CC)	93.4	91.2	2.2 p.p.
Costa Rica (hydroelectric)	93.2	93.6	-0.4 p.p.
Panama (hydroelectric)	94.4	96.4	-2.0 p.p.
Dominican Republic (oil-fired)	89.4	92.6	-3.2 p.p.
Kenya (oil-fired)	95.8	94.8	1.0 p.p.

Output in Mexico increased year-on-year since the major overhauls of Tuxpan and Naco lasted longer in 2015, Tuxpan unit III operated in open cycle, and there were problems with the quality of input gas in 2015. These effects offset the reduction in wind output caused by lower winds at Bii Hioxo and reduced production by Durango, which had a major overhaul this year. Differences in maintenance calendars between years resulted in higher availability than last year.

Hydroelectric output in Costa Rica was negatively impacted by lower dispatching of hydroelectric plants in the fourth quarter of 2016. The lower availability was due mainly to an additional shutdown at La Joya in December 2016 and an unscheduled shutdown at Torito in September 2016 caused by flooding of the machine hall. As discussed in section 2.3, the concessions in Costa Rica are recognised as finance asset in accordance with IFRIC 12.

Output in Panama was higher as a result of higher precipitation in the second half of 2016. The reduction in availability year-on-year is attributable to a major overhaul on the La Yeguada plant.

Output in the Dominican Republic declined year-on-year due to higher hydroelectric generation and to the withdrawal of the more efficient plants from the system in 2015.

Oil-fired output in Kenya was 61.9% higher than in 2015 as a result of higher dispatching in 2016 due to maintenance shutdowns of some of the country's hydroelectric facilities, and to the non-availability of other geothermal plants.

On 18 August 2016, Gas Natural Fenosa, through GPG, was awarded two power generation projects in Chile: the Cabo Leones II wind farm (204 MW) and a solar photovoltaic plant in Inca de Varas (120 MW). This is Gas Natural Fenosa's first electricity generation project in Chile, and it will ultimately supply 858 GWh per year; the investment is expected to amount to Euros 325 million. Construction is expected to commence in the third quarter of 2018, with commissioning scheduled for the fourth quarter of 2020.

On 23 August 2016, Gas Natural Fenosa, through GPG, was awarded its first wind farm in Australia; located in New South Wales, the 91 MW plant is expected to cost Euros 120 million. It is expected to be commissioned in the second half of 2018.

The Group also acquired two photovoltaic projects in Brazil that are ready for construction, with a combined capacity of 60 MW and output of 156 GWh. The total investment will be approximately Euros 85 million and they are expected to be commissioned by late 2017.

Ecoelectrica

The contribution by Ecoelectrica's CCGT in Puerto Rico (equity method) to the consolidated Group increased with respect to 2015 as a result of higher capacity revenues and a 14.1% increase in output, due to the fact that the plant had a major overhaul in the first quarter of 2015 and the shutdown scheduled for the first quarter of 2016 was brought forward to late 2015 due to damage caused by tropical storm Erika.

3. Sustainability

3.1 Environment

Main aggregates

	2016	2015	% Var.
Zero emissions installed capacity (%)	22.1	22.0	0.4
Zero emissions net production (%)	16.4	11.8	39.1
Direct GHG emissions[1] (Mt CO_2 eq.)	19.5	22.4	(12.9)
CO_2 emissions/electricity production (t CO_2/GWh)	411	445	(7.6)
Methane emissions in gas distribution (t CO_2 eq./km network)	9.3	9.3	-
Environmentally certified activities (% of environmentally certified EBITDA/total Group EBITDA potentially certifiable)[2]	90.1	88.3	(2.0)

[1] Scope 1 direct greenhouse gas emissions in accordance with "*The Greenhouse Gas Protocol. A Corporate accounting and reporting standard*".
[2] Approximately 86.8% of Group EBITDA is potentially certifiable.

Gas Natural Fenosa works to ensure compliance with environmental legislation, reduce environmental impact, mitigate climate change, optimise the consumption of natural resources such as water, preserve biodiversity in the environment, prevent pollution and foster continuous improvement, going beyond the legal requirements.

In 2016, new environmental management systems were certified in accordance with ISO 14001 and internal requirements, and there was a slight increase in the percentage of EBITDA certified as a result of the addition of part of the Chilean electricity distribution business. The work to adapt environmental management systems and certify them to international standards and internal requirements will conclude in 2017.

Regarding climate change, there was a significant reduction in direct CO2 emissions with respect to 2015 as a result of lower coal-fired output in Spain, replaced by less polluting output. As a result, specific emissions per unit of power generated were reduced considerably with respect to 2015.

In 2016, Gas Natural Fenosa carried out numerous and varied activities in favour of conserving biodiversity, many of which have gone beyond the requirements set by the environmental authorities and others are voluntary in nature.

As part of its commitment to the environment and to efficient management of natural resources, in 2016 Gas Natural Fenosa made progress with its water strategy and commenced work to define lines of action in connection with the circular economy in 2017.

Note 36 to the annual accounts contains other relevant information on the main environmental and sustainability activities, emissions and environmental investments.

3.2 <u>People</u>

Main aggregates

Employment indicators	2016	2015	% Var.
Number of employees at 31/12	17,229	19,939	(13.6)
Voluntary turnover rate (%)	2.5	3.5	(28.6)
Integration rate (persons with disabilities)[1]	2.4	2.4	-
Employee training hours	50.9	61.4	(17.1)
Absenteeism	2.2	2.0	10.0
Days lost	2,424	3,674	(34.0)
Number of accidents resulting in days lost	65	125	(48.0)

[1] Spain

Human and social development

Gas Natural Fenosa provides stable and quality employment (96% of positions are indefinite) and a solid, structured and appealing professional career.

During 2016, the implementation of the Human and Social Development project continued, the main objective of which is to promote a quality work environment based on respect, diversity and personal and professional development. Through this project, a number of programmes have been promoted and coordinated on the basis of two essential pillars: equality of opportunities, and training as a lever to raise internal awareness about disability.

Gas Natural Fenosa has a common global model for personnel selection for all the geographies in which it operates. This ensures that it applies uniform approach as an employer, using standard criteria and best practices in identifying, attracting and retaining the professional talent necessary to carry on its business.

Gas Natural Fenosa continues to offer all employees the opportunity to participate in the internal mobility programme. Through this programme, employees can apply for any vacant position in any location, irrespective of where the employee's work place is located. This is one of the main components for enhancing career development within the company. To ascertain employees' preferences and concerns in connection with mobility, work continues on the "Conocerte" project. This initiative, which commenced in 2015, has helped to provide individual and centralised information for the entire Company. Aimed at technical professionals not include in executive programmes or the Savia programme, the initiative gathered information about 10,000 employees in 15 countries.

Ethical behaviour, promoting and respecting equality, and occupational health and safety are essential parts of the commitment made by Gas Natural Fenosa to its employees.

These principles are reflected in the company's day-to-day performance through the Code of Ethics, the II Collective Agreement, the Equality Plan and the Protocol for the Prevention of Workplace, Sexual and Gender-based Harassment.

In 2016, progress was made on the implementation of equality and diversity actions for employees, with the design of a Comprehensive Diversity Plan focused on gender, age and disability.

Concerning disability, the Capacitas and Aflora programmes aimed at normalising the professional integration of professionals with disability. Since implementation of these two projects commenced, a total of 156 persons with special needs have received aid relating to employment in Spain, i.e. over 87% of employees with disabilities have availed themselves of these programmes. Gas Natural Fenosa renewed the Bequal Plus Seal in recognition of our inclusion policy as a pioneer in disability commitment within the energy industry.

Gas Natural Fenosa promotes work-life balance through a major set of labour flexibility measures, services and benefits adapted to employees' needs. Our professionals can thus design their own life options in line with their development plans and the company's interests.

Training and talent management

Talent management at Gas Natural Fenosa's is centred on employees' individual development and professional careers, helping to define professional learning in a controlled and consistent manner to ensure that their development is aligned with the company's objectives.

The leadership and talent management model seeks to foster responsibility as well as individual and career development by using innovative tools and methodologies in training and development.

The model was simplified in 2016 to make it more accessible to all employees, the goal being to have a single, homogeneous, standardised model for professional evaluation and development.

The Talent Management and Corporate University unit is responsible for the development of Gas Natural Fenosa's professionals on all organisational levels and for knowledge management in all areas of the company. Training is a success factor for the company since our employees are the ones who achieve business objectives and drive our corporate strategies.

The Corporate University has a network of alliances with academic institutions in Spain and other countries. The Advisory Board, comprising the Polytechnic Universities of Barcelona and Madrid, the Monterrey Institute of Technology, IESE, ESADE and Boston Consulting Group, with the internal units of Gas Natural Fenosa, ensure a permanent link between the company's strategy and the programmes that are implemented.

Gas Natural Fenosa has established itself as a leader in health and safety following the implementation in 2012 of an ambitious “Health and Safety Commitment Plan” aimed at achieving a profound cultural change. The Corporate University has contributed to this process through a related training scheme, under which 100% of the company’s employees have been trained.

Remuneration

Gas Natural Fenosa's remuneration policy is guided by the principles of internal equality and competitiveness in the market. Employees' remuneration depends on whether or not they are covered by the Collective Agreement.

The salary levels of employees covered by the Collective Agreement are based on the professional group and sub-group to which they belong.

For those not covered, salaries are defined individually, in line with the Company's remuneration policy.

Variable remuneration under Gas Natural Fenosa's remuneration policy is designed to promote employee commitment and motivate performance, in line with the long-term interests of the Company and its shareholders.

Annual variable remuneration rewards the achievement of individual targets depending on the position, applying financial, efficiency and growth variables, as well as on quality and security issues, directly related to the fulfilment of the objectives proposed in the Management by Objectives Plan.

Management by Objectives and Commercial Variable Remuneration are methodologies deployed in Gas Natural Fenosa to encourage employee involvement in achieving the objectives of the company and their direct participation in results. Both are arranged through two types of Annual Variable Remuneration, depending on the group addressed:

- Management: based on management by objectives and performance appraisal. Applies to management personnel not covered by the Collective Agreement.
- Commercial: based on the fulfilment of commercial objectives. Aimed at employees with commercial functions.

The compensation package for employees of Gas Natural Fenosa is complemented by a benefits system which includes the pension plan, the main vehicle for funding post-employment commitments.

Furthermore, Gas Natural Fenosa offers a range of social benefits that complement the employees' remuneration package. The "Mis Beneficios" (My Benefits) platform for the workforce in Spain went live in 2016; it provides a single, comprehensive solution for managing and communicating compensation and benefits programmes. The platform continues to be developed to adapt to the various compensation and benefits strategies.

It includes such modules as: "Sistema de previsión social" to help employees understand their retirement and be aware of the Company's retirement plans, and "Bienestar y Salud", which enables employees to manage their well-being and health related plans.

All personnel in Spain also have a flexible remuneration system, which was implemented in 2012. The system enables beneficiaries to design the composition of their compensation package by combining a range of products on offer.

Personnel structure

Note 25 to the Consolidated Annual Accounts provides a breakdown of personnel by category, gender and geographic area at 31 December.

3.3 Taxation

Tax policies and tax risk management

Gas Natural Fenosa's tax policies are aligned with the Gas Natural Fenosa Corporate Responsibility Policy, which establishes as one of the commitments and principles of action to "act responsibly in managing business and comply with tax obligations in all the jurisdictions in which the company operates, assuming the commitment to transparency and collaborate with the relevant tax authorities."

To this end, since 2010 Gas Natural Fenosa has adhered to the "Code of Best Tax Practices" drawn up by the Large Companies Forum in conjunction with the Spanish tax authorities. This initiative, supported by the Spanish government, aims to promote transparency, good faith and cooperation with the tax authorities in business tax practices, and legal certainty in the application and interpretation of tax regulations.

In this respect, the company has expressly undertaken to: (a) avoid opaque structures for tax purposes, (b) collaborate with the tax authorities, (c) regularly report on tax policies to the Board of Directors, and (d) apply tax criteria in line with administrative pronouncements and case law.

To ensure that the tax practices of Gas Natural Fenosa are based on these principles, the group has a General Procedure governing Best Practices in the area of Tax.

In addition, Gas Natural Fenosa has a risk map specifically identifying tax risks and disputes concerning the interpretation and application of tax law. Information on the main tax-related actions is disclosed in Note 21 (Tax Situation) to the consolidated annual accounts.

The tax repercussions of any material or unique transactions are reported to the Board of Directors when they are deemed to be material. The creation or acquisition of holdings in entities domiciled in designated tax havens must be reported to the Board of Directors through the Audit Committee.

On the basis of Spanish legislation concerning countries classified as tax havens (Royal Decree 1080/1991, of 5 July, and Royal Decree 116/2003, of 31 January), Gas Natural Fenosa has interests in only two companies incorporated in such territories:

- 95.0% of Buenergía Gas & Power, Ltd., domiciled in the Cayman Islands. This company indirectly owns only one industrial holding, in a company that engages in power generation by means of a combined cycle gas turbine plant in Puerto Rico (Ecoeléctrica, L.P.), whose income is taxed in that country and which does not provide Gas Natural Fenosa with any tax benefits.
- 52.2% of Gasoducto del Pacífico (Cayman), Ltd., domiciled in the Cayman Islands. This company, which is dormant, was acquired by the Group as a consequence of the acquisition of the CGE group and does not provide any tax advantage for Gas Natural Fenosa.

In 2016, the domicile of the 47.5% holding in Ecoeléctrica Holding, Ltd. and the 47.5% holding in Ecoeléctrica Limited was changed from the Cayman Islands to Puerto Rico; accordingly, they have ceased to be classified as holdings in tax havens.

Intragroup transactions with these entities relate to dividends received, as follows:

Receiving subsidiary	Distributing subsidiary	Amount (thousand Euros)
Global Power Generation, S.A.	Buenergía Gas & Power, Ltd.	6,036

Tax contribution

Gas Natural Fenosa is aware of its responsibility for the economic development of the communities in which it conducts its business. The taxes it pays represent a significant part of the economic contribution made to the countries in which it operates. Therefore, Gas Natural Fenosa pays priority attention to fulfilling its obligation to pay taxes under the laws of each territory.

The taxes paid by Gas Natural Fenosa have considerable economic importance and involve a major compliance effort under formal obligations and cooperation with the tax authorities.

The total tax contribution of Gas Natural Fenosa amounted to Euros 3,423 million in 2016 (Euros 3,636 million in 2015). The following table details the taxes actually paid by Gas Natural Fenosa, by country, segmenting those that represent actual expenditure by the group (called group taxes) and those that are withheld or charged to the end taxpayer (called third-party taxes):

Country	Group taxes						Third-party taxes								Total	
	Corporate income tax (1)		Others (2)		Total		VAT		Tax on hydrocarbons		Others (3)		Total			
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
Spain	199	347	512	549	711	896	1,007	1,169	352	362	229	200	1,588	1,731	2,299	2,627
Argentina	10	4	42	40	52	44	13	13	-	-	22	16	35	29	87	73
Brazil	38	51	49	44	87	95	58	56	-	-	9	18	67	74	154	169
Colombia	75	69	78	78	153	147	7	9	-	-	14	22	21	31	174	178
Chile	42	48	11	16	53	64	117	99	-	-	18	22	135	121	188	185
Mexico	31	33	3	4	34	37	39	32	-	-	11	12	50	44	84	81
Panama	89	8	7	11	96	19	-	-	-	-	3	4	3	4	99	23
Rest LatAm	12	11	1	1	13	12	2	3	-	-	3	2	5	5	18	17
Total LatAm	297	224	191	194	488	418	236	212	-	-	80	96	316	308	804	726
Italy	19	14	7	5	26	19	27	30	42	34	5	5	74	69	100	88
Rest	10	10	23	35	33	45	128	112	49	32	6	6	183	150	216	195
Total	**525**	**595**	**733**	**783**	**1,258**	**1,378**	**1,398**	**1,523**	**443**	**428**	**320**	**307**	**2,161**	**2,258**	**3,419**	**3,636**

(1) Corporate income tax actually paid during the year. Does not include accrued amounts. Information on the reconciliation between the recognised corporate income tax amount and the amount that would result from applying the nominal income tax rate currently prevailing in the country of the parent company (Spain) to pre-tax profits is detailed in Note 21 (Tax Situation) to the consolidated annual accounts.

(2) Includes energy taxes which in Spain amounted to Euros 244 million in 2016 (Euros 262 million in 2015), local taxes, employer social security contributions and other taxes specific to each country.

(3) Basically includes employee income tax withholdings and employee social security contributions.

4. Main risks and uncertainties

4.1. Operating risks

4.1.1. Regulatory risk

Gas Natural Fenosa and its subsidiaries are required to comply with legislation governing the natural gas and electricity sectors. In particular, gas and electricity distribution are regulated activities in most of the countries in which Gas Natural Fenosa performs them.

Legislation applicable to the natural gas and electricity sectors in the countries in which Gas Natural Fenosa operates is generally revised on a regular basis by the competent authorities. Any amendments may affect the current remuneration system for regulated activities, adversely impacting Gas Natural Fenosa's business, profits, grants and financial position.

In the event that competent public or private bodies interpret or apply such regulations based on criteria that differ from those of Gas Natural Fenosa, its compliance might be questioned or appealed and, in the event that an infringement were proven, there might be a material adverse impact on Gas Natural Fenosa's business, prospects, profits, grants and financial position.

Regulatory risk management is founded on smooth communication between Gas Natural Fenosa and regulators. Additionally, in the course of its regulated activities, Gas Natural Fenosa ensures that its costs and investments are aligned with the rates of return recognised for each business.

4.1.2. Gas and electricity volume risk

Most purchases of natural gas and liquefied natural gas (LNG) are made under long-term contracts containing clauses whereby Gas Natural Fenosa is obligated to purchase certain annual volumes of gas ("take-or-pay" clauses). Under such contracts, even if Gas Natural Fenosa does not need to acquire the committed volume of gas at a given time, it is contractually obligated to pay for the minimum volume committed in the take-or-pay clauses.

The contracts stipulate gas volumes in line with Gas Natural Fenosa's estimated needs. However, actual needs may be below the volumes estimated when the contracts were arranged. In the event of significant departures from the estimates, Gas Natural Fenosa will be obligated to purchase a large volume of gas than is actually needed or, failing this, to pay for the minimum volume of gas committed, irrespective of whether or not it acquires the volume that exceeds its needs; this could have a significant adverse effect on Gas Natural Fenosa's operating costs.

In the electricity business, Gas Natural Fenosa's results are exposed to a reduction in the amount of electricity generated, which is shaped by trends in demand for electricity. Additionally, in view of the major role played by CCGT technology in Gas Natural Fenosa's generating fleet, the amount of power generated might be reduced because of the growing importance of power generation from renewable sources.

A decrease in volumes generated would increase uncertainty as regards the achievement of generation/supply objectives.

Gas Natural Fenosa manages contracts and assets on a globally integrated basis to optimise energy balances, enabling it to correct any deviation in the most profitable manner possible.

4.1.3. Operational risk

a) Insurable risks

Gas Natural Fenosa's activities are exposed to a variety of operational risks such as faults in the distribution network, in electricity generation facilities and in gas carriers, explosions, polluting emissions, toxic spillage, fire, adverse weather conditions, contractual breaches, sabotage or accidents affecting the gas distribution network or electricity generation assets, and other damage and force majeure circumstances that might cause bodily harm and/or material damage, affecting or destroying Gas Natural Fenosa's facilities or property. Events such as these, or similar events, are unforeseeable and may interrupt the supply of gas and generation of electricity. In such situations, although coverage is provided by risk insurance policies, such as policies covering loss of profit and material damage, Gas Natural Fenosa's financial situation and results could be affected to the extent that any losses are not insured, coverage is insufficient, or economic losses are generated due to coverage limits or an increase in the excess, as well as potential increases in premiums paid to insurers.

Gas Natural Fenosa might also have to respond to third-party claims for bodily harm and/or other damage caused in the ordinary course of business. Such claims could result in the payment of indemnities under legislation applicable in the countries in which Gas Natural Fenosa operates, which could have a material adverse impact on the business, prospects, financial position and results if the its third-party liability insurance policies not cover the amount of the indemnities.

Gas Natural Fenosa prepares continuous improvement plans to reduce the frequency and severity of potential incidents. Specific asset supervision units have been created to intensify preventive and predictive maintenance, among other measures. Additionally, our approach to insurance coverage is based on optimising the total cost of risk.

b) Image and reputation

Gas Natural Fenosa is exposed to opinions and perceptions of a variety of stakeholders. Such perceptions may be adversely impacted by events caused by the Company or by third parties over which the Company has little or no control, impacting its own reputation or that of the industry. Such impacts might cause medium-term financial damage by increasing regulatory demands or funding costs or by requiring additional expenditure to win customers.

Gas Natural Fenosa is engaged actively in identifying and monitoring potential reputational events and the stakeholders affected. Transparency also forms part of our communication policy.

c) Environment

Gas Natural Fenosa's activities are subject to extensive legislation on environmental protection.

Gas Natural Fenosa and its subsidiaries must comply strictly with extensive environmental protection regulations requiring, among other aspects, the preparation of environmental impact analyses, obtainment of authorisations, licences and permits, and fulfilment of certain requirements. Considerations include:

- Environmental authorisations and licences might not be granted or might be revoked due to failure to comply with the attached conditions;
- The regulatory framework or its interpretation by the authorities might be amended, resulting in higher costs or deadlines for compliance with the new requirements.

In order to mitigate this risk, Gas Natural Fenosa has adopted an integrated environmental management system and has emergency plans for facilities where there is a risk of accidents with an environmental impact. Specific insurance policies have also been arranged to cover this type of risks.

d) Climate change

Demand for electricity and natural gas is related to the weather. A significant part of gas consumption during the winter months is driven by electricity generation and space heating, while summer consumption depends basically on electricity generation for air conditioning. Gas Natural Fenosa's revenue and results from natural gas distribution and supply activities might be adversely affected in the event that the autumn months become warmer or winters become milder. Demand for electricity might also fall if summers become milder, due to a decline in demand for air conditioning. Additionally, hydroelectric generation plant utilisation depends on rainfall in the plant locations and might be affected by drought.

European policies and measures to combat climate change could affect Gas Natural Fenosa's results in the event that the competitiveness of the Company's generation mix is altered.

Gas Natural Fenosa forms part of a number of work groups at European level, enabling strategy to be adapted to new regulations in advance. Gas Natural Fenosa also forms part of clean development projects designed to reduce CO_2 emissions.

e) Geopolitical exposure

Gas Natural Fenosa has interests in countries with different political, economic and social environments; in this regard, two main areas are particularly relevant:

- Latin America

  A large part of Gas Natural Fenosa's operating profits are generated by its Latin American subsidiaries. Latin American operations are exposed to a number of risks inherent in investment in this region. Risk factors linked to investment and business in Latin America include:

  - Considerable influence of local governments on the economy;
  - Significant fluctuation in the economic growth rate;
  - High inflation;
  - Devaluation, depreciation or overvaluation of local currencies;
  - Controls or restrictions on the repatriation of earnings;
  - Fluctuating interest rates;
  - Changes in financial, economic and fiscal policies;
  - Unexpected changes to regulatory frameworks;
  - Social tensions and
  - Political and macroeconomic instability.

- Middle East and Maghreb

  Gas Natural Fenosa has both its own assets and major contracts for the supply of gas from various Maghreb countries and the Middle East, particularly Egypt. Political instability in the zone may result in physical damage to the assets of Gas Natural Fenosa's investee companies or the obstruction of the operations of those or other companies, interrupting the Group's gas supply.

Gas Natural Fenosa has a diversified portfolio both in the countries in which it carries on energy distribution activities (Latin America, Europe) and the countries that supply gas (Latin America, Africa, Middle East, Europe). Diversification minimises the risk of expropriation and of supply interruption due to the knock-on effect of political instability in neighbouring countries. Specific insurance policies have also been arranged for these risks.

4.2. Financial risks

Financial risks (interest rate, exchange rate, commodity price, credit and liquidity risk) are detailed in Note 17 to the Consolidated Annual Accounts.

On 23 June 2016, the United Kingdom voted to withdraw from the European Union ("Brexit"). Although the UK's withdrawal will be accompanied by a process of negotiation over a period of time that cannot be determined as yet, the decision has already had consequences in the capital and foreign exchange markets. Gas Natural Fenosa's exposure to Brexit risk is practically non-existent.

4.3. Main opportunities

Gas Natural Fenosa's main opportunities are as follows:

- Generation mix: Gas Natural Fenosa's generating fleet, consisting mainly of CCGT facilities, has the necessary flexibility to adapt to different market circumstances; it is thus a valuable asset to leverage opportunities related to price and demand volume volatility in the gas and electricity markets.
- CO_2 market evolution: The mechanisms proposed by the European Commission to increase the cost of emission rights are intended to discourage the use of the more polluting technologies so as to counteract climate change. In this context, Gas Natural Fenosa's plants would be more competitive than coal plants and opportunities could also arise in the emissions market.
- Natural gas and LNG procurement portfolio: Management of gas pipelines, investment in plants and the fleet of gas carriers enable the Group to meet its business needs in a flexible, diversified manner, optimising its approach to different energy scenarios. Specifically, the fleet of gas carriers makes Gas Natural Fenosa one of the world's leading LNG operators and a principal in the Atlantic and Mediterranean.
- A balanced structural position in terms of businesses and geographies, many with stable flows, irrespective of commodities prices, making it possible to take the maximum advantage of growth in energy demand and of new business opportunities in new markets.

5. Group outlook

5.1. Strategic priorities

In order to achieve its objectives, Gas Natural Fenosa defines medium-term strategies that are updated periodically to adapt to current and future circumstances, taking into consideration the specific features of each of the Company's business lines.

In May 2016, Gas Natural Fenosa presented its updated Strategic Vision 2016-2020, establishing the Group's strategic priorities for the period.

5.2. Financial priorities

The strategic priorities for the period 2016-2020 are based on a financial policy consistent with growth and dividend targets:

– Strict financial discipline.

– Sustained dividend growth based on sustainable cash flow (70% payout commitment).

– Execute the efficiency plan.

– Manage the business portfolio.

– Maintain a solid business model with regulated or contracted activities accounting for approximately 70% of EBITDA and more than 80% of future capital expenditure.

The strategic objectives for 2018 are detailed below (Euros billion):

	2018 targets
EBITDA	~ **5.4**
Net profit	~ **1.6**
Dividend (Pay-out)	~ **70%**
Net debt/EBITDA	~ **3.0x**

5.3. Group outlook

The updated Strategic Vision 2016-2020 is based on three lines of growth (networks, power generation, and supply) that will enable Gas Natural Fenosa to continue expanding in the future:

- Networks: in gas networks, the investment in gas networks in Chile, Mexico and Colombia, the entry into the distribution business in the region of Arequipa in Peru, new licences, and additional growth derived from the conversion of the newly-acquired LPG distribution points in Spain; in electricity networks, investment in smart grids in Spain, investments to meet the additional demand in Chile and Panama, and electricity subtransmission in Chile driven by new renewable energy facilities.

- Electricity generation: improve the efficiency and performance of the generating fleet by adding 3,500 MW overall, of which 2,500 MW renewable (Spain and International) and 500-1,000 MW CCGTs that will contribute to the downstream development of the LNG business. Growth and development of the international power generation business through GPG.

- Gas supply: new gas supply contracts totalling approximately 11 bcm relating to the two Cheniere projects (Sabine Pass and Corpus Christi), the Yamal LNG project in

Russia, and the Shah Deniz II project in Azerbaijan; additionally, existing gas supply contracts will be adapted and renegotiated to reflect benchmark market conditions. The gas carrier fleet will be expanded by adding four new carriers (two of which were added in 2016) and a mobile regasification unit. That expansion will increase capacity by almost one millon cubic metres EBITDA is expected to increase by about 10%.

As a result, Gas Natural Fenosa is expected to maintain its organic growth trend in 2017 and beyond.

6. R&D and innovation

Innovation is one of the drivers of Gas Natural Fenosa's development; consequently, senior management is implementing an innovation model as part of the Group's updated Strategic Vision 2016-2020.

This model consists of a vision and a focus on innovation, project management methodology and a strong innovation culture within the company to ensure the most appropriate response to a changing situation.

Investment in technological innovation is analysed below:

	2016	**2015**
Total investment (Euro million)	59.2	15.7

The innovation plan is structured through priority lines of action to help achieve the goals set out in the Strategic Plan. This plan structures innovation around five multidisciplinary networks and eight areas of technology: Power Generation, Networks, Customers, Liquefied Natural Gas (LNG) and Automation and information management.

- Power generation:

  - Renewable energy: The company has a balanced generation mix that is able to respond appropriately to the demand for energy in the societies where it operates, and it always seeks the most environmentally-friendly generation technologies. Its priorities in this area include notably: developing new technologies to increase the percentage of renewable energy in its portfolio and integrate it into the power grid, and optimising the use of renewable facilities already in service, for example, by extending their useful lives or harnessing wind more efficiently.

  - Hydroelectric power: Gas Natural Fenosa's main innovation activities in the area of hydroelectric power are conducted through the Centro Internacional de Excelencia Hidráulica (CIEH). That institution's mission is to promote and channel R&D and innovation initiatives to harness conventional and marine hydroelectric energy that can be scaled up for application at the company's facilities around the world.

  - Storage: Innovation in the area of energy storage focuses primarily on storing electricity in batteries, both large installations that enhance power grid operations and small-scale facilities for distributed use.

  - Thermoelectric generation: Gas Natural Fenosa is working on two main lines of innovation in this area: improving power plant performance and reducing emissions from power generation.

– Networks: The main challenge in gas grids is to optimise safety and durability, as well as to increase the degree of optimisation and improve interactions with customers. In electrical networks, it continues to devote considerable efforts to optimising the electricity distribution network, focusing particularly on workplace safety, environmental aspects and supply quality. The goal is for electricity networks to be increasingly more intelligent.

– Customers: In the recently-established Smart Client area of innovation, the company is focused on offering value-added products and services to different categories of end customer.

– Liquefied Natural Gas (LNG):The overall objective is to strengthen LNG transportation, storage and distribution infrastructure, at all levels, so as to promote its use as an alternative to petroleum derivatives and as a more environmentally-friendly propulsion solution for shipping.

– Automation and information management is a horizontal area that seeks to agglutinate existing projects so as to reap synergies and enhance outcomes.

7. Annual Corporate Governance Report

Attached as an Appendix to this Director's Report, and forming an integral part of it, is the Annual Corporate Governance Report for 2016, as required under article 526 of the Spanish Capital Companies Act.

8. Treasury shares

On 14 May 2015, the General Meeting of Shareholders authorised the Board of Directors, for a period of not more than five years, to purchase, for good and valuable consideration, fully paid-up Company shares on one or more occasions, up to a total maximum amount of 10% of the share capital or the maximum figure applicable under the legislation in force at the time of acquisition, provided that the shares acquired directly or indirectly plus those already held by the Company and its subsidiaries never exceed 10% of subscribed capital or such other limit as may be established by law.

The minimum and maximum purchase price is the share price listed on Spain's electronic market, plus or minus 5%.

The variations in the treasury shares of Gas Natural SDG, S.A. in 2016 and 2015 are as follows:

	Number of shares	Amounts in million euro	% Share capital
At 1 January 2015	-	-	-
Acquisitions	2,899,180	58	0.3%
Disposals	(2,899,180)	(58)	(0.3%)
At 31 December 2015	**-**	**-**	**-**
Acquisitions	3,049,189	53	0.3%
Disposals	(2,298,644)	(40)	(0.2%)
At 31 December 2016	**750,545**	**13**	**0.1%**

Transactions with own shares of Gas Natural Fenosa in 2016 resulted in a gain of Euros 0.4 million, recognised under "Other reserves" (a gain of Euros 2 million in 2015).

For complete information about treasury shares see Note 13 to the Consolidated Annual Accounts.

9. Events after the reporting date

Events after the reporting date are described in Note 38 to the Consolidated Annual Accounts.

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Glossary of terms

Alternative performance metrics	Definition
EBITDA	EBIT + Depreciation and amortisation + Period provisions - Other income
Gross financial debt	Non-current financial liabilities + Current financial liabilities
Net borrowings	Gross financial debt - Cash and cash equivalents - Derivative financial assets
Leverage	Net borrowings/(Net borrowings + Net equity)
Cost of net borrowings	Cost of borrowings - Interest revenues
Liquidity ratio	Current assets/Current liabilities
Solvency ratio	(Net equity + Non-current liabilities)/Non-current assets
ROE	Attributable net income/Attributed net equity
ROA	Attributable net income/Total assets
Market capitalisation	No. of shares at end of period X Market price at end of period
Earnings per share	Net income for the period / No. of shares at end of period
Attributable net equity per share	Attributable net equity / No. of shares at end of period
P/E	Closing share price / Earnings per share in the last four quarters
EV	Enterprise value, calculated as: Market capitalisation + Net borrowings
Net capital expenditure	Investment in property, plant and equipment, intangible assets and financial assets - Receipts for divestment of property, plant and equipment and intangible assets - Other investing receipts/payments
Personnel expenses, net	Personnel expenses - Capitalised personnel expenses
WACC	Weighted average cost of capital